

COMMISSION

COMMISSION DECISION

of 15 July 1997

concerning financial aid granted to Lloyd Triestino Società di Navigazione SpA and Italia di Navigazione SpA

(Only the Italian text is authentic)

(Text with EEA relevance)

(98/234/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93(2) thereof,

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

Having, in accordance with the provisions of the above-mentioned Articles, given notice to the parties concerned to submit their comments and having regard to those comments,

Whereas:

On 16 February 1994 (by letter registered under reference SG (94) A/3082 on 24 February), the Permanent Representation of Italy notified the Secretariat-General of the Commission of a new Decree Law ('DL')⁽¹⁾ No 22/94⁽²⁾, which concerned urgent measures for different sectors of the Italian economy. This DL included a proposal to grant financial support to the maritime sector, specifically in the form of a capital injection into Lloyd Triestino

Società di Navigazione SpA (hereinafter referred to as 'Lloyd') and Italia SpA di Navigazione (hereinafter: 'Italia'), the two international liner shipping companies within the Finmare group⁽³⁾, as part of an overall restructuring plan. This Decree Law was subsequently replaced by Law 204/95, which remains in force. It is this recapitalisation which is the subject of this consultation and proposal for a Commission decision.

In view of the publication of DL 22/94 in the *Gazzetta Ufficiale della Repubblica Italiana* on 15 January 1994 and its consequent entry into force, the recapitalisation plan was registered by the Secretariat-General as a non-notified aid scheme.

On 27 July 1994, the Commission decided to initiate the Article 93(2) procedure⁽⁴⁾, considering that there were, at that stage, doubts about the compatibility of the proposed financial support with the Treaty. In response, comments were received from the Italian shipowner's association (Confederazione Italiana Armatori or 'Confitarma'⁽⁵⁾), the United Kingdom authorities and lawyers representing a competitor of Lloyd.

The Italian authorities submitted their comments and further information by letters of 13 October and 24 November 1994. Regular exchanges of correspondence took place during 1995, as the Finmare restructuring plan took shape, and the final information required for the

⁽¹⁾ Under the Italian Constitution (Article 77), in cases of extraordinary need or emergency, the government may adopt provisional measures which have the force of law. These Decree-Laws ('DLs') come into effect automatically following their publication in the Italian State *Gazzetta Ufficiale* (Official Journal) and remain in force for up to 60 days. DLs must be presented by the government to the Parliament for enactment and lose their validity if, after 60 days of their publication in the *Gazzetta Ufficiale*, they have not been enacted. In many instances, DLs have been replaced on expiry by successive new DLs, although some provisions may be amended, and measures can remain in force without enactment for months or even years. However, the Constitutional Court in Italy ruled in 1996 that DLs can no longer be renewed after 60 days as this undermines the principle that DLs are only justified in cases of urgency.

⁽²⁾ DL 22/94 of 13 January 1994, published in the *Gazzetta Ufficiale della Repubblica Italiana* No 11 of 15 January 1994.

⁽³⁾ Finmare is a State-controlled holding company which directly controls 12 shipping companies operating in different sectors, including international liner (container) services (Italia and Lloyd), local and Mediterranean coastal navigation and cabotage. Finmare handles 45 % of Italy's bulk cargo, 9 % of container transport, 18 % of coastal freight and 65 % of passenger traffic through Italian ports (IRI group 1992 to 1993 yearbook).

⁽⁴⁾ OJ C 333, 29. 11. 1994, p. 6.

⁽⁵⁾ Confitarma represents 83 % of the private shipowners in Italy.

Commission to take a decision was transmitted by the Italian authorities on 15 May 1997. There were also numerous bilateral meetings, both in Brussels and Rome, of which the last took place on 17 April 1996.

DESCRIPTION OF THE MEASURES

The proposal is for a capital injection of ITL 60 000 million (ECU 31 million), payable in 1996. Lloyd will receive ITL 40 000 million and Italia ITL 20 million. The Italian authorities have confirmed that this financial support has not been paid to Lloyd or Italia, which are undercapitalised, in advance of the Commission's decision.

The proposal to grant State support to recapitalise Lloyd and Italia is part of the final stage of the restructuring of the Italian public fleet. The principal aim of the present capital injection is to give Lloyd and Italia a viable financial footing and support their adaptation to normal market conditions in the run-up to privatisation, scheduled for early 1997.

The Italian State has emphasized that, without the capital injection, the companies, which are significant employers, would be too weak financially to be privatised. The Italian Government, therefore, wishes to complete the current restructuring process as planned and to allow privatisation.

The planned privatisation is progressing: Finmare commissioned Citibank to identify possible buyers and wide publicity was given to the initial request for expressions of potential interest. As a result, a number of leading Italian and foreign shipping companies have indicated an interest as possible buyers. The Italian Government has prepared *ad hoc* draft legislation, as required by Italian law, to allow the sale to go ahead as soon as the Commission has taken a decision on the capital injection.

BACKGROUND

Since the 1970s, the Finmare group has found itself in grave financial difficulty, which prompted the Italian authorities to propose the restructuring of the group. The second phase of restructuring, developed within the Law of 5 December 1986, established the division of the group

into a number of sectors of activity. Of these the liner (container) division will be the first to be privatised.

Despite this, Lloyd and Italia continued to register losses: the consolidated accounts for 1991 showed combined losses of ITL 53 000 million (ECU 27 million). To cover these losses, both companies have released financial resources through the sale of assets, as part of the recent restructuring process. In addition, over the years, the companies have been in receipt of aid, provided under framework Law 234/89, which had been notified to the Commission. The Commission has verified that the aid granted falls under the aid regime established by framework Law 234/89 (approved by the Commission⁽¹⁾) and that the aid adheres to the conditions under which the scheme was approved. Consequently, this aid constitutes existing aid. Over the last years, both companies have operated at roughly break-even levels.

However, around 1991, IRI⁽²⁾, the parent holding company of Finmare, began to have doubts about the strategic importance of the companies and the abilities of the public holding companies to manage their affairs. From spring 1992, the Finmare group has, therefore, spent considerable time and effort in developing and implementing a restructuring plan.

In January 1994, an outline restructuring plan for the group was presented to the government. This provided for:

- rapid privatisation of the bulk transport sector,
- take-over by the State railway of the companies providing transport links with islands, and
- a merger of the two companies in the international liner sector.

However, the proposal finally reached is not to merge Lloyd and Italia but to privatise them separately. In addition, certain activities and assets have been transferred or sold prior to mergers between companies to improve companies' financial balances within the Finmare group.

While the detailed plan for the final stage of restructuring the group was being developed, the government issued Decree Law (No 22) of 13 January 1994. This provided that: 'in order to improve the financial health and allow a profitable privatisation of the Finmare group, subject to the approval of the Ministers of Transport and Navigation and of the Treasury, of an appropriate restructuring plan presented by Finmare, the Treasury is authorised to provide recapitalisation, for the companies operating in maritime transport in international cargo trade'.

In September 1995, the Government presented the final restructuring plan for the Finmare group, aiming for the financial consolidation of the companies before their privatisation. After discussions with the responsible committees of the Chamber of Deputies and the Senate, the plan was definitively approved and transmitted to the Commission in January 1996.

⁽¹⁾ OJ C 239, 25. 9. 1990, p. 10.

⁽²⁾ IRI (Istituto per la Ricostruzione Industriale) is a public body created in 1933 to coordinate and support, through financial subholdings, economic activities considered to be of national interest (e.g. RAI, Alitalia, Stet, Fincantieri, Finmare).

As was mentioned above, a number of mergers, transfers and asset sales took place within the Finmare group after July 1996. Of these, the only ones which affected the two companies in question were;

- Sidermar, a coastal shipping company, wholly owned by Finmare, ceased its operations in September 1995, following the sale of its fleet of 14 vessels to private operators. The remaining assets and liabilities were then transferred to Lloyd through a merger on 1 September 1996, resulting in an increase in Lloyd's assets of some ITL 50 000 million (ECU 25 million),
- similarly, two ships owned by Viamare, another company within the Finmare group, were sold to Tirrenia, the principal Western Italian cabotage operator in the Finmare group; the remaining Viamare ship was sold to a Greek company. Viamare subsequently ceased operations; the remaining assets and liabilities were transferred to Italia through a merger. The debts of Viamare were settled and Italia thereby obtained assets worth ITL 16 000 million (ECU 8 million).

These arrangements have affected the overall financial picture for Lloyd and Italia, the asset bases of both companies having been increased. As these transactions constituted an international arrangement within the Finmare group, the Italian authorities did not consider them to amount to state aid within the meaning of Articles 92 and 93 of the EC Treaty.

However, the benefits accruing to Lloyd and Italia as a result of the restructuring clearly represent a financial advantage which could constitute State aid. The Commission has accordingly taken these amounts into account in assessing the financial assistance granted to these companies.

OPENING OF THE PROCEDURE (27 JULY 1994)

By decision of 27 July 1994, the Commission decided to open the procedure under Article 92(3) of the Treaty, since the proposed capital injection could not at that stage be justified as being of common European interest.

One Member State and two interested parties presented their observations on the capital injection proposed for Lloyd and Italia in pursuance of the Article 93(2) procedure.

(i) The United Kingdom Government

The UK Government welcomed the decision to open the procedure, considering generally that State aid should not be granted when it may distort competition between

Community shipowners to such an extent as to be contrary to the interests of economic operators and consumers. It particularly noted that there were numerous Community shipping companies in the liner market and that the granting of financial support to the two Italian companies could prejudice the commercial development of more efficient companies⁽¹⁾.

Further, the UK Government stated that financial support for restructuring could not be approved by the Commission, as there were no details of the restructuring process, nor was there any evidence of progress towards re-establishing financial stability; the scope of the privatisation was not clear and there might be doubts about the effects of the privatisation, which could result in further costs of liquidation at a future date. The free-market investor principle did not apply as the alternative effects of different strategies had not been quantified.

On the other hand, the UK Government looked favourably on the Italian authorities' intention to privatise the two companies and recognised that the proposed capital injection could be approved if privatisation guaranteed a return to economic viability in accordance with a fully documented, scheduled and realistic action plan. This might benefit the Community by promoting competition and bringing subsidies to the two companies to an end, while avoiding the potential repercussions of liquidation. The UK Government proposed that the financial support measure and the action plan should be subject to verification and should be monitored by the Commission throughout the period of return to financial stability. The UK also considered that Member States and interested parties should have access to this material and should have the opportunity to make comments.

(ii) A competitor of Lloyd

A competitor of Lloyd stated that Lloyd had abused its dominant position on routes from Italy to the Mediterranean countries and to South Africa, increasing its tonnage and charging below cost as well as by signing binding contracts with shippers. The Commission has not found any evidence to substantiate this assertion.

(iii) Confitarma

Confitarma repeatedly brought the proposed financial support measures to the Commission's attention by providing copies of new decree laws and indicating the sections relating to such support. Generally, they have expressed concern that financial assistance to support the public liner fleet, and the recapitalisation in particular, could be distortive of competition, damaging the

⁽¹⁾ Routes served are: Lloyd — Africa, Asia and Oceania; Italia — North and South America. There is full freedom to provide services for any operator on these routes and competition is fierce.

development of normal commercial strategies. This viewpoint has been endorsed by the competition and trade authority of Italy, in a decision issued on 26 January 1993 to the Italian authorities.

(iv) The response of the Italian authorities

The Italian authorities provided specific details (commercially confidential) on the development of Lloyd and Italia during the period of restructuring; these showed considerable improvements in productivity, with increases in the number of containers carried despite reductions in the number of personnel and ships operated. The companies have adopted a new commercial strategy based on cooperation with other operators, slot charters, etc. Furthermore, the companies' debts have been reduced, income has increased and the companies are both now operating in a healthier financial environment. However, despite these improvements, in particular in the field of productivity and reduced operating costs, an additional capital injection is still necessary in order for the currently under capitalised companies to become financially sound and capable of privatisation.

The Commission also requested further details on the financial position of Lloyd and Italia which the Italian authorities provided at meetings in Brussels on 12 November 1996 and 17 April 1997 and in subsequent correspondence.

In the opinion of the Italian authorities the sums proposed or granted to the two companies were no more than those which a reasonable owner would invest in his companies which he intended to divest himself of. In any event, they maintained, the proceeds of any privatisation sale would exceed any amounts invested in the companies by their owner to prepare them for the privatisation. The Commission requested proof of this assertion, which the Italian authorities undertook to provide.

VALUATION OF THE COMPANIES

An internationally reputed independent consultant was engaged to carry out a detailed valuation of the companies.

The consultant used two methods to determine the value of the companies. The main method used was the discounted cash flows (DCF) method, which is based on the assumption that the value of the company depends on the operating cash flows expected to be generated in the future.

A second, control, method was also utilised, namely the excess earnings (EE) method, which is based on the assumption that the value of the company depends both

on the value of its assets and on the company's expected profitability.

The DCF method used by the consultant is widely recognised as the most appropriate method for the objective valuation of companies. In order to be able to rely on such a method a certain level of information about the company's past and future performance is required. In the present case, the information utilised was the following:

- preliminary 1996 financial reports for Lloyd and Italia,
- the audited financial reports for Lloyd and Italia for 1992, 1993, 1994 and 1995,
- extracts from the 1997 financial reports for Lloyd and Italia,
- the financial plans for Lloyd and Italia for the years 1997 to 1999.

Since 1992 Lloyd has sought to improve its financial performance, initially by consolidating some of its services which resulted in a sharp overall reduction in capacity and a lowering of net losses and latterly through the device of extensive cooperation with partners. The company has moved towards chartering-out its vessels to partners and has then chartered-in a fixed number of slots. These changes have led to an overall increase in the company's operations and revenues (up from ITL 291 600 million in 1992 to ITL 666 300 million in 1996) and a decrease in operating costs. Since 1992 Lloyd has reduced its net annual loss from ITL 29 300 million in 1992 to ITL 1 400 million in 1996.

Italia's performance has also improved in recent years as a result principally of its commitment to a number of specific routes, its revenues have increased from ITL 186 900 million in 1992 to ITL 329 900 million in 1996. The company still, however, remains vulnerable to the increased competition and capacity available in the world market and is seriously undercapitalised. Italia has reduced its net loss from ITL 18 700 million 1992 to a break-even point in 1996.

As is normal practice, a 'control method' was used; the usual control method would be the 'comparables method', in which the main financial figures of similar companies traded on the financial markets or the subject of recent merger/acquisition transactions would be used to reach a value for the company. However, given the absence of a sufficient number of comparable listed companies and merger/acquisition activity this method was not used. The EE (excess earnings) method was utilised instead.

By utilising the methods listed above, a range of values for the companies was reached. This range of values takes into account a number of variables, and by so doing and by utilising a number of techniques, the consultant therefore submits that a realistic range of values for the companies has been reached. The figures in question cannot be revealed for reasons of commercial confidentiality, as this would have an impact on the sale price of the companies.

All the values given, including those at the lower end of the range, were substantially above the total amount of the financial assistance given to the companies, for each company. Hence, even according to the lowest valuation made of the value of the companies, the expected sales price will exceed the proposed capital injection of ITL 60 000 million (ECU 31 million), plus the value of the assets transferred as a consequence of the restructuring of the Finmare group (liquidation of Sidermar and Viamare) amounting to ITL 66 000 million (ECU 33 million).

LEGAL APPRAISAL

According to Article 92(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 shall, in so far as it affects trade between member States, be incompatible with the common market.

As is stated in Article 222 of the EC Treaty, Community law is neutral with respect to the private or public ownership of undertakings. Accordingly, financial support which facilitates the privatisation of State-owned undertakings may not as such benefit from a derogation from the basic principle of incompatibility of State aid with the common market laid down in Article 92(1).

However, when a privatisation is effected by the sale of shares on the stock exchange it is generally assumed to be on market conditions and not to involve aid.

If the company is privatised not by stock-exchange flotation but by trade sale (sale of the company as a whole, or in parts, to other companies) a number of conditions, as set out by the Commission in its XXIIIrd Annual competition report (1993)⁽¹⁾ must be followed:

- a competitive tender must be held which is open to all comers, transparent and not conditional on the performance of other acts such as the acquisition of assets other than those bid for or the continued operation of certain businesses,

- the company must be sold to the highest bidder, and
- bidders must be given enough time and information to carry out a proper valuation of the assets as the basis for their bid.

If the above conditions are followed it can be assumed, without further examination, that no aid is involved.

Before flotation, debt may be written off or reduced, without this giving rise to the presumption of aid, as long as the proceeds of the flotation (or trade sale) exceed the reduction in debt.

In the present case even the lowest valuation of the range of values reached for the expected sale value of the two companies in question exceeds the amount of the proposed capital injection of ITL 60 000 million, plus the value of the assets transferred as a consequence of the restructuring of the Finmare group (liquidation of Sidermar and Viamare) amounting to ITL 66 000 million (ECU 33 million) by a substantial amount.

Moreover, the financial assistance which is the subject of the present consultation should, as an investment and according to general financial theory, entail a premium for risk and the time between investment and return should also be considered. In this context, it should be noted that the range of sales values is in the order of 20 to 25 % and that the lowest value has been chosen as the basis of the assessment. The risk-premium is thereby taken into account. As to the question of timing, the time lapse between the payment of funds and the sale is expected to be short (the sale is planned around the end of 1997), so that the lowest of the expected sales valuations will exceed any possible interest yield which might accrue if the sums invested in the companies were placed on deposit with a bank for the same duration.

Therefore, for the reasons set out above, the financial support may be considered not to constitute State aid.

CONCLUSIONS

In conclusion, the capital injection of ITL 60 000 million (ECU 31 million) as envisaged in the notification, together with the financial assistance derived from the group restructuring of Finmare, has put the two companies in a position where they can now realistically be privatised. The independent consultants have also indicated that both companies are now in a position where they can be expected to operate profitably. The Italian authorities have agreed that no further aid will be given to either of those companies in connection with this privatisation.

⁽¹⁾ XXIIIrd competition report, points 402-403.

The Italian authorities have undertaken to proceed speedily with the privatisation of Lloyd and Italia and in a transparent manner by way of a competitive tender and have confirmed, by an undertaking received on 4 July 1997, the following time-plan:

- an independent consultant has recently been appointed to advise the government on the preparation of the privatisation,
- finalization of these preparations by the end of October 1997 at the latest,
- publication of the tender notice by the end of November 1997 at the latest,
- time limit for submitting bids by the end of December 1997 at the latest.

The Italian Government further confirmed its intention to complete the sale of the two companies within three months following the time limit for submission of bids.

In approving the scheme, the Commission has taken into account these undertakings and will monitor the implementation of the time-plan.

The Italian authorities have undertaken to provide a report, showing the results of the application of the financial support and the process of privatisation within three months of the signing of the sales contract.

It is, therefore, proposed to the Commission that no objections be raised to the financial support granted by the Italian authorities to the two companies,

HAS ADOPTED THIS REGULATION:

Article 1

The financial assistance given to Lloyd Triestino and Italia di Navigazione in the form of the capital injection of ITL 60 000 million (ECU 31 million) and the transfer of assets from the liquidated shipping lines in the

Finmare group, Sidermar and Viamare, amounting to ITL 66 000 million (ECU 33 million), (ITL 126 000 million, or ECU 64 million, in total) does not constitute State aid under Article 92(1) of the EC Treaty.

Article 2

In reaching this Decision, the Commission takes note of the following undertakings provided by the Italian authorities:

- apart from the sums as set out in Article 1, no further assistance shall be given to Lloyd or Italia for the privatisation of those two companies; the authorities shall proceed with the planned privatisation of Lloyd and Italia in a transparent manner by way of competitive tender, in accordance with the conditions in the XXIIIrd competition report as set out above,
- the Italian Government further confirmed its intention to complete the sale of two companies within three months following the time-limit for submission of bids. The tender notice shall be published for the sale of the aforementioned companies at the latest by the end of December 1997. The Italian authorities shall provide the Commission with a report showing the results of the privatisation, including the sales price, within three months of the signing of the sales contract.

Article 3

This Decision is addressed to the Republic of Italy.

Done at Brussels, 15 July 1997.

For the Commission

Neil KINNOCK

Member of the Commission