COMMISSION DECISION

of 4 December 1996

concerning State aid in favour of Bestwood E.F. Kynder GmbH i. GV

(Only the German text is authentic)

(Text with EEA relevance)

(97/450/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given notice in accordance with Article 93 of the EC Treaty to interested parties to submit their comments,

Whereas:

I

On 2 December 1995, the Commission decided to open proceedings under Article 93 (2) of the EC Treaty against State aid to Bestwood E.F. Kynder GmbH ('Bestwood'), now Bestwood GmbH i. GV, in Mecklenburg-Vorpommern which was one of Germany's biggest producers of chipboard and fibreboard products with some 500 workers and has since filed for bankruptcy and disappeared from the market.

Bestwood was formerly State owned and was privatized by the Treuhandanstalt in 1991 when it received aid totalling DM 77 million in guarantees and DM 52 million in payments, mainly on the basis of aid schemes which had been approved by the Commission, in particular on the basis of the former Treuhandregime. Bestwood, however, had also received a long-term loan of DM 5 million at an interest rate of 4 % a year within the framework of the consolidation programme of the Land Mecklenburg-Vorpommern, an aid scheme which had been approved by the Commission in 1994. The approval was on condition that loans awarded to enterprises exceeding the ceiling for small and medium-sized enterprises (SMEs) be notified to the Commission individually. The loan in question was not notified to the Commission although Bestwood was far from being an SME within the meaning of the definition in Commission Recommendation 96/280/EC [1].

The attempt to privatize the enterprise in 1991 was unsuccessful however. There were many irregularities in the privatization process and the purchaser was suspected of having misappropriated the aid granted during the privatization process. Consequently, the German public prosecutors started investigations. The former owner left for Switzerland. Meanwhile, a German court decided to allow the authorities of Mecklenburg-Vorpommern to seize control of all the assets of the former owner which are located in Germany in order to secure their claims for compensation.

The irregularities linked with the privatization had led to continuing economic problems in the enterprise since it still produced in an old-fashioned, ineffective way using antiquated machines. In December 1994, the shares of Bestwood were transferred against payment of DM 2 to a shareholding company of the NordLB, a bank which is wholly State owned. The object of that transfer was to find as quickly as possible a new purchaser for Bestwood and to develop a restructuring concept which would ensure the future profitability and viability of the enterprise.

In the context of that takeover, Bestwood had received a 'risk exemption' in the form of a guarantee by the Land Mecklenburg-Vorpommern for a loan by the NordLB for an amount of DM 25 million. That guarantee was not notified to the Commission either.

Germany also indicated that it would try to privatize Bestwood a second time and that this privatization might require additional aid amounting to DM 100 million.

The Commission concluded that both the DM 5 million long-term loan and the DM 25 million guarantee constituted aid which should have been notified to the Commission pursuant to Article 93 (3) of the EC Treaty. It also had serious doubts as to the compatibility of that aid with the derogations set out in Article 92 (3) (a) and (c) of the EC Treaty, in particular with the Community guidelines on State aid for rescuing and restructuring of firms in difficulties [2]. It therefore decided to open the procedure under Article 93 (2) of the EC Treaty against the aid. In order to expedite the proceeding and to be in a

[1] OJ No L 107, 30. 4. 1996, p. 4.

[2] OJ No C 368, 23. 12. 1994, p. 12.

position to examine any aid to Bestwood at one time, it was also decided to include the new aid envisaged for the second privatization in the proceeding.

The letter to Germany was published in the *Official Journal of the European Communities* (1).

II

By letter dated 29 January 1996, Germany informed the Commission that the interest rate for the DM 5 million loan had been increased to 6,62 % with retroactive effect to the date of the award of the credit.

By letter dated 1 February 1996, Germany informed the Commission that Bestwood would receive DM 18 million in order to keep the enterprise in business until the Commission arrived at a final decision. The notification of that aid was to follow.

In addition, Germany informed the Commission that Bestwood had filed for bankruptcy on 4 December 1995. Meanwhile, a purchaser had been found to whom Bestwood could be sold in the context of a second privatization. The German authorities also submitted a privatization concept elaborated by the purchaser. In order to transfer Bestwood to that purchaser free of debt, however, it would be necessary for the Land Mecklenburg-Vorpommern to pay another DM 26 million to banks and smaller creditors which had their credits secured by land, buildings and equipment owned by Bestwood. Finally, the new purchaser was promised aid in the form of direct grants and guarantees which far exceeded the allowed aid ceiling for the new Länder of 35 %. The proposed aid consisted of a DM 30 million liquidity support for the purchaser, the maximum investment grant possible under the 'Gemeinschaftsaufgabe' (35 % investment grants) and a guarantee covering 80 % of the sum to be newly invested in Bestwood.

By letter dated 16 February 1996, Germany was informed that rescue aid for the period of the Article 93 (2) procedure could only be approved if all the requirements of the Community guidelines on State aid for rescuing and restructuring of firms in difficulties were fulfilled. In addition, Germany was requested to state whether the announced rescue aid was part of the DM 25 million guarantee for which the procedure had already been opened or whether that was new aid. Furthermore, information was requested regarding the system of bankruptcy in the new Länder since it was the Commission's view that the claims of creditors would be met by the sale of the assets of the bankrupt enterprise and not by the State. Finally, the German authorities were informed that, even if the Commission arrived at the conclusion that the previous aid to Bestwood could be approved, new aid for the second privatization to the extent proposed could hardly be approved.

By letter dated 20 March 1996, Germany informed the Commission that the proposed DM 18 million rescue aid was new and thus different from the DM 25 million guarantee for which the procedure had been opened.

For the DM 26 million payments to creditors of Bestwood which were necessary to leave the bankrupt enterprise's property free of charges, the German authorities argued that this aid was necessary in the framework of the second privatization in which a purchaser could be found by a tender in which three companies had submitted bids. The purchaser finally retained, however, was only willing to pay the symbolic sum of DM 1 and this only if the enterprise's assets were free from debts.

In the same letter, Germany informed the Commission that the local Court of Stralsund had decided to open bankruptcy proceedings on 1 March 1996. Up to that date, no additional aid had been paid to Bestwood. The proposed DM 18 million rescue aid, however, would be necessary to allow the bankrupt company's administrator to keep the company in business until the takeover took place. No payment had been made in respect of the DM 25 million risk exemption in relation to NordLB. The NordLB, however, had granted guarantees and loans amounting to approximately DM 25 million in favour of Bestwood and it could be expected that claims might be made against the Land if the NordLB could not recover this amount by the sale of Bestwood assets.

By letter dated 4 July 1996, Germany informed the Commission that, following notification by the administrator that the company's liquidity was exhausted, on 11 June 1996, the assembly of Bestwood's creditors had approved the shut-down of Bestwood's activities on 12 June 1996. Bestwood would accordingly disappear from the market. The administrator had accordingly begun to dismiss Bestwood's employees. That process would be completed by 30 July 1996 whereupon Bestwood would cease to exist. The German authorities confirmed that the additional aid, of which notice was given in their letter of 1 February 1996, with further details in their letter dated 20 March 1996, was based on a restructuring concept which had since been rejected by the regional authorities.

(1) OJ No C 144, 16. 5. 1996, p. 6.

The notification of this aid should therefore be disregarded by the Commission. No such aid was ever granted. Furthermore, the German authorities confirmed that the bankruptcy proceedings had been completed according to the German bankruptcy rules without any intervention of the State, in particular without any additional aid. Any takeover would take place by the sale of Bestwood's assets. Any purchaser would have full freedom of manoeuvre. In any case, there would no longer be any link between Bestwood and a new enterprise. Any aid granted in the context of the purchase of the assets would therefore have to be examined by the Commission independently.

III

By letter dated 30 July 1996, the Commission transmitted to the German authorities comments by third parties, one Italian and one Swedish association of plywood producers as well as a Danish competitor, which it had received on the occasion of the publication of the notice concerning the opening of a proceeding on the matter.

All the third parties expressed their concern about the impact on capacities if Bestwood was restructured with financial support by the State. They argued that Bestwood could certainly not restore its viability without a significant increase of capacities and output which would seriously affect competition in a market with existing overcapacities and which would damage those competitors which do not receive financial support by the State. The Danish competitor also expressed doubts whether Bestwood, even after restructuring, could survive on the market. It pointed out that wood supplies in Mecklenburg-Vorpommern would not be sufficient to supply Bestwood with enough wood and that Bestwood would therefore have to purchase wood in other German Länder, in Poland and the Baltic States. Bestwood would therefore be confronted with transport costs exceeding the corresponding costs of its competitors located in areas with sufficient supplies of wood. In addition, since there were no furniture production plants in Mecklenburg-Vorpommern, Bestwood had no market in its area. It therefore had to sell its products in other parts of Germany, Denmark and Sweden which again would increase its transport costs.

IV

By letter dated 20 August 1996, the German authorities transmitted their response to the comments of the third parties.

The German authorities confirmed that Bestwood had shut down its activities on 12 July 1996 and thus had disappeared from the market. Bestwood had not received any additional aid beyond the aid for which the Commission had opened the Article 93 (2) proceeding. No aid had been granted in the context of a second privatization, contrary to what was originally envisaged when the proceeding was opened.

V

The Article 93 (2) proceeding has confirmed the Commission's view that the financial measures taken by the Land Mecklenburg-Vorpommern until the opening of the procedure must be deemed to be aid within the meaning of Article 92 (1) of the EC Treaty and that they do not comply with the conditions for exemption set out in Article 92 (3) or with the Guidelines for control of State aid for rescuing and restructuring of firms in difficulties, the only framework under which the aid might have been approved.

The DM 5 million long-term loan constitutes aid within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement. Even though the interest rate for this loan was increased retroactively to the reference rate of 6,62 % and might therefore correspond to the normal conditions of the private sector in order to obtain credit loans, in the light of the exceptional financial difficulties Bestwood was facing, no private bank would have granted such a loan without further securities, as the Land Mecklenburg-Vorpommern did.

The aid granted to Bestwood was likely to distort competition and affect trade between Member States. There is extensive trade in particleboard and fibreboard products between Germany and the other Member States. In 1995, Germany exported 622 083 tonnes of particleboard products to other Member States with a value of ECU 264,5 million and 167 647 tonnes of fibreboard products with a value of ECU 92,3 million; it imported 757 214 tonnes of particleboard products with a value of ECU 280 million and 158 343 tonnes of fibreboard products with a value of ECU 88,2 million. Germany's market share in overall Community trade is some 25 % in the particleboard sector and some 3 % in the fibreboard sector. Bestwood was, with its 500 workers, one of the major producers of particleboard and fibreboard products since, within the Community, the average complement in that industry is 40 workers per enterprise. Bestwood was strongly involved in intra-Community trade, since some 35 % of its production was exported, in particular to Denmark and Sweden. Thus, any aid would serve to improve Bestwood's position in the common market compared with competitors not receiving State support.

Since the measures represented aid within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement, they were notifiable under Article 93 (3) of the EC Treaty. There was no exemption from that obligation on the basis of the approved consolidation programme of the Land Mecklenburg-Vorpommern since Bestwood with its 500 employees, at the moment of grant of the aid, far exceeded the SME ceiling. Since Germany did not comply with that requirement, the aid was granted unlawfully.

Nor may the aid be regarded as lawful in substance since none of the derogations under Article 92 of the Treaty may be applied.

The exceptions set out in Article 92 (2) of the EC Treaty do not apply in this case since the purpose of the aid does not correspond to any of the purposes referred to therein.

Bestwood was certainly located in an area where there is serious underemployment and where the standard of living is abnormally low. Aid to promote the economic development of those areas may, according to Article 92 (3) (a) of the EC Treaty be considered to be compatible with the common market. In this case, however, the aid certainly did not contribute to the promotion of the economic development of the region since the aid served to keep in business a loss-making firm rather than for investment and job creating.

Nor does the aid comply with the relevant horizontal Community guidelines on State aid to enterprises.

In particular, the Community Guidelines on State aid for rescuing and restructuring firms in difficulty do not apply. Bestwood, certainly, was a firm in difficulty unable to recover through its own resources. According to the Guidelines, rescue aid may consist of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates. The DM 5 million loan whose interest rate was retroactively increased to the reference interest rate of 6,62 %, which was valid for Germany at the time of the grant of the aid, thus meets this criterion of the guidelines. The German authorities, however, did not produce any evidence of a link between that loan and actual restructuring measures which, according to the guidelines, is required for rescue aid to be granted. Thus, during the procedure it became clear that the aid was intended only to maintain the status quo and postpone the inevitable, while at the same time it transferred the attendant industrial and social problems to other, more efficient procuders and other Member States rather than supporting a restructuring process which should have been initiated when the rescue aid was granted.

Furthermore, the aid was likely to unduly distort competition. There are overcapacities in the particleboard and fibreboard industry and there was a large gap between production capacity and demand in the past which will continue to grow in the future since, until 1997, the annual growth rate for production is estimated at 2,2 %, whereas consumption is only expected to grow by 1,8 % annually. The pressure on competition in that sector cannot be balanced through growing exports. Exports from the Community were steady in the past and are expected to be steady in the future. Apart from overcapacities in the Community, competitive pressures may increase due to growing imports from eastern European countries which benefit from their trade agreements with the Community. Accordingly, the loan to Bestwood could seriously harm its competitors.

The DM 25 million risk exemption in relation to the NordLB loan which is in fact a guarantee and of which the final beneficiary was Bestwood, constitutes aid within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement.

The aid element in such a guarantee is generally equal to the difference between the rate of interest on a loan raised on normal market terms and the actual rate secured by virtue of the guarantee disregarding any premiums. The Commission has consistently taken the view that, whenever, owing to the undertaking's severe financial circumstances, no credit institution would agree to lend to it without a State guarantee, the entire amount of the loan is to be regarded as aid (cf. Decision 94/696/EC [1]).

Since the risk exemption was the precondition for NordLB's financial engagement in Bestwood (they actually took over liabilities for an amount of DM 25 million), it contains a clear aid element which, because of the very high risk of this guarantee, corresponds in full to NordLB's financial engagement.

The risk exemption, for the same reasons as the DM 5 million loan, is liable to distort competition and trade between Member States.

[1] OJ No L 273, 25. 10. 1994, p. 22.

Since the risk exemption was not based on an approved aid scheme, it was notifiable individually according to Article 93 (3) of the EC-Treaty. Germany did not comply with that obligation. The aid was therefore formally illegal.

That guarantee could, however, have been approved by the Commission if it had served to avert Bestwood's insolvency during the proceeding under Article 93 (2). There are precedents in which the Commission approved such rescue aid, such as the Nino Textile case, where there was a danger that the enterprise concerned by the Article 93 (2) proceeding would not survive economically and would consequently have to file for bankruptcy before the final decision on the aid if it was not supported by the State.

A prerequisite for such an approval by the Commission, however, would have been that the risk exemption complied with the Community guidelines on State aid for rescuing and restructuring firms in difficulty. In particular, the risk exemption should have been:

— given in the form of a guarantee or a loan bearing normal interest rates,

— restricted to the amount absolutely necessary to keep Bestwood in business (for example, covering wage and salary costs and routine supplies), and

— paid only for the time needed (generally not exceeding six months) to devise the necessary and feasible recovery plan.

In addition, such rescue aid should not have been granted in a single payment but in several instalments spread over the six-month period. The Commission should have been kept informed about the payments in order to ensure that they were not used for payments other than running costs.

During the proceeding, the German Government was unable to demonstrate that the risk exemption it had given fulfilled all those requirements. As a result, the risk exemption cannot be approved since it does not fulfil the criteria set out above.

The writing-off of debts of approximately DM 100 million envisaged by the Land Mecklenburg-Vorpommern in the event of a second privatization, which would have released a potential purchaser from the corresponding obligations, would also have constituted aid within the meaning of Article 92 (1) of the EC Treaty.

During the proceeding, however, it became clear that the German authorities departed from their original plan to keep Bestwood in business until a purchaser had been found and a second privatization of Bestwood had taken place. Bestwood has, following the conclusion of the bankruptcy proceedings, disappeared from the market. The company is being wound up in compliance with the German bankruptcy rules and all employees are being dismissed. An eventual purchaser of Bestwood's assets will enjoy freedom of manoeuvre concerning the hiring of employees and the continuation of production. In the context of the bankruptcy proceeding, no aid was awarded in addition to the DM 5 million loan and the DM 25 million risk exemption for which the Commission had opened the proceeding.

Taking all those facts into account, the Commission concludes that both the loan from the Land Mecklenburg-Vorpommern amounting to DM 5 million and the risk exemption amounting to DM 25 million are to be regarded as aid for which none of the derogations of Article 92 (3) of the EC Treaty applies.

VI

In cases where aid is deemed incompatible with the common market, the Commission requires the Member State to recover the aid from the recipient [1]. Since the aid to Bestwood is not compatible with the common market, it must be recovered. This assessment is not changed by the fact that Bestwood filed for bankruptcy and disappeared from the market. The aid could be collected in so far as Bestwood's assets are sold and the creditors satisfied from the profits of that sale.

The recovery of the aid is to be made in accordance with German law, including the provisions concerning interest due for late payment of amounts owing to the State, with interest running from the date of the award of the aid [2].

According to the case-law of the Court of Justice, when aid is recovered, the relevant provisions are to be applied in such a way that the recovery required by Community law is not rendered practically impossible. Any procedural difficulties or other difficulties in regard to the implementation of the measure cannot have any influence on its lawfulness [3],

HAS ADOPTED THIS DECISION:

Article 1

The State aid in the form of a long-term loan of DM 5 million and the 'risk exemption' (guarantee) amounting to

[1] Commission communication of 24 November 1983 in OJ No C 318, 24. 11. 1983, p. 3. See also judgements of the Court of Justice in Case 70/72 *Commission v. Germany* [1973] ECR 813 and Case 310/85 *Deufil v. Commission* [1987] ECR 901.
[2] Letter from the Commission to the Member States SG(91) D/4577 of 4 March 1991; see also note 7.
[3] Case C-142/87 *Belgium v. Commission* [1990] ECR I-959 (paragraphs 58-63).

DM 25 million for Bestwood E.F. Kynder GmbH is unlawful since it was granted by the Land Mecklenburg-Vorpommern without Germany complying with its obligation to inform the Commission under Article 93 (3) of the EC Treaty before it was granted.

The aid is incompatible with the common market within the meaning of Article 92 (1) of the EC Treaty.

Article 2

Germany shall ensure that the aid to Bestwood E.F. Kynder GmbH referred to in Article 1 is recovered within two months of the date of notification of the decision.

The recovery of the aid shall be made in accordance with the procedures and provisions of German law, in particular those concerning recovery of amounts owed to the State, and include interest from the date of grant of the aid on the basis of the reference rate applying on that date for the calculation of the net grant equivalent of regional aid in the Federal Republic of Germany.

These provisions are to be applied in such a way that the recovery required by Community law is not rendered practically impossible. Any procedural or other difficulties in regard to the implementation of the measure shall not have any influence on its effectiveness.

Article 3

Germany shall inform the Commission within two months from the notification of this Decision of the measures taken to comply with it.

Article 4

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 4 December 1996.

For the Commission

Karel VAN MIERT

Member of the Commission