COMMISSION DECISION

of 6 April 2005

on the aid scheme which Italy is planning to implement for ship financing

(notified under document number C(2005) 844)

(Only the Italian text is authentic)

(Text with EEA relevance)

(2006/599/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,

Whereas:

I. PROCEDURE

(1) On 26 November 1998 the Commission approved the Italian shipbuilding guarantee scheme provided for in Article 5 of Law No 261 of 31 July 1997, and considered that the aid intensity provided for by the scheme amounted to 1 %.

(2) That Article was amended by Law No 413 of 30 November 1998. On 16 May 2001 Italy notified the Commission of the adoption of a decree of the Minister for the Treasury, the Budget and Economic Planning, which supplemented the guarantee scheme, arguing that, with these modifications and additions, the scheme should be considered free of aid. It is this notification which is the subject of the present decision.

(3) Following the notification there was some correspondence with Italy in order to obtain further information. In addition, the Commission had numerous informal contacts with the Italian authorities and with their consultant, and met them on two occasions.

(4) By letter dated 30 April 2003, the Commission informed Italy that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the notified measure.

(5) The Commission Decision to initiate the procedure was published in the *Official Journal of the European Union* [1]. The Commission invited interested parties to submit their comments on the aid.

(6) The Commission received no comments from interested parties.

(7) By letters dated 4 June 2003, 22 July 2003 and 3 June 2004 the Italian authorities submitted their observations on the Commission's Decision to initiate the procedure. A meeting between the Italian authorities and the Commission took place on 27 January 2004.

(8) By letter dated 3 November 2004 the Italian authorities asked the Commission to define its position on the case. The Commission replied to that letter on 22 December 2004; it did not receive any further correspondence from Italy.

II. DESCRIPTION OF THE SCHEME

(9) The Special Guarantee Fund for Ship Financing (*Fondo speciale di garanzia per il credito navale* — 'the Fund') was provided for in Article 5 of Law No 261 of 31 July 1997. Following a tender procedure, the financial, administrative and technical management of the Fund was entrusted to Mediocredito Centrale SpA ('Mediocredito'). The Fund is intended to cover the risk of failure to recover loans for the construction and conversion of ships granted by banks to Italian and foreign shipowners for work carried out in Italian shipyards. For this purpose the Fund is to provide second-priority end-financing guarantees to the shipowners. The Italian authorities have confirmed that the Fund is not yet operative, so that no guarantees have yet been granted.

[1] OJ C 145, 21.6.2003, p. 48.

(10) The financing loan must have a duration of no more than 12 years and amount to no more than 80 % of the contract price; the interest rate must be no lower than that referred to in the resolution of the OECD Council of 3 August 1981, as amended, or may be equal to the market rate in the event that the financing does not receive any other public assistance aimed at reducing the burden of interest. In addition, the financing is to be secured by a first mortgage on the vessel.

(11) The scheme provides guarantees to shipowners assessed as being economically and financially sound by Mediocredito on the basis of the criteria specified in the decree.

(12) A guarantee can be given on a sum no greater than 40 % of the loan and — within this limit — may cover up to 90 % of the final loss incurred by the banks for capital, contractual interest and interest on arrears, at a rate no higher than the reference rate in force on the date of legal proceedings for recovery of the debt, and costs, including court and out-of-court expenses incurred.

(13) The one-off premium to be paid by the beneficiaries of the Fund is fixed, and was originally set at 1,6 % of the guaranteed amount, independently of the duration of the guaranteed loan. The Italian authorities subsequently informed the Commission that they intended to redefine the one-off premium, which would now be a maximum of 2,3 % of the guaranteed amount for a 12-year loan, and proportionally less for shorter loans. This one-off 2,3 % premium is equivalent to a premium of 0,5 % per annum on the outstanding guaranteed amount of a 12-year loan.

(14) The Italian authorities considered introducing a mechanism of risk differentiation, whereby different projects would be charged different premiums according to the risk involved in financing the project. However, this system was only briefly outlined, and no other detail or information on its operation has been provided to the Commission.

III. **GROUNDS FOR INITIATING THE PROCEDURE**

(15) In its decision to initiate proceedings, the Commission expressed doubts as to whether the scheme satisfied all the tests in point 4(3) of the notice of 11 March 2000 on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (the 'Guarantees Notice') [2], which would have allowed the Commission to conclude that there was no aid involved.

(16) Among other things, the Commission wondered whether a State-provided guarantee scheme which charged the same premium to all users independently of the individual risks of the financed project — in a sector where there was a market willing to offer such guarantees — could be considered likely to be self-financing.

(17) Also, the Commission had doubts that the premiums paid by the beneficiaries were in line with the market, or sufficient to cover all the costs of the scheme.

(18) Last, the Commission could not be certain that a percentage of only 10 % of the most risky part of the loan would be enough to ensure that the lender assessed the creditworthiness of the borrower properly and minimised the risks associated with the transaction.

IV. **COMMENTS FROM ITALY**

(19) The Italian authorities submit that the Fund does not involve aid, for the following reasons:

(i) the rules of the Fund permit guarantees to be granted only to shipowners of meeting strict economic criteria, with a risk profile below the average; these beneficiaries have similar risk profiles, and thus no substantial differentiation of guarantee premiums appears necessary;

(ii) a market survey conducted among several credit institutions operating in Italy has shown that the average market premium for similar guarantees is substantially equivalent to that proposed by the Italian authorities.

(20) Thereafter, by letter of 3 June 2004, the Italian authorities indicated their readiness to adopt a system of risk differentiation whereby projects would be charged different premiums according to the financial risk involved. This system takes as its point of departure the original 0,5 % p.a. premium. Essentially, the premiums would vary according to the length of the loan and the risk of the project. Three different risk profiles would be established. For a 12-year loan, the one-off premium to be paid by the beneficiaries would amount to 2,065 % for the lowest risk category, to 2,603 % for the medium risk category, and to 3,142 % for the highest risk category. This would correspond to a premium ranging between 0,4563 % p.a. of the guaranteed amount for the least risky projects to 0,6562 % p.a. for the most risky ones.

[2] OJ C 71, 11.3.2000, p. 14.

(21) The authorities would establish different ranges of values according to six financial parameters which the authorities would have to assess when a potential beneficiary applied for the scheme. The applicant's overall performance in these parameters would result in it being placed into one of the three different risk categories. However, this system has never been further elaborated, and no other concrete details on its possible operation have been submitted by the Italian authorities.

V. **ASSESSMENT**

1. **Existence of State aid within a meaning of Article 87(1) of the Treaty**

(22) Article 87(1) of the Treaty states that any aid granted by a Member State or through State resources which distorts or threatens to distort competition by favouring certain undertakings is incompatible with the common market in so far as it affects trade between Member States.

(23) The measure to be assessed here consists of a guarantee fund providing cover for the financing of loans granted by banks to shipowners for shipbuilding or conversion work carried out in Italian shipyards. The Commission outlined its approach to such securities in the Guarantees Notice ([3]).

(24) The Guarantees Notice explains why — under certain conditions — a State guarantee can constitute State aid: 'The State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower can obtain lower rates and/or offer less security. In some cases, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms (…). The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. This carrying of a risk by the State should normally be remunerated by an appropriate premium. Where the State forgoes such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under Article 87(1)' ([4]).

(a) *Economic advantage*

(25) The main question in the present case is whether the premiums charged for the guarantee reflect an adequate market price. In light of the general principles of State aid review, and on the basis of the provisions outlined above, it is evident that the underlying principle of the Guarantees Notice is that the benchmark for assessing whether a guarantee is free of State aid is the market. If the State obtains a remuneration for the guarantee that is equivalent to what a private market operator would charge to equivalent beneficiaries, the beneficiaries are not being granted any advantage, and the State is acting like any private investor or creditor operating on the financial market. If, however, the price paid by the beneficiaries and the conditions applied to the guarantees are more favourable than those available in the market, then there is a clear economic advantage to the beneficiaries, and therefore (assuming the other conditions are met) State aid within the meaning of the Treaty.

(26) Point 4.3 of the Guarantees Notice lays down six conditions on the basis of which the Commission will assess whether a State guarantee scheme constitutes State aid. In the first place, therefore, the Commission must consider whether the notified scheme fulfils these conditions; if it does, the Commission can conclude immediately that there is no aid element involved.

(27) Point 4.3 states that a State guarantee scheme that fulfils all the following conditions does not constitute State aid under Article 87(1):

(a) the scheme does not allow guarantees to be granted to borrowers who are in financial difficulty;

(b) the borrowers would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;

(c) the guarantees are linked to a specific financial transaction, are for a fixed maximum amount, do not cover more than 80 % of each outstanding loan or other financial obligation (except for bonds and similar instruments) and are not open-ended;

(d) the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiary enterprises make it, in all probability, self-financing;

(e) the scheme provides for the terms on which future guarantees are granted and the overall financing of the scheme to be reviewed at least once a year;

([3]) See footnote 2.
([4]) Points 2.1.1 and 2.1.2 of the Notice.

(f) the premiums cover both the normal risks associated with granting the guarantee and the administrative costs of the scheme, including, where the State provides the initial capital for the start-up of the scheme, a normal return on that capital.

(28) In the present case conditions (a), (b), (c) and (e) are fulfilled, but conditions (d) and (f) are not, as the risk carried by the State is not remunerated by an appropriate premium.

(29) Point 4.3(d) and (f) of the Notice require that the terms of the scheme be based on a realistic assessment of the risk, so as to make the system in all probability self-financing, and that the premiums collected be sufficient to cover the normal risks associated with granting the guarantees and the administrative costs of the scheme, including, where the State provides the initial capital for the start-up of the scheme, a normal return on that capital. Italy has not been able to demonstrate to the satisfaction of the Commission that the premiums provided for in the scheme can make it self-financing and cover all administrative costs.

(i) Inadequacy of the proposed premium

(30) Credit institutions operating on the financial market would charge their clients higher premiums for similar guarantees, given that a one-off premium of 2,3 % does not appear sufficient to ensure that in all likelihood all costs due to possible defaults and to administrative expenses will be covered. This is also true for the range of premiums between 2,065 % and 2,603 % mentioned in the Italian authorities' letter of 3 June 2004.

(31) The Italian authorities have not had any similar guarantee schemes in operation in the past, and consequently do not possess any reliable historical or empirical data (on e.g. industry defaults, the revenues of the scheme, or the actual administrative costs of running the scheme) which might have enabled them to demonstrate that the scheme would be self-financing.

(32) The Italian authorities argue that the premium proposed is derived from a comparable market benchmark, and should therefore be considered adequate. This is not borne out by the Commission's information.

(33) First, the Italian authorities themselves in their letter of 7 October 1998 state that the average market price of a bank guarantee amounts, in their view, to 0,915 % p.a. This is much higher than the annual premium that would correspond to the one-off premiums proposed by the Italian authorities initially or in the premiums proposed in their letter of 3 June 2004.

(34) Second, the inadequacy of the proposed premium is confirmed by more recent data likewise provided to the Commission by the Italian authorities themselves. In 2003 the Italian authorities conducted a market survey with the aim of investigating how much credit institutions would charge their clients for similar guarantees. According to the letters received from the Italian banks and submitted to the Commission, all banks questioned would charge premiums higher than 0,5 % p.a., or a range of premiums higher than that proposed by Italy in its letter of 3 June 2004. The premiums suggested by the banks are as follows:

Banca CARIGE	between 0,50 % and 0,75 % p.a.
BNL	ca 0,60 % p.a.
Unicredit	0,60 % p.a.
Citigroup	0,60 % p.a.
Deutsche Bank	between 0,70 % and 0,80 % p.a.
ABN Amro	between 0,70 % and 0,75 % p.a.
Banca Intesa	ca 0,75 % p.a.
Banca di Roma	between 0,75 % and 1,25 % p.a.

(35) Third, the inadequacy of the proposed premium is confirmed by the experience the Commission has gained in assessing ship financing schemes in Germany, which, unlike the Italian Fund, have been running for several years. In December 2003 the Commission approved the guarantee schemes operated by the German Länder (State aid measure No N 512/03 [5]) on the grounds that the notified measures did not constitute State aid within the meaning of the Treaty.

(36) The German case showed that, to ensure that the default risks (and the administrative costs) were in all probability covered, higher premiums were needed: the German schemes carried premiums which varied between 0,8 % and 1,5 % p.a., depending on the creditworthiness of the beneficiary.

[5] OJ C 62, 11.3.2004, p. 2.

(37) As the German scheme and the Italian scheme are substantially analogous and raise similar issues, the Commission suggested that the Italian authorities give careful consideration to the Decision in the case of the German Länder guarantee schemes, especially because, as already mentioned, the Länder had already had various guarantee schemes for shipbuilding in place in the past. While the Italian authorities had not been able to produce any evidence to show that the scheme would be 'in all probability self-financing', the German authorities had extensive and reliable historical data on which to base their estimates ([6]).

(38) The Commission accordingly provided Italy with a non-confidential copy of the Commission Decision on the guarantee schemes operated by the German Länder. In addition, when the Italian authorities expressed their desire to have more complete and detailed information on the German case, if possible from the German authorities themselves, the Commission provided the Italian authorities and their consultant with contact details for the German authorities and their consultant.

(ii) Lack of risk differentiation

(39) In addition, the Commission considers that the Fund is not based on a realistic assessment of the risks and would therefore not in all probability be self-financing.

(40) The information available to the Commission indicates that ship financing is a sector in which it is possible to assess and price individual risks, and that a functioning market for the granting of end-financing guarantees for shipbuilding does exist. It appears, therefore, that a ship financing guarantee scheme that charges the same premium to all users, if it functions under the same conditions and restrictions as market operators, will not in all probability be self-financing. This is so because it would always be possible for beneficiaries with lower than average risk to find a guarantor willing to cover their risk at premiums cheaper than the average premium. Unless the system was compulsory, this would leave the guarantee scheme offered by the public authorities with the higher than average risks, so that the system would not be adequately financed.

(41) The information supplied indicates that the guarantee scheme for ship financing provided by Italy carries a fixed premium, and that the use of the scheme is not compulsory. At the same time, Italy confirms that it is possible to assess individual risks and that a market to provide such guarantees does exist. On this basis, the premium guarantee system at issue cannot be held to be 'in all probability self-financing'.

(42) As mentioned above, however, in their submission of 4 June 2004 the Italian authorities manifested a willingness to adopt a system whereby different projects carrying different risks would be charged different premiums. But that willingness has never been transformed into a concrete proposal. The new system was briefly outlined in that letter, but no other details or information on its operation have been provided since, although the authorities were aware that this was an issue of crucial importance for the Commission's Decision.

(43) In any event, even if it were to be held that such a system could ensure a realistic assessment of the risks, the low level of the premiums proposed (see above) would still indicate that the measure was capable of conferring an economic advantage on shipowners using the scheme.

(iii) Coverage of administrative costs

(44) Finally, the Italian authorities have not provided the Commission with reliable and detailed estimates of all the administrative costs related to the planning, the setting-up and the running of the scheme, despite the fact that the Commission raised the issue in the decision initiating the procedure.

(45) The Commission considers that if the premiums collected may prove insufficient to cover all the losses due to defaults, then they are even less likely to be sufficient to cover all the administrative costs as well.

(46) Lastly, the Italian authorities have informed the Commission that the Law has allocated EUR 258 228 449,54 (LIT 500 billion) for the operation of the Fund, which the State has earmarked in the budget; no return on this capital is provided for.

(iv) Conclusion

(47) It follows from the argument set out so far that the premium or the range of premiums proposed by the Italian authorities are not capable of ensuring that the scheme is self-financing and that all administrative costs are covered. In addition, the terms of the scheme are not based on a realistic assessment of the risks. A *fortiori*, therefore, the private investor test is not met.

([6]) It should be pointed out that the market for shipbuilding appears to be global, and the market for finance to shipbuilding appears to be at least pan-European. Therefore, important lessons could be learnt from the German case irrespective of the fact that the schemes there assessed did not concern Italy.

(48) On this basis, the Commission believes that the proposed measure is capable of conferring an economic advantage on the beneficiaries of the Fund.

(b) *Use of State resources and selectivity of the measure*

(49) It is clear that State resources are to be used, given that the measure is a scheme providing public guarantees and that the financing will be provided by the State budget. State guarantees may constitute a drain on the resources of the State if the State takes a financial risk and forgoes an appropriate premium payable by the beneficiaries.

(50) It is likewise evident that the measure is selective, as these State guarantees are to be available only to shipowners who intend to have shipbuilding or conversion work carried out in Italian shipyards (and who meet the criteria set out in the Italian legislation).

(c) *Distortion of competition and effect on intra-Community trade*

(51) The economic advantage conferred by the Fund on specific undertakings may, by its very nature, distort competition, as the State guarantees may facilitate access by these undertakings to certain activities otherwise not open to them. The granting of the guarantees by the State, without an adequate remuneration on the part of the beneficiaries, may give these undertakings and the Italian shipbuilding industry a competitive advantage over European and non-European competitors who have not got the benefit of similar measures.

(52) There is ample intra-Community trade within the global shipbuilding market. The measure is thus capable of affecting trade between Member States.

(53) In conclusion, as all the criteria of Article 87(1) are met, the proposed measure constitutes State aid within the meaning of the EC Treaty.

2. **Compatibility of the aid**

(54) The conditions under which aid is compatible or may be considered compatible with the common market are set out in Article 87(2) and (3). Article 87(3)(e) enables the Council to specify categories of aid that may be considered compatible with the common market by taking a decision by qualified majority on a proposal from the Commission.

(55) At the time of the notification, aid to the shipbuilding sector was regulated by Council Regulation (EC) No 1540/98 of 29 June 1998 establishing new rules on aid to shipbuilding [7] (the 'Shipbuilding Regulation'). According to the Shipbuilding Regulation aid could be granted to the industry only under the conditions and for the objectives which the Regulation laid down. Operating aid was not permissible for shipbuilding contracts concluded after 31 December 2000.

(56) On 1 January 2004 the new Framework on State Aid to Shipbuilding (the 'Shipbuilding Framework') [8] entered into force: it confirmed the prohibition of any operating aid within this sector. Consequently, only aid in compliance with the requirements indicated and for the purposes provided for in the Framework could be considered compatible.

(57) According to the case-law of the Court of Justice [9], unless otherwise specified in transitional transitory rules, notified State aid measures have to be assessed according to the rules in force at the time the decision on their compatibility is adopted. In the case at issue, therefore, the aid has to be assessed under the Shipbuilding Framework.

(58) The decision to initiate proceedings was adopted when the Shipbuilding Regulation was in force, and it was accordingly based on the Shipbuilding Regulation. But there is no need to initiate the administrative procedure afresh when the relevant provisions of two consecutive legislative acts are not substantially different. This requirement is clearly fulfilled in the present case [10].

(59) In the Shipbuilding Framework and the Shipbuilding Regulation, aid to shipbuilding includes all aid granted directly or indirectly to shipyards, to shipowners or to third parties which are available as aid for the building or conversion of ships, such as credit facilities, guarantees and tax concessions [11].

[7] OJ L 202, 18.7.1998, p. 1.
[8] Framework on State Aid to Shipbuilding (2003/C 317/06) (OJ C 317, 30.12.2003, p. 11).
[9] See judgment of the Court of First Instance in Case T-176/01 Ferriere Nord SpA v Commission of the European Communities [2004] ECR, 18 November 2004, not yet reported, in particular paragraphs 134 to 140.
[10] See also Case T-136/01 Ferriere Nord, paragraphs 74 to 82.
[11] See Article 2(2) of the Shipbuilding Regulation and paragraph 11 of the Shipbuilding Framework.

(60) As regards the compatibility of the aid with the common market, the decision to initiate proceedings was based on the fact that the aid was operating aid and as such was incompatible under the Shipbuilding Regulation since 1 January 2001 ([12]). The same rule continues to apply under the Shipbuilding Framework, which does not allow the granting of operating aid.

(61) The decision to initiate proceedings also considered the possibility of assessing the compatibility of the aid in the light of the OECD rules on credit facilities granted for the building and conversion of vessels ([13]). It stated that although the OECD Arrangement and Sector Understanding made provision for guarantees, the provisions of the Arrangement in relation to minimum premium benchmarks did not apply until such time as they had been reexamined by the parties to the Sector Understanding. This is still the case ([14]).

(62) The initiating decision did not assess the aid in the light of other compatibility provisions of the Shipbuilding Regulation, as it was obvious that the aid was not closure aid, rescue or restructuring aid, innovation aid, aid for research and development or environmental aid. It is likewise obvious that the aid does not aim at favouring these objectives within the meaning of the Shipbuilding Framework either, even though the provisions of the Framework are slightly different. Similarly, it is obvious that the aid does not pursue other horizontal objectives now authorised under the Shipbuilding Framework (training, employment, or promotion of SMEs).

(63) It should also be stressed that the Italian authorities have never argued that the measure should be considered compatible. They have consequently never provided any information to the Commission in order to allow it to consider whether the aid qualifies for any of the exemptions from the general prohibition laid down in Article 87(1) of the Treaty.

(64) The Commission accordingly takes the view that none of the exemptions from the prohibition of State aid to the shipbuilding industry is applicable in the present case, and consequently that the measure, which constitutes State aid, is not compatible with the common market.

VI. **CONCLUSION**

(65) The Commission concludes that the Fund scheme is a State aid scheme which is incompatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The State aid for ship financing which Italy is planning to implement on the basis of Article 5 of Law No 261 of 31 July 1997, as amended by Article 1 of Law No 413 of 30 November 1998 and supplemented by the Decree of the Minister for the Treasury, the Budget and Economic Planning dated 14 December 2000, is incompatible with the common market.

The aid may accordingly not be implemented.

Article 2

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

Article 3

This Decision is addressed to the Italian Republic.

Done at Brussels, 6 April 2005.

For the Commission

Neelie KROES

Member of the Commission

([12]) See Article 3(1) of the Shipbuilding Regulation.
([13]) See Article 3(4) of the Shipbuilding Regulation.
([14]) See paragraph 23 of the Shipbuilding Framework, which refers to the same OECD provisions as the decision initiating proceedings.