COMMISSION DECISION

of 16 April 1997

on aid granted by the Region of Sardinia, Italy, in the agriculture sector

(Only the Italian text is authentic)

(97/612/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

After giving notice to the parties concerned to submit their comments [1], in accordance with Article 93 (2),

Whereas:

I

By letter of 1 September 1992, Italy notified to the Commission, under Article 93 (3) of the Treaty, Regional Law No 17 of 27 August 1992 of the Region of Sardinia (hereinafter referred to as 'Law No 17/92').

Article 12 of Law No 17/92 amends Article 5 of Regional Law No 44 of 13 December 1988 of the Region of Sardinia (hereinafter referred to as 'Law No 44/88') which had never been examined under Articles 92 and 93 of the Treaty. Neither had the provisions adopted by the Giunta Regionale (Regional Executive) for implementing that Article undergone such an examination.

Article 5 of Law No 44/88 introduces aid, in the form of subsidized loans, to assist in restoring the liquidity of farms whose financial situation has been affected by adverse circumstances. These loans, which have a maximum term of 15 years (including a three-year pre-redemption period), must be used to consolidate current liabilities.

It is for the Regional Executive to determine, by means of an appropriate decision in each case, the practical arrangements for granting the loans and in particular the adverse circumstances which justify the measure, the sector or sectors involved, the amount of the aid in relation to the degree of indebtedness, and the term of the loan.

According to the information supplied by the Italian authorities, Article 5 of Law No 44/88 has been applied four times since 1988.

(1) *Decision of the Regional Executive of 30 December 1988 (market crisis in the glasshouse sector)*

The adverse circumstance which produced the crisis was the collapse in the prices of glasshouse products, which meant that growers were unable to cover their production costs.

In this first instance in which Article 5 was applied, the only condition laid down by the regional authorities was that the holding's short-term indebtedness should be more than 75 % of the value of its gross output in the year under consideration.

(2) *Decision of the Regional Executive of 27 June 1990 (forestry holdings)*

In 1990 the regional authorities decided to grant the aid provided for in Article 5 of Law No 44/88 to forestry holdings which had plantations which were not yet ready for commercial felling, for the purpose of paying off and/or consolidating debts falling due before 30 June 1990 and contracted in order to make investments and for management purposes, the overdrafts existing on that date, and debts owing to employees (for the payment of wages), to landowners (for rent) and to suppliers (for the purchase of goods).

In this case too, the total short-term debt had to amount to 75 % or more of gross output. The term of the loans was set at 13 years (with a three-year pre-redemption period).

(3) *Decision of the Regional Executive of 20 November 1990 (rabbit farmers)*

In this case the aid was paid to rabbit farmers who had lost at least 20 % of their animals as the result of a disease which had seriously affected the Region in the spring of 1990.

The 15-year subsidized loans (with a three-year pre-redemption period) could cover two annual (or four half-yearly) repayments on long-term loans already contracted, plus an amount equal to the holding's financial requirements for one year.

[1] OJ C 271, 29. 9. 1994, p. 14.

(4) *Decision of the Regional Executive of 26 June 1992 (indebted agricultural holdings)*

In 1992 the aid was extended to all farmers because of the increasingly unfavourable market conditions and the problems caused by bad weather.

In this case the holdings' short-term indebtedness had to be at least equal to 51 % of gross production in the year in question (1991); the duration of the financing operation was the maximum permitted by the basic law (15 years including a three-year pre-redemption period).

The amount of the short-term debt was calculated on the basis of the loans with a term of less than 12 months in existence in 1991 (subsidized or at the market rate, and even if repaid) and the repayment instalments on multiannual financing (subsidized or at the market rate) falling due or paid in 1991 or else falling due in previous years and not paid.

The funding granted could be used to cover the following: subsidized operating loans, debts on medium-term loans (except those taken out for the purchase of agricultural machinery) and the non-paid instalments on subsidized multiannual loans granted by the Region following natural disasters.

The expenditure ceiling for the funding provided for in Article 5 of Law No 44/88 was Lit 5 000 million for 1988; for the three years 1992, 1993 and 1994 it amounted to Lit 40 000 million.

Article 12 of Law No 17/92 lays down technical rules for implementation of the financial operations carried out under Article 5 of Law No 44/88 and the abovementioned decisions.

II

By letter of 1 August 1994, the Commission informed Italy of its decision to initiate the procedure laid down in Article 93 (2) of the Treaty in respect of the aid provided for in Article 5 of Law No 44/88 and the four decisions of the Regional Executive referred to above.

In that letter the Commission informed the Italian Government that the measures in question appeared incompatible with the common market in that they did not fulfil the criteria listed below, which it applied generally to national aid for farms in difficulty:

(a) the aid must cover the financial charges on loans taken out to finance investments already made;

(b) the total subsidy equivalent of any aid granted when the loans were taken out and the aid in question may not exceed the rates generally allowed by the Commission (that is 55 % (75 % in Objective 1 regions) for the processing and marketing of agricultural products and 35 % (75 % in less-favoured areas within the meaning of Council Directive 75/268/EEC [1], as last amended by Regulation (EEC) No 797/85 [2]) for the primary sector);

(c) the aid must be consequent upon a readjustment of the rate of new loans, designed to offset variations in the cost of money (the amount of the aid must not exceed the variation in the rate of the new loans), or must be granted to farms which offer sufficient guarantees of economic recovery, especially where the financial charges resulting from the loans contracted are such as to endanger the holding and perhaps cause its bankruptcy.

(These criteria are hereinafter referred to as 'specific Commission practice for aid to farms in difficulty').

The Commission, having found not only that the text of Article 5 of Law No 44/88 does not take account of these three conditions but also that they are not met in any of the four cases in which Article 5 was applied, considered that the aid in question was liable to distort competition and affect trade between Member States and that it met the conditions in Article 92 (1) of the Treaty without qualifying for any of the derogations provided for in paragraphs 2 and 3 of that Article.

The Commission invited Italy to submit its comments; it also invited the other Member States and other interested parties to do the same.

III

Italy submitted comments in letters of 30 January, 25 August and 1 December 1995.

In its letters, Italy puts forward the following arguments:

1. In general terms, Italy stresses the extremely precarious nature of the social and economic conditions which underlie Sardinia's agriculture and its economy as a whole. In the second half of 1992 the overall indebtedness of Sardinian holdings amounted to Lit 1 613 000 million, equal to 91 % of the value of regional gross production of agricultural products, against a national average of 19 % (of this total, around Lit 350 000 million comprised subsidized loans granted following natural catastrophes).

[1] OJ L 128, 19. 5. 1975, p. 1.
[2] OJ L 93, 30. 3. 1985, p. 1.

According to Italy, in these circumstances a refusal to grant the consolidation loans on the part of the regional authorities would have had very serious social repercussions and would have posed a threat to public safety.

2. The regional authorities' decision to grant an interest rebate on the consolidation loans (adopted on the basis of the criteria laid down in each of the four ad hoc decisions) did not affect the banks' examination of each financing application submitted. The banks could refuse the application for consolidation of liabilities if, even with assistance from the Region, there were insufficient guarantees that the loan would be reimbursed. This shows, according to Italy, that the beneficiary holdings offered the prospect of economic recovery.

3. The form of aid (loans for liability consolidation) does not provide for the grant of new financing, but consists in the rescheduling of liabilities over a longer period.

4. As regards the aid in 1988 and 1992 (for glasshouse crops and all indebted agricultural holdings respectively), Italy points out that it was decided on by the Region in view of the crisis affecting Sardinian holdings, which had undertaken investments by contracting financial obligations which they were unable to meet because of various unfavourable factors (prolonged drought, market crisis, lack of organization at the produce marketing stage, high interest rates).

The fact that the Region of Sardinia received 7 500 funding applications shows the extent of the crisis. According to the Italian authorities, in all the cases involved such a widespread phenomenon cannot be due to poor management on the part of the beneficiary holdings but, on the contrary, must have objective causes which led to excessive farm indebtedness.

5. As for the aid granted in 1990 to holdings in the forestry sector, Italy considers that this must be considered separately for several reasons.

First, at the time the consolidation loan was granted the holdings in question had already made some investments and were in the process of making others. Secondly, trees planted in the past were not ready for commercial felling, which made it difficult for the holdings to repay their debts.

Commercial felling entails a waiting period of several years (as many as 18-20). According to the Italian authorities, all financial operations on such holdings in the period prior to felling should be regarded as being for investment purposes.

6. As regards the aid to rabbit farmers, Italy points out that some of the beneficiary holdings had lost all their animals.

IV

Italy has failed to meet the obligation laid down in Article 93 (3) of the Treaty, firstly by omitting to notify the aid measures at the draft stage and, secondly, by applying them without giving the Commission the opportunity to comment on them. Such non-compliance gives rise to a particularly serious situation in that the aid in question is, because of its nature and for the reasons set out below, incompatible with the common market under Article 92 of the Treaty.

When the procedure pursuant to Article 93 (3) of the Treaty was begun, the Community guidelines on State aid for rescuing and restructuring firms in difficulty [1] (hereinafter called 'Guidelines') had not yet entered into force. Therefore only the rules comprising the specific Commission practice for aid to farms in difficulty applied to the case in question. The Guidelines made it possible for Member States to apply, as an alternative to the specific practice, the assessment criteria laid down for other production sectors (point 2.2 of the Guidelines).

When the Guidelines entered into force, Italy did not ask for the criteria in them to be applied.

Neither did it present arguments designed to contest the applicability of the specific Commission practice for aid to farms in difficulty on which the Commission based its decision to initiate the procedure laid down in Article 93 (2) of the Treaty, or arguments to show that the cases under consideration satisfy the conditions set by the said practice for deciding that aid for financial reorganization is compatible with the common market.

The Commission finds, however, that the conditions laid down in the 1994 Guidelines are not met. The aid in question cannot be regarded as rescue aid within the meaning of those rules since measures of that type must consist of loans at the market rate (or guarantees) whose term and amount are limited to what is strictly necessary for the firm's recovery (see point 3.1 of the Guidelines).

[1] OJ C 368, 23. 12. 1994, p. 12.

The aid in question also does not satisfy the conditions laid down in the Guidelines for restructuring aid. The regional authorities granted the aid for financial reorganization solely on the basis of the existence of liabilities in excess of a certain percentage of the holding's gross output, and not on the basis of a restructuring plan intended to restore the firm's profitability without affecting competition to an extent contrary to the common interest (see point 3.2 of the Guidelines).

The examination carried out by the financial institutions prior to granting the consolidation loan cannot replace the examination to check the firm's economic and financial efficiency within the meaning of the Guidelines or the specific Commission practice for aid to farms in difficulty. The examination conducted by the banks after the Region's contribution towards the interest on loans had been authorized was in fact, as the Italian authorities have admitted, designed solely to check that the holding's financial situation was such as to suggest that the loan would be properly repaid.

Italy's comment to the effect that the Commission should take account of the fact that no new financing was granted but that existing liabilities were simply rescheduled over a longer period (with the Region bearing part of the cost of the debt restructuring operation) is not relevant for determining whether the aid is compatible with the common market.

According to the Italian authorities, some of the beneficiary holdings had made investments in the period prior to the granting of the aid in question. In these specific cases, therefore, the first of the three criteria applied by the Commission for assessing aid to agricultural holdings in difficulty would be satisfied. That criterion, however, has to be combined with the other two laid down in the abovementioned specific provisions. The fact that a holding qualifying for aid for financial reorganization has made investments in the past is not in itself sufficient for determining that the aid is compatible. The Commission notes, moreover, that in none of the cases in which Article 5 of Law No 44/88 was applied was the fact of having made investments a condition for the grant of aid.

Italy invokes a number of other 'objective causes' for the excessive indebtedness of the beneficiary holdings: drought, market crisis, high interest rates, lack of organization at the marketing stage. Apart from the last factor, which cannot be regarded as external to the holding, some of these causes, although they are without doubt 'external' to the holding considered individually (market crisis), are nevertheless expressions of the market forces which confront any entrepreneur.

As regards the climatic factors (drought) which may have contributed to the state of financial crisis in which some beneficiary holdings found themselves, it should first of all be pointed out that the conditions for the grant of the aid in question contain no reference to phenomena of this type (in other words, climatic occurrences are not the reason — or one of the reasons — for the aid granted).

Occurrences of this type, furthermore, can be legitimately regarded as a reason for State aid intended to compensate firms for damage suffered only if certain specific conditions are met, demonstrating that the climatic occurrence has reached a minimum level of intensity below which its effects are part of the normal risks connected with the activity of an agricultural holding.

The specific Commission practice for aid to farms in difficulty takes account of increases in the rates of interest on loans intended to finance investments made in the past by holdings in difficulty. In such cases the aid must be confined to what is strictly necessary to make up the difference between the rate negotiated and the current, higher rate.

As regards the specific arguments put forward by Italy concerning forestry holdings, it is true that the return on investment in the form of planting in this sector is, for obvious reasons, obtained much later than in the case of other crops. The Commission, however, does not share the view of the Italian authorities that all expenditure on a forestry holding in the period between planting and felling should be regarded as investment expenditure. The aid granted to such holdings by the Region of Sardinia served, among other things, to cover debts relating to the normal operation of the holding, social charges and staff remuneration, rent and supplies.

As regards the debts deriving from investments, Italy has also not shown that it respected the other criteria laid down in the specific Commission practice for aid to farms in difficulty, or in the Guidelines, for determining whether national aid can be regarded as compatible with the common market.

As regards the aid granted to rabbit farmers in 1990, Italy maintains that some beneficiary holdings lost all their animals as the result of a virus disease. The measure in question, however, was not confined to such producers (the decision in which the Regional Executive authorized the grant of the aid laid down, as the criterion of eligibility for the measure, the loss of at least 20 % of the holding's stock due to the disease).

Moreover, the Commission's consistent practice as regards damage caused by animal diseases requires that, in order to be declared compatible with the common market, compensatory aid must satisfy certain conditions. They are, in particular, that the disease must be the subject of an eradication programme ordered by the public authorities in the public interest and that the aid must not exceed the amount of the losses caused by the disease (compensation).

The Italian authorities have supplied no information to show that those conditions were met.

In view of the foregoing, the Commission cannot accept the arguments put forward by Italy.

It is always theoretically possible that a legislative provision which has been applied without the Commission being given the opportunity in advance to check whether it complies with the rules on competition, and has been drafted in general terms which do not guarantee compliance with the conditions laid down in Community rules for determining whether State aid can be declared compatible with the common market, may nevertheless, when applied in practice, satisfy those conditions. In such a case, if the information available made this possible, the Commission would be able after the event to establish that the specific cases in which the legislation was applied were compatible.

In the case in point, however, the justifications put forward subsequently by Italy (natural disasters, animal diseases, investments), which seem to indicate such a possibility, are not supported by precise data which make it possible to confirm the existence of concrete instances which could be declared compatible.

V

The aid in question meets the conditions in Article 92 (1) of the Treaty, without qualifying for any of the derogations provided for in paragraphs 2 and 3 of that Article.

It has a direct effect on the production costs of beneficiaries, who have thus been given an advantage over other agricultural producers, both in Italy and in other Member States, who have not received similar aid.

Such measures are liable to distort the terms of intra-Community trade in agricultural products, which is affected by any aid to national production.

Article 92 (1) of the Treaty provides that aid which meets the conditions set out therein is in principle incompatible with the common market. Possible derogations are provided for in paragraphs 2 and 3 of that Article.

The derogations in Article 92 (2) (a) and (c) are manifestly inapplicable. Italy has not supplied any information to show that the derogation in paragraph 2 (b) of that Article is applicable in the case in point.

In order for the derogation in Article 92 (3) to apply, there have to be objectives pursued in the common interest rather than in the sole interest of particular sectors of the national economy. Such derogations, which must be interpreted restrictively, may in particular be applied only where the Commission can establish that the aid is necessary in order to achieve one of the objectives envisaged by those provisions. To apply such derogations to aid which does not meet that requirement would serve to support disturbances of trade between Member States and distortions of competition not justified on the grounds of Community interest, with consequent undue advantages to traders in some Member States.

In the case in point, the conditions for the grant of the aid do not indicate that this requirement is met. Italy has not provided, nor has the Commission found, anything to indicate that the aid in question meets the conditions for the application of one of the derogations provided for in Article 92 (3) of the Treaty (1).

The measures in question are not intended to promote the execution of an important project of common European interest within the meaning of Article 92 (3) (b). On the contrary, because of the effects they may have on trade, they run counter to the common interest.

Neither are they intended to remedy a serious disturbance in the economy of a Member State, within the meaning of the same provision, nor is the aid designed to promote culture and heritage conservation within the meaning of Article 93 (3) (d).

As regards the derogations referred to in Article 92 (3) (a) and (c) in respect of aid to promote or facilitate the economic development of certain areas or activities, the Commission considers, in the light of the foregoing and the applicable Community rules, that, because they take the form of operating aid, the measures in question are not likely to bring about a lasting improvement in conditions in the sector and region involved.

The aid thus does not qualify for any of the derogations provided for in Article 92 (3) of the Treaty.

It is therefore incompatible with the common market.

(1) Judgment of the Court of First Instance of the European Communities of 8. 6. 1995 in Case T-459 *Siemens* v. *Commission of the European Communities* [1995] ECR II-1675.

VI

The aid in question should have been notified to the Commission under Article 93 (3) of the Treaty. Since Italy did not observe this requirement the Commission was unable to give its opinion on the aid before the measures entered into force and the aid was granted.

Given the mandatory nature of the procedural rules laid down in Article 93 (3) of the Treaty, whose direct effect has been recognized by the Court of Justice of the European Communities *inter alia* in its judgments of 19 June 1973 (Case 77/72) [1] and 21 November 1991 (Case 354/90) [2], it is not possible to remedy the unlawfulness of the aid after the event.

Where aid is incompatible with the common market the Commission must make use of its power, recognized in the judgment of the Court of Justice of 12 July 1973 in Case 70/72 [3] and confirmed in the judgments of 24 February 1987 (Case 310/85) [4] and 20 September 1990 (Case C-5/89) [5], to oblige the Member State to recover from the beneficiaries the amount of the aid granted illegally.

In the case in point, reimbursement is necessary in order to restore as far as possible the situation which existed previously, removing all the financial advantages which the holdings which received the aid granted illegally have enjoyed unduly since the date on which the aid was paid.

In view of the foregoing, the aid granted by the Region of Sardinia under Article 5 of Law No 44/88 (decisions of the Regional Executive of 30 December 1988, 27 June 1990, 20 November 1990 and 26 June 1992) must be repaid.

Since the aid is granted in the form of interest rebates, the financial advantage unduly received consists in the difference between the market cost of bank loans to consolidate liabilities and the financial cost borne by the beneficiaries of the consolidation loans which received the regional assistance provided for in Article 5 of Law No 44/88.

Reimbursement, to be made in accordance with the procedures laid down in Italian law, must include the aid granted illegally and interest thereon from the date on which the aid was paid. The interest rate applicable is the reference rate used to determine subsidy equivalent in the context of regional aid [6],

HAS ADOPTED THIS DECISION:

Article 1

The aid granted by the Region of Sardinia under Article 5 of Regional Law No 44/88 and the decisions of the Regional Executive of 30 December 1988, 27 June 1990, 20 November 1990 and 26 June 1992 is illegal in that it was granted without the Commission having been able to give its opinion on the measures at the draft stage. The aid is also incompatible with the common market under Article 92 (1) of the Treaty and does not meet the conditions for a derogation laid down in paragraphs 2 and 3 of that Article.

Article 2

1. Italy shall be required to abolish the aid referred to in Article 1 within two months from the date of notification of this Decision.

2. Within six months from the date of notification of this Decision Italy shall be required to adopt the measures necessary to recover, by means of reimbursement, the aid referred to in Article 1.

3. Reimbursement shall be in accordance with the procedures laid down in Italian law; interest shall accrue from the date on which the aid was paid. The interest rate applicable shall be the reference rate used to determine subsidy equivalent in the context of regional aid.

Article 3

1. Italy shall regularly inform the Commission of the measures adopted to comply with this Decision. The first communication shall be made within two months of the notification of this Decision.

2. Within two months after the expiry of the time-limit in Article 2 (2) Italy shall communicate to the Commission the information enabling it to check, without further investigation, that the requirement to recover the aid has been met.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 16 April 1997.

For the Commission

Franz FISCHLER

Member of the Commission

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[1] [1973] ECR 611.
[2] [1991] ECR I-5505.
[3] [1973] ECR 813.
[4] [1987] ECR 901.
[5] [1990] ECR I-3437.
[6] OJ C 232, 10. 8. 1996, p. 10.