II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 21 April 1999
on the state aid granted by Germany to Dieselmotorenwerk Rostock GmbH

(notified under document number C(1999) 1121)

(Only the German version is authentic)

(Text with EEA relevance)

(1999/600/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)(1) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments on the aid,

Whereas:

I. PROCEDURE

By letter of 25 April 1996, Germany informed the Commission that the Bundesanstalt für vereinigungsbedingte Sonderaufgaben (BvS, the successor to the Treuhand privatisation agency) had granted DEM 20 million in rescue aid in form of a loan to Dieselmotorenwerk Vulkan GmbH (DMV).

By letter of 11 February 1997, the Commission informed Germany of its decision to initiate the procedure laid down in Article 93(2) of the EC Treaty in respect of this aid. In so doing, the Commission gave Germany formal notice to provide it with all the information needed for examining the aid within one month of being notified of the decision.

The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* [1]. The Commission invited interested parties to submit their comments on the aid.

Germany replied by letters of 30 April, 14 July and 10 and 12 September 1997, in which it also informed the Commission of additional aid granted and of a restructuring plan. Further particulars were provided at a meeting on 15 October 1997 between representatives of the Commission and the German authorities.

By letter of 17 December 1997, the Commission informed Germany of its decision to extend the procedure laid down in Article 93(2) of the EC Treaty to the aid measures taken in the meantime and of its continuing doubts as to the compatibility of the total amount of restructuring aid with the internal market.

The Commission decision to extend the procedure was published in the *Official Journal of the European Communities* [2] The Commission again invited interested parties to submit their comments on the aid.

II. DETAILED DESCRIPTION

1. Dieselmotorenwerk Rostock GmbH (DMR), which was known as Dieselmotorenwerk Vulkan from 1995 until 31 July 1997, was divided until recently into four locations:

— the head office and the engine factory in Rostock-Warnemünde and in the city of Rostock, with a workforce of about 360; the main activity is the production, testing and repair of heavy two-stroke diesel engines for cargo vessels,

[1] OJ C 119, 17.4.1997, p. 8.

[2] OJ C 169, 4.6.1998, p. 8.

— the erstwhile engine factory in Bremen-Vegesack, which produced ship engines until August 1997; it is now primarily a foundry and a facility for heavy steel construction which produces a number of basic components for the engines mounted in Warnemünde as well as foundry and steel products for other customers; its present workforce is about 155,

— Mecklenburger Metallguß GmbH (MMG) in Waren, a medium-sized company producing mainly fixed-pitch propellers for vessels, with a workforce of about 110; DMR sold MMG on 27 January 1999 to Walzengießerei Coswig GmbH and Herzberg & Partner GmbH,

— Wismarer Propeller and Maschinenbau GmbH (WPM) in Wismar, a medium-sized manufacturer of shafts and controllable-pitch propellers for vessels, with a workforce of about 50; this company was sold in October 1998 to Schottel-Werft Josef Becker GmbH & Co. KG and Schottel Antriebstechnik GmbH.

The scope of this decision is limited to the parent company DMR, with its factories in Rostock and Bremen. As WPM and MMG were sold during the state aid proceedings and as their restructuring entails separate restructuring aid, the Commission will take separate decisions on the rescue and restructuring aid for them.

2. The origins of DMR date back to 1947, when motor production began in Rostock in the former German Democratic Republic (GDR). After the unification of Germany, DMR was part of the Deutsche Maschinen and Schiffbau AG (DMS). DMR was first privatised in 1992 and sold to Bremer Vulkan Verbund AG (BVV) ([3]). By a contract dated 16 December 1994, DMR was merged with the engine manufacturing department of Bremer Vulkan Werft GmbH in Bremen to form the new company DMV.

After its first privatisation, DMR/DMV carried out an investment programme DEM 192,5 million primarily for the construction of a new engine plant in Rostock-Warnemünde which was commissioned in 1994-96. The investment cost exceeds the minimum amount specified in the privatisation agreement of 1992.

DMR underwent restructuring on several occasions after 1990, and the situation was exacerbated on account of the purchase of the loss-making engine factory in Bremen at its book value of DEM 65 million. According to the auditor's report for 1995, DMV had been in severe economic difficulties since 1994. The company had to report for 1995 a loss of DEM 165 million, with its equity (capital and reserves) being reduced from DEM 178 million to DEM 12,9 million. The liquidity of the company was ensured primarily by loans of DEM 52,6 million ([4]) under BVV's cash concentration system and by a loan of DEM 25 million granted by BvS in 1994.

3. Towards the end of 1995 BVV, DMV's parent company, ran into severe financial difficulties. It had to apply for a debt composition procedure (*Vergleich*) on 21 February 1996 and went into receivership on 1 May 1996. BVV's cash concentration system was terminated at the end of 1995. At the end of March 1996 DMR faced a liquidity gap of some DEM 18 million, which threatened to rise to about DEM 30 million by end of April 1996. No commercial bank was prepared to provide fresh money to the company.

4. In order to rescue the DMR group and to ensure continuation of the restructuring, BvS and the *Land* of Mecklenburg-Western Pomerania provided the following aid by end of 1998:

1. a loan of DEM 30 million (DEM 20 million from BvS and DEM 10 million from the *Land* authorities), originally at an interest rate of 3 % above the discount rate, was disbursed on 2 April 1996, originally to fall due on 31 December 1998;

2. a loan of DEM 19,5 million (BvS, DEM 13 million; *Land* authorities, DEM 6,5 million), was disbursed in July 1996, on the same terms as at 1;

3. a credit line of DEM 25 million (again jointly financed by BvS and the *Land* authorities): first tranche of DEM 15 million disbursed in June 1997; second tranche not yet fully disbursed; maturity: 31 December 1999;

4. state guarantees for an amount of up to DEM 15 million, increased in September 1997 to a maximum of DEM 60 million. These guarantees are counter guarantees (*Avale*) for advance payments received as well as performance bonds and post-delivery guarantees to be provided by DMR in the context of contracts for ship engines; the guarantees were originally valid until privatisation or until 31 December 1999 at the latest;

5. a 100 % state guarantee ([5]) provided on 22 February 1996 by the *Land* authorities to secure a commercial bank loan of DEM 10 million;

6. a 100 % state guarantee provided by BvS and the *Land* authorities in the autumn of 1997 and running until 31 December 1998 to secure a credit line of DEM 10 million.

([3]) The sales agreement (*Kauf- and Abtretungsvertrag*) of 11 August 1992 was concluded between the Treuhandanstalt and DMS, on the one hand, and BVV and Schichau Seebeckwerft AG, on the other. This privatisation was governed by the Treuhand regime of 1992 (Commission Decision of 8 December 1992). An individual notification to the Commission was not required under those rules since the size of DMR and the financial transactions involved were below the relevant thresholds.

([4]) As at 31 December 1995. See Commission Decision 98/2405/EC of 22 July 1998 (not yet published in the Official Journal) on the misuse of restructuring aid for MTW-Schiffswerft and Volkswerft Stralsund, two companies formerly belonging to Bremer Vulkan Verbund, and on the unauthorised provision of an investment loan of DEM 112,4 million to MTW. Section II.5 of that decision contains a detailed description of the cash concentration system. As stated in Section IV of that decision, it is very likely that the main debtors, one of these being DMR, received some of the misused aid. However, since the funds were mixed, it has not been possible to obtain evidence in full.

([5]) This guarantee is fully secured by land charges (*Grundschulden*) amounting to DEM 35 million.

By letter of 10 September 1997, Germany informed the Commission that BvS and the *Land* authorities had waived payment of interest and redemption for the loans mentioned at points 1 to 3 and that these loans could be converted into subordinate shareholder loans if the need arose. According to the auditor's report for 1997 ([6]), loans for an amount of DEM 49,5 million had been declared subordinate in order that DMR need not go into receivership (*Gesamtvollstreckung*). By the same letter, Germany also announced that BvS had waived interest on the investment loan of DEM 25 million granted in 1994 and that this loan would be converted into equity. The original interest rate was 8,5 % per annum. The principal was to be repaid on 30 October 2000.

By letter of 21 December 1998, Germany notified the intention of BVS and the *Land* authorities to grant DEM 10 million in social aid to the 140 or so staff to be laid off in 1999. The detailed restructuring plan annexed to that letter also mentioned the need to prolong the state guarantees amounting to DEM 60 million until at least the end of 2001 ([7]).

5. Since 1996 DMR has taken a number of financial measures in favour of its subsidiaries WPM and MMG. As the present decision does not extend to WPM and MMG, the amounts involved have to be deducted. It is obvious from Germany's letters of 10 September 1997 and 14 December 1998 ([8]) as well as from the auditor's reports that at least the waiver of claims and the capital increases in cash in favour of WPM and MMG were refinanced with aid given to DMR. Therefore an amount of DEM 10,0 million has to be deducted from the aid specified in point 4 above, as this amount was not used for DMR proper but for its subsidiaries ([9]).

6. DMR's financial results for the period 1994-98 show sharp fluctuations reflecting the changes in its main activity (production and repair of ship engines), which contributes more than 80 % of turnover. The figures shown in the following table are, however, not fully comparable as there was a radical change in accounting practices between the business years 1994 and 1995. The positive annual result in 1997 is caused mainly by the debt waiver agreed at the time of the separation of DMR from BVV.

DMR/DMV: Turnover and financial results 1994-98

(million DEM)

Year	Turnover	Operating result	Annual result
1994	180,5	4,4	4,1
1995	181,4	– 165,2	– 165,2
1996	252,7	– 70,5	– 71,0
1997	210,7	– 26,3	30,1
1998 (p) ([1])	194,1	12,7	4,2
1998 (e) ([2])	[...] (*)	n.a.	[...]
1999 (p)	[...]	n.a.	[...]
2000 (p)	[...]	n.a.	[...]
2001 (p)	[...]	n.a.	[...]

([1]) Planned results according to the 1997 restructuring plan.

([2]) Estimated results according to the revised plan of December 1998 (DMR without WPM and MMG); the deterioration in 1998 was caused mainly by loss provisions for the planned redundancies in the following years.

(*) Business secret.

7. The number of ship engines delivered was 19 in 1994, 17 in 1995, 29 in 1996, 18 in 1997 and 17 in 1998. DMR plans to produce [...] in 1999, [...] in 2000 and [...] in 2001.

In the period 1993-97 DMR was the largest supplier of large two-stroke diesel engines in the Community. In Germany it had a market share of between 53 % (1995) and 83 % (1996). For the period 2000/2001 DMR hopes to retain a market share in Germany of some 50 %.

8. The two-stroke diesel engines produced by DMR are used for cargo vessels. Normally tankers, bulk carriers and container vessels are equipped with two-stroke engines while most other types are equipped with four-stroke engines. The engines are produced under licence. On a worldwide basis, there are three licensors for such engines: MAN B & W AG (based in Germany), Wärtsilä NSD Oy AB (based in Finland) and Mitsubishi Heavy Industries (based in Japan). DMR has a licensing agreement with all three, but the Mitsubishi licence has not been exploited. The agreements cover Germany and eastern Europe except Poland and Croatia. Hence, the demand for engines from DMR depends basically on the contracts for cargo vessels awarded to German yards.

As long as DMR was linked to Bremer Vulkan, the company obtained almost all the engine contracts for new ships built at Bremer Vulkan yards, and the original business concept was based on the expectation that this would secure full capacity utilisation for DMR. On the other hand, DMR had hardly any access to orders from other yards as these were very reluctant to place orders with a competitor.

([6]) Received by the Commission on 6 October 1998.
([7]) Arthur D. Little, Überarbeitete Geschäftsplanung 1999–2001 (Chapter 3.4).
([8]) Notification of the privatisation of WPM.
([9]) For information purposes:

(a) WPM
Liquidity aid: DEM 1,5 million
Supplies and services: DEM 0,6 million
User fees: DEM 0,2 million

(b) MMG
Increase in capital (physical assets, land): DEM 1,7 million
Increase in capital (capital contribution): DEM 6,00 million.

In 1995 the Bremer Vulkan yards [10] had received a large number of orders for container vessels. Although some of these orders were later cancelled, this provided DMR with a very healthy order book extending in some cases until 1999. Nevertheless as regards new contracts, DMR's position has changed totally with the collapse of BVV. It is now forced to bid for contracts on the open market, often in direct competition with yards in eastern Asia licensed by Man B & W or Wärtsilä NSD. Apart from problems caused by its weak financial standing, DMR's position is difficult because it is almost the only engine builder linked neither to a licensor nor to a major shipyard.

The number of cargo vessels built in the Community is decreasing. The European market share is almost negligible for tankers and bulk carriers. The market for container vessels, the mainstay of German shipbuilding, has become very difficult as well, with a sharp decrease in new orders in 1996 and again in 1998. Most of the German yards are attempting to address this problem by producing different types of ship or offshore equipment, although this does not produce any orders for engines from DMR.

The prices of engines in German mark terms were under heavy pressure in 1994/95 and again in 1998. DMR's consultant expects the price level to remain at the present low level until the end of 2001 (final year of the investigation period). The main competition now comes from Korea, where a few large engine factories have come on stream in recent years. European manufacturers, and in particular DMR's new plant, do though enjoy advantages when it comes to servicing European yards on account of their closeness to customers, which bears fruit in the mounting and testing period. The financial results of most players on this market were unsatisfactory in 1998. Profits come less from the sale of new engines than from the delivery of spare parts and repair works. There is fierce competition between the licensors and, despite the licensing agreements, fierce competition as well between engine manufacturers, although this is felt mostly outside the Community.

9. Following the collapse of the BVV group in February 1996, BvS and the *Land* authorities entered into negotiations with the administrator of BVV with a view to its separation from the group. These negotiations were held up because of parallel negotiations on an early sale of DMR to one of the licensors (MAN B & W) which broke up in September 1996. By an agreement of 28 April 1997, the shares were transferred at a symbolic price from BVV's intermediate holding company Vulkan Industrie Holding GmbH in Konkurs (VIH) to BvS (51 %) and to the *Land* of Mecklenburg-Western Pomerania (49 %). At the same time it was agreed, subject to approval from the European Commission, that VIH would waive repayment of about DEM 54,8 million of claims against DMV related to the cash concentration system that operated until the beginning of 1996 [11].

According to the auditor's report for 1996, bankruptcy of DMR in that year was avoided only by making VIH's claims subordinate and by the informal declaration by BvS and the *Land* authorities that they would acquire DMR.

10. BvS and the *Land* authorities acquired DMR with the firm intention of reprivatising it as soon as possible. Back in 1996 they had concluded an agreement with Goldman, Sachs & Co. OHG to assist them in the search for potential buyers. The sale proved, however, to be extremely difficult. First, owing to the high degree of concentration in this industry, the number of potential buyers is very small. Second, it was necessary to begin by renegotiating the licensing agreements. The previous agreements had been concluded with DMV when still a subsidiary of BVV and their transfer to DMR needed the approval of the licensors. Third, a sale of DMR was hardly possible as long as the fate of its main customers, the former BVV yards, was unresolved. Volkswerft GmbH and MTW-Schiffswerft GmbH were reprivatised only in early 1998.

Discussions with potential investors started in early 1998. Until now no tangible results have been achieved. According to Germany's letter of 30 September 1998, negotiations on a privatisation are taking place with H. Cegielski-Poznan SA (HCP), a Polish engine builder. However, HCP is itself in the process of being privatised and restructured. All the other plans mentioned, such as discussions with two consortia of medium-sized mechanical engineering firms who would use DMR's facilities mainly for the manufacture of other products, remain rather vague. It must therefore be concluded that the prospects for a privatisation of DMR in its present form are remote. Germany expects that privatisation will not be possible without additional aid in the form of a debt waiver and in respect of the costs of further redundancies.

11. DMR's attempt to draw up a restructuring plan with assistance of the management consultant Arthur D. Little (ADL) was considerably delayed by the privatisation negotiations in 1996, which finally collapsed. The plan, which has been partly implemented since the autumn of 1996 and was finalised by ADL in July 1997, was based mainly on the assumptions of an annual production of 15 to 18 engines per year and stable (1997) prices in German mark terms. The plan contains 56 different measures for achieving a sharp reduction in production costs and the generation of operating profits from 1997 onwards. DMR managed to implement virtually all of these measures, except the planned reduction in wages. It was therefore able to reduce operating losses in its ship-engine-related activities from DEM 31,7 million (1996) to DEM 22,1 million (1997) and it would have achieved an operating profit of DEM 9,4 million in 1998 if special depreciation and loss provisions for the coming years had not proved necessary.

[10] The main yards were: Bremer Vulkan Werft, Schichau Seebeckwerft, Flender Werft, MTW-Schiffswerft and Volkswerft.

[11] See footnote 4. More than 99 % of the shares of VIH had been held by BVV, which exercised full financial and operational control over the group. VIH's and BVV's bankruptcy procedures are being overseen by the same administrator.

The Asian crisis and in particular the developments in the Korean maritime industry caused at the beginning of 1998 a sharp drop in the prices for ship engines, and German yards won very few orders for cargo vessels equipped with two-stroke engines. Consequently, DMR too was awarded very few orders in 1998. The owners of DMR thus asked ADL to review the July 1997 restructuring plan. The latest revised plan dates from 21 December 1998. ADL expects the market to remain very difficult until 2001, with low prices and depressed demand. Production is to be reduced to only [...] engines in 1999, [...] in 2000 and [...] in 2001, this being regarded as the bare minimum from a commercial point of view. Apart from another 140 to 150 redundancies, the plan foresees temporary closures in 1999, a wage freeze until the end of 2000 and some diversification of production. The business plan is explicitly geared towards overcoming the present crisis, minimising losses in 1999/2000 and breaking even in 2001. It does not discuss the DMR's prospects in the medium and long term.

12. The Commission had opened and extended the proceedings primarily because it had doubts whether:

(a) the commercial viability of DMR could be restored by means of the planned restructuring;

(b) the very high level of aid granted was limited to the amount absolutely necessary and whether the abnormally low financing costs would cause distortive effects on competition on the markets for ship engines and foundry products.

III. COMMENTS FROM INTERESTED PARTIES

The Commission received comments on the opening of proceedings from one Member State, which in its letter of 16 May 1997 supported the Commission's position. By letter of 6 June 1997, the Commission forwarded these comments to Germany, which was given the opportunity to react. No such reaction was forthcoming.

The Commission received no comments from interested parties on the extension of the proceedings.

IV. COMMENTS FROM GERMANY

The comments received from Germany prior to the Commission's decision to extend the proceedings are quoted and discussed in that decision [12]. By letter dated 20 February 1998, Germany provided detailed information on DMR's production programme, the progress of the restructuring programme and its financing, and the status of the negotiations with potential investors.

At a meeting on 1 July 1998 in DMR's head office, the restructuring programme was discussed by the German Government, the *Land* Government of Mecklenburg-Western Pomerania, BvS, DMR and the Commission. It was concluded that the business plan set out in the 1997 restructuring programme no longer reflected market conditions, which had dramatically changed since the end of 1997. It was agreed that the business plan should be extensively revised.

By letter of 30 September 1998, Germany submitted a revised provisional plan [13] based on an annual production of 10 engines. In its reply of 30 November 1998, the Commission expressed strong doubts as to the viability of the plan, which could not, in its view, restore a sound financial structure and would necessitate open-ended financial support from the State.

By letter of 21 December 1998, received by the Commission on 30 December 1998, Germany gave details of further changes to the business plan to cope with the continuing deterioration on the market. DMR's board had decided on these changes at its meeting on 7 December 1998. In its reply of 26 January 1999, the Commission informed Germany of its position regarding the latest changes. While it accepted that the revised plan was more realistic, it pointed out that the plan more closely resembled a temporary rescue plan than a genuine restructuring plan. The basic problem, namely that DMR would need further state aid and that there were no realistic prospects for a successful privatisation, remained.

V. ASSESSMENT OF THE AID MEASURES

1. The loans totalling DEM 74,5 million and the subsequent waiver of interest on them granted by BvS and the *Land* authorities since April 1996 constitute state aid. The state guarantees amounting to DEM 80 million also rank as state aid. In their report for 1995, the auditors explicitly state that the continued operation of DMR (then DMV) was possible only if the State provided the necessary loans and/or guarantees [14]. Consequently, DMR was not able to receive loans from commercial financial institutions.

A further loan of DEM 25 million granted on 6 July 1994 by BvS on market terms was converted into state aid in June 1997. At the time, BvS waived interest payments on this loan and announced that it would be converted into equity if this proved necessary [15].

The intended grant of DEM 10 million to finance the voluntary payments under the 'social plan' for employees to be made redundant in 1999 represents new state aid as these payments result from a specific agreement with the workforce and the trade union. This aid was not covered by the extension of proceedings as it was notified only on 21 December 1998.

[12] See footnote 2.

[13] In the interests of a comprehensive presentation of the restructuring programmes, the detailed contents of the letters of 30 September and 21 December 1998 are discussed in Section II of this Decision.

[14] C & L Treuarbeit Deutsche Revision AG, Bericht No 18 10 0147, Dieselmotorenwerk Vulkan GmbH Rostock, Prüfung des Jahresabschlusses zum 31.12.1995 (paragraph 125).

[15] See Section II.4.

2. Under the agreement of 28 April 1997 on the takeover of DMR (then DMV) by BvS and the *Land* of Mecklenburg-Western Pomerania, VIH would dispose of DMV at a zero price and waive its claims of DM 54,8 million (including accrued interest) on DMV. These claims result from the cash concentration system practised in the Bremer Vulkan group until early 1996. The market value of VIH's claims was certainly very much lower than the nominal value of DEM 54,8 million and was probably even close to zero as the loans would have ranked as equity in a bankruptcy procedure. VIH and its administrator could therefore hardly expect any income to accrue from their claims if they had retained ownership of DMR. Any other private buyer of DMR would also have required that the seller VIH waive its claims on DMR as the company clearly had a negative value. BvS and the *Land* authorities behaved therefore in this respect as a private investor. The Commission can therefore accept this measure as being in conformity with the private investor principle. It does not constitute state aid.

3. The above aid is to be assessed under Article 92 of the Treaty and in the light of the criteria set out in the Community guidelines on state aid for rescuing and restructuring firms in difficulty ('the guidelines') ([16]). Except for the DEM 10 million grant notified on 21 December 1998, all the aid has to be regarded as non-notified aid since all the measures were implemented before the Commission was able to take a position on them. Germany failed to respect its notification obligations under Article 93(3) of the Treaty.

4. The guidelines distinguish between rescue and restructuring aid. In the present case this distinction is difficult to apply because DMR was already being restructured when the Bremer Vulkan group collapsed at the beginning of 1996. Until the autumn of 1996 there were good reasons to believe that DMR could be sold to one of the licence holders and, consequently, the preparation of a new restructuring plan and the separation of DMR from VIH were deferred. The basic elements of the restructuring plan were agreed on 11 February 1997 ([17]). On that basis BvS and the *Land* authorities took over the shares of DMR by means of an agreement dated 28 April 1997 and the Commission was informed of the agreed restructuring plan by Germany by letter of 10 September 1997. As the measures taken immediately after the takeover by the new owners for a financial restructuring of DMR were clearly intended to cover a longer period, it is considered appropriate to consider the aid granted prior to the agreement of 28 April 1997 as rescue aid and all subsequent aid as restructuring aid within the meaning of the guidelines.

5. According to the guidelines, rescue aid must:

(i) *consist of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates*

State aid was provided in this form during the rescue period. The loans from BvS carried an interest rate that was three percentage points higher than the discount rate; this can be regarded as a market rate given the originally very short maturity of the loans. The credit line secured by the state guarantee also carried a market interest rate. The counter guarantees of originally DEM 15 million (comprising for the most part *Avale*) secures business activities on commercial terms as well; most of them back bank guarantees required to secure advance payments received for ship engines under construction;

(ii) *be restricted to the amount needed to keep a firm in business*

Germany provided evidence that the funds were limited to the minimum and disbursed only when the payment obligations became due. With the exception of very minor amounts, the loans and guarantees served to finance DMR's day-to-day business since the company, as a part of the bankrupt Bremer Vulkan group, had lost all its working capital in the group and had virtually no access to commercial financing. Its clients were mainly the shipyards of the former Bremer Vulkan group, which were financially strained and also had to undergo financial restructuring;

(iii) *be paid only for the time needed (generally not exceeding six months) to devise the necessary and feasible recovery plan*

As explained above, the Commission can accept in this particular case the delays in drawing up a feasible restructuring plan, primarily because the intended sale of the enterprise failed at the last minute in September 1996 owing to a commercial decision taken by the administrator of BVV ([18]) but also because of the extreme complexity caused by the disintegration of the Bremer Vulkan group;

(iv) *be warranted on the grounds of serious social difficulties and have no undue adverse effects on the industrial situation in other Member States*

The main part of DMR is located in Rostock, a smaller part in Bremerhaven. Both regions are classified as assisted areas and suffer from very high unemployment. In addition, both were particularly affected by the collapse of Bremer Vulkan as this group was one of their main industrial employers. The rescue aid is therefore justified on social grounds.

([16]) OJ C 368, 23.12.1994, p. 12.
([17]) KPMG Deutsche Treuhand Gesellschaft, Prüfungsbericht zum Jahresabschluß 1996.
([18]) The administrator decided not to sell VIH's shares in Neue Sulzer Diesel together with the DMR shares since, in this way, a higher price could be obtained.

The analysis of the impact of the aid on the industry in other Member States can concentrate on the German market for ship engines as DMR's activities did not extend beyond this market at the time ([19]). As described in Section II.8, market access for engine producers is limited by the licensing agreements, which usually delineate the territory for the producer's activities. However, these agreements do not grant a territorial monopoly. In practice, each engine is put up for tender by the relevant shipyard in consultation with the shipowner, and there is fierce competition for the larger engine contracts worldwide. DMR and other Community engine builders have to compete primarily against 'trade engines' ('*Handelsmotoren*') produced under licence by east Asian, primarily Korean, manufacturers. The prices are therefore more or less set by these leaders on the world market and the competitiveness of European manufacturers for standard types of engine depends a great deal on the exchange rate and the capacity utilisation in Asia. Producing a ship diesel engine takes about one year, the full process from contract negotiations until delivery two years. In the relevant rescue period (1996 to spring 1997), DMR received no new orders but lived on the backlog of orders placed during the container ship boom at the end of 1995. In view of this specific situation, it can be assumed that the rescue aid had no adverse effect on European competitors.

Although the rescue aid was not notified and was therefore granted illegally, the Commission has been able to declare it compatible with the common market given the specific circumstances described above. The financial measures were taken to ensure the short-term survival of DMR and, in view of their characteristics, they satisfy the criteria laid down in the guidelines.

6. The restructuring aid replaced the rescue aid, since all the measures were prolonged on more favourable terms, and comprised ([20]):

— the waiver of interest and the suspension of repayment of the loans granted during the rescue period and under the previous privatisation plan of 1994,

— the provision of fresh loans and the increase in the ceiling for counter guarantees from DEM 15 million to DEM 60 million.

7. The suspension of interest and redemption of the principal on the loans described in detail in Section II.4 and totalling DEM 74,5 million and the announcement that these loans might be given subordinate status are to be regarded as constituting conversion from loans into grants with an aid intensity of 100 %. By letter of 10 September 1997, Germany had informed the Commission that these loans from BvS and the *Land* authorities had become subordinate and could be converted into a participating interest.

The credit line of DEM 25 million created and partly disbursed in June 1997 has also been given subordinate status. By letter of 20 February 1998, Germany stated that a repayment as from 1 January 1999 can be made only in so far as the enterprise was not overindebted. This measure too is to be considered as a grant to the extent of the amount disbursed, with an aid intensity of 100 %, since DMR is overindebted. According to the auditor's reports for 1996 and 1997, the equity is negative.

The total cash aid amounts therefore to DEM 99,5 million, of which DEM 10 million needs to be deducted as it was used for the subsidiaries WPM and MMG.

The counter guarantees of DEM 60 million provided by BvS and the *Land* authorities cover in essence the completion and post-delivery risks associated with DMR's contracts. Given the nature of the activities, a total loss is very unlikely since, even in case of bankruptcy, most contracts will be settled. In consideration of the deficiencies to be normally expected in such situations, the Commission estimated an aid intensity of 20 %, corresponding to an aid equivalent of DEM 12 million.

The guarantee of DEM 10 million provided by the *Land* authorities to secure a bank loan of originally the same amount has been reduced to DEM 6,85 million in view of the repayments made by DMR according to Germany's letter of 20 February 1998. The aid intensity is 100 % of the outstanding amount. The same applies to the guarantee of DEM 10 million granted by BvS to secure short-term bridging loans.

8. The total aid equivalent of the restructuring aid provided in the form of loans converted into grants and in the form of guarantees is therefore put at DEM 118,35 million, equivalent to some EUR 60,5 million. (On account of the conversion the rescue aid has no aid element as the aid intensity cannot logically exceed 100 %.) This figure can be reduced by the amounts not disbursed by the date of this decision under the credit lines provided. An additional amount of DEM 10 million is provided for to finance redundancy costs under the social plan in 1999.

9. The aid has to be assessed in the light of the following criteria for restructuring aid laid down in the guidelines:

(i) *restoration of viability*

At the time the procedure was extended, the Commission had doubts about DMR's capability to cover all its costs and in particular its financing costs. Developments in 1998 and the latest revision of the restructuring plan as communicated in Germany's letter of 21 December 1998 (and described in Section II of this decision) show that DMR is not financially viable. The company has suffered extremely high losses since 1995 which have led to its overindebtedness.

([19]) As stated above, the decision does not extend to the subsidiaries.
([20]) For a detailed description of the measures, see Sections II.4 and II.9.

Additional losses are expected in 1999 and 2000, and in 2001 the company will be unable to pay interest on its shareholder loans. The company remains dependent at least on the operating aid being extended into the distant future. Germany stated that a privatisation without additional state aid appeared impossible. The prospects for a recovery on the market for two-stroke ship diesel engines in the Community are bleak in the medium term. Since, therefore, no return to viability can be expected in the foreseeable future, this condition of the guidelines is not met;

(ii) *avoidance of undue distortions of competition through the aid*

Although competition on the market for ship diesel engines is limited on account of the market structure described in Section II.8, the permanent financing of DMR by means of state aid must be regarded as a distortion of competition primarily because the orders in hand do not cover costs. Adverse effects on European competitors, which are mostly in a difficult situation as well, cannot be excluded, particularly as most of the remaining engine producers in Europe have lower capacity and were not able to modernise. The reduction in DMR's capacity that is planned in view of the present emergency situation cannot be regarded as irreversible within the meaning of the guidelines. Since installed plant capacity remains unchanged, DMR could return to its original capacity at short notice by re-employing the necessary personnel;

(iii) *aid in proportion to the restructuring costs and benefits*

The aid has been limited to the minimum necessary for the company's continued operation. The recipient has not been able to make a significant contribution to the restructuring costs and it cannot be expected that DMR can be sold at a positive price. The benefits consist essentially in the (temporary) maintenance of employment in two regions suffering from severe unemployment. Nevertheless, the guidelines recall that 'it does not help a region to prop up artificially companies which, for structural or other reasons, are ultimately doomed to failure'. In line with its position on aid to meet the social costs of restructuring measures, in particular in regions with a low standard of living and with severe underemployment as described in the guidelines [21] and in the guidelines on national regional aid [22], the Commission can, however, accept the intended payment of DEM 10 million in social aid in 1999.

Accordingly, the Commission has concluded that the restructuring aid already granted and the intended prolongation of the measures are not in line with the guidelines and not compatible with the common market. The intended payment of DEM 10 million in social aid in 1999 can be regarded as being compatible with the common market.

VI. **CONCLUSIONS**

The Commission finds that Germany has unlawfully implemented a series of measures for rescuing and restructuring DMR in breach of Article 93(3) of the Treaty. However, the loans and guarantees provided before April 1997 for the rescue of the company and the takeover of DMR by BvS and the *Land* of Mecklenburg-Western Pomerania can be regarded as being compatible with the common market in view of the particular difficulties caused by the collapse of the Bremer Vulkan group in 1996. However, the subsequent waiver of interest and the suspension of repayments on loans amounting to DEM 89,5 million, as well as the continuing provision of state guarantees for a nominal amount of DEM 80 million, cannot be regarded as being compatible with the common market since the measures in question do not satisfy the criteria laid down in the guidelines. These measures must therefore, be terminated and the aid recovered. The intended payment of DEM 10 million in social aid, in 1999, can be regarded as being compatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The financial measures which Germany implemented between February 1996 and April 1997 for the rescue of Dieselmotorenwerk Rostock GmbH (at the time Dieselmotorenwerk Vulkan GmbH), including the provisions on the transfer of ownership of this enterprise contained in the agreement of 28 April 1997, are compatible with the common market within the meaning of Article 92(3)(c) of the EC Treaty.

Article 2

The state aid of up to DEM 118,35 million which Germany has granted for the restructuring of Dieselmotorenwerk Rostock GmbH since May 1997 is incompatible with the common market.

Article 3

The state aid of DEM 10 million which Germany intends to grant for social measures linked to the redundancies at Dieselmotorenwerk Rostock GmbH is compatible with the common market within the meaning of Article 92(3)(a) of the EC Treaty.

[21] See footnote 18 (point 3.2.5).
[22] OJ C 74, 10.3.1998, p. 9 (point 4.15).

Article 4

1. Germany shall take the necessary measures to recover from the recipient the aid referred to in Article 2 and unlawfully made available to it.

2. Recovery shall be effected in accordance with the procedures of national law. The sums to be recovered shall bear interest from the date on which they were made available to the recipient until their actual recovery. Interest shall be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid.

Article 5

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

Article 6

This decision is addressed to the Federal Republic of Germany.

Done at Brussels, 21 April 1999.

For the Commission

Karel VAN MIERT

Member of the Commission