II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 31 October 1995

concerning State aid granted by the Freie und Hansestadt Hamburg, a regional authority of the Federal Republic of Germany, to the ECSC steel undertaking Hamburger Stahlwerke GmbH, Hamburg

(Only the German text is authentic)

(Text with EEA relevance)

(96/236/ECSC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Coal and Steel Community, and in particular Article 4 (c) thereof,

Having regard to Commission Decision No 3855/91/ECSC of 27 November 1991 establishing Community rules for aid to the steel industry [1],

Having given notice to the other Member States and the parties concerned to submit their comments, in accordance with Article 6 (4) of that Decision,

Having regard to the comments received,

Whereas:

I

On 6 July 1994, the Commission decided to initiate proceedings under Article 6 (4) of Decision No 3855/91/ECSC (the 'Steel Aid Code') with respect to various financial measures taken by the Freie und Hansestadt Hamburg (hereinafter referred to as 'FHH') in favour of the steel undertaking Hamburger Stahlwerke GmbH (hereinafter referred to as 'HSW'). It concluded, on the basis of the information provided by the German Government, that a DM 20 million loan by the public Hamburgische Landesbank Girozentrale (hereinafter referred to as 'HLB') to the shareholders of Protei Produktionsbeteiligungen GmbH & Co. KG (hereinafter referred to as 'Protei') and a DM 130 to 184 million credit line, including a DM 10 million swing, for HSW granted by HLB between 1984 and 1994 may have represented State aid incompatible with the Steel Aid Code and the Treaty establishing the European Coal and Steel Community (hereinafter referred to as 'the ECSC Treaty').

The Commission informed the German Government, by letter dated 14 July 1994, of its decision to initiate proceedings, and requested its comments and such additional information as it might consider relevant. The reply of the German authorities dated 8 September 1994 contained some additional information concerning the financial measures in question and various arguments to back the position of the German Government that these measures did not constitute aid (for a full description of the German Government's position as explained in its communications related to this case, see Section III of this Decision).

The letter by which the Commission informed the German authorities of its decision to initiate proceedings was published in the *Official Journal of the European Communities* [2], inviting the other Member States and interested third parties to submit their comments.

[1] OJ No L 362, 31. 12. 1991, p. 57.

[2] OJ No C 293, 21. 10. 1994, p. 3.

In the course of the proceedings, the Commission received the following comments:

— The Government of one Member State stated that it considered the financial measures described in the publication to represent State aid that distorted competition inside the Community to the detriment of the competitors of HSW. It urged the Commission to scrutinize closely any transaction between HSW, HLB and FHH, in order to establish their compatibility with regard to the Steel Aid Code.

— A major European steel company pointed out that the financial measures described in the publication represented operating aid prohibited under the provisions of the ECSC Treaty and the Steel Aid Code. It doubted whether HSW could ever become viable, even after further injections of capital, because the productivity of the company was reported to be much lower than that of other comparable companies in Germany.

— A national steel producers' association pointed out that the DM 20 million loan to the shareholders of Protei, used to raise the initial equity of HSW in 1984, was illegal, if only because it had not been notified to the Commission in advance. It considered the loans granted by HLB to HSW to represent, at least partly, aid that helped to maintain an important competitor of some member companies of the association in operation for a period of 10 years.

The comments were communicated to the German Government by letter dated 5 January 1995 with the request that it state its position. By letter of the same date the German Government was requested to submit detailed information concerning press publications reporting that HLB had extended the credit line for HSW beyond its expiry at the end of 1994.

By letter dated 11 January 1995, the German Government informed the Commission that the credit line had not been extended and that HSW had been sold. It announced further detailed information concerning this transaction. By letter dated 7 February 1995, the German authorities submitted their remarks on the comments of other Member States and third parties and provided some information concerning the sale of the shares in HSW to the Dutch Venuda Investments BV (hereinafter referred to as 'Ispat'), which is part of the Ispat group, based in Jakarta, Indonesia.

By letter dated 13 March 1995, the Commission requested further information concerning the sale of the shares and the financial measures of HLB and FHH in connection with this sale. The German Government's reply was received on 28 April 1995. By letter dated 10 May 1995, the Commission requested some further information, namely copies of particular documents, which were transmitted by letter dated 15 May 1995, except one document that was considered to be confidential and internal. On 22 May 1995, a meeting between representatives of the Government of FHH, the Federal German Government and the Commission was held in Brussels. By communication dated 14 June 1995, the German authorities submitted some additional information and arguments as well as a copy of the tender documents preparatory to the sale of HSW.

On 20 June 1995, a meeting between representatives of the Government of FHH, the German Federal Government and the Commission was held in Hamburg to discuss details of the sale of the company and to exchange various arguments concerning the possible assessment of the case. By communications dated 25 July 1995 and 18 August 1995 the German authorities submitted further information concerning the financing of HSW since 1984 and the use of the aid approved by the Commission in 1984 and 1985.

II

On the basis of the information received, the relevant facts appear as follows:

The old Hamburger Stahlwerke GmbH was founded in 1961 and started its steel activities in 1969. In the period between 1969 and 1982 it suffered losses except in the years 1974 and 1979.

Until 1981, total losses of DM 204 million were covered by the shareholders Korf Stahl AG and Ferrocontor Beteiligungsgesellschaft mbH. In 1982 the company suffered losses of DM 172 million that were not covered by its shareholders. On 20 January 1983 the Court having jurisdiction initiated formal composition proceedings under the 'Vergleichsordnung'. The administrator tried to find a purchaser for the company to allow the continuation of its operation. On 9 December 1983, the Court initiated insolvency proceedings after the failure of the attempted composition.

In 1972 HLB started to take over shares of the old Hamburger Stahlwerke GmbH and held from 1974 a constant 49 % of the shares in a fiduciary capacity as security for liquidity and investment loans granted without guarantees or comparable financial coverage of FHH. At the time of the initiation of insolvency proceedings, HLB had claims totalling DM 52 million that were not covered by guarantees of FHH. Claims of DM 129 million were covered by FHH, which acquired a right of recourse on the insolvent party's estate. The total claim of HLB and FHH on the old Hamburger Stahlwerke GmbH was not considered to represent a provable claim in the framwork of the insolvency proceedings because a judgment by the Court of Last Instance (1) held that HLB was shareholder of the old Hamburgr Stahlwerke GmbH and

(1) Bundesgerichtshof, Judgment of 19 September 1988 — II ZR 255/87, *Der Betrieb* 1988, p. 2141; lower courts: Hanseatisches Oberlandesgericht Hamburg, Judgment of 24 July 1987 — 11 U 182/86, *Der Betrieb* 1987, p. 1778 and Landgericht Hamburg, judgment of 15 August 1986 — 3 O 288/84.

that the public bank HLB was acting a trustee for FHH. This conclusion of the Court led to the legal consequence that any provision of liquidity after 1981, although formally granted in the form of loans, had to be treated as risk capital. The loans were considered to represent capital-relacing loans ('kapitalersetzende Darlehen'). HLB and FHH consequently would only have received repayment on their claims if the liquidation of the old Hamburger Stahlwerke GmbH in the framework of the insolvency procedure had yielded a surplus after satisfaction of all provileged and non-privileged creditors.

Since the administrator in composition proceedings ('Vergleichsverwalter'), who was the subsequent receiver in insolvency proceedings ('Konkursverwalter'), had already tried without success to find a purchaser for the works in the course of the composition proceedings, HLB and FHH decided to promote the continuation of the operations through a new company which would take over the assets of the old Hamburger Stahlwerke GmbH at going-concern value, expecting, according to the German Government, a chance to receive at least a partial repayment of the DM 181 million loan.

The receiver and the manager of the company designed a restructuring scheme. They founded Protei Produktionsbeteiligungen GmbH & Co. KG (a limited partnership, the general partner being a private limited company) and took over the business and assets of the old Hamburger Stahlwerke GmbH through the newly founded Neue Hamburger Stahlwerke GmbH, a 100 % subsidiary of Protei, in early 1984. Later in 1984, the company was renamed Hamburger Stahlwerke GmbH (HSW).

The old Hamburger Stahlwerke GmbH was liquidated. The German Government reported that the expedient to continuing the operations of the old Hamburger Stahlwerke GmbH through an absorbing company was leading to a diminution of the losses of HLB due to its financing of the old Hamburger Stahlwerke GmbH down from DM 52 million to less than DM 5 million, i.e. by around 90 %. The loss borne by the State was cut from DM 129 million to DM 52 million, i.e. by DM 77 million — around 60 %.

The initial equity of Protei, DM 20,2 million, was raised through a DM 20 million loan made by HLB to the shareholders of this company, the receiver (hereinafter referrd to as 'W') and the manager of HSW (hereinafter referred to as 'G'). FHH had granted an amount of DM 20 million to HLB with the order to use this amount to cover the loan to the shareholders of Protei. Only a small portion of the total initial equity of Protei was raised directly by its shareholders, injecting DM 100 000 each. The initial equity of HSW, also DM 20,2 million, was injected by it sole shareholder Protei, using the capital received via W, G and HLB from FHH.

The contract between HLB, Protei, G and W provided that repayment and interest would only be due in the event of HSW making profits. The interest rate was fixed at Bundesbank discount rate plus 7,5 %, but subject to a minimum of 15 % per annum. The parties agreed that W and G should not be liable for the debts arising from the loan and that any taxes and other costs arising from the participation of Protei in HSW should be reimbursed by HLB. Protei relinquished pro rata its share in HSW's profits, according to the ratio between the loan itself and the total share capital of HSW.

The contract also provided that Protei would have to continue the operations of HSW, that it could not decide to liquidate HSW without the assent of HLB and that decisions regarding the management or the members of the supervisory committee would need the assent of HLB. The contract further provided that Protei would not be allowed to sell shares in HSW if HLB objected. It was agreed that Protei would be obliged to enter into negotiations with possible purchasers if HLB so requested. HLB reserved its right to sit in on negotiations concerning the sale of HSW.

In its communication dated 8 September 1994, the German Government explained that, due to this contractual arrangement, which allows HLB/FHH decisive control over the management of HSW, FHH was exposed to a financial risk fully comparable to the risk a shareholder injecting risk capital has to bear without becoming owner of the company.

Between 1984 and 1994, DM 2,8 million in redemption and DM 2,7 million in interest were paid on the DM 20 million loan of HLB. On 19 June 1986 the capital of HSW was increased by DM 11,5 million, raised through corporate funds.

The restructuring concept was backed by State aid approved by the Commission (DM 46 million for investiments, closure aid, research and development and operating losses, and a State guarantee covering DM 40 million). HSW finally only received DM 23,5 million for investments, closure costs and operating results. The remainder of DM 22,5 million was not granted because the Federal Government refused to grant its share for the investment aid because part of the investment to be supported had already been carried out by the old HSW and another part was finally not carried out. The Federal Government further refused to pay its share of DM 15 million because the aid to cover operating losses was connected to losses of the old HSW, which was in winding-up proceedings, and not to expenses the new HSW had to bear. Authorized guarantees covering up to DM 27 million were never used because HSW decided to use other possibilities for financing.

At the outset of HSW's activities in 1984, HLB granted a DM 130 million credit line to the company. The credit line was granted on the basis of regularly renewed yearly

contracts. 60 % of this credit line (DM 78 million) was granted by order of FHH. Under the provisions of German legislation (paragraph 778 of the Bürgerliches Gesetzbuch, or Civil Code, hereinafter referred to as 'BGB'), FHH is obliged to compensate the bank for all expenses incurred in the course of the fulfilment of this order in the same way as if the bank had received a guarantee (paragraphs 765 following — BGB). The credit line was secured by a transfer of ownership by way of security of current assets and the transfer of claims of HSW on third parties. The German Government informed the Commission that the estimated value of the securities in the period between 1984 and 1994 was as follows:

Date	Securities in million DM	Securities in % of credit line
30. 12. 1984	144,0	110,7
30. 12. 1985	157,2	120,9
30. 12. 1986	130,0	100,0
30. 12. 1987	144,1	110,8
30. 12. 1988	172,4	132,6
30. 12. 1989	174,7	134,3
30. 12. 1990	204,3	157,1
30. 12. 1991	167,0	128,4
30. 12. 1992	179,1	137,7
30. 12. 1993	208,4	138,9
30. 12. 1994	204,6	117,5

During the period from 1984 to 1993, HSW suffered losses in all but four years. The following table shows the yearly net operating results in million DM:

1984	+ 13,3
1985	− 2,6
1986	+ 1,3
1987	− 16,5
1988	− 5,7
1989	+ 15,7
1990	+ 8,9
1991	− 8,5
1992	− 19,8
1993	− 24,4

The credit line of HLB was not entirely used until 1992. In 1992, HSW suffered losses of around DM 20 million. It needed the extension of the revolving credit line expiring by the end of the year and an additional credit line of this amount to continue operations. HLB itself acting as a commercial bank required to apply sound business practices, refused to grant an extension of the credit line. By order of FHH, it finally granted the extension of DM 20 million in December 1992, subject to the condition, imposed by the credit commission of FHH, that the company submitted a proper restructuring scheme.

In 1993, HSW suffered losses of DM 24,4 million. It needed the extension of the enlarged credit line of DM 150 million expiring at the end of the year and again needed an extension of the credit line to continue its operations. The management of HLB refused to prolong the credit line. The bank was not even prepared to continue its previous commitment, which was by an amount of DM 52 million not covered by the order of FHH. FHH ordered HLB to prolong the credit line, to grant an extension of DM 24 million and a swing of DM 10 million as from the beginning of 1994. The entire credit line, including the swing, was therefore covered by the obligation on FHH's part to compensate the related disbursements of the bank. FHH thereby accepted the full economic risk connected with all loans granted to the company.

An expert study of January 1994, prepared at the request of the credit commission of FHH, concluded that in the event of a liquidation of HSW the City of Hamburg would suffer losses of around DM 200 milion. A privatization of the company was, according to the experts the best solution because the outgoings from the City's treasury would be lower than if 'aid was continued until restructuring was completed'. It was decided to commence negotiations with possible purchasers to have at least a part of the loans paid back later.

In February 1994, Protei transferred its shares in HSW to G. In return G became liable for the remaining claims of HLB, totalling DM 17.2 million, arising from the DM 20 million equity loan to Protei, and had to pay a purchase price of only DM 275 000. This purchase price was raised through a loan from HLB. Also, G was granted the right to redeem the loans by transferring the shares in HSW to HLB, regardless of whether the value of the shares would be sufficient to satisfy the bank's claim.

In August 1994, shortly after the Commission's decision to initiate the present procedure, an international private investment bank, instructed by FHH to organize and coordinate the sale of HSW, prepared a tender inviting several national and international steel-producing companies to submit their bids for the takeover of HSW. The tender documents informed prospective bidders that G had authorized FHH to dispose of the shares in HSW and that FHH would, assisted lby the investment bank, pursue the sale of HSW.

By contract dated 27 December 1994, HSW was taken over by Ispat. The transfer of shares took effect on 1 January 1995. The purchase price for the shares of DM 10 million was paid to G who transferred this amount immediately to HLB. In surrendering the shares to Ispat, G acted on HLB's instructions because the bank had a claim on G for the surrender of the shares in HSW; G thereby satisfied the bank with regard to all claims arising from the DM 20 million loan of 1984 and the DM 275 000 loan for G to cover the purchase price of the shares in HSW.

In the course of 1994 the credit line was used almost to its limit. On 15 September 1994, for example, HSW used DM 173,7 million of the credit line. By 30 December 1994, HSW had availed itself of DM 166,7 million of the credit line. By 31 December 1994, HLB had claims arising from the credit line of DM 154,1 million on HSW, fully covered by the credit instructions of FHH. The German authorities did not explain how or why the drawing of the credit line was reduced between those two days. The German Government did not inform the Commission whether or not the DM 10 million swing was used in the course of 1994.

HLB and Ispat concluded a separate contract on the day on which the contract between G and Ispat covering the transfer of the shares in HSW was signed. The contract, covering the sale of the claims of HLB on HSW arising from the credit line to Ispat, represents the most important part of the contractual arrangements covering the sale of HSW. It was drafted closely following the standard model which the Treuhandanstalt, the public body in charge of the privatization of former State-held companies in East Germany, used for its privatizations. In the preamble to the contract it is explained that FHH is highly interested in the continuation of the operations of HSW and thereby the safeguarding of jobs. The foreword to the contract explains further that the equity of HSW is negative and that a 'further injection or liquidity by Hamburgische Landesbank would not be considered in present circumstances'. The company therefore appeared due for insolvency.

The contract further explains that the HLB loans are capital-replacing loans (eigenkapitalersetzende Darlehen) — meaning that, in the event of insolvency, they would not be considered claims in insolvency but treated as if they were direct injections of risk capital by a shareholder in a situation in which the company needed additional risk capital to avoid insolvency. Under the provisions of this contract the full claim on HSW is transferred from HLB to Ispat at a purchase price to be fixed in line with a complex formula. The amount established by this formula may be described as the 'liquidate and escape' value. This is amount Ispat may receive if it decides not to continue the operations of HSW but to sell assets, stocks and claims immediately. The amount calculated on the basis of this formula would be reduced by the costs of laying off up to 100 workers and members of the management of HSW, the costs of the closure of two subsidiary companies and some of the costs of honouring the contract. In addition, the contract explains that Ispat expects to be released by FHH from all obligations related to the existing environmental damage at the site HSW uses. HLB accepted that, should such release not be achieved, the costs for the repair of environmental damage would be deducted from the purchase price. The German authorities estimate the purchase price, which is not fixed so far, to be between DM 44 million and DM 74 million (28 to 48 % of the used credit line of HLB). Ispat would not have to raise the purchase price immediately itself. It will be raised by an overdraft account (Kreditkonto) from HLB, backed by a bank guarantee to be provided by Ispat, terminable on, or after 31 December 1995.

Under the provisions of the contract, the purchaser has to continue the operations of HSW at the level of the average production in 1994, produce mainly quality steel, carry out investments amounting to at least DM 70 million, maintain 630 jobs, keep a majority stake in HSW until the end of 1999, inject DM 30 million into the equity and agree to monitor compliance by HLB with all these obligations. The obligations, limited until the end of 1999, are covered by contractual penalties.

With regard to the procedure initiated by the Commission in July 1994, the Contracting Parties agreed that they would pursue any legal remedy against measures the Commission might request in relation to the HLB loans and the providing of security covering these loans by FHH. They agreed to adjust the contract if necessary to ensure the survival of HSW. HLB noted that Ispat and HSW would not bear any financial burden resulting from a Commission decision.

III

The German Government is of the opinion that the financial measures of FHH and HLB with regard to HSW do not constitute State aid.

As regards the DM 20 million loan of 1984, granted to raise the initial equity of HSW, it admitted that the State took over an economic risk nothing short of the risk borne by a shareholder injecting risk capital. However, it is of the opinion that a private investor in a market economy would at that time have acted in the same way.

After the insolvency of the old Hamburger Stahlwerke GmbH, FHH and HLB had claims totalling DM 181 million, which the responsible courts held to arise from capital-replacing loans, with the result that they would only receive repayment in the courser of the bankruptcy proceedings if all other, privileged or non-privileged, crdditors had been satisfied. The administrator in composition proceedings, W, had already tried without success to find a purchaser who would be prepared to take over the company. When the court initiated insolvency proceedings, FHH and HLB decided to promote the take-over of the operations of HSW at going-concern value in order to increase the insolvent estate up to a level that would allow at least partial coverage of their outstanding claims. The German authorities are of the opinion that a private investor in the same situation would also have provided the necessary financing for the continuation of the operations.

In addition, the German Government is of the opinion that the DM 20 million loan which was granted on the instructions of FHH would be covered by the Commission decisions of 1984 and 1985 authorizing State guarantees in favour of HSW of up to DM 40 million. Authorized guarantees for loans of up to DM 27 million were never used because the company decided to use other possibilities of financing.

As regards the credit line, the German authorities pointed out that it was always covered by securities that a private bank would have considered sufficient for a comparable credit line. The public bank HLB was only chosen because it offered better conditions than private banks, owing to its particular standing. The fact that 60 % of the credit line was covered on the instructions of FHH even at the outset was explained by the fact that HSW has no premises of its own to offer as security for a mortgage. HLB is, according to the German authorities, known to be a very prudent bank, keen to exclude even the slightest risk connected to its operations. The fact that HLB requested the additional security through the credit order of FHH does not, in the opinion of the German Government, indicate that a private bank would not have granted a similar credit line without this additional security. Therefore, the credit order of FHH should be seen solely as a shifting of risk from HLB to FHH which would only have had internal effects for the budget of FHH but had nothing to do with HSW. Therefore the German Government is of the opinion that the credit line, at least between 1984 and 1992, did not constitute aid.

As to the enlargement of the credit line by DM 20 million in December 1992, granted on the instructions of FHH and at full risk to the public treasury, the German Government pointed out that HLB had to face the alternative of either granting the enlargement necessary to maintain HSW in operation or of writing-off its entire commitment as irrecoverable. The credit order of FHH, covering the HLB's commitment in the manner of a guarantee, should, according to the German Government, be seen only as an effort by FHH to relieve its subsidiary HLB of the risks connected with the legislation on capital-replacing loans. The order was, according to the German Government, not a causal factor in the decision of the bank to enlarge the credit line in December 1992. A private bank facing the option either of continuing, and enlarging, its commitment or of losing its entire financing would have taken the same decision.

As to the extension of the credit line in December 1993 and its enlargement by DM 24 million plus a DM 10 million swing, and the enlarged credit order of FHH covering the entire financing of HSW, the German Government is of the opinion that the behaviour of the City of Hamburg was justified as being both a managerially and a socially responsible transfer of the company into private risk.

HLB was not prepared to continue its commitment, even to the level of the DM 52 million it had offered before, secured by the current assets of HSW. The German Government claims that the behaviour of HLB in December 1993 may be explained by the fact that a new court decision [1] concerning the question of capital-replacing loans suggested that the entire loan granted by HLB would represent such a capital-replacing loan and would in the event of insolvency be completely lost.

FHH, facing the same risk with regard to its commitment of DM 98 million, decided to provide the necessary financing to allow, at least, a partial recovery of the loans and the continuation of the company after an organized transfer into private risk. The German authorities are of the opinion that this commitment of the Hamburg Treasury should be compared with a high-risk junk bond investment, which they report to be available on the US money market at 15 % per annum interest. If the 100 % financing of HSW after December 1993 constituted State aid, the amount would, in the opinion of the German Government, be limited to this interest, because the company would have had the possibility of covering its financing by such US-junk bonds.

[1] This decision of the Bundesgerichtshof, taken on 13 July 1992, published on 2 October 1992 in *Der Betrieb* 1992, p. 2026, covered a case, not connected to the present case, in which a lender had had a comparable contractual relation with its debtor as HLB had with HSW.

In addition, the German authorities put forward the same arguments as those regarding the DM 20 million enlargement of December 1992, and are of the opinion that any other bank would have behaved in the same way as FHH when it decided to cover the entire credit line in December 1993 plus an extension by DM 24 million and a DM 10 million swing.

IV

Hamburger Stahlwerke GmbH is a company falling under Article 80 of the ECSC Treaty because it produces products listed in Annex I to the ECSC Treaty, so that the provisions of the ECSC Treaty and the Steel Aid Code are applicable.

State aid within the meaning of Article 4 (c) of the ECSC Treaty is, among others, any transfer of State resources to public or private steel firms, in the form of acquisitions of shareholdings or provision of capital or similar financing if the financial transfer is not a genuine provision of risk capital according to usual investment practice in a market economy, allowing for a reasonable prospective future return on investment or other revenue [1].

Hamburger Stahlwerke GmbH was *de facto* a public steel company since its outset in 1984. The State raised its entire equity and injected this risk capital through HLB, W, G and Protei into the company. G and W, controlling Protei, the shareholder of HSW providing its daily management, were bound to strict contractual obligations imposed by the contract with HLB, acting on behalf of FHH, depriving them of the basic rights attaching to a normal shareholding.

The entire contractual situation created in 1984 provided for the control of FHH, through HLB, over HSW. However, according to Article 83, the ECSC Treaty in no way prejudices the system of ownership of the undertakings to which it applies. The Member States are free to run steel companies under public control.

As regards the DM 20 million loan, granted by FHH via HLB to Protei to raise the initial equity of HSW, it is to be concluded that the provision of this loan was similar to the direct injection of risk capital. The contract between the public bank HLB, acting under the instructions of FHH, and the lenders, provided that the State would only receive repayment and interest if HSW made profits. On the basis of these provisions, only DM 2,8 million in redemption and DM 2,7 million in interest were paid for a period of 10 years. The sale of the shares, accepted in lieu of repayment of the loan, covered an additional amount of DM 10 million, so that FHH's final loss on the equity loan, normal interest excluded, is DM 4,5 million. The provisions concerning repayment and interest to be paid on the equity loan reflect the normal revenue an investor would receive on risk capital injected in a private limited company. The loan should therefore be considered to represent a provision of risk capital.

The argument of the German Government that a private investor would likewise have raised risk capital to be injected into the new HSW to allow the continuation of the operations of the old Hamburger Stahlwerke GmbH is not convincing. The Commission has always focused on the behaviour of private investors when establishing whether a given public provision of capital corresponded to normal market practice. The administrator in composition proceedings tried for one year without success to find a private investor to take over the activities. The behaviour of the possible investors invited at that time to take over the company shows that a private investor without a particular relationship to the old Hamburger Stahlwerke GmbH would not have injected risk capital to finance an absorbing company.

In 1984, when the Commission considered the aid connected to the restructuring plan as it was presented by the German authorities, the company was, given the assumed readiness of the private investor Protei to risk its own private capital, held viable with the aid finally approved, that was at that time considered not to exceed the amount necessary the restructure HSW. The fact that even with the prospect of receiving such substantial aid (the Commission had been notified as early as 1982 of the intention to grant the aid) no private investor was found to take over the activities of the old Hamburger Stahlwerke GmbH underlines the point that a private investor would not have been prepared to inject risk capital.

The faxt that HLB also provided some financing for the new HSW does not indicate the contrary. HLB did not provide the loans in the framework of the credit line under conditions that would allow them to be regarded as comparable to risk capital from the outset. HSW had to

[1] See Court of Justice, Cases C-40/85, *Belgium* v. *Commission*, [1986] ECR 2321, 2345; C-303/88, *Italy* v. *Commission*, [1991] ECR, I-1433, 1476 ('ENI Lanerossi'), Commission Decision No 3855/91/ECSC, OJ No L 362, fifth paragraph under II, and communication of the Commission to Member States concerning public undertakings, OJ No C 307, 13. 11. 1993, p. 3, paragraphs 10 to 21.

pay interest, even in years in which it made no profits. The bank received securities to cover its loan that were valuable at least as long as the loans did not have to be considered as representing capital-replacing loans.

Therefore, it is concluded that the DM 20 million loan provided by FHH through HLB and Protei to cover the initial equity of HSW constitutes State aid.

The Commission authorized State guarantees in favour of HSW covering up to DM 40 million in 1984 and 1985. Guarantees covering up to DM 27 million were not used. Since German law provides that a credit order (Kreditauftrag) requires the instructing party to bear liability under the provisions on financial securities (paragraphs 778, 765 and following BGB), the credit order of FHH covering the DM 20 million loan may be considered comparable to a State guarantee. The liability arising from that order is the same as that arising from a guarantee. The aid related to the DM 20 million equity loan is therefore covered by the Commission authorization of 1984/85.

As regards the credit line granted by HLB since 1984, largely covered by a credit order of FHH, it seems appropriate first to consider the structure of the precautionary financial arrangements surrounding the creation of the absorbing company, namely the new HSW.

When the winding-up proceedings in respect of the old HSW were initiated, it became clear that the claims of HLB, totalling DM 52 million, and of FHH, totalling DM 129 million, on the old HSW would not be covered. The background is that the loans of both FHH and HLB were considered capital-replacing loans with the result that they would only have been refunded in insolvency proceedings after the satisfaction of all creditors, privileged or non-privileged. The closure of the company would have led to costs for the cleaning-up of the site, to social costs (social plan) and to the sale of the assets at liquidation value, which is much lower than the going-concern value.

In those circumstances HLB was prepared to grant financing in the form of loans for the new HSW to allow at least partial recovery of its outstanding debts, and finally had 90 % of its outstanding DM 52 million repaid. The decision of HLB to grant a loan of exactly the same amount, DM 52 million, at its own risk in order to finance an arrangement that led to this result appears reasonable from an economic point of view.

FHH granted via HLB the DM 20 million equity loan, covered DM 78 million of the credit line to finance the operations of new HSW, offered aid to be financed by FHH itself (the remainder of the aid authorized was to be covered by the Federal Treasury) of approximately DM 23,5 million and guarantees, therefore amounts to approximately DM 121,5 million.

It is therefore evident that HLB and FHH intended only to grant an amount equal to their outstanding claims, so as to allow the continuation of the operations through an absorbing company and thereby promote a solution that avoided the additional costs of closure.

HLB finally received repayment of 90 % of its claims on the old HSW; FHH only received 60 % of its old claim. The main difference, however, was inherent in the structure of the securities which HLB and FHH had obtained to cover the credit line. HLB, as the formal creditor of also the DM 78 million credit line granted by order of FHH, received security by way of a transfer of current assets and the relinquishing of HSW's claims. Since the credit order of Hamburg to HLB entailed an obligation on FHH to make good all of HLB's financial disbursements in connection with the DM 78 million credit line, those securities would only cover that portion of the credit line if the final value of the securities exceeded the loan granted by HLB at its own risk. Since the going-concern value of the securities was estimated at between DM 144 million in 1984 and DM 204 million in 1994, it is reasonable to assume that the liquidation value of the securities always exceeded the DM 52 million. The fact that the purchase price Ispat has to pay under the terms of the contract is currently estimated at between DM 44 million and DM 74 million supports this conclusion. HLB agreed to grant the credit line on the strength of securities that would always allow its preferential status as creditor before FHH would benefit from the securities.

At the time when the revolving credit line was granted and regularly renewed between 1984 and 1992, the new HSW was not in financial difficulties to such an extent as to need an injection of additional risk capital by its shareholders to avoid insolvency. The company had sufficient capital of its own to cover its partial loss-making operations. Accordingly, HLB had no reason to fear losing the securities due to the German legislation on capital-replacing loans, even though the contractual ploy of setting up the new HSW was an obvious attempt to circumvent this law.

The initial calculation of HLB and FHH concerning the possibility of repayment on the outstanding claims on the old HSW turned out to be nearly correct. HLB received repayment on 90 % of its outstanding claim, which in the framework of the insolvency proceedings covering the old HSW was without valid securities, and replaced this claim by a new claim based on a credit line granted at own risk for the same amount but secured by the new HSW. Only if the financial situation of the new HSW had deteriorated to such an extent as to necessitate the additional injection of risk capital, would HLB have had to face such difficulties as would have arisen in the insolvency of the old HSW, because in that case the law on capital-replacing loans would have come into play. When HLB agreed to grant the credit line it would be confident of two things. First, the ploy of setting up the new HSW was at that time not widely known as a means of circumventing the legislation on capital-replacing loans, so that any later administrator in insolvency would have to face the risk of a court case. Secondly, and most important, FHH had shown its readiness to keep the new HSW in operation so as to safeguard jobs. HLB could reasonably assume that FHH would be prepared to assist HSW in the event of tis financial situation deteriorating.

These conclusions are underlined by the behaviour of FHH in December 1992 and December 1993, when HSW ran into financial difficulties and needed additional liquidity to continue its operations. In December 1992, after suffering operating losses of DM 8,5 million and DM 19,8 million in 1991 and 1992, HSW needed an enlargement of the credit line by DM 20 million. HLB and FHH had to decide whether to renew the revolving credit line and whether to grant the requested extension. HLB decided to continue the credit line of DM 52 million granted at its own risk, without coverage of the credit order of FHH, but refused to participate in any extension of the provision of liquidity. FHH decided not only to renew the order to grant the credit line of DM 78 million, but also instructed HLB to grant the needed DM 20 million extension. FHH increased its coverage of the risk on the credit line from 60 % to 65,4 %.

On the basis of the considerations concerning the background for the creation of the new HSW, the behaviour of HLB seems reasonable. HLB agreed to cover DM 52 million of the credit line, the same amount which it aimed to have repaid through the takeover solution financed. In December 1992, eight years after the initiation of insolvency proceedings covering the old HSW, it was already clear that HLB succeeded by receiving repayment covering 90 % of its claims on the old HSW. It obviously did not intend to grant any further financing for the new HSW, in particular during a very critical period for the entire European steel market, and consequently it refused to grant an enlargement of the credit line at its own risk.

The argument of the German Government that a private bank would have granted the enlargement of the credit line needed because otherwise the entire loan would have been lost, is not convincing. The commitment of HLB to cover part of the credit line of HSW was never comparable to a loan from a normal private bank financing the oeprations of a company. The commitment was based on the wish to recover the claims that HLB had on the old HSW.

The conclusion, explained above, that HLB relied on the readiness of FHH to keep the new HSW in operation so as to safeguard this key industrial undertaking in Hamburg is supported by the behaviour of the bank and the City in December 1992.

The argument of the German Government that HSW did not benefit from the additional DM 20 million credit order is not sustainable. The German authorities explained that the company needed the extension to avoid a cash crisis. Since HLB had already taken all available securities, it would not have found a normal private bank to grant additional loans. The coverage of the additional DM 20 million credit line was not only an internal shift of risks between HLB and FHH to save HLB from financial difficulties. The extension was crucial for the survival of HSW at that time and therefore was to the benefit of the company itself.

HSW again suffered negative operating results of DM 24,4 million in 1993 — the severest since its creation in 1984. The experts instructed by the credit commission of FHH to prepare its decision concluded in December 1993/ January 1994 that HSW was close to insolvency and that the privatization of the company would be the best way to limit the losses of FHH and to safeguard jobs.

Again HLB and FHH had to decide whether to extend the revolving credit line and to grant the needed enlargement by DM 24 million. HLB decided not to continue the credit line granted at own risk and not to grant any further financing. FHH decided to take over the full economic risk relating to HSW and instructed HLB to grant a credit line of DM 174 million plus an additonal DM 10 million swing by the beginning of 1994.

The German Government claims that the decision of the bank was mainly based on the fact that a recently published Court decision indicated that all HLB loans would have to be considered capital-replacing. This argument is not convincing.

The Court decision which is referred to had already been published in a well-known legal journal on 2 October 1992, i.e. even before HLB decided in December 1992 to extent the credit line of DM 52 million. In addition, it is unlikely that the management of HLB would not have relaized that the contractual structure created in 1984 was nothing but an attempt to avoid new problems with the

law on capital-replacing loans, as HLB had already experienced during the insolvency of the old HSW. The experiences after the insolvency of the old HSW had shown that any financing of HSW when in financial difficulties combined with a certain proximity to the shareholders or any kind of indirect shareholding would, in insolvency, lead to the treatment of loans as risk capital. The contractual arrangement at the creation of the new HSW provided for such indirect shareholding of HLB because the actual shareholder of HSW, Protei, was deprived of the basic rights attaching to a normal shareholding, in favour of the bank, which acquired a decisive influence on the fate of the company, as explained above. The difference relative to the shareholder as trustee is negligible, especially in the light of the economic background of German law on capital-replacing loans.

This contractual arrangement was obviously designed to evade the legislation on capital-replacing loans. The legislation, however, provides for efficient safeguards against such evasion and an average receiver in insolvency would readily have been able to reveal the attempted evasion before a civil law-court. It is therefore reasonable to assume that the management of the bank knew from the very beginning that the securities would in the event of insolvency be at least seriously endangered. But they expected not to face the prospect of bankcruptcy, because the State was initially prepared to maintain HSW in operation. The expert study of December 1993/January 1994 prepared for the credit commission of FHH, however, strongly recommended the termination of FHH's involvement in HSW so that such expectation was no longer tenable. In this situation the bank could no longer expect that FHH would avert the insolvency in any case. The management of HLB logically decided to terminate its commitment and to leave further financing to FHH.

The German Government further claims that the behaviour of the State was justified as being both a managerially and a socially responsible transfer of the company into private risk.

The Commission considered these factors in particular in the light of the decisions of the Court of Justice of the European Communities in Case C-303/88, quoted above, and Case C-305/89 [1]. The Court in these decisions pointed out *inter alia* that where the injection of public capital disregarded any prospect of profitability, even in the long term, such injection must be regarded as aid. Considering also the other aspects of possible private investor behaviour, addressed in the decisions of the Court of Justice in Cases C-303/88 and C-305/89, the loans granted by FHH through the HLB on the basis of the credit line are incompatible with normal private investor behaviour. The circumstances of the present case clearly show that there was never a prospect of profitability such as is expected by normal market investors, be it in the short term or the long term, for financing by the FHH.

In addition, it should be recalled that the Court of Justice, in its decision in Joined Cases C-278/92, C-279/92 and C-280/92 [2], held that a private investor would not inject additional capital into an ailing company in anticipation of and with a view to the sale of this company. The sale of the company would deprive the investor of even the slightest prospect of future profitability, even in the long term. The FHH, following the recommendations of the expert study, decided in December 1993 to pursue the privatization of HSW. The loans were intended to avoid a cash crisis and consequent insolvency during the period in which privatization was being prepared. It was not expected that privatization would be possible without writing-off an important part of the debts of HSW.

The prospect of losing the entire claim on HSW if the company applied for bankruptcy was not sufficient for HLB to continue its commitment. The bank had 90 % of its claims on the old HSW repaid as a result of the continuation of its operations by the new HSW. FHH had DM 77 million of its old claim on HSW repaid in the course of this solution, 93,7 % of the initial credit line covered by the State. The remaining financial contribution of the FHH to mirror the total amount of outstanding claims on the old HSW at the outset of the new HSW, as explained above, was in any case considered to represent a lost subsidy, authorized as aid. The insolvency of the new HSW would therefore not have caused any additional unexpected loss. Since the State in 1984 shared the opinion of the bank that the aid contributions to allow the continuation of the operations of the old HSW were economically reasonable because it would allow claims on the old HSW to be recovered, it would consequently have been reasonable to terminate the commitment after having achieved repayment of the old debts.

On the basis of the above it cannot, however, be ruled out that the behaviour of FHH as regards the credit line for HSW during the years from 1984 until the end of 1992 was in line with the normal behaviour of investors in a comparable situation. The reasonable expectation of receiving at least partial repayment on an uncollectable claim also prompted HLB, with its management bound to sound business practice, to cover a credit line of an amount similar to the claim on the old HSW. The situation of FHH and HSW after the insolvency of the old HSW was very unusual. It may not be excluded that the differences as regards the securities, as explained above,

[1] *Italy* v. *Commission*, [1991] ECR I-1603 ('Alfa Romeo').

[2] *Spain* v. *Commission*, [1994] ECR I-4103 ('Hytasa'), see *European Journal of Business Law*, 1994, p. 694.

were sufficiently limited to suggest that, essentially, the behaviour of FHH was comparable to what was considered reasonable by the management of HLB. Focusing only on the respective shares in the credit line, it is to be noted that both HLB and FHH recovered nearly the full amount of their commitment. HLB granted 60 % of the credit line by order of FHH. To that extent, the bank was used by FHH as a tool for granting the credit line; the loans were granted to HSW by FHH through HLB. Therefore, the loans granted on the basis of the credit line should be considered as granted by FHH. Any additional premium, as is expected for guarantees, is consequently not considered necessary by the Commission. The Commission therefore concludes that the credit line of DM 78 million granted by HLB by order of FHH during the period 1984 until the end of 1993 did not constitute State aid.

As regards the enlargement of the credit line by DM 20 million in December 1992, it must be concluded that this extension led to a situation in which FHH risked an amount exceeding its initial old claim on the old HSW, so that the particular economic background of the absorbing solution could not be applied to explain this behaviour. After the severe losses HSW suffered during the years 1991 and 1992, the company was in a deteriorating financial situation. The European steel sector was experiencing its most difficult period since the first half of the 1980s, due to a general slowdown in the economy, a serious imbalance between supply and demand, and structural overcapacities accompanied by a collapse in prices. All of these factors combined to aggravate the financial situation of almost all steel companies in the Community. In this economic environment HLB accordingly refused to increase that part of the credit line granted at its own risk.

As regards the extension and enlargement of the credit line in December 1993 and the fact that FHH agreed to take over the entire risk attaching to the financing of HSW after the refusal of HLB even to continue its previous commitment, it must be concluded that the particular background of the initial financing of the new HSW was not considered by HLB to be sufficient to justify the economic risk of keeping HSW in operation.

The company was close to insolvency. Further heavy losses were expected for 1994. The situation of the steel markets had not improved significantly. The expert study announced only a limitation of losses in the event of privatization. In this situation, the management of HLB decided to terminate its commitment and to accept insolvency if FHH behaved similarly, by terminating its commitment. This overall picture shows clearly that no private investor, in the situation prevailing in December 1993, would have been prepared to inject new risk capital. The only partner of FHH, who was in the same situation, did not consider the previous possible particular justification for the granting of the credit line to be sufficient to justify a continued financing of HSW. It is therefore concluded that the behaviour of FHH could not be deemed comparable to the behaviour of a normal investor in a market economy.

Thus the behaviour of FHH in December 1993, when it instructed HLB to grant a credit line of DM 174 million and a DM 10 million swing to HSW by the beginning of 1994 on full risk of the State, constitutes State aid incompatible with the ECSC Treaty and the Steel Aid Code. The aid element in these loans is visible, not in any preferential interest terms but rather in the actual capital provided.

The loans are to be regarded as being comparable to a direct injection of risk capital because the actual loan capital is, according to the legislation on capital-replacing loans, to be treated as injected risk capital made available by a shareholder of an ailing private limited company.

Any State aid to steel companies is prohibited under Article 4 (c) of the ECSC Treaty. The Steel Aid Code, adopted with the unanimous assent of the Council pursuant to Article 95 of the ECSC Treaty, provides for the possibility of treating certain categories of aid as compatible with the common market, such as aid for research and development (Article 2), environmental protection (Article 3), closures (Article 4) and aid under general regional investment aid schemes in certain territories of the Community (Article 5). The aid granted to HSW does not fall under any of these categories. Rescue and restructuring aid cannot be deemed compatible with the common market under the provisions of the Steel Aid Code.

Any State aid granted unlawfully is, in principle, to be recovered from the recipient firm. Repayment has to be made in accordance with the procedures and provisions of German law with interest, based on the interest rate used as reference rate in the assessment of regional aid schemes, running from the date on which the aid was granted.

As regards the calculation of the amount of aid, the German Government claims that HSW would also have had the possibility of financing its operations by junk bonds available on the US money market. This argument cannot be accepted, because the injection of risk capital into an ailing company in a traditional industrial sector cannot be compared to the private financing of risk investment necessary in an innovative market economy to allow the development of new technologies or the creation and conquest of new markets. Private tools of risk

financing are available for companies which have some chance of winning highly profitable markets. It is widely known that the financial results of steel companies are especially cyclical in nature and an average prudent investor would require an assurance from profit or from cash flow throughout the economic cycle, rather than granting unsecured risk capital without any particular prospect of winning a share in a promising future market.

With regard to the calculation of the amount of aid, it further claims that the amount that HSW could have financed in December 1993 through normal bank loans would have to be deducted from the total amount made available by FHH.

It may be true that the company could have covered part of its financing by loans from private banks, if the securities had been released by HLB and FHH. A private bank, however, would not have granted a loan which would have fallen under the legislation on capital-replacing loans. The German Government explained that the entire amount of the loans granted under the credit line was affected by this legislation. It follows that the behaviour of the State, even as regards an unknown portion of the credit line, was not comparable to a possible loan a private bank might have granted in December 1993.

The conditions of the sale of HSW to Ispat include a *de facto* waiving of claims arising from loans granted in the framework of the credit line. On the other hand, Ispat would pay a certain purchase price for the takeover of the claims. HSW is, after the takeover of all shares by Ispat, intricately bound into the Ispat group so that the payments of Ispat to take over the claims and thereby to release HSW from its debts, may economically be imputed to HSW itself. The Commission therefore, with a view to an economic approach and in order not to request repayment of aid exceeding the undue financial advantage HSW has received, decided to accept the purchase price Ispat would finally pay on the basis of the contractual arrangements with HLB as part of the recovery of aid.

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By way of summary, the Commission therefore concludes that the loans granted to HSW on the basis of the DM 20 million extension of the credit line of December 1992 and the loans granted on the basis of the credit line of DM 174 million and the DM 10 million swing accorded in December 1993 represent State aid incompatible with the ECSC Treaty and the Steel Aid Code. The aid should be recovered. Repayment must be made in accordance with the procedures and provisions of German law with interest, based on the interest rate used as reference rate in the assessment of regional aid schemes, starting to run *pro rata temporis* from the date on which the aid was granted. Interest already paid on the basis of the credit line agreement should be taken into account. The purchase price finally paid by Ispat for the transfer of claims from HLB should be taken as part of the recovery of aid,

HAS ADOPTED THIS DECISION:

Article 1

The contribution to the equity capital of Hamburger Stahlwerke GmbH of DM 20 million, in the form of a loan granted by Freie and Hansestadt Hamburg acting through Hamburgische Landesbank Girozentrale, to the shareholders of Protei Produktionsbeteiligungen GmbH & Co. KG and to that company itself, constitutes State aid. That aid was approved by the Commission in 1984/85.

Article 2

The loans granted to Hamburger Stahlwerke GmbH on the basis of the DM 20 million enlargement of the credit line, accorded by Hamburgische Landesbank Girozentrale on the instructions of Freie und Hansestadt Hamburg in December 1992, and the loans granted on the basis of the credit line of DM 174 million and the DM 10 million swing accorded by Hamburgische Landesbank Girozentrale on the instructions of Freie und Hansestadt Hamburg in December 1993 represent State aid incompatible with the ECSC Treaty and the Steel Aid Code.

Article 3

Germany shall recover the aid referred to in Article 2 from the recipient company. Repayment shall be made in accordance with the procedures and provisions of German law, with interest, based on the interest rate used as reference rate in the assessment of regional aid schemes and starting to run *pro rata temporis* from the date on which the aid was granted. Interest already paid pursuant to the credit line agreement shall be taken into account. The purchase price paid by Venuda Investments BV for the transfer of claims from Hanseatische Landesbank shall be treated as part of the aid recovered.

Article 4

Germany shall inform the Commission, within two months of being notified of this Decision, of the measures taken to comply therewith.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 31 October 1995.

For the Commission
Karel VAN MIERT
Member of the Commission