II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 31 October 1995

concerning the aid granted by Spain to Seat SA, a member of the Volkswagen group

(Only the Spanish text is authentic)

(Text with EEA relevance)

(96/257/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 on the European Economic Area, and in particular Article 62 (1) (a) thereof,

Having given the parties concerned the opportunity to submit their comments, in accordance with the above-mentioned Articles,

Whereas:

I

INITIATION OF THE PROCEDURE IN ARTICLE 93 (2) OF THE TREATY

By letter dated 15 June 1995, the Commission informed Spain of its decision [1] of 7 June 1995 to initiate the procedure provided for by Article 93 (2) of the Treaty with regard to the State aid measures proposed by the Spanish authorities for Seat SA (Seat), a motor vehicle manufacturer belonging to the Volkswagen group (the VW group).

By initiating the procedure, the Commission was expressing serious doubts about the compatibility of the aid with Article 92 of the Treaty, for the following reasons:

— in 1994 the Spanish authorities concluded two aid agreements, one on 11 July between the Spanish central authorities and the Catalan regional authorities and VW-Seat and the other on 29 July between the Catalan regional authorities and VW-Seat, committing Pta 46 billion in State aid to Seat, to be granted by the Ministry of Industry and Energy (Pta 38 billion) and the Generalitat de Catalunya (Pta 8 billion),

— as a result of these agreements, the ICO (Instituto de Crédito Oficial) and the ICF (Instituto Catalán de Finanzas), which are publicly-owned credit institutions, granted Volkswagen AG two loans, amounting to Pta 30 billion and Pta 6 billion respectively, as an advance on the future grants from the Spanish authorities to Seat,

— having examined the aid agreements and the loan contracts, the Commission concluded that State aid had been granted to Seat illegally in the form of the ICO and the ICF loans to the VW group,

— by letter dated 24 February 1995, the Spanish authorities notified their proposal to grant State aid to Seat, in accordance with approved programmes, in support of the eligible costs incurred in 1994 in paying for 30 R&D projects under its multiannual investment plan for 1994 to 1996. Having examined the information supplied, the Commission informed the Spanish authorities that it could not adopt a position concer-

[1] OJ No C 237, 12. 9. 1995, pp. 2 and 12.

ning the notification received, since this referred only to the aid which was to be granted in 1994 to 30 R&D projects, in respect of which an entire State aid package had already been agreed for 1994 to 1996. The Commission also disagreed with the fact that only the parts of the projects relating to expenditure already paid were notified. In addition, the notification was incomplete, since it did not include the subsidies which the autonomous Government of Catalonia was going to grant for the same purpose,

— similarly, the Commission expressed serious doubts about the compatibility of the aid measures with the various criteria laid down in the Community framework for State aid to the motor vehicle industry. .

By means of the abovementioned letter of 15 June 1995, the Commission requested the Spanish Government to submit its observations within one month of the date of the letter.

II

MODIFICATION OF THE ARTICLE 93 (2) PROCEDURE

After the procedure had been initiated, the Spanish Government, by letter dated 27 June 1995, informed the Commission that the various aid measures being scrutinized under the procedure were to be regarded as restructuring aid linked to a plan for restructuring Seat, which was forthwith submitted to the Commission.

The Spanish authorities also informed the Commission that this notification replaced the previous one, sent by letter dated 24 February 1995, relating to the aid for 30 Seat technological and industrial innovation projects in 1994 (formerly Case N 222/95). In addition, they made it clear that the restructuring aid measures now being notified consisted of State aid projects based on programmes previously approved by the Commission and measures promoting technological innovation, modernization, rationalization, training, conversion of the workforce and environmental projects.

In the light of these facts, and since the case involved a company experiencing difficulties and operating in a problematic sector regulated by a Community framework, the Commission decided on 20 July 1995 to amend its previous decision, adopted on 13 June, concerning the initiation of the procedure provided for in Article 93 (2) of the Treaty.

At the same time, the Commission's decision of 20 July amending its previous decision to examine the aid granted to Seat was communicated to the Spanish Government by letter dated 1 August. In the letter the Commission informed the Spanish authorities that, on the basis of the notification submitted, it could not adopt a position on the compatibility of restructuring aid with the Community guidelines on State aid for rescuing and restructuring firms in difficulty or with the Community framework for State aid to the motor vehicle industry. Consequently, the Commission communicated to the Spanish authorities its decision to verify how far the notified plan still reflected the restructuring measures actually adopted and whether the conditions of the guidelines on restructuring aid in general and as regards the motor vehicle industry were met.

The Commission requested the Spanish Government to submit its observations in this respect within one month of the date of the letter.

III

OBSERVATIONS OF THE SPANISH AUTHORITIES

The Spanish authorities replied to the Commission's communication on the modification of the Article 93 (2) procedure for examining the aid to Seat by letter dated 3 August 1995, which confirmed only that the additional information about the Seat restructuring plan requested in the Commission's letter of 28 July (see the second paragraph of Section V) would be supplied at a later date.

That information was subsequently notified by the Spanish authorities to the Commission by letter dated 24 August (registered by the Commission on 14 September) and supplemented at two successive bilateral meetings. Lastly, the Spanish authorities supplied new data and offered further guarantees in their letters of 5 October and 20 October.

IV

OBSERVATIONS OF THIRD PARTIES

With the publication of the decision of 7 June 1995 initiating the Article 93 (2) procedure with regard to the Seat aid measures and that of 20 July 1995 amending the previous decision, the Commission requested the other Member States and interested third parties to send their observations on the aid in question within one month.

In response, the Commission received observations, by letter dated 11 October 1995, from the German Government only. The letter expressed support for the aid granted by the Spanish authorities for the Seat restructuring plan.

By 12 October the Commission had received no observations from other Member States or interested parties on the aid proposed by the Spanish authorities for Seat.

V

ANALYSIS OF THE SEAT RESTRUCTURING PLAN

As already mentioned, the Commission had to carry out an examination to establish how far the notified plan still reflected the reality of the restructuring measures adopted and whether the conditions of the guidelines on restructuring aid in general as well as those for the motor vehicle industry were met.

This assessment was carried out with the help of an independent consultancy, which, on 24 and 25 July 1995, visited the Seat factories in the Barcelona free zone and at Martorell in the company of Commission officials. The object of the visit was to carry out a preliminary examination of the restructuring aspects of the plan submitted by the Spanish authorities and to gather the data still needed for the Commission to adopt a definitive position on the aid measures as re-notified. After the visit, the Commission requested, by letter dated 28 July, further information from the Spanish authorities on the Seat restructuring plan.

The following description of the Seat restructuring plan is based on the results of the visit and on the data supplied by the Spanish authorities and, with the prior agreement of the said authorities, by the VW group at the different stages of the examination under the Article 93 (2) procedure.

(a) Reasons for the adoption of a restructuring plan for Seat

Seat's financial situation deteriorated dramatically in 1993, when the company accumulated losses of Pta 151 billion for a variety of reasons, namely:

— the successive devaluations of the peseta, which adversely affected the company's financial obligations, given the considerable volume of external debt contracted by Seat,

— a large increase in the company's depreciation costs as a result of the VW group's policy for investment in Seat since 1989,

— the initial costs of the new plant at Martorell, which came into service in 1993, and the uneconomic cost of keeping on stream the old, under-used factory in the free zone,

— the high cost of [...](1) in the free zone factory: in 1993 the company announced the loss of 1 865 jobs, and another 7 200 workers were affected by employment regulation measures;

— a fall of nearly 22 % in sales (Pta 493 532 million) in 1993 compared with the previous year, combined with a decline in production of 18,2 % (472 978 units), which resulted in an increase in stocks.

These facts made it necessary to adapt production capacity and the level of employment at the company to Seat's real situation on the market, which, contrary to the company's forecasts, was beginning to show a reduced rate of growth.

In view of all these factors, Seat's survival as a company, with its own capacity within the VW group, was threatened by:

— excess production capacity of approximately 50 % on account of the decline in its share of the Western European market for motor vehicles and of the prospective trend for that market,

— a surplus in the workforce of about 50 %, given the forecast levels of automobile production and the rates of productivity,

— sizeable financial and operating losses, which together were pushing the company towards technical bankruptcy.

(b) The VW group's strategy with regard to the restructuring of Seat SA

Faced with the critical situation of Seat in 1993 — the company would have filed for bankruptcy without the immediate capital contributions from its parent — the supervisory board ('Aufsichtsrat') of Volkswagen AG adopted a set of measures ('Sanierungskonzept Seat SA') on 18 December 1993 with the object of re-establishing the viability of the company, taking account both of its current situation and of Seat's medium-term forecasts (in accordance with VW's annual system of strategic planning, the plan in force in December 1993 was known as 'planning round PR 42' and was based on a probable scenario covering the production volumes, sales, market shares and financial assumptions of the different subsidiaries in the group).

(1) Blanks between square brackets indicate business secrets deleted in the published version of this Decision.

Also on 18 December, the VW board considered the worst-case version of PR 42 the '320 000 scenario' which would have involved certain changes in the restructuring measures. The decisive factor in this scenario was the possibility of maintaining Seat's overall production at 320 000 units a year until 1997. These production and sales targets were to be decisive for calculating the maximum number of jobs which the board considered superfluous (i.e. which would have to be axed) in the light of Seat's real needs for the period 1994 to 1997.

The '320 000 scenario' reflected the industrial restructuring required by Seat's critical situation, compared with the target of 700 000 units a year in the group's previous forecasts (particularly PR 39), which assumed that the existing capacities at the two Seat factories would be kept simultaneously in service: the free zone factory for small automobiles in segment A (the Seat Marbella and its successors) and medium-size vehicles in segment C (the Seat Toledo), and the Martorell plant for the production of medium-size automobiles in segment B (the Seat Córdoba and Ibiza and their successors). In fact, for the greater part of 1993, all this technical capacity was underutilized due to the serious crisis affecting vehicle sales.

The concept of the restructuring plan notified by the Spanish authorities by letter dated 27 June in order to justify the aid measures for Seat, on the basis of which the Commission adopted the Decision of 20 July and whose principal elements were published in the abovementioned *Official Journal of the European Communities,* was consistent with the restructuring measures adopted in December 1993 but the figures were based on the assumptions in the worst-case scenario (the '320 000 scenario').

Moreover, the additional information supplied by the Spanish authorities in their letters of 24 August (registered on 14 September) and 5 October (registered on 6 October) and the visits by Commission officials to the Seat factories in the free zone and at Martorell revealed that the plan implemented by the VW group in December 1993 corresponded to the original assumptions in PR 42, as explained above, which was updated by the VW board in December 1994 when it adopted the new plan PR 43.

The main differences between the plan actually applied (PR 43) and that entertained previously (PR 42) can be summarized as follows:

— the actual volume of Seat automobiles sold in 1994 (313 690 units) was less than forecast in PR 42 (364 048 units). The sales targets for 1995 to 1997 corresponded to the assumptions in the earlier plan,

— the proportion of VW vehicles produced in Seat plant (Martorell) was more than twice the estimated share in PR 42,

— the forecast financial results for 1995 still revealed losses estimated at Pta [...] million, whereas PR 42 envisaged a profit (i.e. the company moved into profit later than forecast).

In short, the restructuring plan which Seat is applying and which constitutes the real basis for the aid measures for that company, corresponds with the PR 42 plan adopted in December 1993 and subsequently updated in plan PR 43.

(c) **Objectives of Seat's 1994 to 1997 restructuring**

The restructuring plan notified by the Spanish authorities had two central objectives:

1. to ensure the viability and solvency of the company, in the medium and long term, during the period 1994 to 1997, and

2. to ensure the competitiveness of Seat as a company with its own vehicle design, manufacturing and marketing capacity within the VW group.

In October 1995, the extent to which these objectives have been achieved gives rise, in accordance with the assessment by the Commission's departments and the current commercial situation on the automobile markets of Western Europe, to the following comments:

Medium- and long-term viability of the company

The optimistic assumptions of PR 42, drawn up in December 1993, which suggested that profits would be obtained from 1995 on, had to be revised. In accordance with the most recent forecasts, it is now hoped that the company will move back into profit in 1997, the last year to which the notified plan applies. Similarly, the results for 1995 are worse than forecast, despite the fact that the sales projections for this year are being fulfilled. At the end of the first half of 1995 losses were recorded amounting to Pta 18,7 million. Still, for the first time since 1992, the company made an operating profit during this same period. For their part, the other viability indicators on which the Commission requested information also suggest that the company has made considerable progress. From these data it is clear that, if sales can grow as forecast in the plan, the company will become profitable in 1997; this will depend to a large extent on the strategy

planned for the other subsidiaries in the group, since Seat would in future be making more VW models each time, principally for sale outside the Community.

Seat as a company with its own capacity within the VW group

Seat's autonomy within the VW group is seriously affected by the restructuring measures the group has adopted. As a result of these plans, Seat will lose its individual position within the group to a certain extent, since it will no longer have its own platforms (internal structure of a model) and dynamic assembly lines (engines and transmissions and other basic mechanical parts). Its purchasing department is integrated into the structure of the group, and the latter now selects the suppliers. The new design centre at Sitges (near Barcelona) is shared with VW and Audi, while the Seat development centre has to compete with the other group centres. Some of its importers and its leasing and personal loan company have been acquired by VW, which also supervises the data centre. Seat models will no longer be produced only in Seat factories. Nevertheless, maintaining a separate identity should not constitute an objective, since the plan has to focus on making Seat a viable and competitive company, capable of competing on the motor vehicles market. Once the restructuring measures have been applied, Seat will not only be fully integrated into the VW group but will be able to compete successfully both within and outside it.

(d) **Restructuring measures — explanation of the restructuring plan**

Now that the measures actually applied to date and Seat's current plans (PR 43) have been verified, the restructuring of the company can be presented as follows:

Industrial measures

(i) Production capacity

At the end of 1993, when the restructuring plan was adopted, Seat had three automobile plants operating in Spain: the factory in Barcelona's free zone, the recently constructed factory at Martorell (which entered into service in 1993), which both produced Seat models, and a plant at Landaben, Navarre, which produced the VW Polo and would be sold to the parent company under the restructuring measures. The production capacities of the two remaining Seat automobile plants having been verified, it can be inferred that at the end of 1993 Seat's actual capacities were 1 500 vehicles a day [1] in the free zone and 1 500 vehicles a day [2] at Martorell. The bottlenecks were due in the free zone to the body shop for the three models (the Marbella, the Toledo and the Terra) and at Martorell to the paint shop. Seat's overall annual production capacity, given the other manufacturing conditions, could stabilize, therefore, at around 670 000 units a year.

The industrial measures adopted by the VW group with a view to restoring Seat to viability provide for the definitive closure of the free zone plant and the concentration of all Seat vehicle production at Martorell. However, the closure has turned out not to be definitive, since Seat resumed production at the free zone factory in October 1994 — with a reduced assembly capacity of 280 units a day — of the old Marbella model. In addition, so that the production of the Seat Toledo and of a new van replacing the Terra could be transferred to Martorell, the daily production capacities were increased compared with the original forecasts, attaining 2 125 units a day, with two paint shops (for the last stages of production) in operation.

Consequently, Seat's maximum technically possible production capacity in October 1995, following the application of the 1994 and 1995 restructuring measures, is 2 045 units a day. However, Volkswagen has taken the decision to close the paint shop in the free zone factory at the end of 1996, with the result that the installed capacity of the Seat plants from 1995 will be 2 125 units a day. Accordingly, it is planned that Seat's overall annual production capacity, following the restructuring operation and assuming no change in the other conditions of production, will be 480 000 units a year.

The current level of production capacity cannot be increased unless new, substantial investment is made to remove the current production bottlenecks.

As regards the reduction of capacity, it can be stated that the anticipated reduction in Seat's technical daily capacity amounts to 29 % of the capacity available at the start of the restructuring plan in December 1993.

Capacity at VW group level

Taking the VW group's installed production capacity — including all subsidiaries dependent on the group

[1] The figure of 1 500 units a day can also be found in a table sent by VW to the Commission in November 1993 showing the capacities of all the group's plants in the Community.

[2] Although the manufacturing capacity of the SO3 model, launched at Martorell in 1993, should in fact be 1 500 units a day, actual production at the end of that year was only 1 150 units a day.

— at October 1995 and throughout the EEA (1), the closure of the free zone factory and the operation of the Martorell plant under the conditions described would mean an overall capacity reduction of nearly 5 %, i.e. production capacity would decline from 12 420 units a day in December 1993 to 11 832 units a day at the end of 1997 (2).

(ii) Modernization programme

As was notified to the Commission, production capacity has been reduced in accordance with an R&D plan, which is estimated to cost Pta 207 200 million between 1994 and 1997 (including Pta 5 100 million for training programmes) and which consists basically of industrial innovation and technological development projects and modernization measures. These projects are particularly relevant to the activity of Seat's technical centre at Martorell. Some of them consist of investment by Gearbox del Prat SA, a wholly-owned subsidiary of Seat.

The financial table showing the investment costs that can be subsidized on an annual basis either by the national authorities or by the Catalan regional authorities, which was set out in the July 1994 aid agreements, has been updated to reflect Seat's actual costs in 1994 and its cost forecasts for 1995. As most recently updated, the schedule is as follows (the figures for 1996 and 1997 are tentative):

(Pta 1 000 million)

	1994	1995	1996	1997	Total
Development of new models	14,3	25,7	27,0	20,6	87,6
Continuation of existing models	18,2	10,8	6,2	0,0	35,2
Innovation and development	1,7	1,8	2,4	2,1	8,0
Quality assurance projects	0,0	0,0	0,1	0,1	0,3
Information technology	1,7	1,5	2,5	0,1	5,8
Environment projects	2,5	2,6	0,1	0,0	5,2
Projects at the planning stage	0	3,5	2,0	8,0	13,5
Total	38,4	45,9	40,3	30,9	155,7

(1) Excludes the production capacity of the Skoda subsidiary, which is not located in the EEA.

(2) The only difference between the table supplied by Volkswagen and that of the Commission concerns the capacity of Martorell, which the Commission fixed at 2 125 units a day instead of 2 100.

The fact that the cost of investments actually carried out in 1994 and 1995 turned out to be lower was attributed by the company to the cancellation of certain projects and to the savings which could be made in projects at the implementation stage.

(iii) Social aspects

The planned targets for cuts in production capacity, combined with the need to improve the company's productivity rates, gave rise to a drastic reduction in Seat's workforce in December 1993 and to changes in the occupational situation of those who remained employed by the company.

Reductions in the workforce

In accordance with the plan notified to the Commission, the company's objective is to adjust the workforce, reducing the number of jobs from 18 469 in September 1993 to a target of 9 330, which in 1995 is the number necessary to produce just 320 000 annual units.

The change in Seat's workforce between 1993 and 1997 (with the actual figures for the number of persons employed in 1993 and 1995) is recorded in the following table:

Human resources

(number of workers)

	1993 (September)	1995 (August)	1997 (PR 43)
Administration, management	3 186	2 842	[...]
Free zone, Barcelona:			
— indirect	3 229	1 088	[...]
— direct	5 563	1 714	[...]
Martorell:			
— indirect	1 633	1 514	[...]
— direct	4 858	5 479	[...]
Total	18 469	12 777	[...]

Thus, the effective reduction in the workforce differs considerably from that in the notified timetable. However, the ultimate objective is nearly as ambitious as that in the original plan.

Other social measures

The reduction of the workforce is to be supplemented by a set of measures designed to reduce the company's personnel costs and increase current productivity rates to the average level for the European automobile industry.

The measures, negotiated with the unions in the form of annual collective agreements, comprise:

— a reduction in the company's payroll of 10 % compared with the wage level for December 1993,

— an increase of 10 days in employees' annual working time (involving a shift from 1 736 hours a year per worker in 1993 to 1 816 hours in 1994 and thereafter: i.e. 1 736 hours plus 80 compulsory hours per worker, in case the market requires high levels of production),

— compulsory flexibility of labour during holidays, depending on production needs,

— the compulsory mobility (to other locations and/or categories of job) of the workforce in accordance with the new production planning,

— an early-retirement scheme for workers over 55,

— part-time working for a maximum of 1 829 workers for a period of two years, with a wage equal to 70 % of that for a full-time job,

— existing temporary contracts to be cut to a maximum of 300 jobs,

— cancellation of the agreements previously signed with the unions.

Cost of the social measures

The reduction in jobs and the application of the restructuring measures affecting working conditions, which are being implemented through a set of measures agreed or to be agreed with the unions, will cost altogether, according to the provisions already made in Seat's accounts for 1993 and the PR 43 forecasts, an estimated Pta 64,5 billion:

(Pta 1 000 million)

Early retirement	36,5
Job regulation	5,3
Incentives for stopping work	20,0
Incentives for changing location	2,7
Total	64,5

The cost is considerable less than originally estimated at the end of 1993

(iv) Training measures

The training programmes in Seat's restructuring plan are designed to give the current manual and non-manual workers the necessary skills to develop and launch new models. Seat's requirements are concentrated in the following areas:

— training needed for the operation of the (highly automated) Martorell plant,

— training in product R&D for the staff of the Martorell technical centre,

— process engineering for manufacturing programmes, focusing on the continuous improvement of quality, together with training for suppliers' workers and those of other companies in the group,

— training to promote the conversion of the workforce and the adaptation of Seat workers to part-time jobs,

— training measures for the network of dealers on national and international markets.

The anticipated cost of the Seat training plan in 1994 to 1997 is Pta 5,7 billion, of which Pta 3,38 billion will have been paid at the end of 1995.

(v) Cost of closing the free zone factory

Apart from the social costs discussed above, Seat will have to meet the restructuring costs associated with the closure of the free zone factory. These costs have been audited and will be considerably lower than originally forecast (Pta 14,2 billion). They may be broken down as follows:

(Pta 1 000 million)

Asset depreciation	2,7
Transfer of the Toledo assembly capacity	2,3
Conversion of the workforce	0,4
Cost of relaunch	0,3
Abolition of part-time work	0,4
Total	6,1

(vi) Financial restructuring measures

In its notification to the Commission, the Spanish Government assessed the financial restructuring measures at Pta 257,8 billion, to be entirely supplied by contributions from VW. However, these contributions do not represent a cost to the company but rather an income with which part of the restructuring costs can be funded. The company is in fact implementing two financial restructuring measures: the reconstruction of its working capital, and the

reduction of its substantial financial debt. It is expected that Seat will be able to reduce its debt by Pta 55,6 billion between 1993 and 1997. In addition, an increase in its working capital of Pta 136,6 billion is required in the same period, since Seat had exhausted nearly all that capital in 1993 to meet the operating losses for that year, thus creating a serious liquidity problem.

(vii) Financing the restructuring plan

The total cost of all industrial, workforce and financial measures making up the Seat restructuring plan for 1994 to 1997 amounts, according to the examination carried out by the Commission, to Pta 441,7 billion. It can be broken down as follows:

(Pta 1 000 million)

Industrial investments and R&D projects	155,7
Training programmes	5,7
Financial investments	17,5
Redundancy costs	64,5
Closure costs	6,1
Increase in working capital	136,6
Reduction of financial debt	55,6
Total	441,7

At the end of 1995 Seat will have already defrayed 67 % of the total cost of the plan, having carried out nearly two thirds of the proposed activities.

The cost will be financed by the cash flow generated by Seat during the period, through the capital contributions from the VW group to its subsidiary, the sale of assets and the financial aid granted by the Spanish authorities.

Resources generated by Seat itself

The The company's own resources, whether they proceed from its commercial activity or from atypical transactions (e.g. the sale of assets outside the VW group, the reduction of items allocated to depreciation and other non-operational items), are calculated to be Pta 165,4 billion, or approximately 37,4 % of the total cost of the restructuring operation.

Contributions from the VW group

The deterioration in Seat's financial situation in December 1993 required urgent action to limit the decline in the company's equity capital and to increase it to the minimum level required by Spanish law, so as to offset the accumulated losses of the company in 1994. VW wrote off Pta 82,3 billion of commercial debts contracted with the group by Seat. In addition, to guarantee the survival of the core business of Seat as an independent company within the group, VW agreed to reduce the prices of the parts and components (including engines) supplied to its subsidiary from Germany and to purchase, through cash contributions, the Seat automobile plant at Lanbaden, Navarre and Seat's financial subisidary, Fiseat.

These measures, which represent 51,2 % of the total cost of the restructuring and were adopted between December 1993 and April 1994, are shown in the following table:

(Pta 1 000 billion)

Debt write-off and capital increase	82,3
Purchase of the Landaben factory	104,4
Purchase of Seat's financial subsidiary	17,6
Interest subsidy for VW	(10,0)
Discounts on the prices of supplies	36,0 (× 4 years)(1)
Total contribution from VW to Seat	203,0

(1) The VW group will make a total contribution of DM 100 million (about Pta 8,7 billion) a year between 1994 and 1997 in the form of discounts on the invoices for supplies from the group to Seat.

Financial aid granted by the Spanish authorities

The aid measures adopted in 1994 by the Spanish authorities in support of the restructuring plan amounted to Pta 36 billion, of which Pta 30 billion was granted by the national authorities in the form of a loan contract between the ICO and VW, and Pta 6 billion was granted by the autonomous Catalonian authorities in the form of a loan contract between the ICF and VW.

The aid agreements and loan contracts entered into in 1994 between the Spanish authorities, VW and Seat established *inter alia* the following:

— VW would transfer immediately to Seat the amounts received under the loans (Pta 36 billion). The transfer has been completed, as shown in Seat's annual accounts,

— VW had to pay interest on the loans received in 1994 to 1997. The interest at the end of 1997 on the Pta 36 billion received under the loan agreements was estimated at Pta 10 billion,

— the total grants from the Spanish authorities (i.e. Pta 46 billion) would cover both amounts: the principal, plus all the interest which VW would normally have had to pay.

The Pta 46 billion which will be granted under the various aid schemes between 1995 and 1998 will consequently be used to repay the principal (Pta 36 billion) and the interest (Pta 10 billion) on the said loans. Consequently, the interest will benefit Volkswagen AG and will reduce its contribution to the financing of the restructuring plan. The total State aid of Pta 46 billion represents 10,4 % of the total restructuring cost.

Although the Spanish Government informed the Commission, in its letter of 5 October 1995, that it had no intention of altering the current aid agreements and loan contracts, it added at the same time that it wanted to consider the entire restructuring cost as a basis for granting the subsidies to Volkswagen/Seat. By letter dated 20 October, the Spanish authorities agreed to use the total cost figure established by the Community at Pta 441,7 billion.

VI

EXISTENCE OF STADE AID

Given the volume of trade in the European Economic Area in the type of motor vehicles produced by Seat, any State aid for the restructuring of the company could distort competition and affect trade within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement.

When initiating the Article 93 (2) procedure, the Commission stated that it was necessary to analyze, in the light of Article 92, the contributions from public funds from the Spanish Ministry of Industry and Energy and the Generalitat de Catalunya to VW-Seat, which are set out below:

— the grants, totalling Pta 38 billion, from the Ministry of Industry and Energy to Seat, under schemes already approved (SBT, PATI, PITMA), on which the loan of Pta 30 billion from the ICO to VW, Seat's parent company, constituted an advance. The ICO loan was paid to VW and was then cashed by Seat in July 1994,

— the grants, totalling Pta 8 billion including the Pta 2 billion part-financed by the Community's Structural Funds), from the Generalitat de Catalunya to Seat, on which the loan of Pta 6 bilion from the ICF to VW constituted an advance. The ICF loan was paid to VW and was then cashed by Seat in March 1995,

— the aid for 30 projects in support of Seat's 1994 investments amounting to Pta 7,2 billion and constituting the first instalment of the abovementioned Pta 38 billion in grants from the Ministry of Industry and Energy.

In addition, the Commission decided subsequently to amend its previous decision to initiate the said procedure, so as to take account of the new notification, submitted on 27 June 1995, in which the Spanish authorities informed the Commission that the said aid measures were to be regarded as aid for the restructuring of Seat.

Having examined the data supplied by the Spanish authorities in this respect, the Commission confirms its opinion that the aid committed by the Spanish authorities for VW-Seat under the agreements of 11 and 29 July 1994 and the granting of the ICO and ICF loans to Volkswagen AG, subject to the explicit condition that the loans constitute an advance on the future grants, constitutes State aid within the meaning of Article 92 (1):

— first, because the aid agreements provided that, if the projects are carried out in accordance with the proposed timetable, the grants formally agreed by the authorities will suffice to cover all the costs associated with the loans. Consequently, VW will not in principle repay the loans, the interest or any additional cost unless it does not carry out the projects, as it notified the Spanish authorities, or cannot substitute equivalent projects for them,

— secondly, because the borrower (VW) has confirmed that it has not paid or been required to pay the interest (including that for late payment) due on the first maturity date stipulated in the loan contract enterd into with the ICO,

— thirdly, because both the ICO and the ICF loan contracts explicitly lay down that:

(a) the loans will be granted as advances on the aid payments,

(b) if certain clauses in the agreement cannot be complied with on account of legal or other obstacles, the other clauses will remain valid and the parties will have to find equivalent aid mechanisms or similar advantages,

(c) Seat will have to assign the grants it receives to the credit institutions as an advance on VW's payment obligations arising from the two loans,

(d) VW will not be liable for the interest due as a result of delays in the authorization and payment of the grants,

(e) the timetable for repaying the debt will be flexible as a result of the assignment of the aid items,

— fourthly, because the amounts of the loans granted by the ICO (Pta 30 billion) and the ICF (Pta 6 billion) are shown in Seat's audited accounts for 1994 and 1995 under the heading 'non-repayable grants',

— fifthly, because the grants from the Ministry of Industry and Energy (Pta 38 billion) and the Generalitat de Catalunya (Pta 8 billion) were calculated in such a way as to cover the net grant to be cashed by Seat (Pta 36 billion, in the form of the two loans to VW under market conditions) plus the bank interest which VW would owe to the ICO and the ICF (Pta 8 billion) until the loans were finally converted into grants to Seat,

— sixthly and lastly, the aid reduced the cost of financing the restructuring plan to Seat and Volkswagen, who are actively engaged in the EEA market for passenger and commercial vehicles, thus giving an artificial financial advantage to Seat and its parent company, Volkswagen.

Consequently, the grants of Pta 36 billion made to Seat through Volkswagen by the national and autonomous authorities and the grants of Pta 10 billion (to VW) to cover the interest constitute State aid for the purposes of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement.

VII

STATE AID GRANTED ILLEGALLY

In addition, by not notifying the said aid measures granted to Volkswagen and Seat, the Spanish Government has infringed Article 93 (3) of the Treaty. Since the Spanish authorities did not notify the aid measures in advance, the Commission could not present its observations on those measures before they were applied in 1994. In short, because it was granted in breach of Article 93 (3), the aid is illegal.

VIII

COMPATIBILITY OF THE AID

Article 92 (1) of the EC Treaty establishes the principle that, except where otherwise allowable, aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market. However, Article 92 (2) and (3) state the circumstances in which such aid is, or may be allowed.

Article 92 (2) specifies certain types of aid which are compatible with the common market. Given the nature, location and purpose of the aid in this case, none of the headings is applicable.

Article 92 (3) lists aid which may be compatible with the common market. Compatibility must be determined in the context of the Community as a whole and not of a single Member State. In order to safeguard the proper functioning of the common market and taking into account the principle established in Article 3 (g) of the Treaty, the exceptions to the principle of Article 92 (1) as set out in Article 92 (3) must be construed narrowly when an aid scheme or any individual aid award is scrutinized.

In particular, the Commission has adopted for the motor vehicle industry a Community framework which lays down the criteria for evaluating the compatibility of aid in this sector with the common market, thereby limiting the scope for discretion allowed by Article 92 (3).

The aid measures for Seat adopted by the Spanish authorities in July 1994 constitute a notable example of State aid to the motor vehicle industry.

In addition, the Spanish authorities notified the Commission on 27 June 1995 that the aid measures should be regarded as aid for the restructuring of Seat. Having examined these facts, the Commission agrees to regard the aid to Seat as restructuring aid, given that the company has carried out a major operation of this type, to which the aid contributed substantially.

In short, the aid to Seat should be analyzed in the light of the Community framework for State aid to the motor vehicle industry (1) and of the Community guidelines on State aid for rescuing and restructuring firms in difficulty (2). The compatibility of the aid must be assessed at the date when it was granted illegally, i.e. July 1994, taking account as appropriate of the subsequent changes to the restructuring plan.

Community framework for State aid to the motor vehicle industry

The framework lays down that, in principle, rescue and restructuring aid should be approved only in exceptional circumstances. The aid must be linked to a satisfactory restructuring plan and only granted where it can be demonstrated that the Community interest is best served by keeping a manufacturer in business and re-establishing its viability. It will be necessary to ensure that the aid will not allow a beneficiary to increase its market share at the expense of its unaided competitors. In cases where certain companies still have excess capacity, for example, in the commercial vehicle sector, the Commission may require reductions in capacity in order to contribute to the overall recovery of the sector.

Community guidelines on State aid for rescuing and restructuring companies in difficulty

The guidelines lay down the general principle that, irrespective of its form, restructuring aid will be authorized only where it is in the Community interest and is linked to a viable restructuring/recovery programme submitted in all relevant detail to the Commission. A restructuring plan will need to satisfy all the following conditions:

1. it must restore the long-term viability and health of the company within a reasonable timescale and on the basis of realistic assumptions as to its future operating conditions; it should therefore normally need to be granted only once;

2. the plan must offset as far as possible any potential adverse effects on competitors;

3. the amount and intensity of the aid must be limited to the strict minimum needed to enable restructuring to be undertaken and must be related to the benefits anticipated from the Commission's point of view.

(1) OJ No C 123, 18. 5. 1989, p. 3.
(2) OJ No C 368, 23. 12. 1994, p. 12.

Having examined the Seat restructuring plan and its application up to October 1995, the Commission has reached the conclusion that the abovementioned general and sectoral requirements are met.

1. *Re-establishing viability*

The principal objective of the restructuring plan was to re-establish Seat's viability. The Commission agrees that the plan enables the company to become viable again within a reasonable period and notes that the financial situation in October 1995 shows that, despite a considerable reduction of the workforce, new investment, cancellation of the debt and the granting of the aid, the company will not get back into profit until 1997. Even then, the profit will be limited (the pretax profit will be some Pta 2 200 million). In accordance with PR 43, the cash flow should be positive from 1995 and will make it possible to reduce the volume of loans outstanding every year.

As regards the trend of the operating profit or loss (i.e. the core activity of the company), the figures achieved at the end of the first half of 1995 are still in accordance with the proposed budget for that year, thus reflecting the improvement in Seat's operational situation. Moreover, the budget anticipates that Seat's liquidity will have improved by the end of that year, so that the company should have no liquidity problems in the short term. Nevertheless, not all the improvements proposed in PR 43 (sales to third markets, asset sales, introduction of new models) appear to have been carried out in 1995. Since the company's weak capital structure is still at a critical level, the need for fresh capital contributions in 1996 or 1997 cannot be ruled out. Given that the granting of the restructuring aid is a one-off transaction, it is assumed that the shareholders will make up any deficit in the capital in the coming years, as was confirmed in the last letter from the Spanish authorities, dated 20 October 1995.

Similarly, Seat has made considerable progress in improving its productivity and quality. The company's objective is to achieve, by the end of 1997, an average production volume of 42 vehicles per worker compared with the average rate of 21,9 vehicles per worker in 1993. The productivity rates set for the Martorell plant in 1997 by the Seat restructuring plan will make the factory one of the most productive in Western Europe. The results of the quality audit at the factory show a gradual improvement, the ultimate objective being to attain the quality levels of the group. A substantial improvement (40 %) is also expected in the repairs covered by the vehicle warranty.

Furthermore, the Commission considers that the R&D projects in the implementation or planning stages will raise the company's products, production methods and results to the level attained by the European automobile industry.

Consequently, assuming that the restructuring plan is applied in full and that there is no downturn on the European automobile market, the Commission is convinced that Seat's prospects of becoming viable in the competitive automobile industry are good.

2. *Avoiding undue distortion of competition*

In 1993, the year when Seat's crisis began, new sales in Western Europe fell dramatically by more than 15 % (24,5 % in Spain) to 11,45 million units, the worst recession since the war. The resulting low level of capacity utilization meant that nearly all automobile manufacturers suffered losses that year.

The Commission takes the view that since 1993 the automobile industry in the EEA has suffered from a structural excess of production capacity and that it will be several years before new registrations of private cars break new records in Western Europe. At the same time, automobile production capacity in Europe will increase further due to the gradual build-up of Japanese manufacturers and to other transfers of manufacturing plants.

In 1993 the company sold 290 155 Seat vehicles producted at the Martorell and the free zone plants and a total of 175 684 Volkswagen Polos built at the Landaben factory in Navarre (still owned by Seat up to the end of 1995). As already mentioned, the company's accounts at the end of 1995 showed a loss of more than Pta 150 billion. Seat's market share in 1993, i.e. the starting point for the restructuring operation, was 2,73 % of the sales on the European market.

The examination of the Seat restructuring plan has shown that the VW group is making a substantial contribution to the restructuring of the automobile industry in Europe. The definitive closure of the free zone factory, offset only in part by the expansion of capacity at other sites, will mean a reduction of 29 % in Seat's capacity and of 5 % in that of the VW group.

Similarly, it is reckoned that Seat's current production and sales plan (PR 43) will not increase the company's market share in the EEA at the expense of its unaided competitors. It is estimated that its market share will not be greater than in 1993 (2,73 %).

3. *Aid proportional to the costs and benefits of restructuring*

In the Commission's opinion, the volume of the aid (Pta 46 billion) and the intensity (10,4 % of the total restructuring cost) are strictly necessary for the restructuring exercise. The intensity of the aid does not exceed the reduction of capacity at Seat.

The beneficiares of the aid — Seat as regards the principal of the loans, VW as regards the interest — will make a substantial contribution to the financing of the restructuring costs. In particular, the Commission has been able to determine the capital contributions made by Volkswagen (see Section V).

Similarly, the Commission has verified that the measures on which the restructuring is based and for whose implementation the aid will be granted are necessary for the objectives pursued by the restructuring operation as a whole. In the Commission's opinion, the proposed volume of financing for the restructuring and the investments which form part of it is necessary. The amount has been structured logically and represents a realistic effort with a view to re-establishing Seat's viability in the competitive automobile industry.

Once the objective of re-establishing a minimum margin of manoeuvre in which the company can operate has been achieved, restructuring efforts will be directed towards:

— reducing installed production capacities by concentrating vehicle production at the modern plant of Martorell,

— adjusting the company's workforce — under socially acceptable conditions — to the new capacity levels and productivity objectives,

— training the remaining workforce in the use of new technologies and systems,

— investing intensively in CAD-CAM systems, CIM and just-in-time production,

— investing in engineering computing equipment and capacity at Seat's technical centre,

— developing new products in synergy with the VW group.

These efforts are regarded, in their entirety, as homogeneous, necessary and sufficient.

Although the restructuring plan provides for the reduction of Seat's financial debt, it must be pointed out that the financial charges after 1997 will still be high and will prevent Seat from surpassing the industry average in terms of solvency.

CONCLUSIONS AND CONDITIONS

To sum up, the Commission considers that the aid granted by the Spanish authorities for the Seat restructuring plan satisfies the criteria laid down in the Community guidelines on State aid for rescuing and restructuring firms in difficulty and the Community framework for State aid to the motor vehicle industry.

In accordance with the Community guidelines on State aid for rescuing and restructuring firms in difficulty and with its practice in cases of restructuring aid in the motor vehicle industry, the Commission must ensure that its conclusions remain valid until the restructuring plan has been fully implemented. To this end it must make its final favourable decision conditional on the fulfilment of a number of criteria designed to prevent the aid from having adverse effects on the industry. The trade distorting effect of the aid depends in part on whether the future restructuring is carried out in accordance with the plan and within the proposed time limit. In particular, the Spanish authorities should ensure that the company closes the paint shop at the free zone plant definitively within the proposed time limit and that Seat's and VW's technical capacities do not exceed 2 125 and 11 813 units a day, respectively, at the end of 1997. In addition, the restructuring plan as amended (PR 43) will have to be applied in full and be monitored. Lastly, no new State aid may be granted to Seat or its subsidiaries in Spain in support of the plan. Similarly, it should be noted that, in accordance with the Community guidelines on State aid for rescuing and restructuring firms in difficulty, restructuring aid must not normally be granted more than once,

HAS ADOPTED THIS DECISION:

Article 1

1. The aid for the Seat restructuring plan which is set out below is compatible with Article 92 (3) (c) of the EC Treaty and with Article 61 (3) (c) of the EEA Agreement:

— aid totalling Pta 38 billion granted by the Ministry of Industry and Energy to Seat, of which Pta 30 billion was granted illegally,

— aid totalling Pta 8 billion (including Pta 2 billion from the Community's Structural Funds) granted by the Generalitat de Catalunya to VW-Seat, of which Pta 6 billion was granted illegally,

provided that the following conditions and obligations are fulfilled:

(a) VW-Seat shall not alter the general contents of, or the timetable for, the Seat restructuring plan (PR 42, as amended by PR 43) and shall ensure in particular that:

— the paint shop at the free zone factory shall close and be dismantled by 31 December 1996, as notified to the Commission,

— the current level of capacity at the Seat plants shall not be increased before 1 January 1998,

— Seat's investment plan, which has been brought to the Commission's knowledge, shall be fully carried out;

(b) the aid shall be used exclusively for the restructuring of Seat SA;

(c) no additional aid, whether in the form of a capital contribution or of any form of discretionary aid, shall be granted to Seat SA or to its subsidiaries in Spain in support of the restructuring plan;

(d) the Volkswagen group shall not offset the reduction of capacity at the end of 1997 with contributions that have not been notified to the Commission; accordingly, the group's technical capacity shall remain limited to 11 813 units a day.

2. Spain shall send the Commission an annual report on the application of the amended restructuring plan (PR 43), the evolution of the costs, the receipt of the aid by the companies involved, the repayment of the two public loans obtained and the fulfilment of the conditions laid down. The report, together with the annual report of Seat SA, should be forwarded by the end of May following the report year.

Article 2

Spain shall inform the Commission, within one month of the notification of this Decision, of the measures taken to comply with it.

Article 3

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 31 October 1995.

For the Commission

Karel VAN MIERT

Member of the Commission