

COMMISSION DECISION

of 31 May 1989

concerning aid provided by the Italian Government to Alfa Romeo, an undertaking in the motor vehicle sector

(Only the Italian text is authentic)

(89/661/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

Having given notice in accordance with the abovementioned Article to interested parties to submit their comments,

Whereas:

I

By letter dated 1 October 1986 the Commission requested from the Italian Government information concerning alleged aid in the form of new capital amounting to Lit 209 billion which, according to press information, the Italian Government provided in 1985 to Alfa Romeo.

By letter dated 21 November 1986 from its Permanent Representation, the Italian Government confirmed that an amount of Lit 206,2 billion in the form of a capital contribution had been allocated to Alfa Romeo on the basis of a decision taken by its shareholders Finmeccanica and IRI during 1985 in order to cover losses incurred by the company in 1984 and during the first half of 1985. Furthermore, it was stated that the information concerning the coverage of the losses which occurred up to the end of 1986 could not yet be provided in view of the recent conclusion of negotiations for the acquisition of Alfa Romeo by Fiat.

By telex dated 18 December 1986, the Commission requested from the Italian Government information concerning any further aid, envisaged or already provided, in favour of Alfa Romeo or Fiat within the framework of the take-over of Alfa Romeo by Fiat.

By telex dated 30 January 1987 from the Italian Permanent Representation, the Italian Government informed the Commission that no public financial assistance was involved or contemplated within the framework of the take-over operation. The acquisition by Fiat took place on the basis of an evaluation of two competing offers from Ford and Fiat undertaken by independent consultants and was therefore consistent with normal market practices. It was stated, finally, that the financial data requested by the Commission were not yet available, but would be forwarded in due course.

Upon a request for further information by the Commission, the Italian Government, in its telex of 27 March 1987, stated that the outside experts had concluded that both offers were economically acceptable, but that the proposal of Fiat was preferable because it offered a speedier renewal of Alfa

Romeo's product range, it included Alfa Romeo's Italian associates, it partly avoided further losses for Finmeccanica and it contained a clearer statement of employment goals. The reply also contained information regarding the price offered by Fiat for the acquisition of Alfa Romeo, involving a partial take-over of a maximum of Lit 700 billion (including the loans granted under Law No 675/77) of Alfa Romeo's debts and a amount of Lit 1 050 billion to be paid by Fiat in five annual instalments starting from the sixth year after 1 January 1987, the date of the acquisition. As regards Alfa Romeo's debts, it was stated that the remaining debts of Alfa Romeo which were not taken over by Fiat were assumed by Finmeccanica (including the loan obtained under Law No 46/82).

Although the Commission requested detailed information on the terms of the sale of Alfa Romeo to Fiat and on the competing offer from Ford on several occasions, the letter dated 2 July 1987 from the Italian Government did not contain any additional information.

On 29 July 1987, the Commission decided to initiate the procedure provided for in Article 93 (2) of the EEC Treaty in respect of the injection of capital amounting to Lit 206,2 billion into Alfa Romeo in 1985 and in respect of an alleged subsidy included in the terms on which Fiat acquired Alfa Romeo. On the basis of the information available to it, the Commission was afraid that the Italian Government had aided Fiat in the sense that it might have given it a competitive advantage by charging it a lower price that could be obtained from the second bidder, i.e. Ford, for the assets of Alfa Romeo which Fiat took over by the end of 1986. Furthermore, it was not able to assess to what extent the acquisition price took account of the capital provision of 1985.

By letter dated 6 August 1987 the Commission therefore requested the Italian Government to submit its comments and respond to the precise questions which were raised in the letter. In accordance with Article 93 (2), the other Member States and third parties were also requested to submit their comments.

II

Within the framework of the procedure, the Italian Government submitted its observations by letter dated 7 October 1987, confirming its view that the terms of sale of Alfa Romeo to Fiat did not contain aid elements falling under Article 92 of the EEC Treaty. It also provided some data

from which it appears that during 1986 an additional capital provision of Lit 408,9 billion was made to Alfa Romeo. The group had suffered losses since 1978 and in 1986 the losses amounted to Lit 313,3 billion. It was further stated that the amount of debt of Alfa Romeo Auto which was not taken over by Fiat amounted to Lit 291 billion. The Italian Government also indicated that Finmeccanica would provide the required information on the take-over conditions as well as on the comparison between the two competing offers, and would do so directly.

Finmeccanica submitted comments to the Commission by letters dated 20 October and 29 December 1987, and 8 March 1988.

Four other Member States submitted observations under the abovementioned procedure.

III

From the information sent by the Italian Government and Finmeccanica as part of the procedure, it became apparent that the injection of Lit 408,9 billion new capital in 1986 served to reduce the net financial debt of the Alfa Romeo Group by an equivalent amount. This capital injection provided by Finmeccanica was partly realized through the subsidiary Saige, wholly owned by Finmeccanica. The injection of new capital therefore substantially improved the financial situation of the Alfa Romeo Group. It should be noted that the capital injection was decided in June 1986 during the ongoing sale negotiations between Finmeccanica and Ford which took place between May and September 1986.

The Commission therefore decided on 10 May 1988 to extend the procedure initiated on 29 July 1987 in order to examine the aid in the form of the provision of new capital of Lit 408,9 billion. Furthermore, the Commission repeated its request to the Italian Government to provide full details on the sale of Alfa Romeo as well as the precise terms of the two competing offers.

By letter dated 19 May 1988, the Commission requested the Italian Government to submit its comments. More specific questions concerning the evaluation of the competing offers were put to Finmeccanica and the Italian Government by letters dated 25 May 1988. In accordance with Article 93 (2), the other Member States and interested parties were also requested to submit their comments.

IV

The Italian authorities presented their comments by letter dated 21 July 1988. The Annexes to that letter, the letter of Finmeccanica dated 15 July 1988, as well as the letter from the Italian authorities dated 17 November 1988 and its Annexes provided detailed information on:

- the financial situation of Alfa Romeo at the end of 1986,
- a timetable of the negotiations between Finmeccanica and the two bidding companies during 1986,
- the terms of the sale agreement between Fiat and Finmeccanica,
- the financial arrangements as regards the assets of Alfa Romeo which Finmeccanica retained, the terms of their subsequent sale to the public banks, as well as the repayment of the remaining financial debt by Finmeccanica,
- the creation of the Alfa Lancia Group by Fiat and its performance in 1987,
- the investments in Alfa Romeo plants in 1986 and 1987 and the aid obtained for those investments.

As regards the capital injection of Lit 408,9 billion in Alfa Romeo which was decided on and provided during June 1986 by the shareholders, Finmeccanica and its subsidiary Saige, the Italian Government stated that there is no objective reason for linking this recapitalization with later decisions concerning the sale of Alfa Romeo: unlike the capital injection of 1985 amounting to Lit 206,2 billion, the new capital injection was not made to offset losses since this was achieved through a reduction of share capital, but was linked both to a triennial investment programme (1986 to 1988) and to the need for the company to maintain a healthy financial position in the light of the strategic choices to be made in order to find a radical solution for its structural crisis. Therefore, the capital contribution should, in the opinion of the Italian Government, be regarded as compatible with the Treaty. Moreover, given Alfa Romeo's prestige value and leading role in the world sportscar market, a large-scale economic restructuring programme which would also help optimize technological potential could appear attractive to private shareholders. The operation was also considered to be fully in line with the Government's policy of privatizing sectors in which State participation is not of strategic importance.

It was also stated that, on the dates when Alfa Romeo's general assembly took the decision to increase the capital by Lit 408,9 billion and when the shareholders paid in the increased capital, negotiations were in progress only with Ford; this in itself would serve to demonstrate that the operation was not intended in any way to favour Fiat. The Italian authorities therefore considered that the Commission's view that the increase in capital enabled Fiat to acquire Alfa Romeo without shouldering the entire burden of its debt is without foundation.

As regards the comparison between the Fiat and Ford offers, the Italian authorities repeated that the decision in favour of Fiat was based on the financial assessment of the two offers undertaken by independent consultants, the conclusions of which formed the basis of a 'fairness opinion' issued on 3

November 1986. The conclusion of the 'fairness opinion' was that the consideration to be received by Finmeccanica under either the Ford proposal or the Fiat proposal was economically acceptable and within the range of valuations which the consultants considered to be fair. They concluded, however, that the Fiat offer was preferable from a financial point of view of Finmeccanica. According to the Italian authorities, the Finmeccanica management board accepted the Fiat proposal because, apart from its financial advantages, it had further advantages compared with the Ford offer, namely:

- it would relieve Finmeccanica of the obligation to share in Alfa Romeo's losses after 1 January 1987 and to contribute to the restructuring required to eliminate the structural causes of these losses,
- the Alfa Romeo product range would be renewed more rapidly, offering a better guarantee that it would attain a reasonable level of competitiveness on the European market within a fairly short period of time,
- all the operating companies of Alfa Romeo would be included,
- a stronger commitment to employment objectives.

The above considerations led the management boards of Finmeccanica and IRI to decide in favour of Fiat. This was approved by the Italian Government by decision of 7 November 1986.

Two other Member States submitted comments on the extension of the procedure.

V

Alfa Romeo is the second largest car manufacturer in Italy. The company, which was set up in 1910, became part of the public holding company IRI in 1933. As in the case of most car manufacturers, the first oil price shock of 1973/74, which caused an unprecedented crisis in the car market, resulted in losses for Alfa Romeo. Alfa Romeo, however, never recovered financially and continued to incur losses throughout the following 14 years.

At the beginning, the company's problems resulted from strategic decisions taken in the preceding years. In the late 1960s, the company decided to enlarge its model range and start producing light cars for which it constructed the Alfa Sud manufacturing and assembly plants near Naples. With these plants, which became operational in 1972, the annual vehicle assembly capacity of Alfa Romeo practically doubled to some 400 000 cars. However, these plants always suffered from excess capacity, industrial relations problems and low labour productivity. The heavy financial burden of Alfa Sud prevented the renewal of the products made by Alfa Romeo's Milan plants and the modernization of their production facilities. During the late 1970s Alfa Romeo's management pursued a defensive market strategy abandoning foreign activities and joint ventures and turning to year-by-year planning.

The year 1980 represented a turning point in the company's strategy. A 10-year strategic plan was adopted involving large-scale investment aimed at enlarging production volume and making it more competitive, accompanied by an aggressive marketing policy. The plan also involved organizational restructuring. In particular, Alfa Romeo and Alfa Sud merged into a single company (Alfa Romeo Auto) while the aircraft engine and industrial vehicle divisions were taken over by two new legal entities (Avio and Arveco). The main features of the new production plan aiming at a break-even level of some 300 000 motor vehicles a year were: renewal of the model range and shortening the production life of models; an agreement with the Fiat group for the production of common components and a joint venture with the Japanese firm Nissan for the production of a new light car (Arna) at the Naples plant. Alfa Romeo would supply the same engines used in Alfa Sud production and mechanical components, while Nissan would supply car bodies. The huge increase in production and plant utilization forecast by the plan never occurred because it was too optimistic, given that Arna proved to be a failure. Indeed, Alfa Romeo's market share dropped steadily and its production declined in the period 1981 to 1984.

In view of the considerable surplus production capacity at European level in 1983/84, Alfa Romeo undertook a review of its objectives by defining new organization structures, no longer based on an improvement of the market in terms of volume and prices, which was now unrealistic, but on a drastic reduction of production and operational costs and a restructuring of its resources in general. The company revised its investment plan setting a much lower break-even level (220 000 vehicles a year), completely renewing the production process and optimizing the model range produced (using the same macrocomponents for different models). All these steps entailed large cuts in the workforce, taken over by the Cassa Integrazione.

For some of these investments, Alfa Romeo received public aid under Law Nos 675/77 and 46/82. In November 1983 and July 1984 the Commission approved investment aid to Alfa Romeo in the form of Lit 88 billion of subsidies and Lit 363 billion as soft loans and interest relief to assist the transfer of some activities to the Mezzogiorno plants and the production of common components with Fiat. In December 1984 the Commission also approved Lit 81,6 billion of soft loans and Lit 39,6 billion of subsidies in support of innovative investments and R&D expenses. These investments cannot be linked to the subsequent capital injection in 1985. They were not presented as part of a wider restructuring operation involving either the technical or financial restructuring of the Group but as a more limited exercise relating specifically to the transfer of some activities to the Mezzogiorno. At no stage during these years did the Italian authorities notify or express to the Commission any intention to inject new capital or grant aid to Alfa Romeo in order to support additional investments or financial restructuring, or to compensate for operating losses of the Group.

As a consequence of the fact that the investment plan did not produce the expected improvements in labour productivity and product quality, the financial results of Alfa Romeo deteriorated drastically during the years 1984 and 1985.

The decision to sell the motor vehicle activities of the Alfa Romeo Group was the result of a series of assessments of future strategy given that the 1980 restructuring plan had proved a failure. These assessments were carried out in 1985 and 1986 both directly by Finmeccanica and IRI and by the appropriate government and parliamentary bodies. They showed that the Group could not become profitable as an independent producer and that the only possible solution to Alfa Romeo's deepening financial and market crisis was to merge the company with a large motor vehicle manufacturer.

Early in 1986, the leading world motor manufacturers were approached to determine whether they were interested in acquiring either the shares in Alfa Romeo as a whole or simply the Group's motor manufacturing activities. The only proposals were those made by Ford and Fiat.

Following intensive technical studies and negotiations between Finmeccanica/Alfa Romeo and Ford, Ford made a formal offer on 30 September 1986 for the acquisition of Alfa Romeo, valid until 7 November 1986. The Ford proposal was to keep Alfa Romeo as a single company in which Ford would take a minority shareholding (about 20%) with the right to exercise an option to acquire a majority stake over the following three years. Ford would preserve Alfa Romeo's identity, brand and distinctive characteristics. It would gradually increase production volume to full capacity by 1994 and preserve the current employment level. The proposal also included put and call options for the acquisition of the remaining shares during the following five years. Thus, the acquisition of all shares would be completed within eight years. Ford would acquire the equity of Alfa Romeo Auto, its subsidiaries Alfa Romeo Credit and Leasing and the national sales companies in 15 countries. Ford would at a later stage also acquire Arna, Spica and Arveco. The Ford proposal also included an investment plan for the subsequent five years at an estimated cost of Lit 4 000 billion. The costs of these investments would be divided among the shareholders (i.e. Finmeccanica and Ford) in proportion to their holdings at the time. Operating losses would also be shared in the same way. Ford expected to return Alfa Romeo to profit by 1990.

On 1 October 1986 Fiat informed Finmeccanica that it was willing to cooperate in the restructuring and relaunch of Alfa Romeo, set out the main points of its proposal and undertook to provide more details as soon as possible. On 24 October Fiat sent Finmeccanica a working proposal and provided further details in its letter of 1 November. It stated that its offer was to acquire the net invested capital of the Alfa Romeo Group, which was estimated, on the basis of information provided by Finmeccanica, at Lit 1 750 billion. Fiat proposed to take over at the moment of acquisition net financial debts of the Alfa Romeo Group, amounting to not more and not less than Lit 700 billion. The remaining Lit 1 050 billion, subject to audit control, would be paid in five annual instalments, the first payable at the end of the sixth year from the date of acquisition and the last at the end of the 10th year.

The objective of Fiat's acquisition was the creation of a new legal entity through the merger of the activities of Alfa Romeo and Lancia for the production of executive cars. By 1992 the new company, to be named Alfa Lancia, would reach a production capacity of 620 000 vehicles a year, of which 300 000 would be Alfa Romeo cars. The existing capacity of Alfa Romeo amounting to 400 000 cars would be maintained and fully utilized with a view to increasing the market share of Alfa and Lancia vehicles. Between 1987 and 1995 Fiat would invest some Lit 5 000 billion in the new company, of which some 75% would be earmarked for Alfa Romeo plants. By the end of 1990, 28 000 workers would be employed in the Alfa Romeo plants. Until 1990, surplus workforce laid off would be absorbed by the Cassa Integrazione or by early retirement schemes. The parts of the Alfa Romeo Group taken over by the new company were its fixed and intangible assets, liabilities up to Lit 700 billion net, the working capital and stocks of Alfa Romeo SpA and Alfa Romeo Auto and the shareholdings in its Italian and foreign subsidiaries except for Alfa Romeo International.

On 6 November Finmeccanica's management board decided to accept the Fiat offer stating that acceptance included the decision of Finmeccanica to transfer to Fiat all shareholdings in the new company which might be assigned to it, either directly or through companies it controlled.

At the beginning of December 1986, as a consequence of the sale agreement between Finmeccanica and Fiat, Alfa Romeo Auto and Alfa Romeo SpA transferred their assets at book value to the Fiat Group.

From 1 January 1987 Fiat assumed full and effective responsibility for the management of the assets transferred. On 2 January 1987, Fiat acquired from Alfa Romeo SpA and Alfa Romeo Auto all assets and the abovementioned shareholdings in Alfa's subsidiaries at a total value of Lit 1 024,6 billion, as subsequently defined on the basis of audited balance sheets at 31 December 1986. On the same date, the new Alfa Lancia Group was created and became operational. Also on that date, the new company became liable for Lit 700 billion of net financial liabilities of the old Alfa Romeo Group.

In May 1987, Alfa Romeo SpA and Alfa Romeo Auto changed their names to Finmilano and Sofinpar respectively. In June 1987 Finmilano and Sofinpar were sold to Banco di Roma and Credito Italiano respectively, the latter controlled by IRI, for a total of Lit 198,9 billion. Before their sale, the remaining assets and liabilities in these companies which were not taken over by Fiat were transferred to Finmeccanica. Finmilano and Sofinpar were left with only Lit 212,2 billion of financial credits which represented the funds obtained by these companies following the transfer to Finmeccanica of the remaining Alfa Romeo assets. These letter box companies kept the tax credits which had been accumulated through the losses of the Alfa Romeo Group and were the main reason for their acquisition by the two banks.

The Alfa Lancia Group has been a profitable undertaking from the first year of its existence despite the losses of its Alfa Romeo division. Fiat was able to reach an agreement with the labour unions of Alfa Romeo which led to a rapid improvement of its financial performance. The Alfa Lancia Group continued to receive aid under Law Nos 675/77, 1089/68, and 219/81 for investments in the plants of the former Alfa Romeo Group. In 1987, aid amounted to Lit 12,4 billion in grants and Lit 67,7 billion in soft loans for investments amounting to Lit 207 billion.

VI

At the moment of its sale, the structure of the Alfa Romeo Group was as follows:

- Alfa Romeo SpA: holding company of Alfa Romeo Group (shareholders: Finmeccanica 84 %, IRI 16 %, others 0,002 %),
- Alfa Romeo Auto: car production (shareholders: Finmeccanica 49 %, Alfa Romeo SpA 33,4 %, Saige 17,6 %),
- Arna: car assembly (shareholders: Alfa Romeo 50 %, Nissan 50 %),
- Arveco: commercial vehicles, components (Alfa Romeo 100 %),
- Spica: components and accessories (Alfa Romeo 100 %),
- Merisinter, MC, Autodelta: smaller production companies (Alfa Romeo 100 %),
- Alfa Romeo Credit, Alfa Romeo International, Alfa Romeo Leasing: finance companies,
- 15 distribution companies in different countries.

In 1986, the last year of its existence, Alfa Romeo Group produced 168 100 vehicles of which 86 500 cars were produced at its Milan plants and 81 800 cars at its Naples plants. The Group sold 180 200 vehicles. Of this number 104 700 cars were sold in Italy and 75 500 exported, an increase of 6,3 and 49,2 % respectively in comparison with 1985. Alfa Romeo's Italian market share in 1986 amounted in the relevant market segments to 14,6 % and its total Community market share amounted to some 1,6 %. The Group's turnover in 1986 amounted to some Lit 3 000 billion of which 28 % was earned through exports. Production capacity of 400 000 cars per year was maintained throughout the 1980s. The rate of capacity utilization in 1986 amounted therefore to 42 %. In the same year, the Alfa Romeo Group had a workforce of some 32 500 persons. In addition, some 13 000 workers were temporarily

unemployed and taken over by the Cassa Integrazione. The financial result of the Group during 1986 was minus Lit 313,3 billion, compared to the record loss of Lit 465,5 billion in 1985.

Fiat is a privately-owned undertaking involved chiefly in the production and marketing of passenger cars, commercial vehicles, industrial vehicles and farm machinery, representing some 75 % of its activities. The remaining operations cover, in particular, industrial equipment, machine tools, avionics, telecommunications, bio-technology, as well as financial operations and services. In 1986, Fiat produced 1 698 700 cars and 59 200 commercial vehicles and improved its market share in Europe to 14 % while still dominating the Italian market with a market share of 61,9 %. The company has been highly profitable in recent years. Even after the Alfa Romeo take-over, Fiat's rate of capacity utilization exceeded 90 %. According to Fiat, it led the European market in 1988 with an estimated 14,9 % market share in Western Europe and registrations amounting to 1,93 million cars.

VII

In its examination of the compatibility with the common market of transfers of State resources in the form of capital injections in the Alfa Romeo Group in 1985 and 1986, as well as in the form of an acquisition price below market value in favour of Fiat, the Commission has verified to what extent these measures contain aid elements within the meaning of Article 92 (1) of the EEC Treaty.

The Commission considers that the two capital contributions of Lit 206,2 billion in 1985 and of Lit 408,9 billion in 1986 to Alfa Romeo SpA and Alfa Romeo Auto respectively contain aid elements or are aids falling under Article 92 (1). On the basis of the consolidated accounts supplied by the Italian authorities by letter dated 7 October 1987, losses incurred by and capital contributed to the Alfa Romeo Group in the period 1979 to 1986 may be broken down as follows:

(billion lira)

	Losses	Capital contributions
1979	91,8	131,6
1980	75,5	201,4
1981	114,4	134,0
1982	91,4	133,7
1983	121,7	1,5
1984	210,9	0,0
1985	465,5	376,4
1986	313,3	408,9
Total	1 484,5	1 387,5

It is thus clear that, in the period in question, all the losses incurred by the Group, totalling Lit 1 484,5 billion, were financed by State contributions amounting to Lit 1 387,5 billion. The latter figure includes the capital contribution of Lit 206,2 billion and Lit 408,9 billion injected in 1985 ⁽¹⁾ and in 1986 which are the subject of this Decision.

The two injections referred to above, totalling Lit 615,1 billion, were effected by the Italian State through IRI and Finmeccanica (the latter also operated through its subsidiary Saige). It should be noted that Finmeccanica had no own resources since its balance sheets for 1985 and 1986 showed a negative cash flow. As a result, IRI, the owner of Finmeccanica, was obliged to intervene, both to remedy the cash flow position and to finance the investments made by Finmeccanica in the two years in question: cf. the capital contribution of Lit 773,5 billion and Lit 1 020,8 billion provided by IRI referred to in page 21 of Finmeccanica's Financial Report for 1986.

It should also be noted that IRI received State resources for this purpose in the form of capital grants and convertible bonds specifically earmarked for Finmeccanica and, in particular '... for the recapitalization and financial restructuring of undertakings in the engineering (and) automotive sectors...' (see, for example, the *Official Journal of the Italian Republic*, General Series No 163, 12. 7. 1985, p. 4954, and No 6, 9. 1. 1986, p. 40).

The present case, therefore, concerns aid granted by the Italian State or through State resources, to Alfa Romeo Auto, by indirect means through public financial entities (IRI and Finmeccanica) wholly controlled by the State. In this connection, the following case-law of the Court of Justice of the European Communities is relevant: Judgment of 14 November 1984 in Case 323/82, *Intermills* ⁽²⁾; Judgment of 10 July 1986 in Case 234/84, *Meura* ⁽³⁾ and Case 40/85, *Boch* ⁽⁴⁾. In addition, as regards 'State aid' pursuant to Article 92(1) of the Treaty by means of measures financed by private undertakings drawing on their own resources, see Judgment of 30 January 1985 in Case 290/83, *Crédit Agricole* ⁽⁵⁾, and Judgment of 2 February 1988 in Joined Cases 67/68 and 70/85, *Van der Kooy* ⁽⁶⁾.

In addition, the Commission refers, as regards the State aid element of the two grants to Alfa Romeo, to its communication of 17 September concerning the acquisition by public authorities of holdings in undertakings.

⁽¹⁾ Total capital contributions in 1985 in fact amount to Lit 376,4 billion; however, part of this amount, i.e. Lit 170 billion, was awarded to Inca Investimenti (formerly the Alfa Sud holding company) to finance activities not related to car manufacturing and therefore not concerned by this Decision.

⁽²⁾ [1984] ECR, p. 3809.

⁽³⁾ [1986] ECR, p. 2263.

⁽⁴⁾ [1986] ECR, p. 2321.

⁽⁵⁾ [1985] ECR, p. 439.

⁽⁶⁾ Not yet published.

According to that communication, State aid is involved where fresh capital is contributed by the State in circumstances that would not be acceptable to a private investor operating under normal market economy conditions. This is the case where the financial position of the company, and particularly the structure and volume of its debt, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested, or where, because of its inadequate cash-flow if for no other reason, the company would be unable to raise the funds needed for an investment programme on the capital market.

In view of the Alfa Romeo Group's losses which increased rapidly from 1983 onwards, as well as its deteriorating net debt situation (Lit 1 427,7 billion in 1985), its negative cash-flow during the last years of observation and the lack of any reasonable return on the capital injected, the capital contributions of Lit 206,2 billion in 1985 and Lit 408,9 billion in 1986 constitute State aid because, under the circumstances described, a private investor operating under normal market economy conditions would not have undertaken this investment.

Indeed, as the Italian Government specified in its letter dated 21 November 1986, the capital injection of Lit 206,2 billion was provided by IRI and Finmeccanica to Alfa Romeo SpA to offset its losses of Lit 98 billion in 1984 and Lit 111 billion in the first half of 1985. The balance of Lit 2,8 billion was covered by the company's reserves. From the Lit 206,2 billion which it received, Alfa Romeo SpA contributed Lit 200 billion to Alfa Romeo Auto to be used for a capital increase in 1986.

The Lit 408,9 billion capital injection during 1986 enabled Alfa Romeo Auto to be recapitalized since in the 1986 financial year it had reduced its equity capital from Lit 336,6 billion to Lit 20,2 billion in order to compensate for the losses which occurred during 1985 and the first quarter of 1986 totalling Lit 317,8 billion. The balance of Lit 1,4 billion was covered by the company's reserves. Without these capital injections Alfa Romeo Auto would have gone into liquidation in 1986. For these reasons, the amount of Lit 408,9 billion resulting from the capital increase decided by Alfa Romeo's extraordinary shareholders meeting on 10 June 1986 was used to improve the net financial position of Alfa Romeo through a corresponding reduction of its debt. Indeed, Alfa Romeo Auto repaid its debts by transferring a corresponding amount to Alfa Romeo SpA and the latter in turn repaid several loans between June and December 1986. At Group level, the net financial debt was reduced during 1986 from Lit 1 427,7 billion to Lit 991 billion.

The Lit 206,2 billion capital injection made in 1985 and the Lit 408,9 billion capital injection made in 1986 constitute aid

in favour of Alfa Romeo. These aids kept the undertaking in business artificially until the moment of its sale.

The aid granted to Alfa Romeo Group in 1985 and 1986 affect trade between Member States because there is intensive intra-Community trade in all such products manufactured by them. In fact, for passenger cars in 1986 trade between Member States amounted to 5,03 million units, of which 9,3% was exported from Italy to the other Member States. In 1986, Alfa Romeo Auto exported 54 000 cars to other Member States, i.e. 32% of its total car production. Alfa Romeo's share of the Community car market amounted to 1,6% in 1986.

In conclusion, the public contributions of Lit 206,2 billion in 1985 and Lit 408,9 billion in 1986 constitute aid within the meaning of Article 92 (1) of the EEC Treaty.

The Commission also investigated whether the acquisition price paid by Fiat was lower than the price offered by Ford in order to establish whether Finmeccanica had renounced a substantial part of the market value of Alfa Romeo and therefore conferred a financial advantage on Fiat.

The Commission compared the two offers on the basis of their present total net value to Finmeccanica. Although the two offers were not identical and were therefore difficult to compare, the Commission concluded that while Ford's offer was on average slightly higher in financial terms, it included future commercial risks for Finmeccanica linked to the development of Alfa Romeo's net results during the period 1987 to 1993. In contrast, Fiat's offer excluded this kind of risk. In consequence, the Commission considers that the absence of future risks for Finmeccanica explains why the Fiat Group was chosen. This excludes the possible difference in earnings resulting from the subsequent sale by Finmeccanica of the remaining businesses not acquired or taken into account by the two bidders.

The Commission therefore considers that the acquisition price to be paid by Fiat which in discounted value terms is equal to Lit 389,9 billion at 1 January 1987⁽¹⁾, was broadly comparable to the one offered by Ford and that therefore no aid element was involved when Finmeccanica accepted the Fiat rather than the Ford offer.

Furthermore, despite the fact that the acquisition price paid by Fiat is lower than the net book value of the assets acquired at the end of 1986, it can be considered to reflect a fair price for the assets acquired, taking into account the estimated future operating losses of Alfa Romeo as well as the significant amounts of investment and rationalization costs which are necessary to restore the company's viability.

⁽¹⁾ Fiat's payment of Lit 1 024,6 billion in five equal instalments starting on 2 January 1993 has been discounted to 1 January 1987 using the Italian official reference rate of 13,05% applicable at that time (see *Official Journal of the Italian Republic*, 15. 1. 1987).

VIII

These aids should have been notified to the Commission as provided for by Article 93 (3) of the EEC Treaty. Since the Italian Government failed to give prior notification of the aids in question, the Commission was unable to state its views on the measures before they were implemented. The aids are therefore incompatible with the common market in that they were awarded in breach of Article 93 (3).

In this respect, it has to be recalled that — in view of the imperative character of the rules of procedure as laid down in Article 93 (3) which are also of importance as regards public order, the direct effect of which the Court of Justice recognized in its ruling of 19 June 1973 in Case 77/72, Capolongo⁽²⁾, the Judgment of 11 December 1973 in Case 120/73, Lorenz⁽³⁾, the Judgment of 22 March 1977 in Case 78/76, Steinike⁽⁴⁾ — the illegality of the aids at issue here cannot be remedied *a posteriori*.

In the case of aid which is incompatible with the common market, the Commission — making use of a possibility given to it by Article 93 (2) and by the Court of Justice (see its Judgements of 12 July 1973 in Case 70/72, Kohlegesetz⁽⁵⁾ and of 24 February 1987 in Case 310/85, Deufil⁽⁶⁾) — can require Member States to recover aid granted to recipients.

IX

Article 92 (3) of the EEC Treaty lists those aids which may be compatible with the common market. Compatibility with the Treaty must be determined in the context of the Community as a whole and not of a single Member State.

In order to safeguard the proper functioning of the common market and taking into account the principles of Article 3 (f), the derogations from the principle of Article 92 (1), as set out in Article 92 (3), must be construed narrowly when an aid scheme or any individual aid measure is scrutinized.

In particular, they may be applied only when the Commission is satisfied that the free play of market forces alone, without the aid, would not induce the prospective aid recipient to adopt a course of action contributing to the attainment of one of the said objectives.

With regard to the exceptions provided for in Article 92 (3) (a) and (c) for aid that promotes or facilitates the

⁽²⁾ [1973] ECR, p. 611.

⁽³⁾ [1973] ECR, p. 1471.

⁽⁴⁾ [1977] ECR, p. 595.

⁽⁵⁾ [1973] ECR, p. 813.

⁽⁶⁾ [1987] ECR, p. 901.

development of certain areas, the application of the aid measure cannot benefit from the exceptions provided for in the abovementioned derogations. Although some of Alfa Romeo's production plants are located in regional assisted areas, the aid measures under consideration constitute rescue aid, which caused serious distortion of competition in the Community car industry since they were not linked to a restructuring plan which would solve the structural problems of the company and restore its viability. Therefore, they cannot be considered to have contributed to the long-term economic development of the regions since they did not secure the long-term viability of employment and were not linked to the regional economy and thus do not qualify as acceptable regional aid. The Commission has followed this approach in previous cases relating to rescue aid for companies operating in such regions. This was confirmed by the Commission's communication on the method for the application of Article 92 (3) (a) and (c) to regional aid⁽¹⁾. Moreover, the Italian Government has not in fact attempted to justify the aid on regional grounds.

As regards the exceptions provided for in Article 92 (3) (b), it results from the foregoing that the aid in question was not intended or designed to promote the execution of an important project of common European interest or to remedy a serious disturbance in the Italian economy. Furthermore, the Italian Government has not invoked this derogation.

With regard to the exception provided for in Article 93 (3) (c) in respect of 'aid to facilitate the development of certain economic activities', the Commission may consider certain sectoral aids to be compatible with the common market if two principles of Article 92 (3) (c) are met, i.e. the aid must be necessary for the development of the sector from a Community standpoint, and must not alter trading conditions to an extent contrary to the common interest⁽²⁾. These principles were systematically verified in order to assess the compatibility of the two capital injections referred to above.

X

As regards the Lit 206,2 billion capital injection provided in 1985 and the Lit 408,9 billion provided in 1986, the analysis of Alfa Romeo's financial situation in 1985 and 1986 as described in section VI demonstrates that without the capital injection which improved the net worth of the company, Alfa Romeo would have had to face serious financial difficulties with its creditors. Moreover, there was no reasonable prospect of a return on capital invested. Therefore,

the capital injections which restored the finances of the Group constitute rescue aid which can only be regarded as compatible with the common market if it fulfils the conditions set out in the Commission's communication to the Member States of 24 January 1979:

- it must consist of cash aid in the form of loan guarantees or loans bearing normal commercial interest rates,
- it must be paid only for the time needed, generally not exceeding six months, to draw up the necessary and feasible recovery measures,
- it must not have any adverse effects on the industrial situation in other Member States,
- it must be notified to the Commission in advance in significant individual cases.

In view of the fact that the aids were not notified in advance, were used to compensate losses and reduce financial debt, were not linked to a restructuring programme, were not paid in the form of loans, and had an adverse effect on the industrial situation in other Member States by enabling the company to continue to compete on an artificially improved financial basis, the capital injections are not compatible with the common market.

Moreover, it is clear from the Judgments of the Court of Justice in Cases 234/84, Meura and 40/85, Boch, that rescue aid will not qualify for one of the derogations under Article 92 where it does not help to restore a company to health, that is to say where the company cannot be expected to be operating on a viable basis without further assistance in a reasonable time, particularly where there is excess production capacity in the industry concerned in the Community. In the present case, it was clear from the late 1970s onwards, after considerable capital injections had been made for the purpose of covering losses during the period 1979 to 1983, that the Alfa Romeo Group would continue to rely heavily on State resources and public funds. This expectation was confirmed by events until December 1986 when State participation in this sector was finally terminated.

As explained in Section VII, without the capital injections of 1985 and 1986 the Alfa Romeo Group would, under normal market economy conditions, have gone into liquidation. Therefore, both capital contributions of Lit 206,2 billion and Lit 408,9 billion constitute rescue aid as they artificially enabled Alfa Romeo to remain in business. This rescue aid does not comply with the abovementioned criteria established in the Commission's letter to the Member States of 24 January 1979.

Furthermore, the argument put forward by the Italian authorities that the capital injection of Lit 408,9 billion was linked to an investment programme to be implemented

⁽¹⁾ OJ No C 212, 12. 8. 1988, p. 2.

⁽²⁾ Judgment of 17 September 1980 in Case 730/79 (Phillip Morris), [1980] ECR, p. 2 671.

between 1986 and 1988, and should therefore be regarded as fully compatible with Community competition rules, cannot be accepted by the Commission. The Commission considers that the capital injection of Lit 408,9 billion in 1986 formed part of the total financial resources of the Alfa Romeo Group in 1986 amounting to Lit 1 129,5 billion, from which not only Lit 382,5 billion of investments were financed, but also losses for an amount of Lit 313,3 billion and net debts amounting to Lit 433,7 billion. Moreover, the Italian authorities were unable to prove that these investments served restructuring purposes linked to a reduction in the unutilized assembly capacity of 56%. Indeed, the strategic plan of 1985 sets out the following three areas of investment in the period 1986 to 1988: reduction of production costs, reduction of overhead costs and development of new products and markets. Thus, the plan did not help to resolve the underlying structural problems of the company.

As market integration progresses as part of the process of creating a single market without internal frontiers by 1992, distortions of competition caused by granting aid are felt more and more keenly by competitors not receiving any aid. This fact has also to be taken into account by the Commission in its appreciation of aid cases. In this respect, the Commission considers that all manufacturers are entitled to a consistent approach compatible with the Treaty. Therefore, the Commission can approve rescue and restructuring aid only in exceptional circumstances. The aid must be linked to a satisfactory restructuring plan, and may be granted only where it can be demonstrated that the Community interest is best served by keeping a manufacturer in business and by re-establishing its viability. In particular, it is necessary for the Commission to ensure that the aid will not enable a beneficiary to increase its market share at the expense of its unaided competitors. In cases where certain companies still have excess capacity, the Commission may require reductions in capacity in order to ensure that the aid contributes to the overall recovery of the sector. In this context, it must be noted that in 1985 and 1986, the years during which Alfa Romeo was rescued through the two capital injections, there was a significant over-capacity in the Community car industry of some 20%.

The Commission has applied this policy consistently in the past. In the motor vehicle industry, which the Commission regards as a particularly sensitive sector, the Commission laid down in Decision 88/454/EEC of 29 March 1988 concerning aid provided by the French Government to the Renault group, an undertaking chiefly producing motor vehicles ⁽¹⁾, that rescue or restructuring aid may be regarded as compatible with the common market only if they are linked to a restructuring plan involving significant capacity reductions in proportion to the aid amount. The same principle was applied by the Commission in Decision

89/58/EEC of 13 July 1988 concerning aid provided by the United Kingdom Government to the Rover Group, an undertaking producing motor vehicles ⁽²⁾, in connection with its sale to British Aerospace.

It has already been stressed that, contrary to the principle established in the abovementioned Decisions, the strategic plan of Alfa Romeo did not provide for a reduction in Alfa Romeo's considerable surplus capacity.

In view of these considerations, it must be concluded that rescue aid granted to Alfa Romeo enabled it to remain in business artificially by avoiding liquidation, the natural consequence of allowing the free play of market forces, and prevented other competitors from increasing their share of the market.

Consequently, the aid granted to Alfa Romeo in the form of capital injections of Lit 206,2 billion in 1985 and of Lit 408,9 billion in 1986 is not compatible with the common market because it does not fulfil the conditions of Article 92 (3) of the EEC Treaty.

XI

As pointed out in Section VIII, the Commission can in such cases require Member States to recover aid granted illegally from recipients.

To this end, it is necessary to withdraw the incompatible aid awarded to the Alfa Romeo Group in the form of capital injections of Lit 206,2 billion in 1985 and Lit 408,9 billion in 1986. In principle, the aid should be repaid by the beneficiary, i.e. Alfa Romeo. However, according to information supplied by the Italian Government by letter dated 21 July 1988, Alfa Romeo SpA went into liquidation on 31 December 1987 and transferred all its remaining assets and liabilities to Finmeccanica (see Section V). Thus, whilst it is no longer possible to recover the total amount of the aid of Lit 615,1 billion from the Alfa Romeo Group, the Commission would stress that the situation is the result of an infringement of Article 93 (3) of the EEC Treaty by the Italian Government. Because the aid was not notified in advance at the planning stage, the Commission was unable to initiate the administrative procedure provided for in Article 93 (2) in good time and was able to define its position only recently, i.e. after the sale of the Alfa Romeo Group.

It has to be considered that Fiat did not acquire the totality of Alfa Romeo's assets and restricted its financial liability towards Alfa Romeo's net financial debts to not more than Lit 700 billion. Therefore, Fiat is not liable for the repayment of the aid, given also the fact that it paid a fair price for the acquired assets of Alfa Romeo.

⁽¹⁾ OJ No L 220, 11. 8. 1988, p. 30.

⁽²⁾ OJ No L 25, 28. 1. 1989, p. 92.

In view of the very special circumstances, therefore, the aid should be recovered from the legal entity which is liable for all the debts of the former Alfa Romeo group exceeding the Lit 700 billion taken over by Fiat, the owner of the Alfa Romeo Group, and which acted as vendor of that Group, i.e. Finmeccanica. Moreover, Finmeccanica is the sole beneficiary of all the revenue generated by the sale of the assets of the former Alfa Romeo Group, i.e. Lit 1 223,5 billion, of which Lit 1 024,6 billion was received from Fiat and Lit 198,9 billion from Credito Italiano and Banco di Roma. The Italian Government should therefore be required to order Finmeccanica to repay the aid in question within two months from the date of this Decision.

The aid should be recovered in accordance with the procedures and provisions of national law including those concerning interest charges on State claims if Finmeccanica does not repay the aid within the two months referred to above,

HAS ADOPTED THIS DECISION:

Article 1

The aid in the form of capital contributions totaling Lit 615,1 billion awarded by the Italian Government through the public holding companies IRI and Finmeccanica to Alfa Romeo is unlawful and therefore incompatible with the common market with the meaning of Article 92 (1) of the EEC Treaty because it was provided in contravention of the rules of procedure laid down in Article 93 (3). The aid is also

incompatible because it does not satisfy the conditions for exemption provided for in Article 92 (3).

Article 2

The Italian Government is hereby required to recover the aid referred to in Article 1 from Finmeccanica within two months from the date of notification of this Decision.

The recovery shall be carried out in accordance with the procedures and provisions of national law including those concerning interest charges on State claims in the event of repayment taking place later than the two months referred to in the preceding paragraph.

Article 3

The Italian Government shall inform the Commission, within two months from the date of notification of this Decision, of the measures taken to comply herewith.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 31 May 1989.

For the Commission
Sir Leon BRITTAN
Vice-President