II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 5 February 1997

concerning the financing of shipbuilding in Denmark during 1987 to 1993

(Only the Danish text is authentic)

(Text with EEA relevance)

(97/364/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, in accordance with Article 93, given notice to the parties concerned to submit their comments, and having regard to those comments,

Whereas:

I

In May 1996 the Ministry for Business and Industry in Denmark published a report containing a study carried out by Coopers & Lybrand, stating that the financing of vessels in Denmark during the period 1987 to 1993 had occurred in some cases on the basis of inflated prices, which could have meant that the aid ceiling applicable during the period might have been exceeded. Thus the purpose of opening the procedure was to investigate whether the maximum aid ceiling, as established by the Commission during the abovementioned period, had been complied with.

The Coopers & Lybrand report clarified the use of a subsidiary model, the so-called mother-daughter company model, which was used when selling vessels. It was explained in the report that the principle of the mother-daughter company model was that a Danish shipyard creates a daughter company. The daughter company thus becomes a Danish shipowner entitled to receive aid in accordance with the Danish home credit scheme. The daughter company then sells the vessel for cash to the real purchaser. The real purchaser looks after its own financing of the vessel. By setting up the subsidiary the daughter company was able to reduce the price by *inter alia* the amount of aid obtained by financing the vessel via the daughter company.

The use of the mother-daughter arrangement in effect transformed the credit terms available to Danish and EU shipowners into cash payment, and also made these payments available for shipowners from third countries.

In contracts where the mother-daughter company model was used, two prices for the vessel occur: one price paid by the daughter company to the mother company, i.e. the shipyard, and one price paid by the real shipowner to the daughter company. Article 11 of Council Directive 87/167/EEC [1] and Article 12 of Council Directive 90/684/EEC [2], require that Member States send 'current reports on each shipbuilding and ship conversion contract by the end of the third month following the month of signing of each contract, containing details of the financial contract support ...'. In such reports information on the contract price and the aid granted is required. On the basis of the information communicated to the Commission, the Commission draws up an annual overall report stating *inter alia* the level of contract-related aid and other operating aid granted in each Member State.

[1] OJ No L 69, 12. 3. 1987, p. 55.
[2] OJ No L 380, 31. 12. 1990, p. 27.

The Danish Government did report to the Commission upon conclusion of each contract but only notified the price from the yard to the daughter company and not the price paid by the real owner. The Commission therefore was not in a position to establish whether or not the aid ceiling had been complied with. Furthermore, the description of the Danish level of State aid in the annual overall reports drawn up by the Commission in the period in question has turned out not to be fully correct, and thus not comparable with the reporting on other Member States.

On 17 July 1996 the Commission decided to initiate the procedure laid down in Article 93 (2) of the Treaty in respect of the aid granted in Denmark for contracts, where the so-called mother-daughter company model, i.e. the creation of a subsidiary when selling vessels, was employed in the period from 1987 to 1993. The Commission focused on the need to be in possession of complete information on all prices paid in each contract as well as the aid granted, i.e. the price paid by the daughter company to the yard and the price paid by the shipowner to the daughter company. In that connection, the Commission emphasized that it would check each contract to see if the cumulation of aid schemes in place at the time did not lead in any single case to the aid ceiling being breached. For these purposes, the Commission would look in particular at:

1. value of all Danish schemes applied;

2. tax-schemes available during the period;

3. advance payment.

By letter of 31 July 1996 the Commission informed the Danish Government of the decision to initiate the procedure provided for in Article 93 (2) of the Treaty [1]. Other Member States and interested parties were informed by publication of the letter in the *Official Journal of the European Communities*, inviting them to submit their comments [2].

II

During the procedure the Commission has received comments from the Danish Government and the Association of Danish Shipbuilders.

The Danish Government submitted its reply to the Commission's decision to open the procedure on 4 September 1996. On the basis of the reply from the Danish Government the Commission requested further information in its letter of 10 October 1996. The Danish Government answered the Commission's request for further information in a letter dated 11 November 1996. Furthermore, for information, the Government forwarded to the Commission a letter to the Ministry of Business and Industry from Coopers and Lybrand on 8 November 1996. Also, the Government forwarded on 14 November 1996 a report conducted by a working group on tax and financing in relation to the vessels built at the B&W yard. Following a meeting with the Commission on 4 December, where the Danish authorities distributed a note dated 3 December 1996, the Danish authorities transmitted further information to the Commission dated 19 December 1996.

The comments received from the Danish Government with direct relevance to the examination of the procedure consists of information on all prices relating to the construction of each vessel, i.e. the price paid by the daughter company to the yard and the price paid by the owner to the daughter company and all aid granted for the specific contracts. Moreover, the Danish authorities have informed the Commission of all aid schemes applied for the specific contracts, including information on specific tax advantages applicable to the shipbuilding sector as well as general tax advantages available to industry as whole. Also, the Commission was informed of the aid's expected and factual impact on the Danish Treasury. In addition, the Danish authorities informed the Commission of ten further cases where loans were granted prior to 1987. These are dealt with separately in the subsequent analysis.

Furthermore, the Danish Government provided information of a more general character concerning the national administration of the aid schemes.

The comments from the Association of Danish Shipbuilders were transmitted to the Commission on 10 September 1996. The comments consist of a report carried out by a panel of Danish lawyers on the national administration of the aid schemes applicable to the shipbuilding sector during the period. The Danish authorities had no remarks on the comments.

As the procedure opened by the Commission focuses on Denmark's compliance with the aid ceiling, any information included in the Commission's examination will relate exclusively to that purpose. Consequently, comments from both the Danish authorities and the Association of Danish Shipbuilders on the national administration of the aid schemes are only included in the Commission's analysis to the extent that it is considered of direct relevance to fulfil the purpose of its examination.

From the information received from the Danish authorities it is clear that the daughter company model was used in only 58 of 65 contracts. In the remaining seven cases it was intended to use the daughter company model, but the plan was actually never carried out. Accordingly, this examination covers the cases where the daughter company model was used for selling vessels, i.e. 58 instead of the initial 65 cases.

[1] SG (96) D/6954.
[2] OJ No C 232, 10. 8. 1996, p. 6.

III

When initiating the procedure the Commission noted that there were indications that vessels for which the daughter company model was used were financed on the basis of inflated prices. It was known that the price of which the Commission was informed was the one that the daughter company paid to the yard. However, the main issue is to determine what was the real price of the vessel so as to establish whether or not the total amount of aid was in conformity with the ceiling then in place.

To that extent, the Commission agreed with the Danish authorities that it could not take the price paid by the daughter company to the shipyard as reflecting the real price of the ship concerned. This price was not an arm's-length price and had not been market tested. It was a price established by the yard itself in order to transform a credit scheme into an aided cash price from which the clients outside the EU could also benefit. In that sense the price in this contract could not be taken as representing the real price of the vessel. Instead, the Commission accepted that the price paid by the real shipowner to the daughter company, as set down in the contract between these parties, should be considered the real contract price for the vessel. This is the amount actually paid by the owner and as such is the only valid basis on which calculation for payment of aid can be based. This is considered to be the price set down in the contract for the purposes of Directives 87/167/EEC and 90/684/EEC on aid to shipbuilding.

Therefore, in its examination of this case the Commission set about the examination of each of the 58 cases and the total aid actually approved by the Danish authorities for any single contract, on the basis of the price paid by the real owner to the daughter company. It must be noted that while the purpose of the daughter company was to create a Danish shipowner who could sell the vessel for cash to the real client, apart from obtaining the aid amounts available to owners, the daughter company did not in any other respects act as a shipowner. From the examination of the contracts between the shipyard, daughter company and owner it is clear that all the usual responsibilities of an owner were passed on to the real owner.

IV

The Danish Government has provided information on all schemes applicable during the period. Furthermore, the Danish Government has provided information enabling the Commission to identify which aid schemes were used in each specific contract and the aid percentage granted.

During the period under investigation there were two general financing schemes applicable ('the home-market scheme' and 'the indexed-financing scheme') and three tax schemes which were specific to the shipbuilding sector.

(i) **Indexed-financing scheme**

The Danish authorities informed the Commission that although it was possible for owners to choose between two different financing schemes only one scheme was applied in the cases under investigation, namely the indexed-financing scheme. The indexed-financing scheme was used in all the 58 cases. The Commission approved the indexed-financing scheme by its letters of 15 April 1987, 19 January 1988 and 30 March 1989 [1] pursuant to the provision of Directive 87/167/EEC on aid to shipbuilding. The scheme was also approved pursuant to 90/684/EEC on aid to shipbuilding, in the Commission's letters of 20 June 1991 and 5 August 1992 [2]. On the basis of the information of the application of the indexed-financing scheme in each contract the Commission has established that the aid granted was in accordance with the Commission's approval. The indexed-financing scheme was applied until 1993, whereafter the Danish Government converted their financing scheme into an interest scheme whose conditions, i.e. that it is possible to receive the aid as a cash grant, are similar to the schemes in other Member States.

(ii) **Use of funds from company start-up accounts and investment funds** [3]

The tax scheme was applicable until end 1987 and consists of the possibility to use money from company start-up accounts and investment funds for buying shares in a vessel. Money invested in 1985 could benefit from the schemes and the contract for the vessel had to be signed before end 1988 and delivered before end 1990. Either private persons or companies could use the money invested as described above to buy ship-shares without being taxed on the money used for such investment. The Commission established that the aid element of this scheme should be calculated at 9 %. The scheme was used in two of the 58 contracts.

(iii) **Advanced write-off** [3]

The tax scheme was applicable for contracts concluded before 31 December 1987 for vessels to be delivered until end 1990. The buyer of the vessel could start writing off of the vessel upon conclusion of the contract, if the buyer did not have shipping as his main business. The Commission approved the aid and established that it should be calculated as 2 %. The advanced write-off was used in two of the 58 contracts.

[1] SG (87) D/4996, SG (88) D/625 and SG (89) D/3952.
[2] SG (91) D/12117 and SG (92) D/10731.
[3] The Danish Government was informed of the Commission's decision in its letter of 15 April 1987, SG (87) D/4996.

(iv) **Scheme for limited partnerships** (1)

Until 1993 a tax-exemption rule allowed a write-off for small private investors who invested in shipbuilding by buying a share in a limited partnership. Initially the tax credit was general and therefore not considered to be State aid. From 1989 the scheme applied only to the shipbuilding sector. When the Commission approved the scheme by a letter of 20 September 1990 it was decided that the scheme should be calculated at 5,4 % under the ceiling. In a letter of 20 June 1991 this decision was revised; thus the scheme should be calculated at 4,3 % under the ceiling. The scheme was used in 11 of the 58 contracts.

V

Referring to the above description it can be established that there were three tax schemes applicable to the sector during the period. All schemes have been approved by the Commission and an aid element has been established for all schemes that should be counted under the ceiling.

During the procedure the Danish authorities have informed the Commission of the general possibility in Denmark for all companies to benefit from corporate taxation. The advantage was that a company, in establishing a daughter company, could offset losses in the daughter company against any tax liabilities in the mother company. Although this possibility was a general measure and therefore not as such to be regarded as State aid, it is of interest to the present case to know whether the general tax rule could be of specific benefit to the shipbuilding sector for yards creating daughter companies. If the latter was the case there might be an element of indirect State aid that could distort competition.

From the information received from the Danish authorities, although there was a general opportunity to benefit from the treatment of losses under corporate taxation rules using the mother-daughter company model, none of the yards included in the examination of the present case actually took advantage of that opportunity.

VI

In their reply dated 11 September to the opening of the procedure the Danish authorities drew attention to the fact that in 27 of the 58 cases under examination the real owner pre-paid a large proportion of the cost of the ship. Subsequently, in their further submission dated 11 November the Danish authorities said that in 57 of the 58 contracts the whole amount or a substantial amount was paid in advance.

The Danish authorities consider that the prepayment price should be adjusted by the value of prepayment which was made. They insist that the incentive for a shipowner to pay in advance occurs if he can get a higher interest by placing his money in long-term bonds. The yard cannot use the money to finance the construction of the vessel, and does therefore not benefit from the money in that respect. The bonds deposit is the owner's security that the yard will fulfil its obligations as to the construction of the vessel. Thus the Danish Government claims that the shipowner is paying today (the date of signing the contract), the future value of his prepayment price. (The future value of the prepayment price is equal to the price that will be paid for the vessel by an owner who wishes to pay cash on delivery, when the vessel is constructed). Because the owner pays in advance, he is benefiting from the higher interest rate accumulated during the construction time obtained via the bonds.

The Danish authorities insist that the value (the interest benefit) is to be added to the advance paid price when calculating the aid eligible for the contract.

The Commission cannot accept the arguments put forward by the Danish authorities as regards the prepayments. As mentioned earlier, the only basis on which the Commission can establish the real price of the vessels concerned is to take the price as set down in the contract between the real owner and the daughter company. It should be recalled that in both Directive 87/167/EEC and Directive 90/684/EEC on aid to shipbuilding the aid ceiling is set by reference to 'the contract value before aid'. This term is in turn defined as the 'price laid down in the contract plus any aid, etc.'. Since the contracts between the daughter company and owner are presumed to be freely negotiated contracts between independent entities, the price as set down must be taken on the sole basis for the calculation of aid allowable.

Furthermore, it must be noted that the financing arrangements that may be put in place with regard to the construction and purchase of vessels varies enormously and that there is no such thing as a standard formula in

(1) The Danish Government was informed of the Commission's decision in its letter of 20 September 1990, SG (90) D/27292 and in a letter of 20 June 1991, SG (91) D/12117.

the industry. The financing package that is put together for any particular vessel will have an influence on the price of that vessel, as will other factors such as the competitiveness of the yard in question, interest rates, price of raw materials, labour, etc.

Since only one price appears in the contracts between the owner and the daughter company, this must be considered the 'price laid down in the contract' for the purposes of Directive 87/167/EEC and Directive 90/684/EEC on aid to shipbuilding. It cannot be subsequently adjusted to take account of what would have been only one element influencing the price of the vessel.

The Danish authorities have drawn attention to the budgetary consequences of the aid schemes in operation at the time (tax schemes excluded). While a total of ECU 890 million (December 1996) of aid was approved during the period, the actual amount of aid paid was ECU 9 million (December 1996). The Danish authorities argue that this element must be taken into account in calculating the levels of aid in the various contracts.

The Commission rejects this contention, since it is the act of making aid available that is likely to cause distortion of competition [1]. The particularities of the financing of Danish aid schemes were such that the ultimate cost to the Danish Treasury of the schemes was considerably lower than had been budgeted, owing largely to unexpected changes in interest rates and inflation. This does not diminish the effect of the aid actually approved for each contract since in determining their costs of construction the yards were able to discount the value of the aid as it was estimated, based on the assumptions at the time about likely future interest rates and inflation. The fact that this ultimately cost the Danish Treasury less than anticipated changes nothing as regards its potentially distorting effects.

VII

The information from the Association of Danish Shipbuilders relates very closely to the national administration of the aid schemes applicable during the period, and more specifically to the opportunities for granting aid as credit facilities instead of direct grants to the constructing yard.

The report from the lawyers which is attached to the letter sent to the Commission is therefore merely a contribution to the parallel Danish debate on the national administration of aid to shipbuilding during the period, and has no relevance to the Commission's inquiry as to whether the aid ceiling has been complied with.

VIII

It should be recalled that during the period under consideration a total of 308 contracts were concluded in Denmark. Of the total number of cases, only 58 used the daughter-company model, and those cases are the subject of this examination. However, the Danish authorities have, in their reply to the opening of the procedure, informed the Commission that in 1986 10 cases were concluded with the financing via indexed loans to owners in Sweden and Norway.

The Danish Government notified the indexed-loan scheme to the Commission on 22 September 1986, and the Commission approved the scheme on 15 April 1987 [2].

As regards the possible breach of the aid ceiling, it is recalled that until the implementation of Directive 87/167/EEC there was no ceiling on State aid granted to the shipbuilding sector, and that the 10 contracts were all concluded in 1986 before the entry into force of that Directive.

While this is not the subject of the present procedure, it can be stated that although the Danish authorities applied the aid option in the form of indexed loans before they got approval of the aid scheme from the Commission, since the Commission approved the scheme at a later stage, and as there was no aid ceiling at the time, there is no need for a formal investigation of these cases.

IX

At the time the procedure was commenced, the Commission thought that there were 65 cases where the mother-daughter model had been used. In the course of the procedure, it transpired that only 58 cases were involved.

The mother-daughter model was created by the shipyards concerned essentially as a means to transform the credit schemes into a cash payment and to enable non-EU owners to benefit from schemes available to EU nationals.

[1] SG (89) D/5521 of 27 April 1989.

[2] SG (87) D/4996.

On the basis of the very complete information provided by the Danish authorities the Commission is able to ascertain for each of the 58 cases the totality of the aid schemes that applied to each contract and the total aid provided in favour of each of them.

As was stated earlier, each of the aid schemes had at the time been approved by the Commission and an aid value calculated within the ceiling on aid had been assigned to each.

In order to assess whether the aid ceiling has been exceeded the amount paid out for each contract is compared with what was allowed. A major difficulty has been to ascertain what the real price of the vessel concerned was. For the reasons outlined above the Commission accepted the Danish Government's contentions that the price set down in the contract between the owner and the daughter company should be the price used as the basis of calculating aid levels in accordance with Directive 87/167/EEC and Directive 90/684/EEC on aid to shipbuilding. For reasons stated above the price in the contract cannot be adjusted to take account of any prepayment.

On that basis the Commission concludes that for 53 of the 58 cases the aid ceiling in force at the time the contract was signed was observed. In those cases the aggregate of the various aid schemes that applied to each individual case was below the prevailing ceiling. In five cases for vessels built at Odense Staalskibsværft A/S (shipbuilding Nos L 148, L 149, L 150, L 151 and L 152) the aggregated aid schemes exceeded the ceiling. The total amount of aid which the Commission considers incompatible with Directive 90/684/EEC on aid to shipbuilding and thereby the common market is Dkr 1,018 million (ECU 137 000, January 1997) in regard to the abovementioned cases,

HAS ADOPTED THIS DECISION:

Article 1

The Danish Government did not adequately fulfil its obligations under Articles 11 and 12 of Directive 87/167/EEC and Directive 90/684/EEC on aid to shipbuilding respectively, namely to inform the Commission about the price paid by the real shipowner as regards the 58 cases under examination.

Article 2

The aid measures adopted as regards contracts for shipbuilding Nos L 148, L 149, L 150, L 151 and L 152 at Odense Staalskibsværft A/S exceeded the ceiling set down in Directive 90/684/EEC on aid to shipbuilding and are hereby declared unlawful, since they were granted in breach of the provisions of the Directive and are therefore incompatible with the common market.

Article 3

Denmark shall require the shipyard concerned to repay the excess aid granted amounting to Dkr 1,018 million (ECU 137 000, January 1997) in accordance with the procedures and provisions laid down by Danish law relating to interest on arrears for debts to the State, with interest running from the date on which the unlawful aid was paid at an interest rate equal to the reference rate that was used at the time to calculate the net grant equivalent of the various types of aid in Denmark.

Article 4

Denmark shall inform the Commission, within two months of the date of notification of this Decision, of the measures taken to comply therewith.

Article 5

This Decision is addressed to the Kingdom of Denmark.

Done at Brussels, 5 February 1997.

For the Commission

Karel VAN MIERT

Member of the Commission