II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 16 September 1998

authorising, subject to condition, aid granted by Italy to Italstrade SpA

(notified under document number C (1998) 2859)

(Only the Italian text is authentic)

(Text with EEA relevance)

(1999/269/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 on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having given notice to the parties concerned to submit their comments [1], in accordance with the aforementioned provisions,

I

Italstrade SpA ('Italstrade') is a company operating in engineering and civil infrastructure construction (roads, railways, etc.); it was previously wholly controlled by Iritecna SpA ('Iritecna'), a wholly owned subsidiary of IRI SpA ('IRI'), which was itself wholly controlled by the Italian Treasury. In 1993 IRI decided, in the context of restructuring its engineering and constructions,

— to put Iritecna into liquidation at a total cost of ITL 4 490 billion (ECU 2,3 billion, and

— to set up a subholding company, Fintecna SpA ('Fintecna'), which was to privatise Iritecna's profitable businesses.

Italstrade, despite heavy losses recorded in the period from 1992 to 1994 was initially transferred to Iritecna to be disposed of. Subsequently, it was considered potentially attractive to private investors, largely because of the size of its order book; the main items in the order book derived from its membership of the Iricav 1 and Iricav 2 consortia, the contractors for the Rome-Naples and Verona-Venice stretches of the projected Italian high-speed rail network. Accordingly the entire share capital in the company was transferred to Fintecna with a view to privatisation.

In the period from 1991 to 1994, the company recorded losses totalling ITL 267 billion (ECU 137 million). Its gross profit margin fell from 9 % of turnover in 1991 to 15 % of turnover in 1994. In this

[1] OJ C 328, 30.10.1997, p. 3.

period Iritecna had to intervene frequently with financial support (capital injections and writing-off debts) amounting in all to ITL 450 billion (ECU 231 million).

The restructuring undertaken by the company (reduction in its work force from 1 447 to 866, writing down the value of work in hand, etc.) together with the prospects generated by the resumption of work on the high-speed rail network, led Fintecna to believe that the company could be quickly privatised. The restructuring plan submitted to the Commission made express provision for placing the business's construction sectors, including Italstrade, on the market as early as 1995. At the end of 1994 an advisor was appointed to sound out the market for potential buyers.

By Decision 95/524/EC [1], the Commission declared that the aid granted to Iritecna and Fintecna in connection with the Iritecna liquidation was compatible with the common market. It also authorised Iritecna to cover Italstrade's losses up to 31 December 1994, which amounted to ITL 450 billion (ECU 231 million).

Article 1 of the Decision required compliance with the restructuring plan approved by the Commission, which among other things called for the privatisation of Fintecna's subsidiaries, including Italstrade, within a reasonable time limit and without further State aid.

After the Decision was adopted, however, the Italian Government informed the Commission that the sale of the company had been suspended in order to allow time for an assessment of the legal implications of guarantees given by IRI in connection with the high-speed rail network.

When that assessment was completed, the procedure for the sale of the company was set in motion once again in November 1995, the objective now being to sell off a minority holding: the whole of the capital was to be sold only when IRI had discharged the guarantees for the work on the high-speed rail network.

In the meantime Italstrade continued to record substantial losses: these went from ITL 15 billion (ECU 8 million) in 1995 (including revaluations of over ITL 16 billion) to ITL 96 billion (ECU 49 million) in 1996.

In order to replenish Italstrade's share capital, which had been eroded by its losses, Fintecna was obliged to provide fresh funding totalling ITL 126 billion (ECU 64 million) in the period 1996 to 1997.

On 24 June 1997, in response to requests from the Commission, the Italian authorities informed it of the measures taken to replenish Italstrade's share capital and reported that negotiations for the sale of the company had resumed. The Italian authorities took the view that Fintecna's funding of Italstrade must be considered a duty (*atto dovuto*) within the meaning of the Civil Code, as Italstrade would otherwise have had to be put into liquidation.

Finally, in March 1997 Fintecna sold 49 % of the capital in Italstrade to a private investor, Astaldi SpA ('Astaldi'); the contract of sale includes the following clauses:

— Astaldi gives Fintecna the option to buy the remaining shares at a predetermined price, the option being valid from January 1999 until six months after the expiry of IRI's guarantees on the work on the high-speed rail network or, in the event of early discharge by IRI itself, until 30 June 1999,

— the selling price is based on an overall valuation of Italstrade amounting to ITL 30 billion (ECU 15 million),

— Fintecna must replenish Italstrade's share capital to bring it to ITL 30 billion at the time of the transfer.

In April and August 1997, in order to comply with the clause requiring it to replenish Italstrade's share capital, Fintecna provided further funding of ITL 27 billion (ECU 14 million).

The Commission now decided to initiate the procedure pursuant to Article 93(2) of the Treaty in respect of the fresh capital contributed in the years from 1995 to 1997, the unsatisfactory restructuring measures taken, and the terms of the privatisation of the company, which appeared to conflict with the conditions laid down in the Decision in 1995. It informed the Italian Government of its decision to initiate proceedings by letter of 1 August 1997 [2].

[1] OJ L 300, 13.12.1995, p. 23.

[2] OJ C 328, 30.10.1997, p. 3.

The Italian Government submitted formal observations in a letter of 20 October 1997.

No other Member State or interested party submitted observations within the time allowed. By letter of 30 January 1998 the Commission requested more information from the Italian authorities. That information was supplied in a letter of 6 March 1998. Lastly, on 5 May the Commission received a copy of the company's balance sheet for 1997 and its industrial plan for the period 1998 to 2000.

The information furnished by the Italian authorities showed that on 31 December 1997 Fintecna provided Italstrade with a further capital injection amounting to ITL 52 billion as an adjustment for the purchaser following further falls in the value of Italstrade's assets. With this injection, the total funding provided by Fintecna to Italstrade after 1994 was brought to ITL 178 billion (ECU 91 million).

II

In its observations presented on the initiation of the procedure, the Italian Government argues:

(i) that the Decision makes provision for injections of fresh capital into Italstrade;

(ii) that Fintecna provided the fresh capital out of its own resources and acted as a private investor would have done, so that the funding does not constitute State aid; and

(iii) that there has been no infringement of the conditions imposed by the Decision.

The Italian Government further argues that, even if the measures referred to are to be considered State aid, they should in any event be declared compatible with the common market pursuant to Article 92(3) of the Treaty.

First (point (i)), the Government contends that at the time of the Decision the Commission was already aware of the need for further funding for the company in order to allow privatisation to take place and that it was informed in good time of each of the recapitalisation operations at Italstrade and of the progress of the sale of the company.

The restructuring plan approved in the Decision provided that sound businesses, and those that could be returned to a sound footing, were to be transferred to Fintecna with a view to privatisation. The Government argues, therefore, that the Decision allowed for the need to finance a measure of restructuring, particularly in the construction industry, which is the industry in which Italstrade operates.

After the Decision, the Government contends, both Fintecna and its parent IRI kept the Commission regularly informed of the progress of the privatisation process. At a meeting in Rome in June 1997, for example, IRI and Fintecna supplied all the information needed for an assessment of the facts at issue in the present Article 93(2) proceedings.

Secondly (point (ii)), the Government argues that Fintecna helped Italstrade using resources generated by Fintecna's own activities, without any contribution on the part of the State, and that Fintecna acted in accordance with the private investor principle, so that its action cannot be considered State aid.

The Government states that Fintecna compared the cost of putting Italstrade into liquidation with the cost of recapitalising and privatising it. Where the foreseeable cost of a liquidation exceeds that of recapitalisation and sale of the company, the Government argues, there is no State aid caught by Article 92(1).

The Government states in particular that Fintecna estimated the cost of putting Italstrade into liquidation at ITL 535 billion, if the company were wound up in an orderly fashion, and at ITL 1 500 billion, if it were wound up in free fall. Fintecna concluded that it would be preferable to recapitalise Italstrade and to keep it in operation pending privatisation. With that end in view, Fintecna behaved as a private investor would have done, and the funds it injected into Italstrade do not constitute State aid.

Thirdly (point (iii)), the Government maintains that it has complied with all the conditions imposed by the Decision, with particular reference to the total cost of restructuring, the commitment to restructure the group, and the privatisation of Italstrade.

On the total cost of the plan approved by the Commission, the Government points out that the Decision authorised a total of ITL 4 490 billion in aid, ITL 1 090 billion being money already given to

subsidiaries, including Italstrade, in the period 1991 to 1993, and ITL 3 400 billion being the estimated cost of putting Iritecna into liquidation, after deduction of ITL 1 653 billion in proceeds from sales by Fintecna.

As things stand at present, the Italian authorities expect that the final cost will be less than the maximum just mentioned, despite the lower returns on the sale of Italstrade: the Decision has thus been complied with.

Turning to the restructuring operations provided for in the Decision, the Government argues that the action taken does in reality comply with the plan approved by the Commission. As regards the reduction in the workforce (and thus indirectly in production capacity), the forecast figures which the Commission cites in the decision initiating the proceedings refer to the active workforce on open-ended contracts, while the figures taken from the annual reports include other staff, such as those on fixed-term contracts and those laid off under the Cassa Integrazione Guadagni wage compensation scheme.

The Government argues that the decline in Italstrade's performance as compared with the forecasts in the plan (net profits of ITL 24 billion in 1995 and ITL 26 billion in 1996) was due to worsening market conditions, and not to a failure to restructure the company.

The Government contends that the results obtained by Italstrade in 1995 and 1996 cannot be compared directly with the restructuring plan which the Commission approved in the Decision. The failure to achieve the turnover called for in the plan caused a reduction of ITL 170 billion in Italstrade's gross margin over the two years. A number of non-operational items amounting to ITL 99 billion have to be added to that negative effect, items which were not foreseeable at the time the plan was drawn up; once this has been done, it can be seen that the restructuring effort provided for has actually been exceeded.

On the obligation to privatise laid down in the Decision, the Government points out:

— that the same question is pending before the Court of First Instance of the European Communities,

— that in any event Fintecna complied with the condition, having sold Italstrade within a 'reasonable time limit' as required by the Decision.

In its decision initiating the procedure, the Commission argued that on the basis of the information at its disposal the sale of Italstrade could not be considered a genuine privatisation: out of the shares in its possession Fintecna had sold only 49 % and had kept the remaining 51 %.

The Government argues that the privatisation of Italstrade must be considered genuine and definitive. The sale of 49 % is linked to specific contractual clauses which make the sale of the remaining 51 % inevitable. The decision to sell the company in two instalments is due to the presence of a contractual clause in the agreement between the high-speed rail company TAV SpA ('TAV') and the Iricav consortium, of which Italstrade is a member. The consortium has won the contracts awarded by TAV for the building of the Rome-Naples stretch of the high-speed rail network. The clause requires IRI to preserve its 'majority participation' in the consortium until the work is completed.

According to the Government, that clause could be cancelled by agreement between the Iricav consortium and TAV. In that event the contract for the sale of Italstrade would already entitle Fintecna to sell the remainder of its holding.

In support of its claim that the sale of Italstrade has to be considered definitive, the Government cites two other points:

— the fact that the Italian competition authority, the Autorità Garante della Concorrenza e del Mercato, found in the course of its own inquiry that, although the sale related to only 49 % of the capital, it nevertheless directly transferred managerial responsibility to the purchaser,

— the fact that the auditors certifying Italstrade's accounts intended to exclude the company's 1997 results from Fintecna's consolidated accounts on the grounds that there was no effective control.

The Decision also required that the privatisation of Italstrade be carried out without further aid. The Government maintains that the financing that Fintecna gave to Italstrade after 1994, amounting to some ITL

178 billion (about ECU 91 million) , should not be considered State aid within the meaning of Article 92, on the grounds explained with reference to point (ii). Alternatively, any aid should be considered compatible with the common market because:

— the funds were provided in connection with a restructuring plan aimed at restoring the company to profitability, as is confirmed by its privatisation,

— the funds were limited to what was strictly necessary to ensure that Italstrade returned to market viability.

III

In the light of what has been said, it will first have to be determined whether or not the measures described infringe the conditions laid down in the Decision. If they do, the question of the compatibility of the aid given to Italstrade up to 1994, which was approved in that Decision, will have to be reconsidered. In order to determine whether the conditions laid down in Article 1(4) and (5) of the Decision have been complied with, it will also have to be established whether the funds given to Italstrade after 1994 constitute State aid caught by Article 92 of the Treaty, and, if more State aid has in fact been granted, whether the measures taken as a whole are compatible with the common market.

As has been explained, the Decision found that the aid granted to Italstrade up to 1994 (ITL 450 billion or ECU 231 million) was compatible with the common market subject to a series of conditions, including the following:

(i) Italstrade was to carry out the measures called for in the restructuring plan approved by the Commission;

(ii) Fintecna and its subsidiaries, including Italstrade, were to be privatised in accordance with the time-scale submitted to the Commission, and in any case within a reasonable time limit;

(iii) the income from the sale of companies was not to be used to assist companies in difficulty which had not yet been sold;

(iv) no further State aid was to be granted in connection with the privatisations,

(i) the obligation to carry out the restructuring measures called for in the plan.

In the decision initiating the procedure, the Commission argued that the reorganisation of Italstrade called for by the restructuring plan had not been completed. In particular, it observed that:

— the number of employees on open-ended contracts in 1994 was 866 (a figure reduced to 793 in 1995) and thus exceeded the total for the construction sector laid down in the restructuring plan,

— this increase in staff coincided with a very unfavourable economic situation, while the company incurred losses of ITL 15 billion in 1995 and ITL 96 billion in 1996.

In its observations, the Italian Government contends that the figures used by the Commission include workers who are on the company's payroll but are not actually working, such as those laid off under the Cassa Integrazione Guadagni scheme. According to the Government, comparing comparable figures gives the following picture:

	1993	1994	1995	1996	1997
Staff provided for in restructuring plan (average)	1 003	759	550		609
Staff at end of year (as shown in personnel register)	854	645	680	642	543

NB: Figures for entire construction sector (Società Italiana per Condotte d'Acqua SpA and Italstrade).

According to the Italian Government, these figures show that the efficiency objective in the plan has been achieved.

To make a proper comparison, however, the figure that must be looked at is the average number of employees over the year (estimated on the basis of the arithmetic average of the end-of-year figures for two successive years):

	1993	1994	1995	1996	1997
Annual average staff (Commission estimate)	n.a.	750	663	661	592

It will be seen that only in 1994 was the real average figure in line with the restructuring plan; subsequently, in both 1995 and 1996, it easily exceeded the figure in the plan.

At the same time, and partly as a consequence, Italstrade's financial results were heavily negative, in contrast to what had been provided for in the plan. The plan anticipated a net profit of ITL 24 billion in 1995, when there was in fact a net loss of ITL 15 billion, and a net profit of ITL 26 billion in 1996, when there was in fact a net loss of ITL 96 billion. Only in 1997 did the company generate a net profit, of ITL 2 billion, but that was in fact accounted for by extraordinary items of income, in the form of funds amounting to ITL 66 billion largely injected by Fintecna.

It is not sufficient to say here, as the Italian Government does, that the worsening situation was due to an unforeseeable decline in the market. The plan provided that, beginning in 1995, the internal restructuring measures would enable Italstrade to achieve a gross industrial margin, before structural costs, equal to 7 % of turnover. In theory, that margin would have allowed the company to generate a profit of about ITL 12 billion in 1995 and ITL 13 billion in 1996, despite the fall in revenue that actually took place.

With an industrial margin of 7 % the Commission took the view that, even on a relatively pessimistic forecast of the market (which proved to be justified), the company would be able to maintain a substantial economic balance without resort to further capital injections. However, Italstrade's 1995 and 1996 industrial margins were negative and indeed in 1996 it made at net loss in excess of its corporate assets.

However, the years 1996 and 1997 were among the more difficult periods experienced by the construction industry in Italy (where Italstrade won over 60 % of its orders) and there was a significant fall in major contracts awarded (above all in the area of public procurement) and a drastic reduction in profit margins. Italstrade undertook a more stringent effort than that in the plan that had been approved in order to deal with the manifest deterioration in market conditions; it cut its operating costs and thereafter rationalised its organisational structure.

Italstrade's effort included reducing its structural costs more drastically than assumed in the restructuring plan approved by the Commission. As can be seen from Table 1, despite a deterioration in its gross margin as in 1995 and 1996, the company cut its structural costs from ITL 15 billion in 1995 (6 % below the cut envisaged in the plan) to ITL 13 billion in 1997 (35 % below the cut envisaged in the plan).

By dint of those restructuring measures, Italstrade maintained a gross margin of around 6 % of turnover although its income remained at a level 70 % below that anticipated in the plan. As a result of those restructuring measures the company was able to achieve a profit, albeit modest, for the first time in many years.

Table 1

Italstrade's financial results

(in ITL billion)

	1995 plan	1995 outturn	1996 plan	1996 outturn	1997 plan	1997 outturn
Net turnover	503	197	790	239	854	330
Gross margin	28	(10)	35	(2)	35	18
Structural costs	(16)	(15)	(19)	(16)	(20)	(13)
Operating loss	24	(15)	26	(96)	27	2

Source: Iltalstrade's annual accounts for 1995, 1996 and 1997 reclassified in the IRI note of 19 January 1998.

In fact, much of the company's net losses in the period resulted from writing down assets in line with the smaller margins which were all that could be generated on work in progress and work already completed.

Moreover, Italstrade's rationalisation measures were made even more stringent, particularly regarding central structural costs, than those prescribed in the plan presented to the Commission.

It can be concluded that the condition imposed by Article 1(2) of the Decision has been complied with, more especially in view of the action taken by the company to contend with a market less favourable than that anticipated in the restructuring plan.

(ii) The obligation to privatise Italstrade in accordance with the time-scale submitted or, in any case, within a reasonable time limit

One of the factors which was felt to justify the Decision was the Italian Government's undertaking to privatise Italstrade rapidly in accordance with the restructuring plan; on the basis of the information submitted it was considered in the Decision that privatisation would be possible in a very short time [1]. The intention to sell off Italstrade rapidly was a major factor in the assessment of the aid granted to Iritecna, among other things, in view of the enormous aid given to Iritecna's construction sector up to that time.

The Commission accepted that some restructuring of the construction sector was still going on at the time of the Decision but, in the light of the Iritecna plan, it expected that this 'should be completed by the end of 1995' [2], allowing the companies to be sold off. For this reason Article 1(3) and (5) of the Decision expressly required that Fintecna's subsidiaries be privatised in accordance with the time-scale submitted to the Commission or, in any event, within a reasonable time and that no further State aid be given.

But the procedure for the sale of the companies was suspended shortly after the Decision was adopted, and set in motion again only in November 1995. According to the Italian Government, this was because of the need to study the legal implications of the contractual guarantees given by IRI for the work on the high-speed rail network.

Only in March 1997 was a contract concluded for the sale to Astaldi of 49 % of the capital of Italstrade, being part of Fintecna's holding. When it initiated the present procedure, the Commission did not have sufficient information to establish whether the sale could be considered genuine and irreversible so as to satisfy requirements of the Decision. The Commission raised doubts regarding the following aspects in particular:

— the transfer from Fintecna to the buyer of power to appoint the management,

— the financial implications for Fintecna of any further losses by Italstrade,

— the terms of the transfer of the remaining 51 % of the capital,

— the possibility that the IRI guarantees in respect of the high-speed rail network contracts might have to be met.

In its reply the Italian Government has supplied sufficient information to dispel the doubts raised by the Commission.

As regards the transfer of managerial power, the buyer is given the responsibility for appointing the managing director (*amministratore delegato*), who has the power to manage the company subject to the authorisation of the board of directors (*consiglio di amministrazione*). The only restrictions relate to acts which might be damaging to Fintecna or IRI in connection with the work on the high-speed rail network. The board of directors itself is made up of seven members, three of them, including the managing director, being appointed by Astaldi, three by Fintecna, and the chairman by Astaldi, subject to Fintecna's agreement.

On the basis of this information it can be concluded that the buyer takes over from Fintecna full power to manage Italstrade.

Turning now to the possibility that Fintecna might have to meet future losses by Italstrade, the contract lays down that the shareholders are to meet any financial liabilities incurred by Italstrade in proportion to their holdings in the company's capital up to the transfer of the residual holding owned by Fintecna. Naturally, from that point Astaldi undertakes entire financial responsibility for Italstrade's results.

Under this arrangement Fintecna will be again under an obligation to inject public funds into Italstrade in the case of any further capital increase. However, under the terms of the contract, those capital increases will entail the joint participation of Fintecna and Astaldi in proportion to their holdings. Moreover, the presence of a private shareholder ensures that any investment in Italstrade will be made on the basis of the return expected on the funds injected; if Italstrade's prospects appear poor, a private investor will not provide further funding and will prefer to wind up the company.

However, it is possible that Italstrade will receive further public funds through Fintecna; those would

[1] See Part III, point 6.
[2] See Part IV, point 3.

nevertheless, be regarded as normal investments on market conditions in so far as they are provided with a significant (almost equal) contribution from a private investor: those funds cannot be considered State aid within the meaning of Article 92 of the Treaty.

When capital injections are provided, the Commission presumes that State aid is not involved where public funds are provided along with a similar investment by private shareholders [1].

In the present case, Fintecna and Astaldi will participate in any increase in Italstrade's capital on the sole basis of their holdings in the company. It may be assumed here that any capital Fintecna injects into Italstrade will be on terms acceptable to a private investor operating on normal market conditions.

Regarding the terms for the transfer of the remaining 51 % of Fintecna's capital to Astaldi, under the contract Fintecna is entitled to transfer its 51 % to Astaldi at the pre-determined price between 1 January 1999 and 30 June 1999 or until six months after the discharge by IRI of the guarantees for the high-speed rail network.

On the basis of the information provided by the Italian Government, there is manifestly no legal obligation on the parties to complete the transfer of Italstrade. Fintecna is merely entitled to transfer the remaining capital holding and only when it exercises that right is the other party obliged to complete the transaction. However, Fintecna may conceivably refrain form exercising its right: in that case the transfer of Italstrade would not be completed and the conditions laid down in the Decision would not have been complied with.

However, the Italian Government has given an undertaking that Fintecna will transfer the remaining holding in Italstrade on the contractual conditions, with particular reference to the deadlines for the exercise of the option itself. In view of that commitment Fintecna's remaining holding in Italstrade can be considered a temporary one only, serving merely to protect IRI with respect to the guarantees it gave in connection with the contracts for the high-speed rail network regarding the acquirer's possible failure to complete.

[1] See application of Articles 92 and 93 of the Treaty to public authorities' holdings in company capital, EC Bull. 9-1984, point 3.2.

Although Fintecna continues to hold 51 % of Italstrade, the condition laid down in Article 1(3) of the Decision has been complied with. The delays in the sale were due to circumstances beyond Fintecna's control (the contractual clause in respect of the work on the high-speed rail network); as far as was in its power, Fintecna acted with the objective of privatising Italstrade as rapidly as possible. That objective has been achieved, as explained above, by virtue of the clauses in the contract of sale and the commitment given by the Italian authorities that the transfer of the remaining holding will be completed as soon as possible.

Regarding the clauses concerning work on the high-speed rail network, the Commission notes that negotiations are taking place between IRI and TAV, the company which awarded the contract, with a view to removing the clause that requires IRI to continue holding an absolute majority of the capital in Italstrade. It notes that a positive outcome to those negotiations could speed up the formal transfer of the entire capital of Italstrade to Astaldi.

(iii) The prohibition on using the proceeds of the asset sales by Fintecna to assist companies in difficulty, and (iv) the prohibition on granting further State aid in connection with privatisations.

In order to decide whether Fintecna has complied with the conditions set out in Article 1(4) and (5) of the Decision, and in particular with the prohibition on the granting of further aid, it has to be established whether the funding Italstrade received after 1994 can be considered an investment on market lines or whether it constitutes State aid for the purposes of Article 92(1) of the Treaty.

When it has to determine whether the financial relations between a State and a public enterprise include a State aid component caught by Article 92, the Commission applies the private-investor test to the financial flows between them. In the present case this means considering whether the funds given to Italstrade were public resources and, if so, whether they would have been invested applying the private-investor test.

Under the Iritecna plan, Italstrade was transferred to Fintecna, a wholly owned subsidiary of IRI, an industrial holding company itself wholly owned by the Italian Treasury. The Italian Government appoints the board of directors of IRI, which in turn appoints the board of Fintecna.

According to the settled case law of the Court of Justice of the European Communities, in particular its judgment in Case C-305/89 Italy v. Commission [1], in order to establish whether an aid measure can be considered State aid within the meaning of Article 92 of the Treaty, 'no distinction should be drawn between cases where aid is granted directly by the State and cases where it is granted by public or private bodies established or appointed by the State'. So, even if the funds given to Italstrade did not come directly from the State, it may nevertheless be that they are public funds.

It is not enough to affirm here, as the Italian Government does in its observations, that the financial measures taken by Fintecna used resources generated by the operation of its own business and not obtained from the State. If Fintecna's operating cash flow is used for an unprofitable purpose, as it was in the case of Italstrade, that reduces the profit accruing to Fintecna's shareholder, IRI, and thus ultimately to the State. Fintecna might have used its own funds for activities with a better return, which would have enabled IRI, and consequently the State, to obtain a better economic return on its investment.

A smaller return on IRI's investment in Fintecna will ultimately be reflected in a loss of profit to the State so that, even though the funds given to Italstrade were not provided directly by the State, they can nevertheless be said to constitute State resources. In order to establish whether or not they are caught by the prohibition in Article 92(1), then, they have to be studied in the light of the private-investor principle [2].

According to that principle, a financial transaction between the State and a public undertaking contains a State aid component if it would not have been acceptable to a private investor operating under normal market economy conditions. In particular, the presence of State aid can be presumed 'where the financial position of the company, and particularly the structure and volume of its debt, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested' [3].

Accordingly, an analysis has to be made of Italstrade's financial position in the years before the increases in capital; this is shown in Table 2.

Table 2

Iltalstrade's financial results

(in ITL billion)

	1993	1994	1995	1996
Net turnover	n.a.	245,1	197,3	238,9
Gross margin	n.a.	(37,5)	18,9 [2]	(2,0)
Net profit (loss)	(183,0)	(19,3) [1]	(15,0) [2]	(96)
Net worth	n.a.	(30,0)	15,0	32,0

[1] After writing off debts of ITL 186 billion by Iritecna.
[2] Taking account of extraordinary items amounting to ITL 45,8 billion including ITL 22 billion relating to the sale of businesses to controlled companies and Iritecna.

Source: Italstrade's annual accounts.

The figures set out above show that Italstrade was not a profitable concern when Fintecna provided the funds. Fintecna provided further funding in 1996 although, given Italstrade's results, Fintecna could not reasonably expect any significant return on its investment.

It is not sufficient to invoke the fact that the costs of putting the company into liquidation would have been higher than those of the recapitalisations carried out. A private shareholder faced with declining market prospects and the impossibility of a return to viability would have put the company into liquidation well before 1996, and indeed before 1994, thus avoiding costly recapitalisations and substantially reducing the costs of the liquidation itself.

The financial resources given by Fintecna to Italstrade after 1994 therefore constitute State aid within the meaning of Article 92(1) if the Treaty. Thus the condition laid down in Article 1(5) of the Decision has not been complied with; consideration will accordingly have to be given not only to the compatibility of the fresh aid granted, but also to the compatibility of the aid received by Italstrade and approved in the Decision (ITL 450 billion).

In assessing compliance with the Decision, it is not enough to say that the total volume of aid approved has not been exceeded. Article 1(5) of the Decision expressly provided that the individual privatisation operations were not to be financed by further State aid. The purpose of this obligation was to reduce the distorting effect of the aid granted, and consequently, to ensure that any resources acquired as a result of the

[1] [1991] ECR I-1603, paragraph 13.
[2] Commission communication to the Member States on the application of Articles 92 and 93 of the EC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector, OJ C 307, 13.11.1993, p. 3, see Part III.
[3] Ibid., paragraph 16.

sell-offs were devoted to reducing the costs of putting the Iritecna/Fintecna group into liquidation.

In addition, given that the businesses likely to be most attractive to potential private investors had been transferred to Fintecna primarily with a view to sale, and only within limits with a view to restructuring, the Decision expressly prohibited further aid to those businesses.

In principle, when State-owned businesses are privatised it may be permissible to grant State aid for acquirers where the sale does not take place on market conditions or for the business where the contract of sale requires the acquirer of the business to carry on unprofitable segments which would have been discontinued by an investor operating on market conditions.

Regarding the sale of Italstrade to a private investor, that sale was carried through in compliance with the relevant Community rules. Both the 1994 procedure, which was subsequently abandoned, and the 1995 procedure, which terminated in the sale of the company to Astaldi, entailed public bids to buy the business. Thus about 20 investors were initially interested in the sale of Fintecna's civil engineering businesses. Of the 20, 13 submitted offers, of which three were placed on a short list. Only Astaldi submitted a binding offer and therefore it alone was admitted to the due diligence stage.

In the procedure followed by Fintecna all potential investors were placed on an equal footing in the sale and the best offer was chosen. That gave the Commission reason to conclude that the sale took place at the market price and thus that no aid was given to Astaldi in the acquisition of Italstrade.

Moreover the contract of sale does not contain any clauses specifically obliging the acquirer to continue any loss-making activities. In any case no element of aid for Italstrade can be discerned in the terms of sale.

On the basis that the aid granted to Italstrade after 1994 constitutes State aid within the meaning of Article 92(1) and, as a result the aid received by the company before 1994, which the Commission approved in the Decision, is in principle likewise unlawful, it has now to be considered whether all the grants of aid, taken as a whole, are compatible with the common market.

IV

Pursuant to Article 92(2) and (3) of the Treaty certain aid is, or may be considered, compatible with the common market.

Article 92(2), (3)(a) and (3)(b) of the Treaty cannot be applied to measures of the kind under consideration here. In view of the variety of Italstrade's activities and locations, and the fact that the aid does not have a regional objective, the only possible exemption is that provided for in Article 92(3)(c), which deals with aid to facilitate the development of certain economic activities. By its very nature, the aid in this case must be considered aid for the restructuring of firms in difficulty.

Regarding such aid, the Commission has published guidelines on State aid for rescuing and restructuring firms in difficulty [1]. In practice, if the Commission is to approve one-off measures to restructure a firm in difficulty, the following conditions must be satisfied:

(i) the measures must restore the long-term viability of the firm;

(ii) the measures must avoid undue distortion of competition;

(iii) the measures must be in proportion to the costs and benefits of restructuring and thus limited to the strict minimum needed;

(iv) the restructuring plan must be fully implemented;

(v) the implementation of the restructuring plan must be monitored and verified by the Commission.

Only if all of these tests are satisfied can the Commission take the view that the effects of the aid are not contrary to the Community interest and approve the aid pursuant to Article 92(3)(c).

As regards condition (i), the restoration of viability, the Italian authorities submitted a restructuring plan in the context of the Decision which was intended to restore Italstrade to profitability from 1995 onward. The aid granted to Italstrade up to 1994 (ITL 450

[1] OJ C 368, 23.12.1994, p. 12.

billion) was held to be compatible with specific regard to that plan and to the Community guidelines. But Italstrade did not achieve the financial results expected and so had to fall back on public assistance once again (receiving ITL 178 billion, as has been explained).

Italstrade's restructuring plan, which the Commission approved in the Decision, was based on prudent estimates of the future development of the company's order book. On 31 December 1992 that portfolio of work amounted to ITL 2 377 billion, of which more than ITL 558 billion related to contracts connected with the high-speed rail network. On the basis of the work schedule laid down by the company awarding the contracts, it was reasonable to expect Italstrade's turnover and financial results to develop as shown in Table 3.

Table 3

Forecast financial results of Italstrade

(in ITL billion)

	1995	1996	1997
Net turnover	503	790	854
Gross margin	28	35	35
Operating result	12	16	15
Net profit (loss)	24	26	27

Source: Iritecna's restructuring plan.

However, the difficulties of the Italian civil engineering sector proved to be more serious than expected and the contracts already secured for the high-speed rail network were delayed for reasons beyond the company's control. In fact, as is shown in Table 1, Italstrade's turnover was substantially lower than forecast:

— in 1995 it amounted to ITL 197 billion , or 39 % of the figure forecast,

— in 1996 it amounted to ITL 239 billion, or 30 % of the figure forecast.

In both those cases, as in 1994, Italstrade's actual turnover was about 50 % less than in 1992, a year in which the crisis in the industry in which Italstrade operates was already very serious. Indeed, the fall in Italstrade's turnover in the period in question was more severe than the downturn in the market as a whole. Faced with that crisis on the market around it, Italstrade reacted by taking further restructuring measures, more stringent than the terms of the plan.

In 1996 the company produced a new internal restructuring plan (see Table 4) with a view to returning the business to a stable level of profitability. The plan provided for a gradual resumption of operations, linked partly to work on the high-speed rail network but mainly based on measures to contain further structural costs below the provisions of the plan approved in the context of the Decision.

Table 4

Italstrade's industrial plan 1998 to 2000

(in ITL billion)

	1998	1999	2000
Net turnover	370	400	453
Gross margin	21	28,5	31
Structural costs	(15)	(15)	(16)
Operating loss	6	7,5	9,5

Source: Italstrade's 1998 to 2000 restructuring plan.

Structural costs are to be kept at 25 % below the level fixed in the plan in order to maintain sufficient profitability despite a turnover appreciably below what was originally anticipated.

Italstrade was to generate a net profit about 2 % of turnover in the period in spite of a production level of less than 50 % of the level fixed in the Iritecna plan for 1996. The company was able to do so by making further cuts in structural costs, through additional reductions in headquarters' staff and restructuring of operational processes.

The fact remains that, in 1996, Italstrade recorded a loss both in operating terms and in overall results; however, even in 1996 there were positive signs in the form of a reduction in operating losses indicating that the company was improving its own competitiveness. In 1997 those signs were confirmed both by a favourable gross margin and by net profits.

As a result of the company's restructuring, particularly in the period 1996 to 1997, in addition to the restructuring in the plan approved by the Commission Decision, Italstrade will be able to reach a satisfactory level of profitability despite the forecast deterioration in market conditions. Nevertheless, it must be kept in mind that long-term profitability is being attained through the crucial contribution of internal

rationalisations (reductions in capacity, etc.) rather than on the basis of favourable market prospects.

It can be considered that the first condition for approval of aid for restructuring is thus satisfied.

The Commission notes that the company has been transferred to a private shareholder, so that the State will not, under the contractual terms, be made financially liable for any losses that Italstrade may incur. The presence of a private controlling shareholder (see Part III(ii)) also provides a better assurance of Italstrade's prospects of profitability.

Condition (ii) is that the aid avoids undue distortion of competition. In principle, any aid granted by a State to a firm causes undue distortion of free competition since it leaves that firm in a more favourable economic situation than its competitors. This effect consequently has to be balanced by reductions in production capacity, especially in an industry such as construction, where there is substantial overcapacity.

In the present case the restructuring plan approved by the Commission in the Decision already provided for significant cuts in production capacity. The production capacity of a construction firm, both in terms of its ability to plan and design and in terms of its ability to implement its plans, is based mainly on its human resources; the significant reduction in the size of Italstrade's human resources base at the time of the Decision, along with the relevant decline in production, pointed clearly to a substantial fall in its market share. The Commission accordingly held that the aid given to Italstrade up to 31 December 1994 satisfied the tests for restructuring aid.

But Italstrade received further aid after the Decision, and it must therefore be asked whether these new resources have not affected trade between Member States in a manner contrary to the common interest; this would be the case if Italstrade had been put in a position to use the resources to finance trading practices enabling it to increase its own market share at the expense of competitors without State aid.

As has been explained, however, Italstrade reduced it staff and thus its production capacity in the period 1995 to 1997, and the reductions went beyond what was provided for in the plan.

The Commission took the view that the development of turnover provided for in the plan (see Table 3) would not affect trade to an extent contrary to the common interest. As it turned out, Italstrade's turnover in the period 1995 to 1997 was about 30 % of what was called for in the plan, and the pace of incoming orders was a great deal slower, as shown in Table 5.

Table 5

Italstrade's turnover and order book

(in ITL billion)

	1993	1994	1995	1996	1997
Net turnover	660	245	197	239	370
Order book	1 653	1 284	1 256	1 077	1 036
Including high-speed rail network	558	530	480	380	n.a.

Source: Italstrade's annual accounts.

It is clear form these figures that, as a result of its restructuring, Italstrade has been competing less and less on world markets. The pace of acquisition of orders foreseen in the restructuring plan approved in the Decision was largely equivalent to turnover in each of the years covered in the plan. That level of production and of orders was considered compatible with the common market in view of the significant restructuring already undertaken by the company.

Despite reducing turnover to about 70 % of the level anticipated in the plan, Italstrade reduced its order book by around 40 % of its level as at 31 December 1993, limiting its competitive activities on reference markets to levels significantly below those in the Iritecna plan. Accordingly, its ultimate competitive position will not affect trade to an extent contrary to the common interest.

Condition (iii) is that aid be in proportion to costs and benefits: if State aid is to be declared compatible, it must be limited to the strict minimum needed to finance the return to viability and must not be used to finance aggressive competitive practices, except to the extent necessary to restore the firm itself to profitability.

From the information supplied by the Italian Government it can be concluded that the funding

provided by Fintecna to Italstrade was needed to cover losses due mainly to the writing-down of assets and to the costs of reducing production capacity (staff cuts). During the delays in the sale of Italstrade, Fintecna financed further restructuring, going beyond what was laid down in the Iritecna plan, in order to cope with the unexpected worsening in market prospects.

The Commission takes the view, therefore, that the aid granted did not bring the company additional liquidity which was unrelated to the process of restructuring and might have helped to finance aggressive commercial or investment practices not necessary to the restructuring operation.

The Commission would also observe that Italstrade will not qualify for any tax credit in respect of the losses covered by the funds contributed by Fintecna.

Lastly, the recipient will make a significant contribution to the financing to the restructuring operation, as any further burdens are to be borne by both owners of holdings in the company in proportion to those holdings until the point when the remaining 51 % of the share capital is transferred.

The Italian Government should be required to submit periodic reports on the progress of privatisation and on the implementation of the restructuring plan drawn up for Italstrade,

HAS ADOPTED THIS DECISION:

Article 1

The aid of Italstrade, namely the capital injections granted in the years 1995 to 1997 totalling ITL 178 billion (ECU 78 million), and the aid granted up to 1994 already approved by the Commission amounting to a total of ITL 450 billion, constitute State aid within the meaning of Article 92(1) of the Treaty and Article 61(1) of the EEA Agreement.

The aid satisfies the tests laid down in the Community guidelines of 27 July 1994 on State aid for rescuing and restructuring firms in difficulty. It is consequently declared exempt pursuant to Article 92(3)(c) of the Treaty and Article 61(3)(c) of the EEA Agreement from the prohibition imposed by Article 92(1) of the Treaty and Article 61(1) of the EEA Agreement, being aid that is compatible with the common market, provided that Article 2 is complied with.

Article 2

Italy shall transfer its remaining shares in Italstrade held by Fintecna to the private shareholder on the terms and conditions stipulated in the contract of sale, in particular the time when the option must be exercised.

Article 3

In order to secure full cooperation in the arrangements for monitoring this Decision, Italy shall provide the Commission with half-yearly reports on Italstrade's economic and financial situation and communicate to it in good time the main steps in the sale of Fintecna's remaining holding in Italstrade.

The first report shall set out Italstrade's economic and financial results at 30 June 1998 and shall reach the Commission by 31 December 1998.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 16 September 1998.

For the Commission
Karel VAN MIERT
Member of the Commission