II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 27 September 1994

concerning the agreements between the Dutch State, Volvo Car Corporation and Mitsubishi Motors Corporation on the future ownership, plans and financial arrangements of Netherlands Car BV (ex Volvo Car BV)

(C 3/92 ex N 645/91)

(Only the Dutch text is authentic)

Text with EEA relevance

(94/1036/EC

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having regard to the Agreement establishing the European Economic Area, and in particular subparagraph (a) of Article 62 (1) thereof,

Having given the parties concerned the opportunity to submit their comments, in accordance with the abovementioned Articles [1],

Whereas:

I

By letter of 4 October 1991 the Netherlands notified the Commission, pursuant to Article 93 (2) of the Treaty and in compliance with the terms of the Commission's decision of 13 March 1991 closing a procedure under Article 93 (2) on Volvo Car BV (VCBV) [2], of the agreement between the Dutch State, Volvo Car Corporation (VCC) and Mitsubishi Motor Corporation (MMC) on the future of VCBV, a Dutch company owned by the Dutch State (70 %) and VCC (30 %), that is producing the Volvo 400 series. The notification described the terms of the phased sale of the Dutch State's holdings in VCBV to MMC and VCC and the proposed participation by the new shareholders in financial arrangements which had been the subject of examination in the decision of 13 March 1991. The notification claimed that the terms of these agreements did not entail State aid.

In March 1991 the Commission closed the Article 93 (2) procedure which it had opened in July 1989 in respect of the Dutch Government's proposed revision and execution of three former financial arrangements in support of VCBV. Following the modifications made to the original notification, the Commission was satisfied that the proposed measures did not contain State aid.

The new series of agreements notified to the Commission covered a wide and complex range of provisions on the future ownership, management and development of VCBV. They included the planning and funding of

[1] OJ No C 105, 25. 4. 1992, p. 16.
[2] OJ No C 143, 1. 6. 1991, p. 6.

investments in a new car series, arrangements for management of the company, purchases of the new cars in equal shares by each of the 'industrial parties' (VCC and MMC), and the separation of financial liabilities between shareholders, particularly concerning the existing and the future business of the company.

In their notification the Netherlands maintained that the agreements did not entail State aid. They emphasized the complexity of the negotiations on the Dutch State's phased withdrawal from the company, the need to regard individual elements of the agreement as parts of a global outcome rather than in isolation, and the desire of the Dutch State to dispose of its holding while minimizing its exposure to future commercial risks.

The Commission appreciated the complexity of the case and the need to take account of both individual provisions and the overall agreement emerging from the negotiations in assessing it from the perspective of Article 92 of the EC Treaty. From the perspective that the participation of the Dutch State in the agreements had to be compatible with the behaviour of a private investor operating under normal market conditions if the presumption of State aid was not to apply, the Commission considered that different aspects of the agreement suggested the existence of State aid.

II

On 26 February 1992 the Commission therefore decided to initiate the Article 93 (2) procedure with respect to the possible State aid elements in the arrangements between the Dutch State, VCC and MMC [1]. By letter dated 20 March 1992, the Commission informed the Dutch Government of its decision and requested it to submit its comments within one month from the date of that letter. No comments on the opening of the procedure were received from third parties other than from the industrial parties directly concerned by the procedure.

In the opening of the procedure the Commission described in detail the nature and details of the new agreements as well as its doubts as to the compatibility of the notified agreements with Article 92. According to the Commission, these agreements contained provisions which, *prima facie*, constituted State aid within the meaning of Article 92 to the extent that:

— the decision to end the Volvo 400 series earlier than anticipated at the time of the Commission decision of 13 March 1991 would be at the expense largely, if not exclusively, of the Dutch State; yet there was no evidence of the State receiving any compensation for this loss,

— the price and terms on which Mitsubishi acquire a holding in VCBV appeared unduly generous,

— it was difficult to justify the proposal of the Dutch State to lend Fl 700 million interest free to the company for developing the new car series from the perspective of a rational private investor.

Furthermore, the Commission was particularly concerned with following provisions in the agreements from the perspective of Article 92:

— it was not certain that the system of allocating costs between the Volvo 400 series business and the new project business, if acceptable in principle, would not give rise to unfair loading of costs on the former business at the expense effectively of the Dutch State,

— the proposed transfer pricing system for Volvo 400 series cars charged to VCC could entail State aid.

III

Following the opening of the procedure, the Netherlands submitted its comments to the Commission's letter by letter dated 20 May 1992. By letters dated respectively 21, 25 and 22 May 1992 VCC, MMC and Netherlands Car BV (NedCar), formerly VCBV, also submitted their comments with regard to the opening of the procedure.

By letter dated 8 July 1992 the Commission requested supplementary information from the Netherlands by way of a detailed questionnaire. The Commission also asked the Netherlands for its remarks on the different comments of the companies concerned. A reply to this request was received by letter of 22 December 1992. The Commission sent an additional questionnaire to the Netherlands by letter of 19 March 1993 in order to make a final analysis of the State aid elements involved possible. The Netherlands answered these additional questions by letter of 2 June 1993.

By letter of 4 October 1993 the Netherlands informed the Commission of its intention to grant a guarantee on a loan to NedCar. It was argued that this loan was necessary given the temporary liquidity problems of NedCar. As this guarantee was given by the Dutch State in its function as a normal shareholder and in proportion to its shareholding, the Commission did not consider this guarantee to be State aid.

Following this correspondence, a series of meetings was held on 6 October 1993, 8 February, 9 March, 28 April and 3 May 1994 to further discuss the issues raised in

[1] OJ No C 105, 25. 4. 1992, p. 16.

the opening of the procedure and the information provided by the Netherlands. This was complemented by further written information from the Netherlands, and the companies concerned dated 18 November 1993 and 9/10 March, 21 and 28 April, 2 and 24 May 1994.

IV

In their replies to the opening of the procedure all parties insisted on their view that the agreement should be regarded as a whole, when asking the question whether any State aid is involved. Apart from the prices paid for the shares, there are other considerations which should be taken into account. These include a technology transfer from MMC which could lead to a loss reduction on the Volvo 400 series, the sharing of the fixed costs by the project and the Volvo 400 series with a reduction of costs for the latter, and an improvement in marketing efficiency by the transfer of this task to VCC.

As regards the Commission's view that the new agreement would, when compared to the previous arrangements, be at the expense of the Dutch State, the Netherlands maintained that all other options available would have been less beneficial to it than the agreement in question. These options contained in the Dutch Government's view the immediate liquidation of VCBV, its continuation as a going concern with the development of a new model, a phased termination (i.e. stopping production after the end of the Volvo 400 series without the development of a new model), and the sale of all shares to VCC. A privatization of VCBV via the stock market would have been impossible without the consent of VCC, since VCBV was a private limited company. Such consent was very unlikely to be forthcoming. An alternative producer, that was interested in buying VCBV, could not have been found, despite VCBV's efforts to that effect. Therefore, the liquidations scenario was seen by all parties as a relatively likely outcome, had it not been for the present arrangement. VCC explicitly stated that it would have been willing to see VCBV liquidated. Furthermore, both industrial parties maintained that they had not been seeking aid and that even if other options might have been more beneficial to the Dutch State than the one chosen, no benefit accrued to VCC and MMC as a result of the solution found.

As regards the individual elements of the agreement containing State aid according to the Commission, the Dutch State, NedCar and VCC insisted that the premature termination of the Volvo 400 series constituted in fact a gain to the Dutch State and VCC, since with increasing model age sales prospects would have dropped and losses would have increased. These increased losses would in their view have more than offset the additional payments into the funds, and therefore a premature termination would have been likely even without the project. In connection with this argument, VCC also claimed that the shortfall in sales due to the premature termination will only be 100 000 cars instead of the Commission's estimate of 230 000, due to bad market conditions.

The industrial parties also argued that because of the project it was possible to spread the overheads of the Born plant, therefore increasing the profitability of the Volvo 400 series and thus reducing the losses falling on the Dutch State.

All parties insisted that the consideration paid by MMC for its shares was fair, since in addition to the share price MMC agreed to provide additional input in the form of training and management techniques, which would improve the Volvo 400 series profit forecast and therefore the probability of a higher return for the Dutch State. In the most recent meetings and the information transmitted in writing, the effects of these efforts were demonstrated. In addition, MMC agreed to a loss limitation for the Dutch State, which it regards as a concession, while the Dutch State did not provide any of the traditional assurances as to the value of the company, such as warranties or guarantees. Furthermore, VCC and MMC have to pay for any use they make of NedCar's resources before 1996. Therefore, MMC considered that it paid for the acquisition of shares much too early, thus in effect granting an interest-free loan to NedCar. To enable the Dutch State to exit from NedCar, it also acquired a 50 % share contrary to its original intention to limit itself to 30 % i.e. 60 000 cars p. a. Originally, it intended to buy this share only in a company that contained only assets useful to the project, but negotiations with VCC along these lines failed. Therefore, the actual venture is larger, more expensive and more risky than MMC had intended it to be, but because of the unique opportunity to enter the Community market in cooperation with an established manufacturer MMC was willing to take the leap.

The arrangement on the interest-free loan is seen by all parties as being advantageous to the Dutch State, when compared to the previous arrangement. This assertion is based on the fact that the money from the royalty payments to the A and B funds is only revolved once for this loan, whereas the 1991 decision allowed for the unlimited revolution of the A-fund and one interest-free revolution of the B-fund, so that all industrial parties had the legitimate expectation of at least one further revolution. Thus the repayment of these funds to the Dutch State in their view occurs earlier and therefore has a higher present value. Furthermore, although it gave up the chance of obtaining a surplus on these loans, the

Dutch State has a higher certainty of repayment, since the instalments after 1998 will be independent of the sales of the new car and will be guaranteed through payments by NedCar into a blocked account one year in advance. This latter certainty does not exist for the industrial parties. Furthermore, the parties insisted that the Dutch State's contribution to the project would probably be lower than that of VCC and MMC, since the latter have to bear the cost overruns estimated at Fl 500 million.

Fixing of the 1998 exit price for the Dutch State in spite of the significant investments in NedCar, undertaken in the interim by the parties, is claimed to be a normal method, which reduces the incentive of the option holders (VCC and MMC) to minimize the value of the company. This was specifically requested by the Dutch State to escape the risk of a much lower future receipt due to possible launching losses or learning curve effects.

As concerns the determination of the sales price, both VCC and MMC claimed that VCBV had a negative book value, and that its only value to both parties lay in the efficiency gains to be obtained through restructuring the company and injecting new technology and in the value of the assets obtained. The gains were made possible through the participation of MMC, without which VCC would have sought to close the Born plant. The buyers, i. e. VCC and MMC, would not pay for all these gains, since they were only made possible by their own efforts. The asset value is estimated by both companies to be significantly lower than the price agreed upon, namely of Fl 300 million (VCC) or 180 million (MMC) respectively. The fact that the Dutch State bought VCBV shares from the Dutch holding company, DSM, for a significantly lower price than the one it obtained from VCC and MMC is also cited as proof that the valuation of the company was rather too high than too low.

As the buyers did not want to acquire an interest in a going concern with the attached goodwill but only assets, they regarded the valuation by KPMG, which was undertaken on a going concern basis, as irrelevant. They further criticized it as being based on unrealistic sales expectations, taking no account of either liquidation costs or the costs of developing a successor model and including no risk factor.

On the cost allocation system the parties stated that this system cannot be discriminatory, since its adoption requires the consent of all participants. NedCar does the allocation for all parties.

On the transfer prices the parties submitted that any discrimination would be prevented by the fact that all shareholders keep the option to return to the old system. Furthermore, the new system does not guarantee a net profit for VCC, since the 'reference gross profit level' produced losses for the company in 1991. The fixed cost guarantee to NedCar by VCC in case of lower sales of Volvo 400 cars is also seen as an incentive for VCC to increase sales and reduce costs.

V

In all its letters the Netherlands emphasized its view that all elements of the transaction had to be seen as a whole and that, by doing this, it would become clear that the Dutch State had achieved the best possible outcome. Since the opening of the procedure the Commission has come to accept that all provisions of the Shareholders' Agreement should be seen as a whole. It therefore does not any longer consider it useful to look at the different elements of the agreement and to answer the viewpoints of the Netherlands and the industrial parties as expressed in the previous paragraphs, but rather sought to establish whether the expected return from the sale is at least equal to the real value of the company or the sale contains State aid.

As the Netherlands did not solicit bids for VCBV but negotiated exclusively with VCC and MMC, the Commission, in line with its constant practice, considers it necessary to dispose of an independent valuation of the company to serve as a reference basis to compare with the expected return of the present deal. Since the Dutch authorities and the industrial parties did not consider the KPMG valuation to be a reliable basis of comparison, a further independent asset-based study was undertaken on the Commission's request by the firm of auditors, Marshall and Stevens Inc., which arrived at a "fair market value for continued use' of Fl 424 245 million, resulting in a figure of Fl 297 million for the 70 % share of the Dutch State. If the present arrangements lead to a lower income for the Dutch State, then the Dutch State should have tried to dispose of its holding in NedCar by an open bid. The argument, put forward earlier by the Dutch authorities, that no purchaser would have come forward because of VCC's 30 % share in the company, was not convincing, since e.g. BMW was willing to take a majority shareholding in Rover Group although Honda also had a 20 % stake in that company.

The Commission assesses that the result of this asset valuation is a good proxy for the value of the company as a whole, since at the moment of sale the values of the current and long-term liabilities as well as the provisions are estimated to have cancelled out the values of the receivables and other liquid assets as well as the

inventory and the financial assets. Therefore, the Commission considers the amount of Fl 297 million as the floor for the income that the Dutch State should draw from the sale of NedCar, for it to be satisfied that no State aid is involved in the sale arrangements. The Dutch authorities accepted this approach by the Commission.

The Commission can agree to the argument that the weak competitive position of VCBV left it with insufficient funds to develop a new model on its own and that the old shareholders did not want to inject the funds necessary for it. This, however, does not apply to the facelift of the Volvo 400 series, work on which was already under way. Therefore, the only other remaining realistic alternative that was also put forward by the Dutch authorities was the termination of production of the plant without the development of a new model and without the injection of new funds. The industrial parties and the Netherlands argued that in such a case, sales of the product would have fallen more rapidly and that this would have led to a closure of the company in 1993, when its revenue would have fallen below a level needed to cover its out-of-pocket expenses. Although it may be questioned that production in a plant would be halted immediately, just because its revenue would fall below this point for one year, this argument is accepted for calculating what the Dutch State would have obtained from the A and B funds in such a situation. Assuming sales of 93 700 in 1992 and 83 000 in 1993, the funds would have held Fl 303,2 million in nominal terms or Fl 289,6 million in 1991 present value terms. This result is very close to the income from the asset valuation.

In order to assess the effect of the present arrangements on the Dutch State's revenue, the Commission calculated the returns to the Dutch State in present value terms on the basis of the information available in 1991. It established two alternative but realistic scenarios, assuming a more optimistic and a more pessimistic market development with Volvo 400 sales varying accordingly, as well as higher and lower degrees of rationalization and cost reduction through the intervention of MMC with an effect on the development of NedCar›s losses. The financing requirements for the development loans for the new model were also taken into account as well as the projected income from spare parts sales for the Volvo 400 series. The optimistic and pessimistic scenarios yielded incomes to the Dutch Sate in 1991 present value terms of Fl 365,3 million and 274,0 million respectively, which results in an expected value for the Dutch State of the present agreements of Fl 319,7 million.

Comparing this estimated return with the established value of the company and with the alternative path that could have been taken by the Dutch authorities, the Commission is satisfied that the arrangements of the sale of NedCar to VCC and MMC do not contain State aid elements.

It will, however, have to be ensured that these returns to the Dutch State are not reduced further through other elements of the complex agreements of NedCar's privatization. Here, the Commission was concerned about three aspects:

— Article 13.1 of the Shareholders' Agreement contains a provision allowing the Dutch State to sell its remaining shares in 1998 at half price to one industrial party, if the other party has stepped out of NedCar through bankruptcy or voluntary sale before that date. The Netherlands has argued that this is merely an additional option, which might be used rather than attempting to sell 50 % of the remaining shares to the bankrupt party, which would disrupt NedCar. Furthermore, if only one party remains, it might have to run NedCar unprofitably below capacity and without the desired synergy effects. The commission considers that these arguments might have some validity in the case of the bankruptcy of one party, but are not at all convincing in case of the voluntary buyout by one partner, which thereby shows its willingness to operate the plant alone at full capacity. It is therefore concerned that such a half-price sale could constitute State aid to the remaining industrial party, which it would have to investigate, should such a scenario arise. The Netherlands has undertaken to notify the Commission, if it wishes to make use of this provision of the Shareholders' Agreement,

— while a Separate Agreement between the parties establishes a minimum return of Fl 380 million in nominal terms to the Dutch State from the whole transaction and thus a loss exposure limit [1], Article 4.2 (d) of the Shareholders' Agreement stipulates, that if this limit were in danger of being exceeded, the parties would decide whether and how to continue production of the Volvo 400 series. Although this provision would apply only in a worst case scenario and although the partners might in such circumstances decide to prevent further losses through closure of the plant, the provision could lead to additional exposure on the Dutch State's side and therefore to a lower return to it, which would have to be regarded as State aid. While the Commission acknowledges that such a case is rather unlikely, and that even in its pessimistic scenario this problem does not arise, it would however have to investigate such aid, should the parties have to invoke this provision. The Netherlands has undertaken to notify to the Commission any intention to invoke this provision of the Shareholders' Agreement,

[1] OJ No C 105, 25. 4. 1992, p. 18.

— while production of the Volvo 400 series continues at the Born plant, preparations for production of the new models including the necessary investment are under way. This M/V-car project will require substantial investment in new machinery which for practical reasons may also be used for the Volvo 400 series. The potential for distortions through inadequate depreciation rules for these investments is large. If the depreciation on such machinery, installed exclusively because of the new project and for its eventual employment in it, were partly charged to the old production line, losses on the Volvo 400 series and thus the Dutch State's loss coverage obligation would increase, which would be an element of indirect subsidization to the new project. Therefore the Commission will have to analyse these cost allocation rules for the production plant, once they are finalized. Cost allocation rules have so far been agreed only for the managerial and engineering departments. Here, the Commission is satisfied that these rules do not contain State aid elements. The Netherlands will have to notify the Commission of these allocation rules once they have been agreed upon. It has also asked the Commission to indicate which rules it would consider adequate. An outline of the Commission's view is added to the letter to the Dutch Government as an appendix.

On the issues that still have to be analysed separately, i. e. transfer price system and the adequacy of the share price paid by MMC, the Commission has been convinced by the information provided by the Netherlands and the industrial parties that they do not contain State aid. In particular, the share price paid by MMC is adequate, as the company provided and still provides 'payments in kind' in the form of technical support to NedCar improving thereby the production cost of the Volvo 400. Evidence of this support and the positive effects on the cost structure of NedCar has been provided.

VI

In conclusion, the Commission notes that the various agreements between the Dutch State, VCC and MMC on the future of NedCar, as they are executed now, do not contain elements of State aid. It also notes that specific provisions of these agreements might lead to the granting of State aid in the future and that the Netherlands has undertaken to notify the Commission of such aid in these cases so that it could investigate them and take a position as to its compatibility with Article 92 (1) of the Treaty as well as Article 61 (1) of the EEA Agreement. It will also immediately be notified by the Netherlands of the rules governing the allocation of costs for the production plant between the Volvo 400 series and the M/V projects, so that it can form its opinion on whether these provisions contain State aid,

HAS ADOPTED THIS DECISION:

Article 1

The various agreements between the Dutch State, VCC and MMC concerning the future ownership, plans and financial arrangements of Netherlands Car BV do not contain elements of State aid on condition that the provisions of Article 2 are respected.

Article 2

The Netherlands shall notify the Commission if it wishes to make use of any of the following provisions of the Shareholders' Agreement:

— the provision of Article 13.1 allowing the Dutch State to sell its remaining shares in 1998 at half price to one industrial party, if the other party has withdrawn from Netherlands Car BV through bankruptcy, voluntary sale or for any other reason before that date,

— any decision of the shareholders on the basis of Article 4.2 (d) on whether and how to continue the production of the Volvo 400 series in circumstances where the loss compensation limit of the Dutch State is in danger of being exceeded.

Furthermore the Netherlands shall notify to the Commission the cost allocation rules between the Volvo 400 series and the new project for the production plant upon their agreement by the shareholders.

Article 3

The Netherlands shall inform the Commission within one month from the notification of this Decision of the measures taken to comply herewith.

Article 4

This Decision is addressed to the Kingdom of the Netherlands.

Done at Brussels, 27 September 1994.

For the Commission

Karel VAN MIERT

Member of the Commission