II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 12 March 1997

concerning State aid for Aircraft Services Lemwerder (ASL)

(Only the German text is authentic)

(Text with EEA relevance)

(97/753/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 Article 62 (1) (a) thereof,

Having given notice in accordance with Article 93 to interested parties to submit their comments to it,

Whereas:

I

On 30 May 1995 the Commission decided to initiate the procedure under Article 93 (2) of the EC Treaty in respect of aid granted by the authorities of the *Land* of Lower Saxony to Aircraft Services Lemwerder GmbH (ASL), an enterprise specialized in the maintenance and refurbishing of civil aircraft. The enterprise is located in Lemwerder, a structurally disadvantaged area which has been eligible for regional aid under Article 92 (3) (c) of the EC Treaty since 1 January 1995.

Until 1993 the plant was a branch of DASA, which then decided to close the plant down, discontinung its maintenance and refurbishing activities in Lemwerder and transferring its military aviation activities to DASA's Manching plant in Bavaria. The *Land* of Lower Saxony intervened and negotiated an agreement with DASA in order to safeguard the civil aviation activities at the Lemwerder plant. An independent consultancy firm was commissioned by it to report on the possibilities of continuing civil aricraft maintenance as an independent activity.

The report excluded DASA as a potential partner at the Lemwerder plant. DASA decided to discontinue its civil aviation maintenance activities, because they were no longer economically viable in view of the sharp falls in prices and worldwide overcapacity.

Consequently, drastic measures regarding employment, working hours and wages were a prerequisite for the continued existence of the Lemwerder plant.

The report concluded that there were estimated overcapacities of 25 - 30 % in the sector which were not expected to decrease, whereas the annual increase in demand would be only 3 - 4 %, with the result that the market was expected to be a buyers' market even after the year 2000. It therefore recommended that the Lemwerder plant should concentrate its activities on light and heavy maintenance, technical modification, refurbishing, equipping, painting and repair of civil aircraft. These activities could be supplemented by, among other things, R&D, logistics, training, and maintenance and repair of components.

Taking a price of US$ 44 per man-hour for heavy maintenance and a price of US$ 75 for painting and assuming an exchange rate of US$ 1 = DM 1,70 (current rate: US$ 1 = approximately DM 1,65, after two years of a constant rate of US$ 1 = DM1,50), the report come to the conclusion that the Lemwerder plant needed at least 400 000 man-hours of work and an annual turnover of some DM 42 million in order to be economically viable.

On the basis of this report, the *Land* of Lower Saxony decided to set up a new company called ASL Aircraft Services Lemwerder GmbH (ASL). This company bought all the assets of DASA's Lemwerder plant for DM 1. The *Land* of Lower Saxony provided it with equity capital amounting to DM 10 million, of which DM 3,25 million was paid up immediately; the remainder would, according to the German authorities, be paid up before the end of 1996. ASL is wholly owned by a subsidiary of Norddeutsche Landesbank Girozentrale, a public enterprise. However, the entrepreneurial responsibility for ASL belongs to the *Land* authorities, which have guaranteed Norddeutsche Landesbank, as the (formal) owner of ASL, against any financial and legal claims by third parties.

ASL is specialized in the maintenance and refurbishing of civil aricraft. The military activities of the former DASA plant had been gradually transferred to DASA's Manching plant in Bavaria by 30 June 1996.

DASA paid DM 80 million to ASL, given that it would have had to finance a social plan (DM 64,5 million) and pension claims (DM 27,5 million) in the event of closure of the Lemwerder plant. This amount was entered in ASL's balance sheet as a provision (Rückstellung) but served partly to finance the negative cash flow that was expected during the restructuring. In order that ASL could use DM 60 million of this amount freely as liquidity, the *Land* authorities gave a unilateral guarantee to ASL to cover the cost of the social plan and pension claims up to that amount should the company not prove viable.

DASA has also agreed to award certain contracts to ASL in the period up to and including 1998; these would include the refurbishing and repair of military components, thereby guaranteeing 160 000 man-hours of work each year.

In the course of the restructuring, ASL decided to reduce its workforce from 1 200 to 575 by 30 June 1996. Assuming an average rate of DM 80 (US$ 54) per man-hour and an annual workload of 400 000 man-hours, it concluded that it could be viable from 1998 onwards after making losses amounting, according to their own forecasts, to DM 16,5 million in 1995, to DM 15,3 million in 1996 and to DM 10,3 million in 1997. The positive figures from 1998 onwards were based on the assumptions that the restructuring would then have been completed and that the situation in the maintenance market would improve and prices recover from that date onwards. According to those estimates (which were submitted to the Commission), turnover was expected to be DM 47,2 million in 1995, DM 63,2 million in 1996 and some DM 65 million from 1997 onwards.

In order to increase competitiveness, the workers agreed to a reduction of 10 % from 1 January 1995 and a further reduction of 7 % from 1 January 1996 in those components of their wages not covered by their collective bargaining agreement. In addition, more flexible working hours were agreed, with up to 50 hours a week, weekends included, having to be worked without any additional financial compensation.

Besides the reduction in the workforce from 1 200 to finally 575 by 30 June 1996, ASL scaled down capacity for military aircraft maintenance by 75 % and for civil aircraft maintenance by 30 %.

The Commission examined the above measures in the light of Article 92 of the EC Treaty and concluded that the measures taken by the *Land* of Lower Saxony, both the capital injection of DM 10 million and the unilateral guarantee of DM 60 million, may constitute State aid. At the time, it had serious doubts whether the aid qualified for the exemptions under Article 92 (3) of the EC Treaty and under the Community guidelines on State aid for rescuing and restructuring firms in difficulties [1]. It therefore decided to initiate the Article 93 (2) procedure on 30 May 1995.

II

By letters dated 27 June, 27 September and 29 November 1996, the German authorities gave their views on the Commission's decision to initiate the Article 93 (2) procedure in respect of the aid granted to ASL.

According to the German authorities, the capital injection by the *Land* of Lower Saxony amounting to DM 10 million did not constitute aid within the meaning of Article 92 (1) since the *Land* authorities had in this case acted as any private investor would have done. The restructuring of ASL had led to substantial savings which allowed ASL to act in the same flexible way as a medium-sized enterprise. Wages, salaries and fringe benefits had been reduced. The workforce had been further

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

reduced from 782 to 575 on 30 July 1996. Total working time had become more flexible. Negotiations were already under way with potential home-fleet customers, and the Indonesian State holding IPTN had expressed an interest in acquiring 25,1 % of ASL. All this suggests that the losses in the start-up phase could be cancelled out and reasonable profits could be expected. Against this background, any investor operating under normal market economy conditions would come to the conclusion that a financial participation in such an enterprise was promising. The Commission, in assessing the company's profitability prospects, had focused too closely on the plans submitted to it. It would run counter to economic reality to make the behaviour of an entrepreneur in a market economy dependent solely on specific business prospects. Taking all these points into account, the German authorities took the view that the *Land* of Lower Saxony had acted as any private investor would have done.

As for the unilateral guarantee amounting to DM 60 million, the German authorities stressed that it enabled ASL to use the payments received from DASA as liquidity without reducing the employees' claims in the event of ASL's bankruptcy or of other major changes within the enterprise. They also highlighted the fact that the guarantee would be activated only in the event of ASL's bankruptcy or of a further substantial reduction in the workforce and only in respect of ASL's employees, not in respect of ASL itself.

The German authorities were convinced that ASL can become profitable. During the first half of 1995, ASL had achieved an average price of DM 90,91 for a total of 375 000 man-hours (maintenance: 165 000 man-hours, DM 70 per man-hour; components sector: 110 000 man-hours, DM 120 per man-hour). ASL's capacities were fully utilized. There were even bottlenecks in respect of new orders. For 1995, orders corresponding to 500 000 man-hours were expected, exceeding both the consultant's and ASL's forecasts by 25 %. In addition, ASL was less dependent on the US$/DM exchange rate since 70 % of ASL's business was transacted in DM.

A profit and loss account dated October 1995 and submitted by the German authorities showed an overall turnover of DM 73 million in 1995, 50 % up on ASL's own forecast and 100 % up on the consultant's forecast, while expected losses amounted to DM 15 million, slightly below the estimated figure of DM 16,5 million.

III

By letter dated 26 January 1996, the Commission transmitted to the German authorities the comments of third parties, one German competitor and one Danish competitor, which it had received following publication of the Commission's decision to initiate the procedure [1].

The German competitor stressed that the relevant market for ASL's activities is and will remain a buyers' market for at least another five to eight years, with overcapacities estimated at 30 %. Therefore, an aircraft maintenance company would need a significant number of home-fleet customers in order to survive. Large arilines had their own maintenance facilities and basically optimized their capital and workforce utilization by acquiring additional business from smaller operators who do not invest in maintenance facilities because of the existence of a buyers' market. Since ASL did not have a home fleet or any special relationship with a large airline, it depended entirely on the spot market. The German competitor also pointed out that ASL had announced at the end of 1995 that it aimed for a cost base corresponding to a man-hour rate of less than DM 100. ASL, however, had offered its services at man-hour rates that were as much as 25 % below that target figure. Such market behaviour was possible only because of the capital injection by the *Land* of Lower Saxony, a step which, given the market situation, no private investor would have been prepared to take.

The Danish competitor expressed its concern about the aid for ASL and stressed that such an aid represented an unacceptable distortion of competition in an already saturated market.

IV

By letter dated 21 February 1996, the German authorities transmitted their reply to the comments made by third parties.

They emphasized that, contrary to one of the competitors' observations, ASL was able to attract a significant home-fleet clientele. It received a total of 31 orders from four airlines (two German, one Danish and one Icelandic airline). ASL had offered its services to those airlines at world market prices. At the same time, it was negotiating with other airlines in order to increase its home-fleet clientele.

[1] OJ C 295, 10. 11. 1995, p. 17.

The German authorities also highlighted the fact that in 1995 ASL had received orders corresponding to 537 000 man-hours, 34 % higher than the consultant's estimation, and had achieved a turnover of DM 80 million, significantly higher than the estimated turnover of DM 47 million. The operating loss amounted to only DM 10 million and was expected to be further reduced to DM 7 million for 1996.

In addition, they stressed that ASL was continuing to cut costs, which stood at DM 125 per man-hour in 1995, and that a further reduction to close on DM 100 could be achieved by further reductions in the workforce (to 575) in 1996.

As regards the unilateral guarantee, the German authorities emphasized again that the authorities of the *Land* of Lower Saxony had entered into commitments only *vis-à-vis* the employees in the event of ASL's failure, and not *vis-à-vis* the enterprise itself. The guarantee entailed no legal obligation to provide the enterprise with capital.

V

In July 1996 the Commission, in response to a request from the German authorities, agreed to postpone a final decision since a new plan was being worked out for ASL under which it would be re-privatized and new investors would assume the entrepreneurial risk in full.

By letter dated 4 October 1996, the German authorities forwarded to the Commission two letters of intent. In the first letter, the Indonesian state holding IPTN expressed an interest in acquiring 25,1 % of ASL's shares. In the second letter, a group of three private investors expressed an interest in purchasing the remaining 74,9 %. After purchasing the shares, they would also be prepared to provide ASL, via a financing company, with equity amounting to DM 10 million.

The privatization contracts were to be signed by the end of October 1996.

The German authorities also pointed out that ASL had not been in a position to use the entire DM 80 million provided by DASA as freely available liquidity since in 1994 ASL had to repay DM 35 million to DASA in order to enable it to cover the costs of a social plan for employees who had remained with DASA. In addition, ASL had to provide another DM 6 million under a social plan to cover claims of 250 of its own employees who had been made redundant. Finally, in 1994 ASL had to pay a further DM 9 million to DASA for stocks taken over in.

As a result, only DM 30 million out of the original DM 80 million was available to ASL as liquidity reserves.

At the Commission's request, the German authorities sent on 6 November 1996 copies of the privatization contracts and of the most recent profit and loss account for ASL.

According to the German authorities, ASL was sold on 31 October 1996. The purchase of 25,1 % of ASL's shares by IPTN, however, did not go ahead since IPTN had sought additional guarantees in respect of ASL's liquidity and equity capital which the *Land* of Lower Saxony had been unwilling to give.

Nevertheless, the negotiations with the private investment group, which was prepared to acquire 100 % of ASL's shares, were successful. ASL was sold for a symbolic price of DM 1, this being, according to the German authorities, the usual price for an enterprise which had expected to incur losses in 1996 and 1997 and anticipated becoming profitable only at the end of 1997. The purchasers planned to grant via PVV GmbH, a company wholly owned by them, a loan amounting to DM 10 million in order to bolster ASL's equity capital. The German authorities stressed that this loan would be financed in full by the investors without any public money being involved. The only condition was that the Land of Lower Saxony would not withdraw the capital injected into the company.

In the context of the sale of ASL, the *Land* of Lower Saxony withdrew the DM 60 million guarantee in respect of the social plan for ASL's empoyees that would be activated in the event of ASL's bankruptcy. It also stated that it would not enter into any further financial undertaking in favour of ASL.

The profit and loss account presented by the German authorities confirmed that ASL made estimated losses of DM 8 million in 1996. The attached balance sheet indicated that ASL would have used up all its liquidity reserves by the end of 1996 and would therefore urgently need a fresh injection of capital in order to cover the losses which were expected before the company became profitable at the end of 1997.

In response to a futher request for information from the Commission, the German authorities indicated on 22 November and 16 December 1996 that the private investors would finance the DM 10 million capital injection entirely out of their own resources and that no public undertaking would be entered into in the future. Furthermore, the DM 10 million loan provided by the purchasers had the effect, under German company law, of replacing equity capital and could not, therefore, be secured by ASL's assets. As a result, the amount involved would have been irrevocably lost in the event of ASL's bankruptcy. The loan would be granted for a period of 10 years at an annual interest rate of 6 %, with the first two years being a grace period. The German authorities also transmitted copies of records of ASL's board of management meetings, the audited balance sheet for 1995 and the monthly management reports for 1996.

VI

The Article 93 (2) procedure confirmed the Commission's view when instituting the procedure that the measures taken by the *Land* of Lower Saxony had to be regarded as aid within the meaning of Article 92 (1) of the EC Treaty.

That the capital injection of DM 10 million provided by the *Land* of Lower Saxony in order to safeguard an uneconomic activity in a newly established enterprise constitutes State aid is already established by the Commission communication of 1984 [1]. The fact that the *Land* of Lower Saxony was not directly the owner but that it guaranteed the Norddeutsche Landesbank against any claims arising as a result of its being the owner changes nothing in this respect. ASL is formally owned by Durum, a wholly owned, Zurich-based subsidiary of Norddeutsche Bank/Girozentrale. The Norddeutsche Bank/Girozentrale is a public enterprise, its shares being held by the *Land* of Lower Saxony (50 %), the *Land* of Saxony-Anhalt (10 %), the municipally owned Niedersächsischer Sparkassen- und Giroverband (33,33 %), and the Zweckverband der Sparkassen Sachsen-Anhalt (6,67 %).

In applying the market economy investor principle [2], it has to be concluded that a normal investor would not have acted in the same manner as the *Land* of Lower Saxony did in 1994. Both forecasts for ASL, which had been compiled by the consultants and then modified by the new owners and which had been submitted to the Commission by the German authorities before the procedure had been instituted, indicated that the losses anticipated in the first three years would not be offset in subsequent years.

The DM 60 million guarantee also constitutes aid. DASA had provided ASL with DM 80 million in exchange for being released from liabilities of DM 92 million in respect of pensions and a social plan which would have arisen if Lemwerder had been shut down completely. Even though there was no legal link with the contract between ASL and DASA concerning the provision of DM 80 million and although ASL had no legal obligation to set this amount aside, it is certain that the workers would have preferred to accept the DASA payments instead of providing ASL with the money if they had not been convinced by the unilateral guarantee that their claims would have been met. Thus, there was a clear factual link between the unilateral guarantee and the opportunity to use DM 60 million as a liquidity reserve. On the basis of the guarantee, the DASA workers renounced their immediate claims on DASA, and DASA was able to provide ASL with resources which it would have had to provide anyway. At the same time, there was no legal obligation on ASL to set this amount aside since the workers who had meanwhile been taken over by ASL and knew that this money was available deferred their claims under the social plan. In this connection, the guidelines on State aid for rescuing and restructuring firms in difficulty state that 'the obligations a company itself has under employment legislation or collective agreements with trade unions to provide redundancy benefits and/or early retirement pensions are part of the normal costs of a business which a firm has to meet from its own resources. This being so, any contribution by the State to these costs must be counted as aid. This is true regardless whether the payments are made direct to the firm or are administered through a government agency to the employees' (point 3.2.5). Thus, the unilateral guarantee clearly constitutes aid.

Moreover, the success of ASL's restructuring is attributable primarily to external factors, such as the US$/DM exchange rate and the acquisition of a 75 % home-fleet-based clientele, over which the company has no great influence. According to point 3.2.2 (i) of the abovementioned Community guidelines, these factors should not therefore constitute the basis for a sound restructuring plan. The Commission thus doubts whether the restructuring measures, at the moment when they were adopted and the aid was granted, could be regarded as sufficient to restore the company's viability.

On the other hand, it cannot be denied that ASL, in implementing the restructuring measures, was much more successful than foreseen in its own forecasts. The figures provided by the German authorities confirm that ASL was a loss-making enterprise in 1995 and 1996, although the losses were diminishing. In 1995 losses amounted to DM 14,514 million, DM 2 million lower than the DM 16,5 million forecast, while the turnover of DM 77,952 million exceeded the forecast by DM 30 million. In 1996 ASL reduced its losses to DM 7,934 million, equivalent to around 50 % of the originally estimated losses of DM 15,3 million. The expected turnover of DM 69,018 million also exceeded the original forecast by DM 6 million. In addition, according to the German authorities, ASL obtained roughly the prices which it expected to achieve and which the consultant had regarded as un-

[1] Application of Articles 92 and 93 of the EEC Treaty to public authorities' holdings (EC Bulletin 9-1984).
[2] Application of Articles 92 and 93 of the EEC Treaty and of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13. 11. 1993, p. 3).

realistic. Owing to cost-cutting measures, ASL was also able to reduce its costs from DM 125 per man-hour to DM 100 per man-hour, approaching the market prices for its services.

All these developments could be attributable to an easing of the situation in the aerospace maintenance market, where overcapacity was estimated at 25 - 30 %. The European aerospace industry as a whole achieved spectacular growth during the 1980s but was affected by a deep recession from 1990 onwards which was due to the general economic crisis and, for the military part of the industry, to political détente. The computed consumption of aerospace equipment in the EU fell by 14 % between 1990 and 1992. In 1993 the airline industry's overcapacity, along with the continuing contraction in defence budgets, continued to dampen activity in the aerospace industry. Production was down 7,4 % in value terms as domestic demand weakened and exports stagnated. The industry cut capacity corrspondingly in that period. However, according to the information available to the Commission (Panorama of EU Industry 1995/96), the previous overcapacity in the aerospace sector as a whole seems to have diminished and it is reckoned that growth in production will accelerate again on the back of the general recovery in the world economy and the need to replace old aircraft, particularly business aricraft and helicopters. The aerospace maintenance industry is also expected to benefit.

The successful re-privatization of ASL is also an indication that the business plans were realistic and that the company, after the further losses anticipated in early 1997, can justifiably expect to break even by the end of this year. Although the investors will purchase the enterprise for the symbolic sum of DM 1, they will provide a DM 10 million loan which will, as the German authorities confirm, be financed completely out of their own resources and will provide the company with sufficient liquidity until it breaks even. Moreover, under German company law, this loan will, in the event of the company's bankruptcy, replace equity capital and will thus be irrecoverable for the investors. This demonstrates the investors' confidence in ASL's future and in the restoration of its profitability, for which they will, if necessary, carry out additional restructuring measures. Otherwise, they would hardly have been prepared to inject such a large amount of their own capital into the company. Under such circumstances, it is difficult for the Commission to substantiate the absence of any prospects of the company becoming viable and to prevent private investors taking over a company that is operating at full capacity and even encountering production bottlenecks.

Furthermore, it has to be taken into account that the German authorities have promised that there will be no more public financial involvement in the company. This will ensure that ASL will act in the market like any other company and will no longer be in a position to distort competition with the help of financial support from the public authorities.

It should also be borne in mind that, according to the letter from the German authorities of 6 November 1996, the unilateral guarantee was withdrawn and no longer had any impact on ASL's activities.

For these reasons, it can be assumed that the company's viability will be restored without additional financial support from the public authorities.

In addition, there have been substantial reductions in maintenance capacity (75 % for military aircraft and 30 % for civil aircraft). The reduction for civil aircraft was 33 % in terms of man-hours and 50 % in terms of manpower. Thus, the reduction in capacity carried out by ASL corresponds to or even exceeds existing market overcapacity.

Compared with the level of State aid, the investor's financial risk is not insignificant. The investors are taking over a company whose equity capital is used up. Should the plan fail, they would lose DM 10 million of their own capital which they would have to finance themselves in full.

Finally, when assessing the restructuring measures in favour of ASL, it has to be noted that ASL is located in an area which is ow eligible for regional aid pursuant to Article 92 (3) (c) of the EC Treaty and in which the closure of a large company like ASL would lead to a further increase in unemployment without any prospect of alternative jobs being created.

In view of ASL's apparently restored viability, the significant reduction in capacity and the considerable financial contribution made by the investors and since this was the first time that ASL had been restructured with the help of public money, the Commission has concluded that the capital injection of DM 10 million and the unilateral guarantee - since withdrawn - for DM 60 million in favour of ASL's workers, both provided by the *Land* of Lower Saxony, can be approved under Article 92 (3) (c), taken in conjunction with the Community guidelines on State aid for rescuing and restructuring firms in difficulty.

In view of the continuing overcapacity in the aircraft maintenance sector, this approval should be conditional on ASL being prevented from distorting competition in future with the help of public funds.

To that end, steps must be taken to ensure that, for a period of at least five years, the German authorities do not grant any *ad hoc* operating aid or any *ad hoc* aid to finance capacity-enhancing projects,

HAS ADOPTED THIS DECISION:

Article 1

Both the capital injection of DM 10 million and the unilateral guarantee - since withdrawn - for DM 60 million, which were provided by the Land of Lower Saxony to Aircraft Services Lemwerder GmbH (ASL), constitute illegal aid because they were not notified to the Commission before being granted, in breach of Article 93 (3) of the EC Treaty.

However, they satisfy the criteria laid down in the Community guidelines on State aid for rescuing and restructuring firms in difficulty and are therefore compatible with the common market within the meaning of Article 92 (3) (c) of the EC Treaty and Article 61 (3) (c) of the EEA Agreement, on condition that Germany refrain until 31 December 2001 from granting ASL any *ad hoc* aid to finance capacity-enhancing projects or to cover any losses incurred by it.

Article 2

Germany shall inform the Commission, within two months of the notification of this Decision, of the measures it has taken to comply herewith.

Article 3

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 12 March 1997.

For the Commission

Karel VAN MIERT

Member of the Commission