COMMISSION DECISION

of 24 April 2007

on State aid C 26/2006 (ex N 110/2006), temporary defensive mechanism to shipbuilding — Portugal

(notified under document number C(2007) 1756)

(Only the Portuguese version is authentic)

(Text with EEA relevance)

(2007/581/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 those provisions [1] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) By letter dated 7 February 2006 (registered on 10 February 2006), Portugal notified the Commission of its intention to grant operating aid to Estaleiros Navais de Viana do Castelo SA (ENVC). By letter dated 13 March 2006, the Commission requested further clarifications, which Portugal provided by e-mail dated 28 April 2006.

(2) By letter dated 23 June 2006, the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.

(3) By letter dated 25 July 2006 (registered on 26 July 2006), the Portuguese authorities presented their comments in the context of the abovementioned procedure.

(4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [2]. The Commission called on interested Parties to submit their comments. There were no comments from third Parties.

II. DETAILED DESCRIPTION OF THE AID MEASURE

(5) The aid is intended for Estaleiros Navais de Viana do Castelo SA (ENVC), a Portuguese shipyard currently employing some 1 000 people.

(6) On 14 November 2003, ENVC signed a contract with a French ship owner, Fouquet Sacops SA, for the delivery of a chemical and oil tanker (hull No 227), for the contract price of EUR 22 900 000. The vessel was delivered on 26 April 2005.

(7) Portugal proposes to grant ENVC aid for this contract in the form of a grant of EUR 1 461 702 on the basis of Council Regulation (EC) No 1177/2002 concerning a temporary defensive mechanism to shipbuilding [3], as amended by Council Regulation (EC) No 502/2004 [4] (the TDM Regulation). The TDM Regulation entered into force on 3 July 2002 and expired on 31 March 2005; therefore, it was no longer in force at the time Portugal notified the aid.

(8) Portugal claims that the contract is nonetheless eligible for aid under the TDM Regulation, on the following grounds.

(9) Article 4 of the TDM Regulation states that 'This Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry …'. Portugal states in this respect that the contract in question was signed on 14 November 2003, i.e. while the TDM Regulation was still in force, and therefore remains eligible for aid.

(10) Portugal further argues that the contract in question was the subject of lower price offers by Korean shipyards, thus fulfilling the conditions of Article 2 of the TDM Regulation and that the aid is thus justified to counter unfair competition from Korean shipyards.

III. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

(11) The Commission, in its decision to initiate the formal investigation procedure in the present case, stated that it had doubts about the compatibility of the aid with the common market based on the TDM Regulation for the following reasons.

[1] OJ C 223, 16.9.2006, p. 4.
[2] See footnote 1 above.
[3] OJ L 172, 2.7.2002, p. 1.
[4] OJ L 81, 19.3.2004, p. 6.

(12) First, the Commission had doubts concerning the incentive effect of the aid. The Commission noted, in this respect, that Portugal had not provided evidence that, at the time ENVC signed the contract, there were any public assurances that the shipyard would obtain the aid. On the contrary, Portugal did not have a TDM scheme in place. In addition, according to the information available, the decision by the Portuguese authorities to grant aid to ENVC (conditional on approval by the Commission) was taken only on 28 December 2005, i.e. long after the contract had been signed and the ship delivered. It thus appeared that ENVC had not been induced by State aid to sign the contract, given that the aid was not available at the time the project was concluded.

(13) Second, the Commission questioned the legal basis for approving the aid. The Commission pointed out that the TDM Regulation had expired on 31 March 2005 and was therefore no longer in force at the time Portugal notified the aid. Although the TDM Regulation applied to contracts signed during its period of application, it was doubtful that the Commission could still assess the notified measure on the basis of an instrument that was no longer part of EU law.

(14) In addition, the Commission noted that Korea had challenged the compatibility of the TDM Regulation with WTO rules. On 22 April 2005, a WTO Panel had issued its report concluding that the TDM Regulation and several national TDM schemes existing at the time when Korea initiated the WTO dispute were in breach of Article 23.1 of the Understanding on rules and procedures governing the settlement of disputes (DSU) ([5]). On 20 June 2005, the WTO Dispute Settlement Body (DSB) had adopted the Panel report including its recommendation that the Community bring the TDM Regulation and the national TDM schemes into conformity with its obligations under the WTO Agreements ([6]). On 20 July 2005, the Community had informed the DSB that it had already complied with the DSB ruling and recommendations since the TDM Regulation had expired on 31 March 2005 and Member States could no longer grant operating aid under it.

(15) Authorising the proposed aid would be tantamount to continuing to apply the TDM Regulation in breach of the Community's obligation to comply with the DSB ruling. The Commission, therefore, did not consider at that stage that the aid could be in conformity with the Community's international obligations.

(16) Third, concerning the aid intensity, the Commission noted that the aid amount appeared to be in excess of 6 % of the contract value and thus contrary to the maximum aid intensity allowed by Article 2(3) of the TDM Regulation.

([5]) See *EC — Measures affecting trade in commercial vessels*, WT/DS301/R, paragraphs 7.184-7.222 and 8.1(d).

([6]) See WTO document WT/DS301/6.

IV. COMMENTS SUBMITTED BY PORTUGAL

(17) Portugal noted that the aid amount referred to by the Commission in the decision to initiate the formal investigation procedure (EUR 1 401 702) ([7]) did not correspond to the notified aid amount (EUR 1 461 702).

(18) Concerning the intensity of the aid, Portugal noted that, according to the TDM Regulation, the maximum aid intensity was 6 % of the contract value before aid (as opposed to 6 % of the contract value mentioned in the Commission's decision to initiate the formal investigation procedure ([8])) and that on this basis the aid intensity complied with the TDM Regulation.

(19) More generally, Portugal noted that the objective of the TDM Regulation was to counter unfair competition from Korea and that all shipyards in the EU were subject to the same conditions for obtaining aid under the Regulation. In Portugal's view, the aid did not therefore affect trade in the common market and for this reason it was doubtful that it could qualify as State aid under Article 87(1) of the EC Treaty.

(20) Concerning the incentive effect, Portugal provided new evidence showing that the shipyard had requested the aid on 25 September 2003, i.e. prior to signing the contract. In this context, Portugal submitted a copy of the letter from the Portuguese authorities to the shipyard dated 26 September 2003, in which the Portuguese authorities acknowledged receipt of the request for aid and reminded the shipyard that the aid was conditional on approval by the Commission. According to Portugal, this letter was indicative of the Portuguese authorities willingness to grant the aid, provided all legal conditions were met.

(21) Portugal further argued that, based on previous practice, there was an understanding that requests for aid by the shipbuilding industry would be supported by Portugal provided there was a legal basis for doing so (in this case, the TDM Regulation). The fact that the aid had been formally approved by Portugal only in December 2005 was due to internal administrative delays. However, this did not detract from the fact that the shipyard had expectations of receiving the aid, based on the above considerations (see recital 20) and on the general policy of the Portuguese authorities in this respect. The shipyard had evidence that lower prices had been offered by Korean shipyards in relation to the contract and accepted the contract on the assumption that it would receive the aid from the Portuguese authorities.

([7]) Paragraphs 4 and 21 of that decision.

([8]) Paragraphs 10 and 21 of that decision.

(22) Concerning the legal basis for approving the aid, Portugal reiterated its comments in the notification to the effect that the TDM Regulation was the appropriate basis for approving the aid because the contract had been signed while the TDM Regulation was still in force and, indeed, prior to the TDM Regulation being condemned by the DSB. Portugal noted that the situation was therefore no different from that of aid measures granted by other Member States (under TDM schemes) for contracts signed while the TDM Regulation was still in force. It was the moment when the contracts were signed that determined the eligibility of the contracts for aid, and not the moment when the aid was notified or granted. Portugal also noted that none of the beneficiary shipyards had been requested to reimburse the aid following the WTO panel report. Failing to improve the aid to ENVC would, thus, be contrary to the general principle of equal treatment.

V. ASSESSMENT

(23) According to Article 87(1) of the EC Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, in so far as it affects trade between Member States, is incompatible with the common market.

(24) The Commission considers that the proposed measure constitutes State aid within the meaning of Article 87(1) of the EC Treaty: it takes the form of a grant financed by State resources; even if the TDM Regulation applied in all Member States, as argued by Portugal, the measure is selective as it is limited to ENVC; this selective grant is likely to distort competition by providing ENVC with an advantage over other competitors not receiving aid. Finally, shipbuilding is an economic activity involving extensive trade between Member States. As such, the measure affects trade between Member States.

(25) The Commission thus confirms that the notified aid measure falls within the scope of Article 87(1) of the EC Treaty.

Compatibility with the common market

The aid amount and aid intensity

(26) Following the comments submitted by Portugal, the Commission confirms that the notified aid amount is EUR 1 461 702. On the basis of Article 2(3) of the TDM Regulation, the maximum aid intensity allowed is 6 % of the contract value before aid ([9]). The Commission concludes that the notified aid conforms to the maximum aid intensity allowed by the TDM Regulation.

The incentive effect

(27) As a general principle, State aid may be considered compatible with the common market only if it is necessary to induce the recipient firm to act in a manner which assists attainment of the objectives envisaged by the relevant derogation ([10]).

(28) The Commission notes in this respect that the objective of the TDM Regulation was to 'effectively enable Community shipyards to overcome unfair competition from Korea' (see recital 6). Direct aid up to 6 % of the contract value before aid could thus be authorised provided there had been competition for the same contract from a shipyard in Korea offering a lower price (Article 2).

(29) The new evidence supplied by Portugal shows that the aid was requested by the shipyard prior to signing the contract. In addition, Portugal provided a copy of a letter from the relevant Portuguese authorities (Directorate-General for Industry) to ENVC, dated 26 September 2003, acknowledging receipt of the request for aid, requesting evidence of compliance with Article 2(1) of the TDM Regulation (i.e. evidence that there was competition for the contract from a Korean shipyard offering a lower price – this evidence was subsequently submitted by the shipyard) and reminding the shipyard that the granting of aid was subject to prior notification to and approval by the Commission. The Commission considers that the above facts were indicative of the willingness of the Portuguese authorities to grant the aid, provided all conditions were met. As the conditions for eligibility appeared to be met in this case, these facts were bound to create expectations on the part of the shipyard that it would receive the aid ([11]). On this basis, the Commission's doubts about the incentive effect of the aid are allayed.

([9]) Article 1(f) of Regulation (EC) No 1540/98 (OJ L 202, 18.7.1998, p. 3), to which Article 2(6) of the TDM Regulation refers, states that 'contract value before aid shall mean the price laid down in the contract plus any aid granted directly to the yard'. On this basis, the aid amount (EUR 1 461 702) corresponds to 6 % of the 'contract value before aid' (EUR 22 900 000 + EUR 1 461 702) and complies with the maximum intensity allowed.

([10]) See judgment in Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671, paragraphs 16 and 17.

([11]) See, by analogy, Article 38 of the Guidelines on National Regional Aid for 2007-13: 'aid may only be granted … if the beneficiary has submitted an application for aid and the authority responsible for administering the scheme has subsequently confirmed in writing that subject to detailed verification, the project in principle meets the conditions of eligibility (…) before the start of the work on the project'. In the case of aid subject to individual notification to and approval by the Commission, confirmation of eligibility must be made conditional on the Commission decision approving the aid (OJ C 54, 4.3.2006, p. 13).

The legal basis

(30) In the decision to initiate the formal investigation procedure, the Commission noted that the TDM Regulation had expired on 31 March 2005 and was therefore no longer in force at the time when Portugal notified the aid. Although the TDM Regulation applied to contracts signed during its period of application, it was doubtful that the Commission could still assess the notified measure on the basis of an instrument that was no longer part of EU law.

(31) The comments submitted by Portugal following the decision to initiate the formal investigation procedure have not allayed the Commission's doubts on this issue.

(32) The Commission notes that, with regard to notified aid, its practice is to base its assessment on the laws in force at the time of the assessment ([12]), unless otherwise specified in the law in force itself. Portugal internally approved the aid (subject to approval by the Commission) and notified it to the Commission long after the TDM Regulation had expired.

(33) Portugal maintains, in this respect, that the TDM Regulation is applicable to the contract in question based on Article 4 of the Regulation, which states that 'This Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry …'. Portugal argues that the contract was signed on 14 November 2003, i.e. while the TDM Regulation was still in force, and therefore remains eligible for aid.

(34) However, the Commission considers that Article 4 as quoted above does not define the application in time of the TDM Regulation. Rather, the temporal application of the Regulation is defined in Article 5 ([13]), which states that it 'shall expire on 31 March 2005'.

(35) In contrast, Article 4 establishes additional conditions for the compatibility of the aid. This is also confirmed by the second part of Article 4, which provides that the TDM Regulation shall not apply to 'final contracts signed before the Community gives notice in the *Official Journal of the European Communities* that it has initiated dispute settlement proceedings against Korea (…) and final contracts signed one month or more after the Commission gives notice in the *Official Journal of the European Communities* that these dispute settlement proceedings are resolved or suspended'.

([12]) See case N 122/2005 'Unless otherwise specified, the Commission applies to notified projects the rules in force at the time of assessment of their compatibility'.

([13]) As amended by Council Regulation (EC) No 502/2004.

(36) From the above, it is clear that the TDM Regulation was only to be applied as long as there was a pending dispute with Korea ([14]) and in any event, no later than 31 March 2005.

(37) This interpretation is supported by the very objective of the TDM Regulation: it was designed 'as an exceptional and temporary measure, in order to assist Community shipyards in those segments that have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition, … [and was to apply] for limited market segments and for a short period only' ([15]) (recital 3).

(38) The fact that the Council did not renew this Regulation following its expiry is a clear indication that it did not intend to continue to authorise the Commission to approve aid under the TDM Regulation. This is compatible with the fact that the Community informed the DSB that the Member States could no longer grant operating aid under the Regulation.

(39) The Commission notes, in this context, that the interpretation of the TDM Regulation must also be seen in the light of the Community's international obligations. According to the settled case law of the Court of Justice, Community legislation must, as far as possible, be interpreted in a manner that is consistent with international law, including the EC's WTO obligations ([16]).

(40) The Panel report and the DSB ruling adopting that report condemned the TDM Regulation *per se* for being in breach of WTO rules and required the Community to stop applying the TDM Regulation. The obligation of the Community to implement the DSB ruling also covers future decisions to grant new aid in application of the TDM Regulation ([17]). The Community, by informing the DSB that it had already complied with the DSB ruling and recommendations given that the TDM Regulation had expired on 31 March 2005 and Member States could no longer grant operating aid under it, undertook not to authorise new aid under the Regulation. Accordingly, approving the present aid would result in a breach of the Community's international commitments.

([14]) Recital 7 confirms this assessment: 'the temporary defensive mechanism should only be authorised after the Community initiates dispute settlement proceedings against Korea (…) and may no longer be authorised if these dispute settlement proceedings are resolved or suspended (…)'.

([15]) Our underlining.

([16]) Case C-53/96 *Hermès International* v *FHT Marketing Choice BV* [1998] ECR I-3603, paragraph 28; Case C-76/00 P, *Petrotub SA and Republica SA* v *Council of the European Union* [2003] ECR I-79, paragraph 57.

([17]) See *EC — Measures affecting trade in commercial vessels*, WT/DS301/R, paragraph 7.21.

(41) Finally, it should also be noted that Portugal did not submit its notification within a reasonable time. Portugal notified the measure only on 7 January 2006, i.e. about 27 months after the shipyard had filed the application for aid, 10 months after the TDM Regulation had expired and 6 months after the Community had informed the DSB that the Member States could no longer grant operating aid under the TDM Regulation. Given the exceptional and temporary nature of the Regulation, as well as the EC's WTO commitments, of which Portugal was aware, Portugal could not expect the mechanism to continue being applied beyond the date of its expiry.

(42) The Commission further notes that even if ENVC had expectations of receiving the aid, this did not entitle the shipyard to receive the aid, which was dependent not only on approval by Portugal but also on notification to and approval by the Commission.

(43) Similarly, and contrary to Portugal's argument, the principle of equal treatment is not in question in the present case. Shipyards in Member States which had a TDM scheme in place were entitled to receive aid on the basis of schemes that were approved by the Commission before 30 March 2005, but the Commission has taken no further decisions approving new aid under the TDM Regulation since that date. Also, the Commission notes that pursuant to the DSB ruling, the obligation to no longer grant new aid under the TDM Regulation applies both to aid under approved schemes as well as to ad hoc aid, thus making no distinction between aid to shipyards covered by a scheme or, as in the case at hand, ad hoc aid outside of a scheme (see paragraph 14 above: the DSB ruling recommended that the Community bring not only the TDM Regulation but also the national TDM schemes into conformity with its obligations under the WTO Agreements).

(44) On the basis of the above, the Commission concludes that the notified aid cannot be approved under the TDM Regulation. Since no other exemption clause under Article 87(2) or (3) of the EC Treaty applies, the aid is thus incompatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The notified aid of EUR 1 461 702 that Portugal planned to grant to Estaleiros Navais de Viana do Castelo SA in relation to a contract signed by the latter cannot be authorised under Council Regulation (EC) No 1177/2002 concerning a temporary defensive mechanism to shipbuilding, as amended by Council Regulation (EC) No 502/2004, and is therefore incompatible with the common market. The aid must not be implemented.

Article 2

This Decision is addressed to Portugal.

Done at Brussels, 24 April 2007.

For the Commission

Neelie KROES

Member of the Commission