II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 26 June 1997

concerning State aid in favour of SKET Schwermaschinenbau Magdeburg GmbH (SKET SMM), Saxony-Anhalt

(Only the German text is authentic)

(Text with EEA relevance)

(97/765/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,

Whereas:

I

By letter dated 21 March 1995 [1] the Commission informed the German Government of its decision to initiate proceedings pursuant to Article 93 (2) of the EC Treaty in respect of aid granted by the Treuhandanstalt (THA) and its successor organization, the Bundesanstalt für vereinigungsbedingte Sonderaufgaben (BvS), to SKET Schwermaschinenbau Magdeburg GmbH (SKET SMM). The enterprise was located in the new German *Land* of Saxony-Anhalt and has since filed for bankruptcy. SKET used to employ approximately 1 800 people and was the largest manufacturer of machinery and equipment in the new *Länder*. Its product range included rolling mills, wire-drawing mills, cranes, steel wire and cable-making machines, dressing and sizing technology, vegetable oil extraction plants, sewage treatment plants and dust collectors.

SKET was founded in Magdeburg in the middle of the nineteenth century as a ship repair yard and iron foundry and became 'Friedrich Krupp Grusonwerke' after a merger with Krupp, Essen, in 1893. Four-fifths of the internationally renowned engineering works were destroyed during the Second World War. After the war the enterprise resumed trading under Soviet control, becoming, in 1954, VEB Schwermaschinenbau 'Ernst Thälmann' Magdeburg. In 1969 it became the seat of the newly founded 'Ernst Thälmann' combine comprising 18 subsidiaries with 30 000 employees and an annual turnover of DM 2,6 billion. At the time SKET was the largest producer and exporter of heavy machinery in the Comecon countries. After the unification of Germany, SKET was transformed by the THA, which was the agency responsible for privatizing East German state property, into SKET Maschinen- und Anlagenbau AG and later into limited companies (19 447 workers).

In its Decisions of 10 June 1993 (NN 43/93) and 13 October 1993 (NN 95/93) the Commission approved DM 427,6 million of aid granted in 1992 and 1993 by the THA to SKET AG.

[1] OJ C 215, 19. 8. 1995, p. 8.

In 1993 the THA split SKET AG into eight companies, the largest of which was SKET SMM. Of the remaining seven companies, three were privatized and two were liquidated. The parent company SKET SMM had two subsidiaries, Drahtziehmaschinenwerk Grüna GmbH (DZM) in Chemnitz and Entstaubungstechnik Magdeburg GmbH (ETM) in Magdeburg, which are not affected by the liquidation of SKET SMM. DZM merged with a West German firm in 1995 and currently produces wire-drawing machines under the name Herborn & Breitenbach GmbH Chemnitz (H&B), while ETM produces dust-collecting systems.

In July 1994 the Commission was belatedly notified of the prolongation of the previously granted aid and of the grant of an additional liquidity loan. At the request of the German Government, the decision to initiatie Article 93 (2) proceedings was postponed so as not to jeopardize the ongoing privatization negotiations. On 26 October 1994 the THA concluded a privatization contract with Firma Oestmann & Borchert Industriebeteiligungen, which acquired 51 % of SKET SMM's shares and was to act as broker for a further 24 %. The remaining shares were retained by the THA and later by the BvS pending subsequent privatization. The legal validity of the privatization contract was made dependent upon a favourable Commission decision. On 25 November 1994 the German Government notified financing measures in support of this privatization. In December 1994 the THA renounced all claims to the repayment by SKET SMM of company loans in order to prevent the company from having to file for bankruptcy.

After a preliminary analysis of the aid measures, the Commission decided to initiate the Article 93 (2) procedure. The German authorities were informed by the abovementioned letter of 21 March 1995. In initiating the procedure, the Commission expressed serious doubts about the aid's compatibility with Article 92 of the EC Treaty because it was not limited to the minimum necessary and the future competitiveness of the enterprise was in doubt.

In October 1995 the German Government notified further measures in favour of the company because of the illiquidity of the investor and to safeguard orders received until 1996. In December 1995 the Commission was informed of the advance payment of a loan which had been notified as part of the planned loss cover for SKET SMM in 1996.

In January 1996 the German Government announced the failure of the intended privatization due to the withdrawal of the investors, and notified liquidity measures to assist SKET SMM pending the drafting of a new restructuring plan. The previously notified aid for the continued operation of the company until the end of 1995 was maintained. A new restructuring plan for 1996-98 was notified in April 1996, under which SKET SMM was to remain in public ownership and the company was to be restructured independently of any privatization. The Commission appointed an independent expert to assess the notified restructuring plan's effectiveness. The expert expressed doubts about the plan's feasibility. In his opinion, although it was based on correct assessments and arguments, it was unlikely to succeed because of the lack of any current or prospective orders.

By letter dated 12 August 1996 [1] the Commission informed the German Government of its decision to extend the Article 93 (2) proceedings to include the liquidity measures introduced in 1995 in favour of SKET SMM and its subsidiaries and the new restructuring plan. In extending the Article 93 (2) proceedings, the Commission expressed serious doubts as to the compatibility of the aid with Article 92 of the EC Treaty on the grounds that the aid was out of proportion to its effect and that the long-term viability of the company remained uncertain. Germany later notified instances of the actual granting by the BvS of financial help to SKET as set out in the second restructuring plan in so far as it could be put into effect before the bankruptcy. These notifications gave actual effect to the restructuring plan and are covered by the Commission's decision to extend the Article 93 (2) proceedings.

On 15 October 1996 SKET SMM filed for bankruptcy and has been in liquidation since then. By letter dated 19 November 1996 (registered on the same day) the German authorities notified the measures taken in favour of SKET SMM up until 15 October 1996. In January 1997 the German Government notified the extent of the measures taken in favour of the subsidiaries in 1996. It is clear from this that the restructuring plan for the subsidiaries has so far been carried out without major modifications. At the same time, however, the German authorities have stated that the future financial needs of the subsidiaries for the period covered by the notified restructuring plan are not yet clear. The Commission currently does not have sufficient information at its disposal for it to be able to assess the compatibility of the notified aid measures for ETM and H&B/DZM with Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement. Consequently, this Decision covers only the question of the compatibility with those provisions of aid granted to SKET SMM.

[1] OJ C 298, 9. 10. 1996, p. 2.

For details of the grant by the BvS to SKET SMM of the financial resources covered by this Decision (duration of loans, interest rates, fees, etc.), reference should be made to the Commission's decisions to initiate and extend the Article 93 (2) procedure and to the legal assessment in Section V of this Decision.

II

By letter dated 13 June 1994 (registered on 14 June 1994) the German Government belatedly notified aid previously granted by the THA to SKET SMM. The aid consisted in the prolongation until the end of 1994 of loans totalling DM 290,7 million, the provision of an additional loan of DM 65,5 million to cover liquidity needs, investment guarantees worth DM 35,1 million and counter-guarantees worth DM 30 million. At the Commission's request of 20 June 1994, the German Government provided additional information by letter dated 19 July 1994 (registered on 20 July 1994).

Further to a request by the German authorities dated 31 October 1994, it was decided to defer taking a decision because of the expected notification of additional aid connected with the planned privatization of the company. The additional aid involved in the privatization of SKET SMM totalling DM 557,5 million was belatedly notified by the German Government by letter dated 25 November 1994 (registered on 28 November 1994). It entailed the provision of DM 371,5 million of equity by waiving repayment of the shareholders' loans which the THA had provided after unification, the covering of annual losses until 1996 and the financing of a redundancy programme. This would require DM 186 million (DM 174,3 million for SKET SMM and DM 11,7 million for ETM) and was to be covered by selling surplus real estate to the THA.

By a third notification made to the Commission by letter dated 9 December 1994 (registered on 12 December 1994), the immediate waiver of DM 477,8 million of debt was notified in order to prevent the company from having to file for bankruptcy. This took the form of the provision of DM 371,5 million of equity and DM 106,3 million to cover the planned losses of both SKET SMM and its subsidiaries for 1994.

By letter dated 4 October 1995 (registered on 6 October 1995) the German Government belatedly notified additional aid measures to maintain the company's liquidity during the Article 93 (2) proceedings. To safeguard orders received until 1996, counter-securities were provided for a bank guarantee for a further DM 150 million. By letter dated 12 December 1995 (registered on 13 December 1995) the early payment of an interest-bearing loan of DM 20 million (which had been notified as part of the planned loss cover for SKET SMM in 1996) was notified. At the end of 1995 the investors pulled out and the privatization failed.

By letter dated 16 January 1996 (registered on 17 January 1996) the German Government announced the failure of the intended privatization and the drawing-up of a new restructuring plan, and at the same time notified the provision of a DM 20 million loan to SKET SMM to ensure its liquidity until March 1996. By letter dated 13 March 1966 (registered on 15 March 1996) the German authorities withdrew the notification of the aid involved in the intended privatization which had not been granted prior to the failure of the privatization. By letter dated 14 March 1996 (registered on 15 March 1996) the German Government belatedly notified the provision of a liquidity loan of DM 60 million for the first quarter of 1996 and of DM 30 million for April 1996.

By letter dated 23 April 1996 (registered on the same day) the Commission was notified of the new restructuring plan for SKET SMM for the period 1996-98. The financial measures amounted to DM 352,1 million including the liquidity measures already notified for 1996. Following a request made by the Commission on 15 May 1996, the German authorities sent by letter dated 23 May 1996 (registered on the same day) the entire restructuring plan as devised by the Roland Berger consultancy.

The Commission received observations from third parties up to 9 November 1996. By letter dated 19 November 1996 (registered on the same day) the German authorities notified the granting to SMM of subsidies totalling DM 65 million since June 1996 and informed the Commission that DM 15 million of the April loan had been converted into a grant and that DM 61 million of the counter-guarantees had been called. They said that these measures were in line with the notified restructuring plan. By letters dated 30 January 1997 (registered on the same day) and 31 January 1997 (registered on 3 February 1997) the German authorities informed the Commission of the amount of guarantees and counter-guarantees called to date in accordance with the notified restructuring plan.

III

By letters dated 19 and 26 November 1996 the Commission transmitted to the German authorities the comments by third parties — a Swedish association of machine makers and an Italian and a German competitor — which it had received in response to publication of its decision to initiate the procedure. The observations by the Italian competitor concerning the extension of the procedure were received after the deadline for the receipt of comments.

The third parties expressed their concern both about the proportionality of the amount of the aid compared to its effect and about the viability of the company, even with the aid. The Swedish association argued that a non-viable company was being kept going with the help of a substantial amount of State aid in a market characterized by intense competition and a low rate of capacity utilization. All the third parties were concerned in particular about the misuse of State aid by SKET SMM — and one competitor in particular was concerned about misuse by H&B/DZM — to sell products below variable cost, the corresponding losses being covered by the State aid. SKET SMM was said to offer its products for sale at between 25 % and 45 % below the market price. The complainants gave several examples. It was objected that SKET SMM openly used the involvement of the BvS through aid to attract orders below cost price. This submission concerns exclusively orders from outside the EC, namely the Asia-Pacific area. It was argued that this behaviour was putting European competitors — in particular German and Italian producers — under heavy price pressure and was therefore threatening to distort competition in the Community.

IV

By letters dated 16 February 1996 (registered on 19 February 1996), 13 March 1996 (registered on 15 March 1996), 6 January 1997 (registered on 7 January 1997) and 9 January 1997 (registered on 30 January 1997) the German Government responded to the third parties' comments.

The specific examples given were disputed and other examples given where the Italian competitor had succeeded in winning the order. The German authorities commented on each example given. In some cases the orders had been placed with the Italian competitor, whereas in others they had been placed with SKET SMM, the counter-offers being in each case only marginally higher (no more than 5 %). The German Government argued that State aid was not being used to cut prices but to finance cost-cutting programmes. Furthermore, it said, SKET SMM was not present on the Swedish market.

Finally, the German authorities assured the Commission twice that since 1996 SKET SMM had been under strict instructions, following a resolution adopted by the company's shareholders, not to offer or supply its products at prices below direct cost except with the BvS's formal consent. Such consent had been neither requested nor given.

V

The Article 93 (2) proceeding has confirmed the Commission's view that most of the financing measures taken by the BvS in favour of SKET SMM covered by the initiation and extension of the procedure must be deemed to be aid within the meaning of Article 92 (1) of the EC Treaty and that they are not covered by the exception provided for in Article 92 (3) (c) or by the Community guidelines on State aid for rescuing and restructuring firms in difficulty [1], the only framework under which the aid might have been approved.

Mechanical engineering is one of the basic industries of the Community, representing 7,8 % of total industrial production and employing 1,94 million workers in 1995. The Community is the world's biggest producer in the sector, with production totalling ECU 229,7 billion in 1995. Germany's share of overall Community production is 44 %. The Community mechanical engineering industry is largely export-oriented, with exports increasing by 8,6 % in 1995, the corresponding figure for Germany being 7,6 %. Intra-Community trade is expanding (by 3 % in Germany and by 18 % in Spain). In Germany, in particular, exports are equivalent to 91 % of domestic consumption [2].

SKET SMM was, with its approximately 1 400 employees, one of the larger producers of heavy machinery in the Community, where only 4 % of engineering companies employ more than 100 people (1990 figures, the most recent available). Thus, any aid would improve SKET SMM's position in the common market *vis-à-vis* other competitors who do not receive any State support. Roughly 50 % of SKET SMM's turnover in 1996 was accounted for by the sale of rolling mills, which were mainly exported outside to third countries. SKET SMM has a 15 % share of the world market for wire rod mills. The granting of State aid may distort or threaten to distort competition between Community manufacturers even if they compete mainly in markets outside the Community, because the respective competitive strengths of the market players may be altered to the advantage of the recipient and to the disadvantage of those not in receipt of aid. Consequently, intra-Community trade is likely to be affected by the measures taken in favour of SKET SMM.

A special feature of this case is the fact that two different notified restructuring plans are covered by the Article 93 (2) EC procedure. Neither plan has been fully implemented and certain measures have been taken in their place. For clarity's sake the following overview lists all measures, namely those which have been notified and those which have been put into effect. For the purposes of determining the compatibility of the aid measures, all intended measures and the policies underlying them have to be taken into consideration. It should be noted, however, that not all of the notified financing measures have been implemented.

[1] OJ C 368, 23. 12. 1994, p. 12.
[2] Panorama of EU Industry, Short-term supplement 2/1996, p. 47.

Overview of notified measures in favour of SKET SMM from 1994 until the date of filing for bankruptcy (15 October 1996) (1)

(DM million)

Measures	
regional investment aid	25,5
discharge of environmental liabilities	12,2
loan for employment measures under § 249h AFG	16,8
redundancy allowances under § 111 BetrVerfG	54,8
Subtotal	109,3
Guarantees	
80 % counter-guarantee by Saxony-Anhalt (purchase price Oestmann & Borchert)	9,2
export credits (Hermes)	68
counter-guarantees	180
Subtotal	257,2
Waiver of debt	
prolongation of guarantees 1992 and later transformation into an interest-bearing loan in 1994	[290,7] (2)
prolongation of liquidity loan 1993 until 31 December 1994	[69,9] (2)
waiver of debt in order to build equity (290,7 + 69,9 + 1,2)	[361,7] (2)
waiver of debt in order to cover losses for 1994	80,3
transformation and increase of investment loan for 1993 [67] into investment guarantee at end 1994 (90,6) and into loan at end 1995 (31,8), waiver	[67] (2) 31,8
liquidity loan for 1994, waived in 1995	65,6
liquidity loan for second half of 1994, waived in 1995	91,7
loans dating from before 1 January 1990 transformed into new loan end 1994 then waived in 1995	22,8
Subtotal	1 081,5
Loans	
liquidity loan to cover losses for 1995	156,8
liquidity loan at end 1995	20
liquidity loans 1996	75
Subtotal	251,8
Grants	
grants 1996	80
Aggregate amount of notified measures (3)	1 779,8

(1) Not all notified measures have actually been awarded by *inter alia* the BvS; see legal assessment and table below.
(2) Award declared compatible with the common market by Commission Decisions NN 46/93 and NN 95/93.
(3) The total includes the measures declared compatible with the common market by Commission Decisions NN 46/93 and NN 95/93. This sum does not represent the actual amount of aid (see legal assessment and table below).

The individual measures

The company was granted DM 15 million (DM 25,5 million was notified) under the German law for improving regional economic structures (*Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur, 23. u. 24. Rahmenplan*). Measures under that law qualify as regional investment aid under Article 92 (1) EC Treaty and have been exempted under Article 92 (3) (a) of the EC Treaty (N 464/93, N 157/94, N 531/95).

Purchase price counter-guarantee

On the occasion of the privatization of SKET SMM, the *Land* of Saxony-Anhalt provided Oestmann & Borchert with a counter-(deficit) guarantee worth DM 9,2 million for a bank guarantee to secure the payment of 80 % of the purchase price (DM 10,2 million plus DM 1,4 million interest) to the BvS. The counter-guarantee was conditional on the payment of a fee.

The privatization contract never came into force, the purchase price was not paid, and neither the bank guarantee nor the counter-guarantee by the *Land* was called. The guarantee is therefore not to be regarded as aid since it had no effect.

Export credit insurance

SKET SMM took out export credit insurance under the federal Hermes programme up to a maximum of DM 68 million for orders from the CIS.

The export credit insurance scheme is in keeping with the OECD consensus and can therefore be considered to be compatible with Articles 92 and 93 of the EC Treaty.

Measures which do not constitute aid

The discharge of possible environmental liabilities originating before 1 January 1990 (DM 12,2 million) is considered not to be aid under the Treuhand arrangements because neither the companies nor their buyers can be held responsible for pollution which is entirely due to the former political system (N 108/91, E 15/92, N 768/94). Job creation measures under § 249h of the German law for the improvement of working conditions (*Arbeitsförderungsgesetz*, DM 16,8 million), which apply to employment in the social and environmental fields and to young people in the former GDR, are not deemed to constitute assisted measures within the meaning of Article 92 (1) of the EC Treaty or Article 61 (1) of the EEA Agreement (NN 117/92).

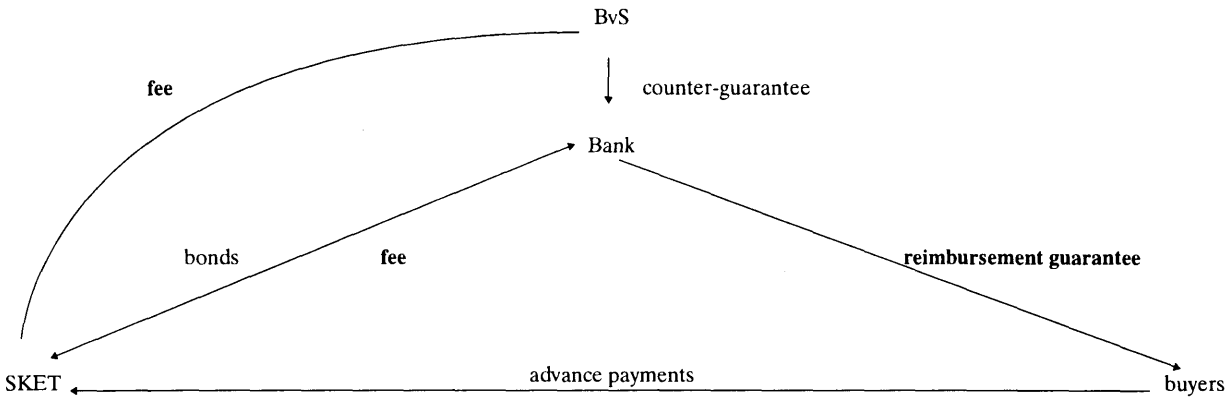
The German authorities take the view that the conversion of old loans dating from before 1 January 1990 into new loans (DM 22,8 million, interest free, without any deadline for reimbursement) and their subsequent discharge does not constitute aid. Under the Treuhand arrangements the discharge of such debt is not deemed to be aid since there is no advantage to the beneficiary (N 108/91). Effectively, the decision about the discharge of old loans has been deferred for a year. It can be argued here that a late discharge of old loans following their conversion in the balance sheet cannot be viewed differently since the effect on equity is the same.

SKET SMM awarded to laid-off personnel redundancy allowances of DM 43,8 million under the German Employees' Representation Act (§ 111 *Betriebsverfassungsgesetz*). This was financed by the BvS, since SKET SMM remained in its ownership until bankruptcy. The allowances were awarded under a redundancy programme which provided for a reduction in personnel between 1994 and 1995 from 3 180 to approximately 2 000 employees. SKET SMM had taken over most of the employees from the former combine, which originally employed 30 000 and at the time of German unification some 19 500. A major aspect of the downsizing of the former combine, next to land and production capacities, was the reduction of the extreme overmanning. The payment of redundancy allowances to lay off surplus staff stemming directly from the initial over-staffing of companies characteristic of planned-economy enterprises is comparable to the burdening of the company with old debts before unification. Relieving the company of the burden of the related costs confers on it no advantage which outweighs the disadvantage of the inherited burden. The granting of loans worth DM 43,8 million in order to lay off such personnel can accordingly be deemed not to be aid within the meaning of Article 92 (1) of the EC Treaty.

Aid within the meaning of Article 92 (1) of the EC Treaty

Counter-guarantees for performance and advance payment bonds

The BvS gave SKET SMM counter-guarantees for performance and advance payment bonds to cover a maximum risk of DM 180 million. Neither the bonds nor the counter-guarantees have been called. The highest amount of advance payments secured was DM 61 million. SKET SMM paid a counter-guarantee fee of 0,25 % a year to the BvS on the maximum risk plus a one-off fee of 0,5 % to the bank on the maximum risk for the bonds.



A counter-guarantee, like a guarantee, constitutes aid if it is provided on other than normal market terms and hence places the beneficiary at an advantage.

Advance payment and performance bank bonds are customary in industrial plant construction owing to the large sums needed to carry out orders. Both types of guarantee and the counter-guarantee are strictly tied to the individual orders (contracts). The customer has to make a considerable up-front payment to enable the supplier to execute the contract, that is to buy the necessary raw materials. At the same time, he needs to be assured of speedy reimbursement of this sum should it not be possible to execute the order properly. Such a guarantee is provided, not by the manufacturer, but by a bank which pays on first call by the customer. The bank obtains from the manufacturer a fee and a lien on the ordered goods. Smaller companies whose capital resources are too limited to be recognized by banks as security for the unconditional execution of a contract are usually provided with a counter-guarantee by their parent company.

SKET SMM was provided with a counter-guarantee to secure its contracts. The bank had obviously asked for a counter-guarantee because it considered that, in view of its poor liquidity situation, SKET SMM could not provide the necessary assurances that contracts would be carried out come what may. Consequently, the BvS — as SKET SMM's parent or holding company — was asked to provide a counter-guarantee.

This kind of risk-covering is not unusual in the sector concerned and is not confined to SKET SMM. Such reinsurance does not in itself constitute State aid unless it is granted on other than normal market terms.

The answer to the question whether the counter-guarantee was provided on normal market terms depends on the following two factors:

— SKETT SMM's financial situation at the time of the provision,

— the amount which a company like SKET SMM would have to pay for such a counter-guarantee.

The amount to be paid for such a counter-guarantee depends on the financial situation of the beneficiary, that is on the probability of default, comparable to the assumption of the lending risk by a guarantor.

In the Commission's experience, a company in a financial position comparable to that of SKET SMM in the industrial plant construction sector would have to pay approximately 3 % a year in order to obtain such guarantees on the open market. Consequently, the counter-guarantees provided by the BvS in favour of SKET SMM at an interest rate of 0,25 % a year on the maximum amount were not provided on normal market terms and therefore conferred a financial advantage on the company.

In view of the above, the provision of the counter-guarantees for performance and advance payment bonds at an interest rate of 0,25 % a year instead of 3 % a year must be regarded as aid [1], the aid element of which has to be defined by a cash grant equivalent.

The cash grant equivalent of the counter-guarantee has to be determined as in the case of a loan guarantee [2], that is once the premiums paid have been deducted, the interest subsidy representing the difference between the reference interest rate (3 %) and the rate obtained thanks to the State guarantee (0,25 %).

Waiver of debt

Between 1990 and 1992 the THA granted the then SKET AG a DM 90 million liquidity loan (subsequently reduced by DM 1 million) and guarantees worth DM 223,7 million. On 30 June 1993 the Commission decided (NN 46/93) that the prolongation of guarantees worth DM 201,7 million and the loan of DM 89 million (total of DM

[1] See also Commission Decision N 107/96 on construction financing guarantees.
[2] See the Commission notice on the *de minimis* rule for State aid, OJ C 68, 6. 3. 1996, p. 9.

290,7 million) were compatible with Articles 92 and 93 of the EC Treaty. A liquidity loan of DM 69,9 million and an investment loan of DM 67 million were also granted in 1993, which the Commission likewise exempted under Article 92 (3) of the EC Treaty (NN 95/93).

In 1994 all these measures were prolonged for one year and in 1995 they were waived as debt (including interest) in order to create equity (DM 361,7 million). The conversion of guarantees into loans (DM 201,7 million) and vice versa (DM 67 million, see below) was effected by the changing of positions between the BvS and the banks.

Part of SKET's debt was decreased by a land sale: land of SKET SMM which was not necessary to its operations was re-transferred to the BvS for the nominal book value (DM 174,3 million). This value was determined in accordance with the law for the transformation of State-owned companies into private limited companies (§§ 9 and 10 *DM-Eröffnungsbilanzgesetz*). Since SKET SMM was not paid a particularly preferential price, the debt clearance effected by this sale does not confer any additional advantage on the company.

A further debt of DM 80,3 million was waived in 1995 to cover losses incurred in 1994. The investment loan of DM 67 million (which was approved under the second Commission decision on SKET SMM) was converted into an investment guarantee in 1994. That same year the investment guarantee was increased to cover bank loans worth an additional DM 23,6 million (to a maximum of DM 90,3 million). In 1995 the guarantee was reduced and converted into a bank loan of DM 31,8 million. This loan was waived by BvS in favour of SKET SMM that same year. In determining whether this constitutes State aid, account must be taken of the fact that the granting of the DM 67 million was authorized by the second Commission decision on SKET SMM (NN 95/93). The increased — and hence newly granted — amount of DM 23,6 million, at least, was waived in order to reduce the loan to DM 31,8 million. Consequently, it is the new loan of DM 31,8 million that was waived in 1995.

The new liquidity loans granted in 1994 (DM 65,6 million and DM 91,7 million, giving a total of DM 157,3 million) were waived in 1995 in order to keep the company operational. The former loan was granted in two instalments on the following terms: DM 40,6 million at a rate of 5,8 % a year from 1 December 1993 until 30 June 1995, thereafter interest free and unlimited in time; DM 25 million interest free and unlimited in time. The latter loan was likewise granted in two instalments: DM 54,7 million interest free from 1 November 1994 until 31 December 1995; DM 37 million at an annual rate of 5,45 % for November. It is clear from the liquidity and equity situation as described in the Commission's decision to extend the Article 93 (2) procedure and at V below that SKET SMM would not have been granted bank loans to cover operating expenses on market terms.

The waiver of old debt, the granting of which was authorized by the first two Commission decisions on SKET SMM, resulted, not in any new liquid resources being injected into the company, but in the company's liquidity being maintained until the end of 1995, when the privatization failed. These measures have to be regarded as pure subsidies. The first debt waiver was exempted under Article 92 (3). As already indicated in the decision on the Treuhand arrangements (N 108/91), it was to be expected that the loans and guarantees of the THA to East German firms would *de facto* become grants the longer the companies remained financially dependent on the THA. It is accordingly logical to consider that the conversion of loans into grants constitutes additional aid. It can now be concluded, however, that these measures are covered by the abovementioned earlier Commission decisions on SKET SMM, which regarded it as a company in difficulties.

The waiver of the abovementioned new debt contracted in 1994 and 1995, the granting of which is not covered by the earlier Commission decisions on SKET SMM, constitutes an outright subsidy and is therefore to be considered new aid. The nominal amount of the aid is DM 269,4 million.

Loans

The BvS granted SKET SMM a supplementary loan of DM 156,8 million to cover all losses in 1995. The amount was granted in five instalments: DM 62,2 million at 6,8 % (DM 29 million on 13 March 1995, DM 30 million on 24 March 1995, DM 3,2 million on 24 April 1995) and DM 94,6 million at 5,4 % (DM 31,9 million on 19 June 1995, DM 62,7 million on 14 January 1995). A repayment deadline was not fixed.

The further liquidity loans granted between the failure of the privatization and the bankruptcy amount to DM 95 million: DM 20 million was granted in 1995 at an interest rate of 6,5 % a year, DM 15 million at an interest rate of 4 % a year and the remaining DM 16 million interest free and for an unlimited period. In all, up to the time of the bankruptcy SKET SMM was granted loans amounting to DM 251,8 million.

Since a provision of loans on market terms to a company in a financial situation comparable to that of SKET SMM is highly unlikely and since it conferred on SKET SMM a considerable financial advantage which it would not have gained under market conditions, the provision of the loans totalling DM 251,8 million has to be regarded as aid.

Grants

The award of DM 80 million in grants to SKET SMM in 1996 was effected at a time when it was becoming increasingly clear that, owing to the lack of orders, the company would not achieve the planned turnover and that, in view of the existing debt burden and the threat of bankruptcy, the provision of further loans hardly served any purpose. The grants were not linked to any specific restructuring measures or projects but served to secure liquidity and avoid bankruptcy.

Overview of aid measures awarded in favour of SKET SMM from 1994 until 15 October 1996

(DM million)

Measures	
Guarantees	
counter-guarantees at an interest rate of 0,25 % p.a. instead of 3 % p.a.	[180]
Waiver of debt	
prolongation of guarantees 1992 and later transformation into an interest-bearing loan in 1994	290,7
prolongation of liquidity loan 1993 until 31 December 1994	69,9
waiver of debt in order to build equity (290,7 + 69,9 + 1,2)	[361,7]
waiver of debt in order to cover losses for 1994	80,3
waiver of investment loan 1995 ([67] – >90,3 – >31,8)	31,8
liquidity loan for 1994, waived in 1995	65,6
liquidity loan for second half of 1994, waived in 1995	91,7
Subtotal	269,4
Loans	
liquidity loan to cover losses for 1995	156,8
liquidity loan at end 1995	20
liquidity loans 1996	75
Subtotal	251,8
Grants	
grants 1996	80
Nominal amount of aid (1)	601,2

(1) The total does not include the amounts approved for SKET by Commission decisions in 1993 [in brackets].

Possible exemptions under Article 92 (2) and (3) of the EC Treaty

Unlawful aid

Since the measures taken by the BvS in favour of SKET SMM constituted aid within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement, they had to be notified to the Commission under Article 93 (3) of the EC Treaty. Parts of the aid were granted prior to notification and the totality was awarded without awaiting the Commission's final decision under the procedure. Consequently, the award was formally illegal.

In addition, the aid must be regarded as incompatible with the common market as none of the exceptions set out in Article 92 of the Treaty is applicable.

The features of the aid in the present case do not satisfy the requirements of Article 92 (2) (a) and (b) of the EC Treaty.

Nor are the measures covered by the exception in Article 92 (2) (c) of the EC Treaty. For Article 92 (2) (c) to apply to the aid granted to SKET SMM, one would need to adopt an extremely broad interpretation of the provision. In the Commission's opinion, Article 92 (2) (c) is not intended as a general exception to Article 92 (1) but is restricted to those exceptional cases where infrastructure deficits in the zonal border areas still need to be eliminated. The present measures do not fall within this category.

Furthermore, no information has been made available to the Commission enabling it to determine whether the criteria set out in Article 92 (2) (c) were fulfilled. In particular, the German Government has not submitted that the Magdeburg area is still affected by the division of Germany, that the economic disadvantages of the area were caused by that division, or that the aid granted to SKET SMM served to compensate for these disadvantages. According to the case-law of the Court of Justice of the European Communities [1], Member States which invoke this exception must provide all necessary information to the Commission to enable it to verify that the conditions set out in that provision are fulfilled.

With regard to the conditions for exemption set out in Article 92 (3) of the EC Treaty, SKET SMM was undoubtedly located in an area where there is serious underemployment or where the standard of living is abnormally low. At 16,5 %, the unemployment rate in Saxony-Anhalt is both the highest in Germany and considerably higher than the Community average of 10,8 %. Pursuant to Article 92 (3) (a), aid to promote the economic development of such areas may be considered compatible with the common market. In the present case, however, the aid clearly could not contribute to the promotion of the economic development of the area since it was used, not to create lasting investment and employment, but to keep an unprofitable company going.

Restructuring

Nor are the various horizontal Community guidelines on State aid to enterprises applicable in this case. In particular, neither the restructuring linked to the privatization contract nor the second restructuring plan fulfil the requirements of the Community guidelines on State aid for rescuing and restructuring firms in difficulty.

The privatization contract — the first restructuring plan (1994-95)

As is shown below, the privatization plan — as described in the Commission decision to initiate the procedure provided for in Article 93 (2) of the EC Treaty — did not restore the viability of SKET SMM. The aid also led to anti-competitive behaviour. In addition, the plan was not fully implemented and not all the conditions it contained were met.

The granting of the aid is to be regarded as incompatible with the common market pursuant to Article 92 (3) (c) of the EC Treaty. The waiving of debt and the granting of counter-guarantees were out of proportion to the expected benefits from the Community's point of view and paved the way for undue distortions of competition based on predatory pricing.

Under point 3.2 of the Community guidelines on State aid for rescuing and restructuring firms in difficulty, restructuring aid is admissible if there is a restructuring plan that fulfils the following requirements:

Restoration of viability

The privatization plan would not lead to the restoration of the long-term profitability and viability of SKET SMM within a reasonable time-scale on the basis of realistic assumptions.

The investor's plan was based on the assumption that, without major restructuring of costs (stable personnel costs, increase in already excessively high material costs), sales could be increased by nearly 35 % between 1994 (DM 282 million) and 1997 (DM 418 million).

(DM million)

Materials costs

1993	1994	1995 (plan)	1996 (plan)	1997 (plan)
180,5	211,4	191,5	200,6	206,6

Personnel costs

1993	1994	1995 (plan)	1996 (plan)	1997 (plan)
135,8	135	137	136,1	136,1

[1] Case C-364/90 Italy v. Commission [1993] ECR I-2097, paragraph 20.

Annual turnover

1993	1994	1995 (plan)	1996 (plan)	1997 (plan)
266,3	282,4	331,8	364,7	418

Annual losses (DM 120 million in 1996) were to be reduced so dramatically that in 1997 a DM 7,4 million profit would be booked. Similarly, the negative cash flow of DM 101,6 million in 1996 would be reduced to minus DM 4,5 million in 1997.

(DM million)

Annual results

1993	1994	1995 (plan)	1996 (plan)	1997 (plan)
– 213,2	– 80,3	– 122,3	– 120,1	7,4

Cashflow

1994	1995 (plan)	1996 (plan)	1997 (plan)
– 156,6	– 168,9	– 101,6	– 4,5

The assumption of increasing sales under future operating conditions was questionable to say the least, even if unprofitable production was to be abandoned, due to dependence on the CIS market (high political and economic risk) and the modernization backlog. Even if such an outcome were feasible, the company was likely to require further injections of public money at the end of the restructuring period because the projected result would not have been sufficiently high given the heavy losses incurred the previous year. In the privatization contract itself it was assumed that, by the end of the restructuring period in 1998, SKET SMM would have accumulated heavy losses.

(DM million)

Planned loss cover by the BvS

1994	1995	1996
80,3	103,7	113,9

Avoidance of undue distortions of competition

As stated above, there is intra-Community trade in the mechanical engineering industry, and in particular in the rolling mill and wire-rod mill sectors, where SKET SMM is predominantly active. The granting of aid to a manufacturer may thus distort or threaten to distort intra-Community trade. Competition between Community producers in markets outside the Community may also be distorted by altering the respective competitive positions of the individual Community operators.

According to a recent study carried out for the Commission, the European mechanical engineering industry is in recession. Owing to market dominance by east Asian producers, the Community's share of the world market fell from 47 % in 1986 to 40 % in 1994. The industry is currently aiming for greater specialization. It can therefore be said that the EU market is currently showing a tendency towards overcapacity.

Although the German authorities and the company challenge claims of low pricing, the Commission's independent expert came to the conclusion that in 1995 SKET SMM sold rolling mills at considerably below variable cost in three cases. Two of these cases involved orders from Asia (Jian Yin/China, Yu Din/Taiwan) and one concerned an order placed by a German customer (Freital/Saxony), the first two orders being the subject-matter of the first complaint to the Commission by the Italian competitor. These led to heavy losses that year (DM 106,4 million, compared to earnings of DM 55,8 million from these orders). The losses were clearly covered by the BvS (additional liquidity loan of DM 156,8 million to cover losses in 1995). Consequently, State aid was misused in order to acquire through aggressive, anti-competitive behaviour only part of the orders that were needed in order to fulfil the basic assumptions underlying the privatization plan. The granting of the aid was not a precondition for the anti-competitive behaviour, but it enabled SKET SMM to engage in low pricing.

Implementation of the restructuring plan

In the end, the company did not fully implement the restructuring plan submitted to the Commission, as described in the decision to extend the Article 93 (2) procedure. The investor pulled out in January 1996 after

SKET SMM's operating results had badly deteriorated owing, among other things, to the marked reduction in orders.

Ultimately, the first restructuring plan could not lead to the restoration of SKET SMM's viability. The plan failed and was not sufficiently far-reaching to justify the granting of aid under the abovementioned Community guidelines for restructuring firms in difficulty. A second restructuring plan was then proposed.

The second restructuring plan (1996-98)

As indicated in the Commission decision to extend the Article 93 (2) procedure, not only would SKET SMM's profitability not have been restored by this restructuring plan either, but the aid was out of proportion to the costs and benefits of the restructuring. Furthermore, the restructuring plan was again not fully implemented.

Restoration of viability

As was borne out by the independent expert appointed by the Commission, the restructuring plan would not have led to the restoration of the long-term profitability and viability of SKET SMM within a reasonable time-scale on the basis of realistic assumptions. As stated in the decision to extend the Article 93 (2) procedure, the restructuring plan was partly based on assumptions which, in the opinion of the Commission's independent expert, were unrealistic given the company's future operating conditions.

A sharp reduction in personnel and material costs (DM 76,4 million and DM 54 million respectively) was planned, but was not to come into effect until 1996.

(DM million)

Planned materials costs

1996	1997	1998
170,2	166,7	159,4

Planned personnel costs

1996	1997	1998
135,6	103,4	91,4

At the time of the expert's appraisal, the legal conditions for the laying-off of workers were not yet met and the measures to reduce materials costs had still to be finalized. In view of the situation with regard to orders and the estimated losses for 1996 (DM 191 million), there were sufficient grounds for entertaining considerable doubts both as to the implementation of the restructuring plan up until 1998 and as to the estimated liquidity requirements for 1996. In particular, at the time of the appraisal (June 1996) SKET SMM's employees were nearly all working short-time because of the lack of orders. In particular, owing to the company's dependence on the new CIS markets, it was highly questionable whether it would achieve the planned turnover target of DM 221 million in 1996.

(DM million)

Planned annual turnover

1996	1997	1998
221	283,5	283,5

According to the appraisal, the success of SKET SMM depended entirely on whether it won any orders. But even if it did so and approached break-even by 1998, its credit rating would in all probability still have been so low that further guarantees, that is additional aid, would probably have been necessary. The restructuring plan itself forecast a loss of DM 500 000 for 1998. The plans make no earnings forecasts beyond that date.

(DM million)

Planned annual results

1996	1997	1998
– 191,8	– 54,3	– 0,5

Furthermore, it was clear that SKET SMM would have to be restructured by 1998 even without any privatization. Even in the event of a subsequent privatization, aid could therefore not be ruled out in advance.

Under the circumstances, a probably unavoidable slight change of plan or even of schedule would have brought about a situation which would demand further aid. The restructuring plan could not therefore be considered capable of enabling SKET SMM to cover all its costs and generate a minimum return on the capital invested with the result that, upon completion of the restructuring measures, the company would no longer have been dependent on State support and would have been able to compete in the marketplace on its own. The viability criterion set out in the guidelines would therefore not be satisfied.

Proportionality in relation to restructuring costs and benefits

Besides the abovementioned distortive effects on competition due to the granting of aid to a market player in an industry suffering from excess capacity, the amount of aid earmarked and granted under the privatization plan was

not related to any expected benefit from the Community's point of view since the expenditure was exceedingly high in relation to the strong likelihood that the restructuring would not be successful under the prevailing circumstances.

(DM million)

Intended restructuring measures	
Rationalization	
Investment	58
Personnel reduction (redundancy allowances)	24
Financial restructuring	
Liquidity and loss cover	246,6
Counter-guarantees at an interest rate of 0,25 % a year	180
Total	508,6

Intended aid measures of the BvS	
Investment	58
Liquidity and loss cover	246,6
Counter-guarantees at an interest rate of 0,25 % a year	180
Total	484,6

The notified aid represents 95 % of the total restructuring costs and there is no planned private investor involvement. Instead, the restructuring was intended to prepare the ground for a (second) privatization at a later stage, for which more aid would undoubtedly be required.

Implementation of the restructuring plan

In the end, the company did not fully implement the restructuring plan that was submitted to the Commission. At the time of evaluation of the plan by the Commission's expert (June 1996), the planned turnover for 1996 had decreased by DM 75 million. The company had planned on winning new orders worth DM 143 million that year, but the forecast was for only DM 78 million, of which no more than DM 30 million had by that time actually been contractually secured.

In the autumn of 1996 the management of SKET SMM proposed to the supervisory board a third restructuring plan which provided for a substantial reduction in both capacity and personnel. The employee representatives on the supervisory board rejected the plan and the management filed for bankruptcy on 15 October 1996.

In the light of all the facts set out above, the Commission has come to the conclusion that the following measures granted by the BvS are to be regarded as aid to which none of the exceptions laid down in Article 92 (3) of the EC Treaty apply:

(DM million)

Measures	
Guarantees	
Counter-guarantees at an interest rate of 0,25 % a year instead of 3 % a year	[180]
Waiver of debt	
Waiver of debt in order to cover losses for 1994	80,3
Waiver of investment loan	31,8
Liquidity loan for 1994, waived in 1995	65,6
Liquidity loan for second half of 1994, waived in 1995	91,7
Subtotal	269,4
Loans	
Liquidity loan to cover losses for 1995	156,8
Liquidity loan at end 1995	20
Liquidity loans 1996	75
Subtotal	251,8
Grants	
Grants 1996	80
Nominal total (1)	601,2

(1) The total excludes the nominal maximum counter-guaranteed bank credits. *The difference between the interest rate actually paid for the counter-guarantees (0,25 %) on the maximum amount of the bank credits (DM 180 million) and the market interest rate (3 %) less the amount of any premium paid constitutes the aid element to be calculated by the Member State under this Decision.*

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). As this is the case with the measures in favour of SKET SMM which are the subject-matter of the present Decision, the aid must be recovered. This assessment of the situation is not altered by the fact that SKET SMM has since filed for bankruptcy and is no longer present on the market. The recovery is intended to compensate for the lasting effects on competition resulting from the granting of the aid. The recovery of the aid is not impossible since SKET SMM's assets will be sold and creditors will be satisfied out of the proceeds of the sale.

The recovery of the aid is subject to German law, including the provisions on interest due for late payment of amounts owing to the State, such interest being payable at the normal market reference rate from the date of the grant of the aid (2). In particular, the recovery claim must not be treated less favourably than claims resulting from acts of national public authorities.

In accordance with the case-law of the Court of Justice, the relevant provisions must 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 cannot have any influence on its lawfulness (3),

HAS ADOPTED THIS DECISION:

Article 1

The following aid granted by the Treuhandanstalt and its successor, the Bundesanstalt für vereinigungsbedingte Sonderaufgaben, to SKET SMM is unlawful inasmuch as Germany failed to comply with its obligation under Article 93 (3) of the EC Treaty to inform thereof the Commission in good time:

(a) the provision of counter-guarantees at an interest rate of 0,25 % a year instead of 3 % a year, taking into account any premiums paid;

(b) the waiver of DM 80,3 million of debt in order to cover losses for 1994;

(c) the waiver of an investment loan of DM 31,8 million in 1995;

(d) the waiver of a liquidity loan of DM 65,6 million for 1994;

(e) the waiver of a second liquidity loan for 1994 of DM 91,7 million;

(f) a liquidity loan of DM 156,8 million to cover losses for 1995;

(g) a liquidity loan of DM 20 million granted at the end of 1995;

(h) liquidity loans of DM 75 million granted in 1996;

(i) grants totalling DM 80 million awarded in 1996.

The aid is incompatible with the common market within the meaning of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement and is covered by none of the provisions for exceptions and exemptions in Article 92 (2) and (3) of the EC Treaty and Article 61 (2) and (3) of the EEA Agreement.

Article 2

Germany is required to recover in full the aid referred to in Article 1 within two months of the date of notification of this Decision. The amount to be repaid shall bear interest from the date on which the aid was granted, in accordance with the provisions on the payment of interest on arrears in the case of liabilities to the State, at the rate applied in calculating the net grant equivalent of regional aid in the Federal Republic of Germany.

Repayment shall be made in accordance with the procedures and provisions of German law. The claim for repayment shall not be treated less favourably than claims resulting from acts of the German authorities. The present provisions are to be applied in such a way that the repayment required by the Community is not rendered impossible. Any procedural or other difficulties in regard to the implementation of the measure shall not have any influence on its lawfulness.

Article 3

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

(1) Commission communications in OJ C 318, 24. 11. 1983, p. 3, and OJ C 156, 27. 6. 1995, p. 5. See also Case 70/72 Commission v. Germany [1973] ECR 813 and Case 310/85 Deufil v. Commission [1987] ECR 901.
(2) Commission letter to the Member States SG(91) D/4577 of 4 March 1991 and Case C-142/87 Belgium v. Commission [1990] ECR I-959.
(3) Belgium v. Commission, see above, paragraphs 58-63.

Article 4

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 26 June 1997.

For the Commission
Karel VAN MIERT
Member of the Commission