II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 16 September 1998

authorising subject to conditions, aid granted by Italy to Società Italiana per Condotte d'Acqua SpA

(notified under document number C(1998) 2858)

(Only the Italian text is authentic)

(Text with EEA relevance)

(1999/338/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,

Whereas:

I

Società Italiana per Condotte d'Acqua SpA (Condotte) is a company operating in engineering and civil infrastructure construction (roads, railways, etc.); it was previously the property of Iritecna SpA (Iritecna), a wholly owned subsidiary of IRI SpA (IRI), which was in its turn wholly owned by the Italian Treasury. In 1993 IRI, which wished to restructure its engineering and construction activities, decided:

— 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 (Fintecna), which was to privatise Iritecna's profitable businesses.

Condotte recorded losses totalling ITL 152 billion over the period from 1991 to 1994. Its gross profit margin fell from 11 % of turnover in 1991 to 4,5 % in 1994, with a low point of 2 % in 1993. The shareholders repeatedly had to make up the company's losses, at a total cost of more than ITL 118 billion (ECU 61 billion).

Despite its losses, Condotte was considered to be potentially attractive to private investors, largely because of the size of its order-book; the main items in the order-book derived from Condotte's 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. Iritecna's controlling stake in Condone, which amounted at that time to 91,7 %, was accordingly transferred to Fintecna, with a view to privatisation.

The restructuring measures which Condotte now undertook, reducing its workforce from 1 500 to less than 1 000, 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

[1] OJ C 327, 29.10.1997, p. 4.

believe that Condotte could be privatised as early as 1995; and this was expressly provided for in the plan for the restructuring of Iritecna which was submitted to the Commission. At the end of 1994 an adviser was appointed to select potential buyers for Condotte.

By Decision 95/524/EC [2] (the Decision) the Commission declared that the aid granted to Iritecna and Fintecna in connection with the Iritecna liquidation was compatible with the common market. The Decision also authorised Iritecna to cover Condotte's losses up to 31 December 1994, which amounted to ITL 110 billion, or ECU 56,4 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 Condotte, 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 Condotte 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 project.

When that assessment was completed in November 1995, the procedure for the sale of Condotte was set in motion once again, 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 mean time Condotte continued to record substantial losses: these reached ITL 71 billion (ECU 36 million) in 1995, falling to ITL 21 billion (ECU 11 million) in 1996.

In order to replenish Condotte's share capital, which had been eroded by its losses, Fintecna was obliged to provide fresh funding of ITL 65 billion in March 1996 (ECU 33 million) and a further ITL 7 billion (ECU 4 million) in December 1996. As a result of these transactions Fintecna's holding in Condotte increased to 95,8 % of the capital.

On 24 June 1997, in response to a request from the Commission, the Italian authorities informed it of the measures taken to replenish Condotte'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 Condotte must be considered a duty (*atto dovuto*) within the meaning of the Civil Code, as Condotte would otherwise have had to be put into liquidation.

Finally, in March 1997, Fintecna sold 45,7 % of the capital in Condotte to a private investor, Ferrocemento SpA (Ferrocemento); the contract of sale includes the following clauses:

(a) Fintecna gives Ferrocemento an option to buy the remaining shares at a predetermined price, and Ferrocemento gives Fintecna an option to sell them at the same price; these options are valid 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;

(b) the sale price is based on a valuation of ITL 100 billion (ECU 51 million) for Condotte;

(c) Fintecna must replenish Condotte's share capital to bring it up to ITL 40 billion at the time of the transfer;

(d) Fintecna is to have no further interest in Condotte's trading results from the time of the transfer of 45,7 % of the shares, this being achieved by means of a compensation mechanism which adjusts the selling price for the remaining 50,1 % of the capital.

In June 1997, in order to comply with the clause requiring it to replenish Condotte's share capital, Fintecna provided further funding of ITL 33 billion (ECU 17 million).

The Commission now decided to initiate proceedings under 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. The Commission informed the Italian Government of its decision to initiate proceedings by letter of 1 August 1997 [3].

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

No other Member State or interested party submitted observations within the time allowed. By letter of 1 December 1997 the Commission requested more information from the Italian authorities. That information was supplied in a letter of 22 January 1998, and at a meeting which took place in Rome on 20 January 1998.

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

[3] See footnote 1.

The Italian authorities provided further particulars by letters of 10 and 12 February. Lastly, on 5 May the Commission received a copy of the company's balance sheet as at 31 December 1997 and its industrial plan for the period 1998 to 2000.

The information furnished by the Italian authorities showed that on 17 December 1997 Fintecna had provided Condotte with a further capital injection amounting to ITL 58 billion (ECU 30 million) as an adjustment for the purchaser, following further falls in the value of Condotte's assets. With this injection, the total funding provided by Fintecna to Condotte after 1994 was brought up to ITL 163 billion (ECU 84 million).

II

In its observations the Italian Government argues:

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

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

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

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

As regards point (i), the Italian Government contends that at the time of the Decision the Commission was already aware of the need for further funding of the company in order to allow privatisation to take place and that the Commission was informed in good time of each of the recapitalisation operations at Condotte 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 Italian 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 Condotte operates.

After the Decision, the Italian 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 which now form the basis of the Article 93(2) proceedings.

As regards point (ii), the Italian Government argues that Fintecna helped Condotte 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 Italian Government states that Fintecna compared the cost of putting Condotte 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 Italian Government argues, there is no State aid caught by Article 92(1).

The Italian Government states in particular that Fintecna estimated the cost of putting Condotte into liquidation at ITL 600 billion, if the company were wound up in an orderly fashion, and at ITL 2 700 billion, if it were wound up in free fall. Fintecna concluded that it would be preferable to recapitalise Condotte 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 Condotte do not constitute State aid.

As regards point (iii), the Italian 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 Condotte.

On the total cost of the plan approved by the Commission, the Italian 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 Condotte, 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 Condotte: the Decision has thus been complied with.

Turning to the restructuring operations provided for in the Decision, the Italian 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 letter initiating proceedings refer to the active workforce

engaged 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 Italian Government argues that the decline in Condotte's performance as compared with the forecasts in the plan, which called for net profits of ITL 19 billion in 1995 and ITL 40 billion in 1996, was due to worsening market conditions, and not to a failure to restructure the company.

The Italian Government contends that the results obtained by Condotte 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 130 billion in Condotte's gross margin over the two years. A number of non-operational items amounting to ITL 46 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 Italian Government points out:

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

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

When it initiated the proceedings, the Commission argued that on the basis of the information at its disposal the sale of Condotte could not be considered a genuine privatisation: out of the shares in its possession Fintecna had sold only 45,7 % and had kept 50,1 % (the remaining 4,2 % is quoted on the Milan Stock Exchange).

The Italian Government argues that the privatisation of Condotte must be considered genuine and definitive. The sale of 45,7 % is linked to specific contractual clauses which make the sale of the remaining 50,1 % 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 and the Iricav consortium, of which Condone is a member. The consortium has won the contracts awarded by TAV for the building of the Rome-Naples stretch of the high-speed network. The clause requires IRI to preserve its 'majority participation' in the consortium until the work is completed.

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

In support of its claim that the sale of Condotte has to be considered definitive, the Italian 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 45,7 % of the capital, it nevertheless directly transferred managerial responsibility to the purchaser,

— the fact that the auditors certifying Condotte'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 Condotte be carried out without further aid. The Italian Government maintains that the financing that Fintecna gave to Condotte after 1994, amounting to some ITL 163 billion (about ECU 84 million), should not be considered State aid within the scope 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 financing was provided in connection with a restructuring plan aimed at restoring the company to profitability, something which is confirmed by its privatisation,

— the funds were limited to what was strictly necessary to ensure that Condotte 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 Condotte 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 Condotte after 1994 constitute State aid caught by Article 92 of the Treaty, and, if more State aid has in fact been granted, it will then have to be considered whether the aid measures for Condotte, taken as a whole, are compatible with the common market.

As has been explained, the Decision found that the aid granted to Condotte up to 1994 (ITL 110 billion or ECU 56 million) was compatible with the common market subject to a series of conditions, including the following:

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

(ii) Fintecna and its subsidiaries, including Condotte, 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 Article 93(2) proceedings, the Commission argued that the reorganisation of Condotte called for by the restructuring plan had not been completed. In particular, it observed that:

— the number of employees on open-ended contracts had increased in the period 1994 to 1996 from 383 to 431 (or 513 including Metroroma, which was taken over in 1996),

— this increase in staff coincided with a very unfavourable economic situation, with losses of ITL 71 billion in 1995 and ITL 21 billion in 1996.

In its observations the Italian Government contends that the figures used by the Commission include workers who are entered on the company's personnel register (*libro matricola*) but are not actually working, such as those laid off under the Cassa integrazione guadagni scheme. According to the Italian 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

Note: Figures for entire construction sector (Condotte 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 what was laid down in the plan.

At the same time, and partly as a consequence, Condotte'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 19 billion in 1995, when there was in fact a net loss of ITL 71 billion, and a net profit of ITL 40 billion in 1996, when there was in fact a net loss of ITL 21 billion. In 1997, whereas the plan anticipated a net profit of ITL 37 billion, the company in fact made a loss of ITL 78 billion.

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 Condotte to achieve a gross industrial margin, before structural costs, equal to 7 % of turnover. In theory, that margin would have allowed the company's losses to be contained at roughly ITL 20 billion in 1995, despite the fall in revenue that actually took place.

With an industrial margin of 7 % the Commission took the view that, even with a 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. In fact Condotte's 1995 industrial margin was negative and indeed it made a net loss in excess of its corporate assets.

However, in 1996 and above all in 1997 Condotte 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. The period 1995 to 1997 proved to be one of the most difficult periods experienced by the construction sector in Italy (where Condotte generates over 70 % of its income).

Despite adverse trading conditions, Condotte maintained an adequate operating profit margin and reduced its structural costs more drastically than assumed in the restructuring plan approved by the Commission. As can be seen from Table 1 its 1996 gross margin reached 12 % of net turnover, compared with the figure of 7 % anticipated in the plan. In 1997, its structural costs were around 20 % below those anticipated in the plan, as a result of further restructuring measures adopted by the enterprise.

Table 1

Condotte's financial results

(in billion ITL)

	1996 planned	1996 actual	1997 planned	1997 actual
Net turnover	1,425	496	1 366	603
Gross margin	126	61	120	41
Structural costs	(35)		(37)	(31)
Operating loss	38	(21)	37	(78)

Source: Condotte's annual accounts for 1996 and 1997 (excluding for Metroroma).

Much of the company's net losses in the period resulted from writing down assets in line with the smaller margins which were capable of being generated on work in progress and work already completed.

Moreover, Condotte's rationalisation measures continued into the first months of 1998; headquarters staff was further cut from 110 as at 31 December 1997 to 105 as at 27 March 1998 (they had numbered 185 on 31 December 1996). Managerial staff, with an appreciably higher unit cost, was cut from 25 as at 31 December 1997 to 19 as at 27 March 1998.

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 Condotte in accordance with the timescale 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 Condotte 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 ([4]). The intention to sell off Condotte rapidly was considered 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' ([5]), 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 timescale 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 Ferrocemento of 45,7 % of Condotte's capital belonging to Fintecna. When it initiated proceedings, the Commission did not have sufficient information to be able to establish whether the sale could be considered genuine and irreversible so as to satisfy the requirements of the Decision. The Commission raised doubts regarding the following aspects in particular:

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

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

— the terms of the transfer of the remaining 50,1 % 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

([4]) See Section III, point 6.
([5]) See Section IV, point 3.

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 Ferrocemento, three by Fintecna, and the chairman by Ferrocemento 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 Condotte.

Turning now to the possibility that future losses by Condotte might have to be borne by Fintecna, the contract establishes a complex mechanism for the adjustment of the selling price for the 50,1 % of the share capital remaining with Fintecna; this has the result of excluding Fintecna itself from any financial burdens whatsoever deriving from operating losses by Condotte.

The selling price for the 50,1 % is set at ITL 50,1 billion, but this is to be adjusted to include:

— the portion borne by Fintecna in any further capital increase, whether or not intended to cover losses made after the transfer of the shares (to be added to the price),

— the portion accruing to Fintecna in any profits made by Condotte and distributed to the shareholders after the transfer of the shares (to be subtracted from the price),

— any payments by Fintecna to cover losses made by Condotte after the reference date laid down in the contract (to be added to the price).

All of the items described, including the selling price, are indexed from the date of the particular transaction to the date of transfer of the remaining 50,1 % of the capital, at a rate of interest laid down in the contract.

On the basis of this information, it can be confirmed that Fintecna will not bear the financial effects of any further losses by Condotte. It is clear, then, that Fintecna will no longer be liable for the company's operating losses. From the point of view of liability, the privatisation of Condotte can be regarded as complete even though Fintecna continues to hold the majority of the share capital.

The contract lays down the following mechanism for the transfer of the remaining 50,1 % of the share capital to Ferrocemento:

— Fintecna is entitled to transfer its 50,1 % to Ferrocemento at the predetermined price between 1 January and 30 June 1999 or until six months after the discharge by IRI of the guarantees for the high-speed rail network,

— Ferrocemento is entitled to acquire the 50,1 % in Fintecna at the predetermined price at any time from the date of discharge of the guarantees referred to until 30 June 1999 or until six months from the date of discharge of the guarantees by IRI.

It transpires from this that there is no legal obligation on the parties to complete the transfer of Condotte. Each party is entitled to call for completion of the sale, and only if one exercises its right is the other obliged to complete the transaction. It might conceivably happen that neither party exercises its right: in that case the transfer of Condotte would not be completed, and the condition 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 Condotte 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 Condotte 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.

Despite the fact, then, that Fintecna continues to hold 50,1 % of Condotte, 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 Condotte as rapidly as possible. That objective has been achieved, as was explained, 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.

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 Condotte. The Commission notes that a positive outcome to those negotiations could speed up the formal transfer of the entire capital of Condotte to Ferrocemento.

(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 determine whether Fintecna has complied with the conditions set out in Article 1(4) and (5) of the Decision, and in particular the prohibition on the granting of further aid, it has to be established whether the funding that Condotte 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 of the Treaty, the Commission applies the private-investor test to the financial flows between them. In the case under consideration, this means considering whether the funds given to Condotte after 1995 were public resources and, if so, whether they would have been invested in accordance with the private-investor test.

Under the Iritecna plan, Condotte 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 of 21 March 1991 in Case C-305/89 Italy v. Commission ([6]), in order to establish whether an aid measure can be considered State aid within the scope 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'. Thus, even if the funds given to Condotte 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 Condotte, that reduces the profit accruing to Fintecna's shareholder IRI and thus ultimately to the State. Fintecna might have used its own funds to engage in activities with a better return; this would have enabled IRI, and consequently the State, to obtain a better economic return on its investment.

A lower 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 Condotte 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) of the Treaty, they have to be studied in the light of the private-investor principle ([7]).

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' ([8]).

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

Table 2

Condotte's financial results

(in billion ITL)

	1992	1993	1994	1995	1996
Net turnover	672,1	660,3	445,3	352,9	495,7
Gross margin	33,8	14,8	19,5	(19,0)	60,9
Operating income	(9,1)	(34,9)	(9,0)	(74,8)	0,1
Net profit (loss)	(40,7)	(87,7)	(23,9)	(70,9)	(20,4)
Net worth	39,9	63,9	46,9	(23,9)	28,1

Source: Condotte's annual accounts.

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

It is not sufficient to plead 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.

Furthermore, a shareholder not subject to the unlimited guarantee rule in Article 2362 of the Civil Code would have been liable for Condotte's debts only up to the amount of the equity of the company, possibly via insolvency proceedings, and would consequently have been liable for amounts significantly smaller than those actually injected into Condotte.

([6]) [1991] ECR I-1603, paragraph 13.

([7]) 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 (see Part III), (OJ C 307, 13.11.1993, p. 3).

([8]) Ibid., paragraph 16.

The financial resources given by Fintecna to Condotte in 1996 and 1997 therefore constitute State aid within the meaning of Article 92(1) of 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 Condotte and approved in the Decision, which amounted to ITL 110 billion.

In assessing compliance with the Decision, it is not enough to say that the total volume of aid approved has not been exceeded. 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 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 purchasers 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 Condotte 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 Ferrocemento, entailed making public offers 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 two were placed on a shortlist. Only Ferrocemento 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 Ferrocemento in its acquisition of Condotte.

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 Condotte can be discerned in the terms of sale.

As has been explained, the aid granted to Condotte after 1994 constitutes State aid within the scope of Article 92(1) of the Treaty and, as a result, the aid received by the company before 1994, which the Commission approved in the Decision, is in principle likewise unlawful; the possibility has now to be considered whether the grants of aid, taken as a whole, are compatible with the common market.

IV

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

Paragraphs 2, 3(a) and 3(b) of Article 92 of the Treaty cannot be applied to measures of the kind under consideration here. In view of the variety of Condotte'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 paragraph 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.

As regards such aid, the Commission has published Guidelines on State aid for rescuing and restructuring firms in difficulty ([9]). In practice, if it is to approve one-off measures to restructure a firm in difficulty, the following tests 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.

([9]) OJ C 368, 23.12.1994, p. 12.

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 it under Article 92(3)(c) of the Treaty.

As regards test (i), the restoration of viability, the Italian authorities had submitted a restructuring plan at the time of the Decision which was intended to restore Condotte to profitability from 1996 onward. The aid given to Condotte up to 1994 (ITL 110 billion) was held to be compatible with specific regard to that plan and to the Community Guidelines. However, Condotte did not achieve the financial results expected and so had to fall back on public assistance once again (receiving ITL 163 billion, as has been explained).

It should be pointed out, however, that Condotte's failure to return to profitability was the result of a market situation which was not foreseeable at the time of the Decision.

Condotte'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 2 255 billion, of which more than ITL 795 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 contract, it was reasonable to expect Condotte's turnover and financial results to develop as shown in Table 3.

Table 3

Forecast financial results of Condotte

(in billion ITL)

	1995	1996	1997
Net turnover	896	1 425	1 366
Gross margin	66	126	120
Operating result	31	91	83
Net profit (loss)	19	38	37

Source: Iritecna's restructuring plan.

The above valuations have already given due regard to the difficulties of the civil engineering sector, which experienced a severe crisis in the 1990s, in staging a recovery. They allowed for a rate of acquisition of orders much below Condotte's potential and indeed assumed the company would be focusing on work related to the high-speed rail network. None the less, the crisis in the sector continued until 1996 with a severity that was not foreseeable, giving some signs of recovery only in the second half of 1997.

Moreover, the contracts already secured for the high-speed rail network were delayed for reasons outside the company's control.

With the interaction of those two factors, Condotte's turnover was in fact substantially lower than forecast in the plan, as is shown in Table 1:

— in 1995 it amounted to ITL 353 billion, or 39 % of the figure forecast,

— in 1996 it amounted to ITL 496 billion, or 35 % of the figure forecast.

In both those years, as in 1994, Condotte's turnover was about 40 % less than in 1992 and 1993, years in which the crisis in the industry in which Condotte operates was already very serious. Faced with this crisis on the market around it, Condotte reacted by taking further restructuring measures, going beyond what had been provided for in the plan; although these were not enough to secure net profits, they did allow the company to record a positive operating result in 1996, its first in a long time.

In particular, the restructuring measures concentrated on reducing structural costs, which in 1996 reached levels some 10 % below what had been provided for in the restructuring plan. In 1997, as has been indicated, these costs were about 20 % below what had been provided for in the restructuring plan. In that period, the company stepped up its internal restructuring effort with the aim of returning to a stable level of profitability. For example, headquarters staff, an item reflected in structural administrative costs, was reduced from 201 on 31 December 1995 to 105 in March 1998, with management staff, which has a higher unit cost, falling from 51 at the end of 1995 to 19 in March 1998 (down 61 %).

As a result of these operations and of further restructuring efforts affecting the entire structure of the group, Condotte succeeded in 1996 in reversing the negative economic trend that had been apparent up to 1995, in spite of the crisis in the construction sector. Its gross margin went from − 5,4 % of turnover to positive figures in both 1996 and 1997 (ITL 61 billion and ITL 41 billion respectively).

In 1996 and 1997 Condotte recorded a net loss, particularly heavy in 1997, but this was due mainly to the extraordinary items representing the costs of restructuring.

The restructuring efforts undertaken will bring the company to a better level of profitability in future years, bearing in mind the anticipated slow-down in work on the high-speed rail network, as forecast in the industrial plan presented to the Commission.

Table 4

Condotte's industrial plan 1998 to 2000

(in billion ITL)

	1998	1999	2000
Net turnover	660	570	459
Gross margin	95	84	70
Operating result	13	9	10
Operating loss	8	8	5

Source: Condotte's 1998 to 2000 restructuring plan.

As a result of the company's restructuring effort, particularly in the period 1996 to 1997, in addition to the plan approved by the Commission Decision, Condotte 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 may be considered that the first test of the admissibility 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 Condotte may incur. The presence of a private controlling shareholder (see section III) also provides a better assurance of Condotte's prospects of profitability.

The second test requires that the aid avoid 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 offset by reductions in production capacity, especially in an industry such as construction, where there is substantial overcapacity.

In this case the restructuring plan approved by the Commission in the Decision has 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 Condotte'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 Condone up to 31 December 1994 satisfied the tests for restructuring aid.

But Condotte 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 so if Condotte 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 who had received no State aid.

As has been explained, however, Condotte reduced its staff and thus its production capacity in 1995 and especially in 1996 and 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, Condotte's turnover during the period 1995 to 1997 was about 40 % of what was called for in the plan, and the rate of incoming orders was a great deal slower, as is shown in Table 5.

Table 5

Condotte's turnover and orderbook

	1993	1994	1995	1996	1997
Net turnover	660	445	352	495	603
Order book	2 012	2 411	2 214	2 376	2 058
Including high-speed rail network	795	1 566	1 516	1 792	n.a.

Source: Condotte's annual accounts.

It is clear from these figures that, as a result of the restructuring of the company, Condotte has been competing less and less on world markets. Its order book for work connected with the high-speed rail network (orders won as a result of the formation of the Iricav consortia at the beginning of the 1990s) has increased as a proportion of its overall activities, from 39 % in 1993 to

75 % in 1996. The increase in the order book in 1994 was almost entirely due to the acquisition by Iritecna of a further share in the Iricav consortium for the high-speed rail network. In the same way, the increase in turnover in 1996 is the direct consequence of the progress of the work of the consortium itself.

Moreover, the industrial plan for the period 1998 to 2000 that was drawn up by the company's new management entails, through its concentration on orders already placed for the high-speed rail network, a further reduction in the company's presence on the market. In future, turnover will therefore be reduced, resulting in a further reduction in the distortion caused by the grants of aid.

At the same time, the company has substantially reduced its operations abroad, where the number and value of new contracts has fallen significantly. It has consequently reduced its production capacity by much more than what was called for in the restructuring plan for the company. Accordingly, its ultimate competitive position will not affect trade to an extent contrary to the common interest.

Test (iii) requires 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 Condotte was needed to cover losses due mainly to the writing-down of activities and to the costs of reducing production capacity (staff cuts). During the delays in the sale of Condotte, Fintecna financed further restructuring efforts, going beyond what was laid down in the Iritecna plan, in order to cope with the unexpected worsening of 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 also observes that Condone 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 of the restructuring operation, as any further burdens are to be borne entirely by the buyer of the company, through the mechanism for adjusting the price of the transfer of the 50,1 % of the share capital still in Fintecna's possession.

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 Condotte,

HAS ADOPTED THIS DECISION:

Article 1

The aid to Società Italiana per Condotte d'Acqua SpA (Condotte) to which this Decision relates, namely the capital injections granted in the years 1995 to 1997 totalling ITL 163 billion, and the aid granted up to 1994 already approved by the Commission, amounting to a total of ITL 110 billion, constitute State aid within the meaning of Article 92(1) of the Treaty and Article 61(1) of the EEA Agreement.

It satisfies the tests laid down in the Community Guidelines of 27 July 1994 on State aid for rescuing and restructuring firms in difficulty. The aid is consequently declared exempt, under 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 Condotte to the private shareholder on the terms and conditions stipulated in the contract of sale, in particular the terms within which the option is to 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 Condotte's economic and financial situation and communicate to it in good time the main steps in the transfer of Fintecna SpA's remaining holding in Condotte.

The first report shall set out Condotte'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