II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 5 June 2002

on the measures to restructure and privatise Koninklijke Schelde Groep implemented by the Netherlands

(notified under document number C(2002) 2007)

(Only the Dutch version is authentic)

(Text with EEA relevance)

(2003/45/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) 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 pursuant to the provisions cited above [1] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) In May and June 2000 the Commission received two letters from third parties on alleged aid to Koninklijke Schelde Groep BV (hereinafter KSG) in connection with the sale of the company to Damen Shipyards Group (hereinafter Damen). It requested information on this matter by letter dated 30 May 2000 (D/53220).

(2) By letter of 6 July 2000 (registered under A/35591 on 7 July) the Dutch authorities informed the Commission of the planned measures in favour of KSG. They stated that Article 296 of the EC Treaty applied to all these measures; however, if that proved not to be the case, the letter should be considered as notification pursuant to Article 88(3). The Minister for Economic Affairs provided further explanations on the 'conditional notification' in a meeting with Mr Monti on 4 September 2000. The Commission requested information by letters dated 8 September 2000 (D/54316) and 1 March 2001 (D/50927). By letter dated 12 March 2001 (registered under A/32227 on 15 March), the Dutch authorities asked for time in which to reply to the letter of 1 March and this request was granted by letter dated 23 March 2001 (D/51254). They replied by letters dated 5 October 2000 (registered under A/38308 on 11 October) and 11 July 2001 (registered under A/35724 on 16 July).

(3) As early as 1998 the Dutch Minister for Economic Affairs informed Mr Van Miert of measures taken at that time (letter of 4 December 1998, registered on 8 December under C/06585). The Commission subsequently requested information by letters dated 7 January 1999 (D/50038) and 26 February 1999 (D/50890). The Dutch authorities replied by letters dated 2 February 1999 (registered under A/30915 on 4 February) and 23 March 1999 (registered under A/32377 on 25 March).

(4) By decision of 25 July 2001 the Commission initiated the Article 88(2) procedure in respect of these measures, informing the Netherlands by letter dated 30 July 2001 (D/290603). Two further requests from the Dutch authorities for time in which to reply (letters dated 31 August and 27 September 2001, registered under A/36875 on 31 August and A/37626 on 1 October respectively) were granted by letters dated 11 September 2001 (D/53695) and 5 October 2001 (D/54096). The Dutch authorities responded to the decision by letter dated 15 October 2001 (registered under A/38035 that same day).

[1] OJ C 254, 13.9.2001, p. 6.

(5) The decision was published in the *Official Journal of the European Communities* ([2]). Interested third parties were invited to submit their comments on the aid. The Commission received four replies. The Dutch authorities were asked to react by letter dated 25 October 2001 (D/54431). The Commission raised further questions by letters dated 6 November 2001 (D/54572), 24 January 2002 (D/50281) and 4 March 2002 (D/50919). After requesting time in which to reply by letter dated 29 November 2001 (registered under A/39352 on 3 December), a request which was granted by letter dated 11 December 2001 (D/55144), the Dutch authorities gave their reactions to the interested parties' comments and answers to the aforementioned questions by letters dated 14 December 2001 (registered on the same day under A/39978), 7 February 2002 (registered on 13 February under A/31096) and 25 March 2002 (registered on 2 April under A/32413). Damen sent its own comments, answers and further information by letters dated 17 December 2001 (registered on the same day under A/39992) and 17 April 2002 (registered on the same day under A/32876). Meetings between representatives of the Commission, Damen and the Dutch authorities took place on 3 and 15 April 2002.

(6) One of the questions raised by the Commission concerned the price paid by Damen for KSG. The Dutch authorities submitted a consultant's report on KSG's value at the time of privatisation. The Commission instructed an independent expert to prepare a second expert opinion on the methodology and financial details of this report. The expert started working in January 2002 and submitted the final report in March of that year.

2. **DETAILED DESCRIPTION OF THE MEASURES**

2.1. **Koninklijke Schelde Groep**

(7) KSG was founded in 1875 as Koninklijke Maatschappij 'De Schelde' (hereinafter KMS). Its main shipbuilding location has always been Flushing in the province of Zeeland. Following several mergers in the 1960s and early 1970s, KMS became part of Rijn-Schelde-Verolme Scheepswerven en Machinefabrieken N.V. When this company went bankrupt in 1983, central government and the province of Zeeland acquired 90 % and 10 % respectively of KMS shares. In 1992 KMS was renamed KSG ([3]).

(8) Ever since it was founded, KMS, and later KSG, has supplied vessels for the Dutch Navy, but it has also built commercial vessels. Over the last 40 years or so it has developed various other industrial activities. Some of the subsidiaries involved in these activities formed an integral part of the KSG holding company, while others were only partly owned by KSG. The company's structure was frequently changed. An overview of the legal entities and the corresponding activities in 1999 is set out below.

Schelde Maritiem BV (marine division):

— Schelde Scheepsnieuwbouw: naval and commercial shipbuilding

— Scheldepoort: ship repairs

— Schelde Offshore: offshore activities

Schelde Industriële Productiebedrijven BV (industrial products division):

— Schelde Machinefabriek BV: machine working of intermediate and finished parts, assembly of machines and machine structures, trade in spare parts for marine engines (later Schelde Marine Services BV)

— Schelde Gears: gear transmissions for ships and industrial applications

— Schelde Technology Services BV: consultancy and technical services in the field of material and welding technology

— Schelde Exotech: specialist equipment and high-grade repair work for the processing industry and power stations (among others)

— Rederij 'De Schelde BV': management of vessels built by KSG

— Schelde Onroerend goed BV: ownership and management of real estate

KSG Deelnemingen BV (shareholdings):

— Fabricom Installation Technology (45 %): industrial construction

— Schelde Industrial Engineers & Contractors (100 %): boiler construction, energy-conversion systems, thermal waste-processing installations

— Schelde Heron (60 %): turbines for combined heat and power generation

— Polymarin BV (100 %): high-grade, fibre-reinforced composite structures for aerospace, shipbuilding, etc.; mouldings in thermoplastic and thermosetting resins

— KNM Steel Construction SDN BHD (36 %): combined heat and power installations, waste incinerators and industrial construction in South-East Asia

— (until 1998) Schelde Apparaten- en Ketelfabriek (AKF): machine engineering

([2]) See footnote 1.
([3]) http://www.schelde.com.

(9) Total turnover in 1999 amounted to EUR 226,7 million, 64 % of which concerned shipbuilding and ship repairs. The Royal Dutch Navy is KSG's main customer. Construction of its most important order, four frigates, started in 1998 (negotiations started as early as 1992). In April 2000 the first frigate was launched; the last one is to be delivered in 2004. Their total value is roughly EUR 1,5 billion; KSG's share of the contract is worth about EUR 540 million. Many of the parts are supplied direct to the navy but are then fitted into the vessels by KSG. On account of the workload represented by these frigates, commercial shipbuilding declined to zero in 2000/2001. In the past, however, KSG built various commercial vessels which were caught by Council Regulation (EC) No 1540/98 of 29 June 1998 establishing new rules on aid to shipbuilding ([4]) (hereinafter the Shipbuilding Regulation).

2.2. **Damen Shipyards Group**

(10) Damen was founded by two brothers in Hardinxveld-Giessendam in 1927. In 1970 the company was split and the site in Beneden-Hardinxveld was taken over by the son of one of the two brothers. The main customers at that time were large dredging companies. By the early 1980s Damen had developed into a specialist in tugs and small utility vessels. In subsequent years several other companies merged with the group, including two large ship-repair yards and a yard specialising in large luxury yachts. Control of Damen is still in the hands of Mr Damen, who owns the company together with his children. The consolidated turnover of Damen, including KSG, currently amounts to about EUR 680 million; the group had about 7 000 employees in 2000 ([5]).

2.3. **Measures taken by the Netherlands**

(11) During 1998 KSG got into serious financial difficulties, particularly as a result of its non-shipbuilding activities. In order to avoid immediate bankruptcy and to tide KSG over until privatisation, the Dutch authorities provided in January 1999 a convertible subordinated loan of NLG 35 million (EUR 15,9 million) ([6]) and an additional advance payment of NLG 15 million (EUR 6,8 million) for the frigates. It was also agreed that, subject to further conditions, the Dutch navy would buy from KSG an additional amphibious transport ship that was to be completed in 2007 ([7]). The measures were conditional on a sound business plan and cooperation in finding a private party for KSG's privatisation.

(12) The loan and advance payment were provided to KSG Maritiem en Industriële Bedrijven, within which one - month deposits plus 175 base points; KSG paid a provision of NLG 175 000 (EUR 79 000). The loan was to be repaid by 1 October 1999, or earlier in the event of the Dutch authorities taking a final decision on a capital injection. As privatisation negotiations took longer than expected, repayment was postponed.

(13) The additional advance payment concerned profits that otherwise would have been paid in two equal amounts in 2002 and 2003. Accordingly, the interest subsidy for the advance payment amounts to EUR 1,41 million (discounted to end-2000 value).

(14) The Dutch authorities held talks with several candidates with a view to privatising KSG. In the end, Damen was the only company that wanted to buy KSG. Negotiations continued during 1999. In February 2000 the Dutch State and Damen reached agreement on the basic principles of the takeover. After a due-diligence investigation, negotiations were concluded on 14 July 2000.

(15) The privatisation consisted of the following measures:

The Dutch authorities provided a new convertible subordinated loan of NLG 70 million (EUR 31,8 million) ([8]) to KSG.

The Ministry of Defence agreed to provide an interest-free loan of NLG 45 million (EUR 20,4 million) for the relocation of the military activities from the current location in the centre of Flushing to KSGs site some 10 km further east, which was deemed necessary in view of the limited size of the sluices providing access to the current site. The loan is conditional on the construction of the new location, which is to be completed in five years at a total cost of NLG 125 million (EUR 56,7 million). If after five years the cost turns out to be lower, Damen will pay back the corresponding part of the loan in the sixth year. The remainder is to be paid back in 10 annual instalments. The loan will be paid out in 2002 and 2003. The current estimated cost of the relocation remains limited to EUR 45,4 million ([9]), and so the interest subsidy amounts to EUR 6,0 million (discounted to end-2000 value).

(16) Apart from the amphibious transport ship already announced in 1998, the government has indicated that it plans to buy some additional naval vessels from KSG.

([4]) OJ L 202, 18.7.1998, p. 1.
([5]) http://www.damen.nl.
([6]) The loan was provided by Nederlandse Investeringsbank and was financed in part by the Ministry of Economic Affairs (NLG 25 million (EUR 11,3 million)) and the Ministry of Defence (NLG 10 million (EUR 4,5 million)).
([7]) Delay has occurred owing to the uncertainty surrounding the navy's equipment policy. In the summer of 1998 the new government decided on a substantial cut in the defence budget. It was decided to prepare a Cabinet paper setting out a framework within which this cut could be achieved. The paper was finalised in January 1999 and forms the basis of the navy's equipment policy until 2010.
([8]) This is the net value of the loan. The gross value was EUR 38,2 million, which was partially offset by a related corporate tax claim of EUR 6,4 million.
([9]) An independent expert has confirmed that the figure of NLG 100 million is the most realistic.

(17) Having taken these measures, the Dutch authorities on 29 September 2000 transferred the new loan, the 1998 subordinated loan and the shares in KSG to Damen for the symbolic price of NLG 4. Damen has undertaken to complete the four frigates in accordance with the existing contracts.

3. GROUNDS FOR INITIATING THE ARTICLE 88(2) PROCEDURE

(18) When the Commission initiated the Article 88(2) procedure, it explained that the measures concerned KSG's military and commercial activities alike but that, on the basis of the information available, it was unable to determine whether the measures were caught by Article 296 of the Treaty. In addition, it could not rule out the possibility that state aid was involved and it had doubts as to whether the measures complied with the rules laid down in the Community guidelines on State aid for rescuing and restructuring firms in difficulty ([10]) (hereinafter the rescue and restructuring aid guidelines) and with the Shipbuilding Regulation. These doubts concerned in particular the relationship between the measures and the restructuring plan, the abandonment of structurally loss-making activities, the effects of the restructuring on competitors and whether the aid was limited to the minimum.

(19) In addition, the Commission could not be sure that Damen had paid a market price for KSG, in particular because there had not been an open call for tender placing all competitors on an equal footing and providing them with the same information and access to a transparent procedure at the same moment in time.

4. COMMENTS FROM INTERESTED PARTIES

(20) Following the publication of the decision to initiate the procedure ([11]), the Commission received comments from the United Kingdom and Spain, a competing ship-repair yard and the recipient. The recipient's comments largely coincide with those of the Netherlands. Both sets of comments are summarised in Section 5.

4.1. Comments by the United Kingdom authorities

(21) The United Kingdom shares the Commission's concerns and notes that both KSG and Damen are direct competitors of United Kingdom shipyards. It seems clear that the aid involves support for commercial shipbuilding. Mega yachts are a growing market for several United Kingdom shipyards and any aid given to competitor yards in the Netherlands is likely to distort competition. In the case of a mixed yard being bought by a commercial shipbuilder, the United Kingdom takes the view that this does not fall entirely within the scope of Article 296 of the Treaty as it clearly involves commercial shipbuilding.

(22) The United Kingdom has little confidence in the claim that all interested companies were aware of the efforts of the Dutch authorities to find a candidate with a view to selling the KSG shares, as they would have expected United Kingdom companies to show interest.

4.2. Comments by Spain

(23) Spain takes the view that the measures fall completely outside the scope of the Treaty because (i) KSG's main customer is the Dutch navy, (ii) most of its activities concern defence, (iii) the four frigates will form the backbone of the Dutch navy and (iv) the only requirement of privatisation was that military capacity should be safeguarded. Moreover, in the event of doubts as to the applicability of Article 296 of the Treaty, the Commission should, pursuant to Article 298, have examined, together with the Netherlands, whether the aid affected the production of or trade in products not intended for specific military uses and how the aid measures could be adjusted to comply with the rules laid down in the Treaty. In any case, the Article 88(2) procedure should have been restricted to KSG's commercial production, i.e. products not intended for specific military purposes.

(24) Lastly, Spain questions whether Regulation (EC) No 1540/98 applies, given that the measures concern the period 1998-2000 and that no new contracts for commercial vessels were won by KSG during this period.

4.3. Comments by a competing ship-repair yard

(25) A competing ship-repair yard takes the view that the measures distort competition and allow KSG to compete in the ship-repair market on unfair terms and on the basis of unrealistically low prices. Any aid would directly harm this competitor's competitive position.

5. COMMENTS FROM THE NETHERLANDS AND FROM DAMEN

(26) The comments from Damen and the Netherlands coincide as regards the main conclusions and reinforce each other as regards the details. They are therefore presented together.

(27) The Netherlands makes the general comment that it informed the Commission of the measures in 1998 and 2000. It regrets that the Commission did not express its doubts at an earlier stage.

([10]) OJ C 288, 9.10.1999, p. 2.
([11]) See footnote 1.

5.1. **On the application of Article 296 of the Treaty**

(28) The Netherlands takes the view that Article 296 of the Treaty applies in view of the short-term importance of having the four frigates delivered on time and of the military and strategic importance of safeguarding naval shipbuilding in the Netherlands over the medium and long term. Maintaining a sufficient contribution from the Dutch defence industry should be seen in the context of other aspects of security policy.

(29) Dutch security policy is described in the *Hoofdlijnennotitie* of January 1999 and the *Defensienota* of November 2000 ([12]). It is deemed essential to maintain a specific industrial capacity for fundamental military technology in the field of naval vessels with a view to protecting essential interests of national security. This is the case for most NATO members. Taking account of the provisions of Article 296 of the Treaty, military equipment is normally procured from Dutch suppliers. Several further arguments were put forward, including the following.

(30) The Dutch navy must be operationally independent, e.g. for military and other assistance in the Netherlands or in its overseas territories. The capacity for and intensity of cooperation with other NATO members and EU Member States is another important aspect.

(31) The four LCF frigates form the backbone of the navy and are deemed essential for the performance of its duties. If they are not delivered on time, the navy will not be able to provide an adequate command platform and sufficient air defence capacity for its task groups.

(32) Intensive international cooperation takes place on sensor, weapon and command systems. If delivery of the LCFs is delayed and/or disrupted, this cooperation would be jeopardised. In that case the assumptions on which defence and security policy is based would be directly compromised.

(33) Apart from the LCFs, the navy also needs a second landing platform dock (hereinafter LPD). Like the first LPD, the intention is that the second should be built by KSG. It is increasingly important to have direct access to transport capacity, as illustrated by recent crises in, for example, the former Yugoslavia and Ethiopia/Eritrea. The Helsinki European Council of December 1999 underlined the need for transport capacity and laid down specific objectives. The second LPD is very important if these objectives are to be achieved.

(34) Intensive technical cooperation takes place between the navy and KSG. Continuity is essential to this cooperation.

([12]) *Defensienota* 2000, Lower House of the Dutch Parliament, 1999-2000, 26900, Nos 1-2.

(35) The relocation to Flushing East and access to a covered dock of an appropriate size are essential for naval shipbuilding. The interest-free loan must be considered within the context of defence and security policy.

5.2. **The State acted as a private company would have done**

(36) The Dutch authorities agree that private companies are not responsible for defence and security policy. Nevertheless, they took the same actions that a private company would have taken.

(37) As a shareholder, the State had no influence on KSG until 1998. KSG was a company under the *structuurregime* (structural scheme). Under Dutch law this means that the board of directors is subject to the supervision of the Board of Commissioners. The latter consisted of five persons, two of whom were appointed by the State. However, the law requires the commissioners to act solely in the interests of the company, without instructions or consultation. Only in 1998, when the financial situation deteriorated, could the State set conditions before providing new capital.

(38) The State did set such conditions. First, KSG had to shed all its non-core business, retaining only naval and commercial shipbuilding. Second, it had to cooperate with the State to find a strategic partner for the takeover. Third, it had to cooperate with a potential candidate on a common business plan. The measures decided on in December 1998 constituted an interim solution, also with a view to the awaited Cabinet paper on defence policy. Suspension of payments was unacceptable in view of the risks associated with completion of the LCFs and uncertainty surrounding naval shipbuilding in the Netherlands.

(39) In addition, finishing the LCFs in a bankruptcy situation would have involved much higher costs, even on the basis of 'business-like' costs only ([13]). These were estimated at a minimum of EUR 123 million, while guarantees to suppliers were estimated at a further EUR 131 million. As the financial problems were concentrated in the area of non-shipbuilding activities, the Netherlands looked at the possibility of splitting the company. However, that would have infringed the legal rights of creditors. As such, any buyer of KSG would have to take over the whole company.

([13]) These additional costs are caused by (i) creditors who are prepared to deliver basic products for the frigates only on condition that the government also pays the debts on other contracts; (ii) increased personnel costs to prevent employees from leaving; (iii) additional costs after delivery of the frigates; (iv) a bankruptcy scenario, which would entail at least one year's delay, resulting in additional costs in related supply contracts for the frigates and higher maintenance costs for the old frigates.

(40) At the start of the 1990s the Netherlands started proceedings with a view to selling its shares in KSG. With the help of an investment bank, several candidates were approached. In the second half of the 1990s the State made renewed efforts. Efforts to find a buyer for KSG were widely reported in the press. In addition, companies in this particular market are well aware of what is going on in Europe. One of the candidates was a German industrial group. The State did not rule out any company in advance. However, in the end only Damen remained. The only condition for privatisation was that military interests had to be safeguarded; no other non-commercial conditions were imposed.

(41) Lastly, the relationship between the Dutch navy and KSG has always been businesslike. The fact that the State was a shareholder was of no relevance when orders were placed with KSG. In 1992, when the process was launched to place the LCF order with KSG, it could not have been foreseen that the company would run into difficulties eight years later.

5.3. **No undue distortion of competition**

(42) The Dutch authorities do not accept that the rescue and restructuring aid guidelines are applicable, but confirm that they acted in the spirit of those guidelines. An initial indication of this is the fact that the measures taken in 1998 were strictly necessary for KSG's continued existence and included a subordinated loan at a market rate.

(43) According to the Dutch authorities, undue distortion of competition was avoided by terminating activities between 1998 and 2000. Staff cuts concerned around 500 jobs, i.e. 30 % of the total workforce. Damen's business plan provides for further concentration on core business: naval shipbuilding, mega yachts, ship repairs and the associated engineering works. The outlook for these activities is favourable.

(44) Aid would be limited to the minimum and the causes of the losses have been dealt with. KSG's restructuring entailed high costs, mainly in connection with the closure of the boiler construction plant, reorganisations and the finalisation of a foreign defence contract. Lack of experience with large projects abroad gave rise to enormous losses and high risks. The losses in commercial shipbuilding are a result of the strategy followed since the mid-1990s of building new types of ship with which KSG had insufficient experience. KSG recorded significant losses in the gas turbines sector as well. All these activities have been closed down and/or sold or, as regards production of gas turbines, are to be closed down/sold in the short term. Ship-repair activities will be brought in line with the Damen group's other activities. Naval shipbuilding will be continued and yacht construction has been started. From this the Netherlands concludes that the business plan will enable KSG's viability to be restored without spillover effects and at a minimum cost to the State.

(45) The Netherlands states that the State's contribution corresponds to the negative value of KSG at the time of privatisation. This contribution has enabled Damen to restore KSG's viability without spillover effects. The State has not provided funds in excess of what was strictly necessary for privatisation. According to Damen the agreement reached between it and the Dutch Government was essentially that Damen would ensure the long-term profitability of KSG's shipbuilding and ship-repair activities (in synergy with its own activities in these sectors), while the Dutch Government would bear the financial costs of closing down KSG's unprofitable non-shipbuilding activities. Damen explained that KSG had used the 1998 loan in full prior to privatisation and that it used the new loan purely to settle KSG's outstanding debts. It subsequently emerged that the capital injection was insufficient to cover all the debts for which Damen had assumed liability.

5.4. **Damen's restructuring plan for KSG**

(46) Damen referred to the business plan which it had drawn up for KSG and which had been submitted at an earlier stage, and commented on the ongoing implementation of the restructuring plan. The details are provided in the next section.

5.5. **Market price**

(47) The Netherlands and Damen submitted a consultant's report containing an assessment of KSG's value at the time when the shares were sold to Damen. This report concludes that the value of the KSG shares at the time was negative to the tune of between EUR […] (*) million and EUR […] million. While core activities showed a slightly positive result, the negative value resulted, *inter alia*, from high financial claims and risks, low capacity utilisation and uncertainty surrounding future orders for operational activities. Accordingly, the report concluded that the sale would not entail any advantage for the buyer, Damen.

5.6. **Observations on third-party comments**

(48) In general, the Netherlands refers to the comments by Damen. Damen welcomes and endorses the comments made by Spain; the Netherlands refers to its previous positions. Damen confirms the remark by the United Kingdom to the effect that the market for mega yachts is growing. It is surprised by the United Kingdom's comment that it does not believe that all interested parties were aware of the Dutch Government's plan to privatise KSG. Not only was this widely reported at the time in both the national and international press, but other non-Dutch shipbuilders showed they were aware of it by requesting from the Dutch authorities further

(*) Business secret.

information about the possibility of acquiring KSG. Damen asked an independent British yacht dealer for his comments. The dealer mentioned five United Kingdom shipyards which had recently expressed an interest in building large motor yachts or sailing yachts, three of which were basically sailing yacht builders as opposed to motor yacht builders. He could not identify any company in the United Kingdom at the time that could be compared or could compete with Dutch yacht builders such as Amels.

(49) With regard to the comments by the competing ship-repair yard, the Netherlands and Damen note that KSG's ship-repair activities are subsidiary to its (naval) ship-building activities. None of the aid has benefited KSG's ship-repair activities or has been used for that purpose.

6. THE RESTRUCTURING PLAN

(50) During negotiations with the Netherlands, Damen carried out a due-diligence investigation and devised a restructuring plan. The main components of the restructuring plan are (i) concentrating on core business and developing the construction of mega yachts, (ii) terminating or selling off most of KSG's non-core business, (iii) focusing future shipbuilding activities on the segments for which KSG is best equipped, and (iv) streamlining the management structure and simplifying the legal structure. As indicated above, the closure of loss-making non-core business was imposed as a condition for the 1998 measures. Consequently, restructuring started even before the privatisation agreement had been finalised.

6.1. Concentrating on core business and developing the construction of mega yachts

(51) Naval shipbuilding will remain KSG's core activity. Being the Dutch navy's preferred supplier is, of course, a major asset and the outlook for future orders is relatively healthy. In addition, shipbuilding is expected to benefit from Damen's sales organisation and from the way in which the company wins orders and follows through the building process. The product range will be geared towards patrol tasks. Military vessels will be smaller and less complicated than was the case in the 1970s and 1980s. With a view to achieving full capacity utilisation, particularly after the frigates are completed in 2003/2004, marketing efforts will focus on emerging economies such as India and Malaysia. Shipbuilding may increasingly be located in those countries.

(52) An important feature of the business plan is the relocation of the military activities from the centre of Flushing to Flushing East, some eight kilometres away. Relocation is necessary because of the small size of the sluice, which limits the maximum size of naval vessels that can be built there. Production facilities will be constructed on two existing docks in Flushing East and the welding shop, the blocks factory and section building will be relocated.

(53) Specific restructuring measures for the ongoing construction of four frigates were not deemed necessary. Damen found in its due-diligence investigation that work on the frigates was on schedule. Although some risks were identified, there was no reason to expect them to jeopardise the company's expected profits on the order. Negotiations are currently under way with the Dutch navy on two hydrographic registration vessels, an amphibious transport vessel and unmanned minesweepers. Apart from the relocation, no further restructuring measures are necessary for naval activities.

(54) KSG's plans to start yacht construction form an important part of the restructuring plan. Damen is already engaged in building mega yachts with Amels in Makkum, and one of the […] motivations for the take-over of KSG was the need to acquire additional capacity for yacht construction with a view to meeting demand. The restructuring plan assumes that at least one yacht with a value of between EUR […] million and EUR […] million will be built each year. Current orders total EUR […] million for 2003, rising to EUR […] million for 2006. KSG's facilities could be adapted relatively easily for yacht construction. The relocation of some activities to Flushing East has permitted the refurbishment of a former dock that was filled with sand. The construction of private yachts does not fall within the scope of the Shipbuilding Regulation, which applies to commercial vessels only ([14]).

(55) According to Damen, the market for mega yachts (i.e. custom-designed motor yachts with a steel hull and an aluminium structure of more than 40 metres in length) is global and booming. More than 80 such yachts were being built around the world in 2000, compared with 25 in 1995. Damen's main competitors are Feadship (the Netherlands), Lürssen (Germany) and Benetti (Italy). This is an extremely specialised market comparable to the market for racing cars. The customer selects the yard on the basis of specific design requirements and technical expertise rather than price. According to Damen,

([14]) Article 1 of Council Regulation (EC) No 1540/98 of 29 June 1998.

there is no question of any surplus capacity: Amels' current order-book is the best in the company's history. Its competitors' order books are believed to be similar or even healthier in terms of total length being built. Apart from these four yards, there is a large number of smaller mega yacht builders with a production capacity of around one yacht every two years.

6.2. **Closing down or selling off most of KSG's non-core business**

(56) The restructuring plan provides for the continuation of three activities which are related to shipbuilding but do not constitute shipbuilding itself: process technology (Exotech), the engineering works and trade in machine spare parts. […].

(57) By far the most significant losses occurred in non-shipbuilding activities, notably boiler construction and, to a lesser extent, gas turbines. The main reasons for these losses were a lack of experience when entering new markets, insufficient hedging against technical risks in large individual projects and insufficient size to benefit from economies of scale and to gain experience. Another major loss-making project concerned the construction of a […] for […].

(58) Almost all these activities have now been terminated or sold off and the main outstanding claims have been settled. SIEC (boiler construction) went bankrupt in 1999, NEM-Schelde (industrial engineering) and Schelde-Heron (gas turbines) were wound up in 2000/2001. Other non-core activities have been hived off: activities in process management and technology (Franken & Goes) and equipment technology (Fabricom Installatietechniek) were sold in 1999. Activities in steel construction (KNM Steel Construction) and, after restructuring, plastic products (Polymarin) were sold off in 2000. A start was recently made on winding up […].

(59) There has been no need to restructure Exotech or trading activities in ship diesel engine spare parts. However, in view of the persistently bleak market outlook, the engineering works was restructured. It was halved in size in 1999. A reasonable degree of capacity utilisation is expected for 2001, and the works should break even. […].

6.3. **Refocusing future shipbuilding activities**

(60) Compared with non-shipbuilding activities, losses in commercial shipbuilding have remained relatively small. Although it is possible to attribute losses on individual orders to specific causes, more general factors are at play. Of course, the difficult market in which the European shipbuilding industry operates at present is one of them. In addition, as a result of the limited orders from the Dutch navy and the relatively small size of the yard, KSG is faced with a structural difficulty in achieving full capacity utilisation by booking appropriate orders that can be fitted in between military orders. To cover at least the fixed costs, any owner will be tempted to accept low profit margins or even small losses on 'topping-up orders'. The problem is exacerbated by the fact that KSG's workforce is generally highly skilled and specialises in naval shipbuilding. That means that they may either lack experience or simply be overqualified for work on other types of ship. As a result, KSG's management has accepted orders with expected low profit margins and high risks. In addition, KSG has had to cope with difficult market conditions for carriers as a result of the strength of the United States dollar.

(61) Damen's approach is to focus on building ships for which KSG is best suited, which correspond to the skills of KSG's workforce and for which there is no surplus capacity. The restructuring plan provides for the complete termination of cargo vessel construction because Damen is convinced that, in the current circumstances, KSG will never be able to make a profit on these activities. Instead, KSG will concentrate on building naval vessels for third countries and special, highly specialised utility vessels, such as buoy handling and maintenance vessels and R&D ships ([15]).

(62) Damen already has a strong market position in the special utility vessels segment. In addition, its sales organisation is particularly large by shipbuilding standards. It is difficult to predict how the market for special utility vessels will evolve. These vessels are not used intensively and, as such, their lifetime is quite long.

(63) Losses in the ship repairs segment resulted from difficult market conditions and a number of ill-judged projects (two in 1999). Again, the problems are due partly to large conversion projects […]. Damen intends to put a stop to projects of this kind and in 2000 the organisation was thoroughly restructured. Damen expects Scheldepoort to benefit from the synergy with its ship-repair activities, in particular for 'distant' markets, and possibly to take over its ship-repair activities for which it is best equipped. Damen does not expect market conditions for ship repairs to improve in the near future, but Scheldepoort has a strategic location on the busy River Schelde and may benefit from the increasingly strict safety standards for ships. Damen therefore expects that KSG's ship-repair activities can be maintained more or less at the current level, which is significantly below that at the end of the 1990s.

([15]) Yacht construction will not be able to absorb capacity available elsewhere in KSG because it is a separate business requiring different skills and facilities.

(64) The following table summarises developments:

(EUR million)

Employment	31.12.1998	25.2.2000	29.9.2000	Future	Turnover 1998	Turnover September 2000
New shipbuilding	755	638	590	-	171,1	123
Yachts	—	—	—	+		
Ship repair	155	154	145	=/-	25,4	17,2
Gear wheel transmission	39	46	51	[...]	10,4	14,5
Engineering works/naval services	132	108	84	[...]	14,5	13,2
Boiler construction	109	96	0	0	35,4	0
Industrial construction	0	0	0	0	22,7	0
Process management and technology	134	91	86	[...]	15,0	8,2
Synthetic products	77	73	0	0	7,7	0
Gas turbines	6	5	5	0		

(0: (no activities),
+: (increase),
-: (decrease),
=: (stable)).

6.4. **Simplifying the legal structure, reducing overheads and new ICT infrastructure**

(65) Immediately after the takeover, Damen simplified the company's legal and management structure and reduced KSG's overheads. The relocation will result in further savings in management costs.

(66) Lastly, the ICT infrastructure is too extensive and cumbersome for KSG's activities. Investments in new ICT infrastructure are planned.

6.5. **Restructuring costs, financing and planned financial situation**

(67) The following restructuring costs have been identified.

(68) Privatisation negotiations started in 1999. At the same time, KSG started restructuring but also incurred further losses. Those losses can be regarded as restructuring costs given that they were unavoidable and necessary to restore profitability. The 1999 loss was huge: NLG 137 million EUR 62,2 million), of which NLG 43 million (EUR 19,5 million) was due to operational losses, interest and taxation. The remaining losses, NLG 94 million, represent one-off costs relating to the winding-up of SIEC and NEM, reorganisations and the write-down of shareholdings. Only a small amount, NLG 15 million (EUR 6,8 million), was incurred in 1999, the remainder being set aside as provisions for later years. Since Damen has provided figures on restructuring costs for later years, the relevant figure for 1999 is the sum of NLG 43 million and NLG 15 million, i.e. NLG 58 million (EUR 26,3 million). Discounted to end-2000, this amounts to EUR 27,8 million.

(69) From the point at which it was privatised until December 2001, Damen incurred costs for closing down loss-making activities totalling EUR 71,7 million (see following table). Further costs are likely to be incurred for some items; however, the Commission takes the view that they cannot be considered as relating directly to the restructuring plan but should be treated as normal business costs. The same applies to the minor costs relating to the construction of the frigates and to the unspecified provision that must be created to cover claims by former employees who have come into contact with asbestos.

(EUR million)

Restructuring measure	Realised costs until December 2001
SIEC (boiler construction):	
— bank loans and guarantees	[...]
— various projects	[...]
— payment to receiver	[...]
— claims for damages	[...]
SIEC total	[...]
NEM (industrial engineering)	[...]
Heron (gas turbines)	[...]
Schelde gears ([16])	[...]
[…] project ([17])	[...]
Reorganisation costs (including redundancy costs, accountancy costs and legal costs) ([18])	[...]
Total	71,7

([16]) Costs up to April 2002.
([17]) Costs up to April 2002.
([18]) Estimate: up to April 2002 EUR […] million had been spent.

(70) In 2000 the total cost of relocating naval shipbuilding to Flushing East was estimated at about EUR 56,7 million, but the current estimate is EUR 45,4 million. Discounted to end-2000, this amounts to EUR 38,8 million ([19]).

(71) Investments in mega yacht construction amounted to EUR 5,4 million. The expected investment in ICT infrastructure amounts to EUR 2,3 million. Discounted to end-2000, this amounts to EUR 2,1 million.

(72) The restructuring has been financed by aid measures, the proceeds of divestments, the proceeds of the sale of surplus land in the centre of Flushing and additional own resources from KSG and banks. A complete financial overview is provided in the following table:

(EUR million)

Restructuring costs		Financing	
1999 losses	27,8	1998 Subordinated loans	15,9
2000-01 closure of non-core business and claims	71,7	1998 Additional advance payment	1,4
Relocation	38,8	2000 Subordinated loan	31,8
Investments in yacht construction	5,4	Interest-free loan	6,0
		Total aid:	55,1
ICT infrastructure	2,1	Divestments	22,1
		Land sales ([20])	19,3
		Other contributions from KSG/Damen (including increase in bank financing)	43,5
		Investor contribution	90,7
Total	145,8		145,8

([20]) Estimated value in 1999/2000.

([19]) This is based on the assumption that costs are evenly spread over the 2002-2007 period. Neither Damen nor the Netherlands has provided a detailed schedule.

(73) The financial figures in the plan concern the period 2000-2005. The restructuring plan is based on the following balance-sheet forecasts:

(NLG million)

	Adjusted 1999 balance	Takeover balance	Forecast balance 31.12.2000
ASSETS			
Fixed assets	120,6	156,6	151,6
Raw materials and consumables	7,7	7,7	7,7
Work in progress less instalments	- 80,2	- 82,3	- 17,7
Finished products and trading stock	9,9	9,9	9,9
Debts	74,4	59,2	39,2
Cash	42,0	110,2	1,4
Total	174,3	261,2	192,0
LIABILITIES			
Own funds	- 47,1	- 30,2	- 28,1
Provisions	81,0	66,9	30,9
Subordinated loans		119,0	119,0
Long-term liabilities	39,5	4,5	4,2
Short-term liabilities	100,9	101,0	66,0
Total	174,3	261,2	192,0

([21]) Adjusted for the purpose of comparison. Changes with the original figures are due to the application of Damen's valuation methods.

(74) Under the plan, the company was to be restored to modest profit levels in 2001. The following table shows the main indicators for all shipbuilding and ship-repair activities. The original plan assumed that at least one yacht would be built per year. Since then, forecasts have been adjusted to reflect a higher level of yacht construction activity. As regards yacht construction, the current order book is very much in line with that scenario.

(EUR million)

	2000	2001	2002	2003	2004	2005
Low level of yacht construction activity						
Forecast turnover	[...]	[...]	[...]	[...]	[...]	[...]
Results on orders	[...]	[...]	[...]	[...]	[...]	[...]
Operating results	[...]	[...]	[...]	[...]	[...]	[...]
High level of yacht construction activity						
Forecast turnover	[...]	[...]	[...]	[...]	[...]	[...]
Results on orders	[...]	[...]	[...]	[...]	[...]	[...]
Operating results	[...]	[...]	[...]	[...]	[...]	[...]

7. **ASSESSMENT**

7.1. **Application of Article 296**

(75) Article 296(1)(b) stipulates that: 'any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.' Conversely, where a measure caught by the definition of state aid within the meaning of Article 87(1) affects military production as well as commercial or dual-use production, it cannot be fully justified on the basis of Article 296. The Commission does not share the viewpoint of the Dutch and Spanish authorities to the effect that, by virtue of the military aspects, the whole measure is caught by Article 296, even if there is a clear effect on competition in non-military sectors. That interpretation clearly conflicts with the wording of the Article.

(76) The Netherlands has provided information regarding the essential security interests involved in this case. The Commission cannot deny that such interests exist. At the same time, it is clear that the Netherlands has rescued and restructured the whole company and not just the military part. First, the financial resources provided to KSG have not been used for its military activities, but for its commercial activities. It is therefore clear that the measures have indeed affected the conditions of competition as regards commercial products. Therefore, in accordance with its standard practice, the Commission must assess the measures in the light of the State aid rules in so far as they distort, or threaten to distort, competition in markets for products that are not caught by Article 296.

7.2. **The business-like behaviour of the Netherlands**

(77) The Commission does not dispute that the sale of KSG to Damen was perhaps the least costly way of safeguarding the State's interest as a customer ([22]) and that a private customer in the same situation would have tried to minimise its losses in a similar way. The Dutch authorities do not refer explicitly to the Court decision in Joined Cases C-278/92, C-279/92 and C-280/92 (Hytasa) ([23]), but their reasoning is similar in some respects. In paragraphs 21 and 22 of that judgment the Court states:

> 'In order to determine whether such measures are in the nature of state aid, it is necessary to consider whether in similar circumstances a private investor of a size comparable to that of the bodies administering the public sector might have provided capital of such an amount […]. In that respect a distinction must be drawn between the obligations which the State must assume as owner of the share capital of a company and its obligations as a public authority.'

The reasoning of the Dutch authorities is based on the distinction that must be made between the State's obligations as a customer with a contract for four frigates and its obligations as a public authority.

(78) However, a private customer would never find itself in that situation. The State was placed in this unfortunate position not as a result of normal, competitive (business-like) procurement, but in connection with procurement of military vessels, which is not organised on a 'business-like' basis. As is common in national defence policy throughout the European Union, the Netherlands reserved the order in principle for its own industry, in this case KSG. There was no open competitive tender procedure. This political decision does not become a commercial one when the shipyard gets into difficulties and needs state support in order to survive and ensure that the frigates are finished. In other words, given that this is a political decision which must be safeguarded, the State cannot claim that the aid for the yard is justified because a private company would have done the same in similar circumstances. Given the original political decision and the intent to safeguard its implementation, the State always acts in its capacity as a public authority. It is not appropriate therefore to distinguish between the obligations which the State must assume as a customer with a contract for four frigates and its obligations as a public authority. Accordingly, the measures cannot avoid being assessed in the light of Articles 87 and 296 of the Treaty.

([22]) The Commission would, however, not take into account the guarantees that the government would have to provide to suppliers. Being the customer, such guarantees do not constitute a cost that would be additional to signing the original contract. Nevertheless, it is clear that the cost of privatisation was below the cost of bankruptcy.

([23]) Joined Cases C-278/92, C-279/92 and C-280/92 Spain v Commission [1994] ECR 4103.

7.3. **Privatisation: potential aid to Damen**

(79) The Commission acknowledges that the Netherlands has followed relatively open procedures and that competitors may well have been aware of the plan to privatise KSG and may have had an opportunity to express an interest. The consultant's report submitted by the Netherlands confirmed that Damen paid (more than) KSG's market value. It found a negative value of between NLG 150 million and NLG 200 million, which is significantly below the negative price. The Commission asked an independent expert to prepare a second expert opinion on the report. That expert criticised various elements of the calculation of KSG's value in the original report. However, when these various criticisms are considered, the effect on the final result is largely neutral, with the result that the expert's value calculation is more or less the same. The Commission therefore takes the view that the price for which KSG was sold to Damen did not contain an element of State aid in the buyer's favour.

7.4. **Assessment in the light of the rescue and restructuring aid guidelines**

(80) There is no doubt that the measures taken by the Netherlands have been financed though state resources and that they favour certain undertakings, namely KSG and — indirectly — its new shareholder, Damen. Nor is there any doubt that the measures affect trade between Member States since the types of product that KSG manufactures are widely traded. The measures are therefore caught by the definition of State aid within the meaning of Article 87(1) of the Treaty.

(81) The Commission has examined whether the exemptions set out in Article 87(2) and (3) of the EC Treaty apply. The exemptions in Article 87(2) should be able to serve as a basis for declaring the aid compatible with the common market. However, the aid measures (a) do not have a social character and are not granted to individual consumers, (b) are not designed to make good the damage caused by natural disasters or exceptional occurrences and (c) are not required in order to compensate for the economic disadvantages caused by the division of Germany. The exemptions in Article 87(3)(a), (b) and (d) of the EC Treaty do not apply either in that the measures are not designed to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. Nor are the measures designed to promote the execution of projects of common European interest, culture or heritage conservation.

(82) Indeed, the Dutch authorities did not attempt to justify the aid on the grounds specified in the preceding paragraph.

(83) As far as the first part of the exemption in Article 87(3)(c) is concerned, namely aid to facilitate the development of certain economic activities, the Commission notes that the aid did not relate to R&D, environmental objectives or investment by SMEs. It is clear that the purpose of the aid was to rescue and restructure KSG. Consequently, the Commission has assessed the aid in the light of the rescue and restructuring aid guidelines and, in part, the Shipbuilding Regulation.

(84) The Netherlands rescued the whole company and the restructuring plan concerned all its activities. In addition, the activities caught by the Shipbuilding Regulation are inextricably linked to naval shipbuilding because they have common facilities and, to some extent, a common workforce and a common legal structure. Accordingly, the following assessment also concerns KSG's military activities. In fact, except for the assessment of rescue aid, there is no need to make a distinction between the measures justified under Article 296 and those affecting commercial and dual-use production. However, as explained below, it was necessary to determine the extent to which restructuring measures had affected commercial shipbuilding within the scope of the Shipbuilding Regulation. Under Article 5 of that Regulation, the Commission may exceptionally consider rescue and restructuring aid compatible with the common market provided that it complies with the rescue and restructuring aid guidelines. However, that Article lays down a number of additional conditions that must also be complied with. In this section, the measures are assessed in the light of the rescue and restructuring aid guidelines. The assessment in the light of the Shipbuilding Regulation is carried out in Section 7.5.

Firm in difficulty

(85) From 1998 until it was privatised in 2000, KSG can properly be considered as a firm in difficulty. It was unable, using its own resources or funds obtained from its creditors, to stem losses which would almost certainly have put it out of business in the short term had the authorities not intervened. The figures in the annual accounts show beyond doubt that the threat of bankruptcy was real. As explained above, the measures taken by the State in 1998 cannot be compared to a capital injection on commercial terms.

Rescue aid

(86) The measures taken at the end of 1998 have the effect of rescue aid to their full nominal value of EUR 22,7 million. They enabled KSG to stay afloat for the time needed to find a buyer and work out a restructuring plan. The rescue and restructuring aid guidelines ([24]) set out clear conditions for such aid.

(87) First, the aid must consist of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates. The subordinated loans comply with this requirement. The additional advance payment serves the same purpose as a loan, but no interest is charged on it.

(88) Second, the aid must be restricted to the amount needed to keep a firm in business. In the Commission's view, this condition is fulfilled. A larger amount was allocated to the restructuring measures taken prior to privatisation. In addition, the 1999 annual report refers to the difficult financial situation, notwithstanding the aid provided.

(89) Third, the aid must be paid only for the time needed to devise the necessary and feasible recovery plan. This should generally not exceed six months, but in this case the final privatisation, which was an absolute condition for the recovery plan, was not carried out until September 2000. To a certain extent, the delay resulted from the fact that the Cabinet had agreed a substantial reduction in the defence budget, creating uncertainty for future naval procurement policy. Further delay was caused by the difficulties encountered in concluding the privatisation agreement, while the situation of KSG deteriorated significantly. In this particular case the Commission can accept the longer period.

(90) The subordinated loans were originally granted for a period of less than twelve months. When it was realised that privatisation would not be possible within that period, reimbursement was tacitly postponed until the privatisation agreement had been finalised. In contrast, the advance payment's effect extends over a longer period since those payments were originally scheduled for 2002 and 2003.

(91) Lastly, the aid must be warranted on grounds of serious social difficulties and have no undue adverse effects on the industrial situation in other Member States. Besides the military argument, the Commission can also take account of the fact that KSG is the largest employer in the province of Zeeland. Immediate, uncontrolled bankruptcy without any social plan would result in serious social difficulties. For the bridging period, the Commission regards the adverse effects on the industrial situation in other Member States as limited and not undue. Indeed, the aid has been used to settle claims on various projects, most of which were carried out for foreign customers.

(92) In conclusion, the subordinated loan meets the criteria set out in the guidelines, but the additional advance payment fails to meet those criteria as regards its form and the period during which it has effect. However, it represents only 30 % of total rescue aid, which corresponds to the share of naval activities in total turnover. Accordingly, it can be justified under Article 296 of the Treaty. In so far as the rescue aid does not affect the conditions of competition in the common market for products which are not intended for specifically military purposes, the Commission concludes that the rescue aid decided in December 1998 is compatible with the common market.

([24]) Since the rescue aid was granted in full in the period before the entry into force of the 1999 rescue and restructuring guidelines, the Commission has assessed it in the light of the 1994 Community guidelines for rescuing and restructuring firms in difficulty (OJ C 368, 23.12.1994, p. 12). The extension of those guidelines until the entry in force of the new guidelines was published in 1998 (OJ C 74, 10.3.1998, p. 31).

Restructuring aid

(93) The following aid components, discounted to end-2000, are caught by the definition of restructuring aid within the meaning of point 11 of the rescue and restructuring aid guidelines. In the first place, with the new subordinated loan KSG obtained resources that it would not have been able to obtain under market conditions. The loan formed part of the privatisation agreement between central government, the province of Zeeland and Damen, which, as explained in Section 7.2, cannot be justified on the basis of private investor or private customer behaviour. The aid component therefore consists of the nominal value of NLG 70 million (EUR 31,8 million). The same applies to the original subordinated loan of NLG 35 million (EUR 15,9 million) granted in 1998 ([25]). These points are confirmed by the fact that Damen converted NLG 100 million (EUR 45,4 million) of the loans into equity capital. Second, the aid component of the advance payment — EUR 1,41 million — must also be considered as restructuring aid since it was used for that purpose over a period extending beyond the completion of privatisation. Lastly, as described in paragraph 15 above, the expected aid component of the interest-free loan amounts to EUR 6,0 million. It has to be concluded that KSG benefited from restructuring aid totalling EUR 55,1 million.

(94) Below the Commission assesses the aid in the light of the criteria set out in Section 3.2.2 of the rescue and restructuring aid guidelines.

Eligibility of the firm

(95) As explained in paragraph 85 above, KSG constitutes a firm in difficulty within the meaning of the guidelines.

Restoration of viability

(96) As indicated in points 31-34 of the rescue and restructuring aid guidelines, the Commission can find restructuring aid compatible with the common market only where there is a restructuring plan that restores the viability of the firm. First and foremost, in the Commission's view, the fact that Damen was willing to buy the company and invest significant amounts in it is a strong indication of the viability of KSG's remaining activities.

(97) The restructuring plan provides for the closure or sale of most of KSG's non-core activities. For the remaining parts, as described in Section 6, Damen has tackled the underlying causes of losses over the last few years and has established a sound basis for a return to profitability. The Commission regards the outlook for shipbuilding for the Dutch navy, yacht construction and ship repairs as good. It notes that none of the third parties has argued that the market segments for mega yachts and the construction of special utility vessels would encounter difficulties. On the contrary, the United Kingdom stated in its comments that the market for mega yachts is growing. As regards ship repairs, Damen's restructuring plan is based on a careful assessment of the relevant market.

(98) The greatest uncertainty surrounds future shipbuilding activities. As already stated, KSG has a structural problem with achieving full capacity utilisation by obtaining appropriate orders that can be fitted in between military orders. Since the Dutch navy has no specific plans for orders, the outlook is uncertain, especially from 2007 onwards.

(99) Whether Damen will be successful in attracting naval shipbuilding orders for third countries remains to be seen: the conclusion of contracts is normally preceded by five years of contacts and negotiations. The Commission notes that there is fierce competition in this segment but, at the same time, it realises that a relatively small number of orders may suffice for the purpose of 'topping up' capacity and, in any case, it has no evidence to suggest that Damen's plans in this area would fail. It also points out that Damen already has a strong market position in the special utility vessels segment and that its sales organisation is exceptionally large by shipbuilding standards. Clearly, Damen might

([25]) Since a commercial interest rate applied to the 1998 loan, the aid component on the occasion of the transfer to Damen still amounted to its nominal value.

be forced to accept lower profit margins on commercial shipbuilding, and the possibility of its incurring incidental losses cannot be ruled out, but it would be unduly pessimistic to regard its commercial shipbuilding as 'structurally loss-making' within the meaning of rescue and restructuring aid guidelines.

(100) The Commission concludes that the assumptions as to future operating conditions must be regarded as reasonable and realistic. Damen's restructuring plan provides the Commission with the requisite confidence that KSG's viability will be restored.

Avoidance of undue distortions of competition

(101) According to points 35–39 of the guidelines, measures must be taken to mitigate as far as possible any adverse effects of the aid on competitors. In this case, KSG and Damen limited the adverse effects to a great extent by closing down/selling off most of their non-core business and by switching commercial shipbuilding to the more dynamic market segments of mega yachts and specialised utility vessels. In terms of employment and turnover, production levels decreased significantly. Between 1994 and September 2000 employment fell by 2309 full-time equivalents. Turnover declined by 50 %.

(102) The Commission concludes that the capacity reductions made in non-core business are sufficient to mitigate the adverse effect of the aid and that undue distortions of competition as regards non-core business have been avoided. The assessment of shipbuilding and ship repairs in the light of the Shipbuilding Regulation is set out in Section 7.5.

Aid limited to the minimum

(103) The amount and intensity of the aid must be limited to the strict minimum needed to enable restructuring to be undertaken in the light of the existing financial resources of the company, its shareholders or the business group to which it belongs (point 40 of the guidelines). In this case, however, the amount of the aid corresponds to the 'negative price' which Damen was willing to pay for KSG, including all its liabilities and outstanding contracts ([26]). This implies that the aid was expected not only to cover the cost of restructuring in so far as KSG's own resources were inadequate, but also to enable a sufficient profit to be realised on the capital invested in the remaining activities. From this perspective, the profit forecasts contained in the restructuring plan do not seem disproportionately high.

(104) The Commission has investigated the level of KSG's liabilities and notes that there were persistent financing difficulties prior to privatisation in spite of the rescue aid. The banks had significantly reduced their credit facilities and the State did not want to provide additional capital before a privatisation agreement was signed. Following privatisation, the net cash flow moved sharply into the black. The balance sheet as per 31 December 2000 showed a cash position of EUR […] million instead of the planned EUR […] million. This corresponds, however, to the payment of instalments on the frigates (the balance-sheet item 'work in progress less instalments' amounted to -EUR […] million instead of the planned -EUR 8,0 million) and the to financial requirements resulting from the […] project and relocation. There was no surplus cash for aggressive, market-distorting activities not linked to the restructuring process.

(105) Damen's contribution consists firstly of the substantial risks it took by guaranteeing to finish the frigates under construction. Secondly, as indicated above, Damen converted NLG 100 million (EUR 45,4 million) of the subordinated loans into equity capital.

(106) From the above the Commission concludes that the aid is limited to the minimum as required by the rescue and restructuring aid guidelines.

([26]) Section 6.6 assesses whether or not the negotiations between the Netherlands and Damen have ensured a proper 'market price'.

Further conditions

(107) As indicated in point 43 of the rescue and restructuring aid guidelines, the Commission regards any failure to implement the plan as misuse of aid. Pursuant to points 45 and 46 of the guidelines, it will require an annual report on the restructuring.

(108) In conclusion, the Commission finds that the conditions laid down in the rescue and restructuring aid guidelines have been complied with.

7.5. **Assessment in the light of the Shipbuilding Regulation**

(109) In view of the structural difficulties in the shipbuilding sector, the Commission has a strict policy on restructuring aid for companies active in that sector. That policy is set out in particular in Article 5 of the Shipbuilding Regulation, which concerns restructuring aid. Such aid must comply not only with the rescue and restructuring aid guidelines but also with a set of additional specific conditions.

(110) The restructuring measures affect commercial shipbuilding caught by the Shipbuilding Regulation in the following way:

— of the 1999 losses, EUR 7,1 million is caused by or attributable to commercial shipbuilding ([27]),

— all costs associated with the closure of non-core business and the settlement of outstanding claims concern non-shipbuilding sectors and the […] project. They bear no relation to commercial shipbuilding activities,

— the relocation affects military shipbuilding, commercial shipbuilding caught by the Shipbuilding Regulation and some of the yacht construction activities. On the basis of turnover forecasts for these activities, the Commission attributes 8 % of the cost, i.e. EUR 3,1 million, to activities caught by the Shipbuilding Regulation ([28]),

— the investments in yacht construction do not affect commercial shipbuilding caught by the Shipbuilding Regulation,

— the expected investment in ICT infrastructure will benefit all shipbuilding activities, including yacht construction and ship repairs. On the basis of a calculation comparable to the one effected for the relocation, the Commission arrives at a figure equal to 11,9 % of the costs, i.e. EUR 0,3 million.

([27]) (EUR 4,9 million is directly attributable to commercial shipbuilding activities. An amount of EUR 9 million concerns both commercial and military activities. The share attributed to commercial shipbuilding was calculated on the basis of commercial production as a percentage of total production over the period 1995-1999. The amount of (EUR 7,1 million is discounted to end-2000.

([28]) Turnover forecasts were included in the comments by the Netherlands and by Damen since they had been incorporated into the expert's study on the value of KSG at the time of privatisation. The figures are based on Damen's expectations at the time of the due-diligence investigation. The Commission considers the scenario of intensive yacht construction to be the most appropriate for this calculation, something which has been confirmed by Damen. In the Commission's view, the period 2002-2007 is the most appropriate: although the relocation began as early as 2000, its effects in terms of capacity utilisation were not felt until 2002. Figures for the post-2007 period are not available and would not in any case be reliable. The relocation affects yacht construction only to the extent that the workload exceeds the capacity of the dock refurbished for this purpose (the corresponding turnover is estimated at NLG […] million, which is the figure in the order book for that year and which will be realised in full in the refurbished dock, whereas the somewhat higher 2004 figure will partly be realised in the 'old' military dock). On the basis of those assumptions, it is calculated that 'topping-up orders' constitute […] % of total expected turnover that is affected by the relocation. It is true that such orders may also comprise naval shipbuilding for third countries, which implies that, as a percentage of total turnover affected by the relocation, commercial shipbuilding caught by the Shipbuilding Regulation should be lower. The current order book also suggests that commercial shipbuilding activities were more limited than expected at the time of privatisation. On the other hand, after 2007, commercial shipbuilding caught by the Shipbuilding Regulation may increase, in particular when military orders are limited. The Commission therefore regards 8 % as the best estimate available.

It must be concluded that some EUR 10,5 million (7,2 %) of total restructuring costs can be regarded as destined for shipbuilding activities caught by the Shipbuilding Regulation. Consequently, 7,2 % of the total aid, or EUR 4 million, can be regarded as favouring those activities. In order to determine whether that part of the aid is compatible with the common market, the Commission must ascertain whether the conditions set out in the Shipbuilding Regulation have been met.

(111) The first condition (Article 5(1), first indent) has been met, given that KSG has not been granted rescue or restructuring aid pursuant to Council Regulation (EC) No 1013/97 of 2 June 1997 on aid to certain shipyards under restructuring ([29]).

(112) As required by the second indent of Article 5(1), the Netherlands has not given clear and unequivocal undertakings that no further rescue or restructuring aid will be granted to the firm or its legal successors in the future.

(113) The third indent of Article 5(1) requires there to be a genuine and irreversible reduction in the shipbuilding, ship repair or ship conversion capacity of the firm concerned commensurate with the level of aid involved. However, the restructuring actually increased capacity. The following effects have been identified:

— the relocation of military activities to the Flushing East site entails a significant reduction in the surface area used for assembly, panel building, steel welding, piping and various other activities. However, the overall effect is an increase in efficiency and capacity due to the new hall on the docks. The main dock in Flushing centre, currently used for the military frigates, is not to be closed. The fact that it may be used principally for shipbuilding not caught by Shipbuilding Regulation does not constitute closure: it may be used for commercial shipbuilding caught by the Regulation for a period of ten years and use of the dock for the stated purposes is not independent of Damen (fifth and sixth indents of Article 5(1)),

— part of the site in the centre of Flushing, including 500 metres of quay, will be sold. However, alongside the main dock, KSG will construct a new, 200-metre-long quay on the site. In Flushing East a quay has been extended by a 66-metre-long pier so that two frigates can be finished together. As a result, the overall length of the quays and piers has been reduced by 234 metres. However, it appears that the length of piers and quays did not represent a bottleneck as regards production in the period preceding the aid measures. Damen has demonstrated that all the quays and piers have been usable to date and that they may all have been used in the recent past. However, it has not been demonstrated that the reduction would entail a capacity reduction in relation to the level of actual production in the preceding five years,

— as regards ship repairs, the restructuring has entailed a reduction in the workforce from 155 in 1998 to 139 in 2000 (down 10 %). Damen and KSG have not made any significant investments in the ship-repair yard. The value of production is estimated at EUR […] million per annum, significantly below the corresponding levels in 1998 and 1999. However, neither Damen nor the Netherlands has undertaken to limit production in the event of demand trends proving more favourable than expected.

(114) The Commission's requests notwithstanding, neither Damen nor the Netherlands has submitted an acceptable proposal for a capacity reduction within the meaning of the Shipbuilding Regulation. On the basis of all the aforementioned effects, the Commission concludes that there is no capacity reduction commensurate with the aid within the meaning of the third to sixth indents of Article 5(1) of the Shipbuilding Regulation. Accordingly, the aid allocated to commercial shipbuilding caught by this Regulation, i.e. EUR 4 million, is not compatible with the common market.

8. **CONCLUSIONS**

(115) The 1998 subordinated loan and the additional advance payment constitute state aid within the meaning of Article 87(1) of the Treaty. They constitute rescue aid. The part not caught by Article 296 is compatible with the common market pursuant to the rescue and restructuring aid guidelines.

([29]) OJ L 148, 6.6.1997, p. 3.

(116) The privatisation agreement whereby both the KSG shares and the subordinated loans were transferred to Damen for a symbolic price does not contain a State aid component in favour of Damen.

(117) The 1998 subordinated loan, the interest on the additional advance, the new subordinated loan and the interest-free loan constitute State aid within the meaning of Article 87(1) of the Treaty in favour of KSG. The fact that KSG's bankruptcy would have increased the cost of the frigates by a greater amount than the aid in question does not affect this analysis. The Netherlands has invoked Article 296 of the Treaty, but this is not relevant since most of the aid can be regarded as compatible with the common market pursuant to the rescue and restructuring aid guidelines. The Commission has established that the restructuring plan provides a sound basis for restoring viability and that the aid is limited to the minimum. Undue distortion of competition has been avoided in so far as activities not caught by the Shipbuilding Regulation are concerned. However, the aid attributable to activities that are caught by that Regulation, i.e. EUR 4 million, is not compatible with the common market since there is no capacity reduction commensurate with it. This part of the aid should be recovered from the recipient,

HAS ADOPTED THIS DECISION:

Article 1

The privatisation agreement between the Netherlands and Damen Shipyards Group (Damen) does not contain State aid pursuant to Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement in favour of Damen.

The measures in support of the restructuring of Koninklijke Schelde Groep ('KSG') constitute State aid pursuant to Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement in favour of KSG.

Article 2

The State aid which the Netherlands has implemented in favour of KSG, in so far as it can be attributed to activities that are not caught by the Shipbuilding Regulation, is compatible with the common market.

Article 3

The State aid of EUR 4 million which the Netherlands has implemented in favour of KSG, in so far as it can be attributed to activities not caught by Regulation (EC) No 1540/98, is incompatible with the common market.

Article 4

1. The Netherlands shall take all necessary measures to recover from the recipient the aid referred to in Article 3 and unlawfully made available to the recipient.

2. Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient until the date of its recovery. Interest shall be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid.

Article 5

The Netherlands shall submit an annual report on implementation of the restructuring plan for the period until 2007, or until a later date if the implementation of the restructuring is delayed.

Article 6

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

Article 7

This Decision is addressed to Kingdom of the Netherlands.

Done at Brussels, 5 June 2002.

For the Commission
Mario MONTI
Member of the Commission