

COMMISSION DECISION
of 16 November 2004
on aid granted by Germany to grain brandy distilleries

(notified under document number C(2004) 3953)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/240/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

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

Having called on interested parties to submit their comments pursuant to the provisions cited above and having regard to their comments ⁽¹⁾,

Whereas:

(3) The Commission first asked Germany for further information about the criticised amendments on 3 January 2001. Germany replied by letter dated 14 February to the effect that the aid measures in question had already been notified to the Commission in 1976 and that the new Law merely served to improve the existing mechanism. On 16 March the Commission addressed a further set of questions to Germany, which then asked for an extension of the time limit; this was granted by the Commission by letter dated 9 April.

(4) On 24 April Germany's reply reached the Commission, which on 19 November again communicated its initial conclusions and comments. By letter dated 19 December Germany confirmed its explanations of 14 February and gave a renewed assurance that the aid in question complied with Community law.

I. PROCEDURE

(1) By letter dated 22 November 2000, six German industrial producers which are members of the Federation of Industrial Grain Distilleries submitted a complaint to the Commission about the amendment of Germany's Spirits Monopoly Law of 2 May 1976 by the Budget Consolidation Law ('HsanG') of 22 December 1999 ⁽²⁾.

(2) The complainants wanted it to be established that by amending the Spirits Monopoly Law ⁽³⁾ the German legislator had introduced a scheme which infringes Article 87 of the EC Treaty: it treats industrial and agricultural grain distilleries - which up to then had been equally entitled to aid - unfairly, since only the agricultural producers would still be eligible for aid. They claim that the new scheme gives the agricultural grain brandy distilleries an indisputable advantage in the form of aid that is incompatible with the Community competition rules.

(5) By letter dated 22 February 2002 the Commission requested Germany, under Article 17(2) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽⁴⁾, to comment and submit appropriate proposals on how the legislation on aid for grain distilleries could be made consistent with Article 87(1) of the EC Treaty. On 19 March Germany informed the Commission in writing that it regarded such measures as unnecessary, because it could not endorse the Commission's conclusions. This applied in particular to the conclusion that grain brandy was an industrial not an agricultural product.

(6) By decision of 19 June 2002 the Commission proposed a number of appropriate measures to Germany for revising the German Law on Aid to Grain Distilleries. By letters dated 19 and 23 July Germany informed the Commission that it was rejecting the proposal and was therefore not prepared to carry out the appropriate measures within the time limits set.

⁽¹⁾ OJ C 269, 8.11.2003, p. 2.

⁽²⁾ Bundesgesetzblatt Jahrgang 1999 Teil I Nr. 58, published in Bonn on 28 December 1999. The Budget Consolidation Law introduced a general reform of the German spirits monopoly. It came into force on 1 October 2000.

⁽³⁾ Branntweinmonopolgesetz of 2 May 1976.

⁽⁴⁾ OJ L 83, 27.3.1999, p. 1, as amended by the 2003 Act of Accession.

- (7) Under Article 19 of Regulation (EC) No 659/1999 the Commission therefore decided on 16 October 2002 to initiate a formal investigation procedure in respect of the aid measures concerned. The decision was published on 11 September in the *Official Journal of the European Union* ⁽⁵⁾, all interested parties being invited to submit comments on the measures in question.
- (8) Germany commented on the initiation of the procedure on 12 November.
- (9) The Commission received a total of 54 submissions from third parties, including a petition with some 2 000 signatures. These were forwarded to Germany on 7 February 2003, with a request for comments. On 26 February Germany asked the Commission to extend the time limit for its reply, which was granted on 27 February. Germany's reply was finally received in the Commission on 19 March.
- (10) On 5 June a meeting took place at Germany's request; Germany submitted a preparatory letter to the Commission on 4 June; this was followed by a further letter on 2 July.
- (11) The complainants commented in writing to the Commission on 13 August prior to a meeting which took place at their request on 29 August.
- (12) On 5 March 2004 the Commission forwarded the complainants' letter of 13 August 2003 to Germany. Germany replied to this by letter dated 5 April.
- (14) On 9 April 1976 Germany notified to the Commission the reformed Spirits Monopoly Law ⁽⁹⁾ under Article 93(3) (now Article 88(3)) of the EC Treaty read in conjunction with Article 4 of Council Regulation No 26 of 4 April 1962 applying certain rules of competition to production of and trade in agricultural products ⁽¹⁰⁾. Article 4 of the said Regulation states: 'The provisions of Article 93(1) and of the first sentence of Article 93(3) of the Treaty shall apply to aids granted for production of or trade in the products listed in Annex II to the Treaty' [*now and in what follows Annex I of the EC Treaty, Commission italics*] ⁽¹¹⁾. Consequently, the Member States have a simple duty to inform, without an authorisation by the Commission being necessary.
- (15) In its letter of notification, Germany pointed out to the Commission that it would continue to meet its legal obligation to buy up the production of domestic spirits manufacturers at a cost covering price.
- (16) In the 1976 notification, no distinction was made by type of product, i.e. between neutral alcohol and aromatic alcohol such as grain brandy. The Commission did not comment at that time on the wording of the notification.

II. DESCRIPTION OF THE SCHEME

A. The German spirits monopoly and its development

- (13) The German spirits monopoly was introduced by the Law of 8 April 1922 ⁽⁶⁾ and amended as a consequence of decisions of the Court of Justice of the European Communities (*inter alia* Case 45/75 *Rewe-Zentrale* ⁽⁷⁾) by

- (17) Following the amendment of the statute in 1976, the monopoly consisted in the buying-up and marketing of alcohol by the Federal Spirits Board ('BfB', *Bundesmonopolverwaltung für Branntwein*). The BfB buys the alcohol at statutorily guaranteed prices, rectifies it ⁽¹²⁾ and sells it at market prices. This does not include grain brandy.

⁽⁵⁾ OJ C 308, 11.9.2002, p. 6.

⁽⁶⁾ Reichsgesetzblatt I, pp. 335, 405.

⁽⁷⁾ [1976] ECR 181 (para. 27). The Court held in particular that Article 37 (now Article 31) of the Treaty is infringed 'if the charge imposed on the imported product is different from that imposed on the similar domestic product which is directly or indirectly covered by the monopoly'.

⁽⁸⁾ Gesetz zur Änderung des Gesetzes über das Branntweinmonopol, Bundesgesetzblatt I N 50, 7 May 1976, p. 1145.

⁽⁹⁾ The notification concerned all products covered by the monopoly, including grain brandy.

⁽¹⁰⁾ OJ 30, 20.04.1962, p. 62/993, as amended by Regulation No 49 (OJ 53, 1.7.1962, p. 62/1571).

⁽¹¹⁾ Annex II of the Treaty became Annex I with the entry into force of the Treaty of Amsterdam. The contents remained unchanged, however.

⁽¹²⁾ Rectification: processing of alcohol by distillation, filtration, etc.

- (18) In the case of grain brandy, Deutsche Kornbranntwein-Vermarktung GmbH ('DKV', German Grain Brandy Marketing) ⁽¹³⁾, founded on 14 June 1930, was given a similar task to the BfB by the Law of 2 May 1976, but only for the buying-up and marketing of grain brandy. The 1976 Law granted DKV the exclusive right to purchase the bulk of domestic grain brandy production at statutorily guaranteed prices which cover the costs ⁽¹⁴⁾ of the producers, whether industrial or agricultural, and to market the grain brandy at market prices, if necessary after conversion and/or rectification. Up to the year 2000, over 80 % of the grain brandy produced in Germany was marketed by DKV, and the other 20 % by the distilleries themselves ⁽¹⁵⁾.
- (19) In return for performing the statutory duty transferred to it in Article 82 of the Spirits Monopoly Law, DKV receives a consideration, which in the absence of a market price is determined in accordance with the Basic principles of pricing public contracts on a total production cost basis (LSP).
- (20) The German grain brandy producers entitled to aid are obliged to deliver to DKV quantities corresponding to their distillation rights, which are determined annually by the government agencies. They may also produce a larger quantity of alcohol, but without a price guarantee. The agricultural distilleries (in contrast to the commercial ones, for obvious reasons) have a statutory duty to process the materials (grain) which they produce themselves and to use the by-products of distillation in their farming operations, e.g. feeding the stillage to cattle and using the slurry as fertiliser.
- (21) Some distilleries/producers, however, also exploit and market all or part of their production themselves, without making use of DKV. Where this is the case, they receive from DKV, as part of the distillation rights granted to them, the equivalent of the rectification, storage and marketing costs which DKV has saved. These producers, therefore, are placed on an equal financial footing with those who deliver their production to DKV.
- (22) In the HsanG, amendments were made to the monopoly in order to reduce the aid. First of all, the group of recipients was restricted and the mechanism for allocating the aid partly revised. Following the entry into force of the HsanG, only the agricultural distilleries qualify fully for the old scheme, since under Article 40(5) of the amended Spirits Monopoly Law the distillation rights of the commercial distilleries for the operating years 2000/2001 to 2005/2006 were fixed at 50 % of the regular distillation rights ⁽¹⁶⁾. After the transitional period up to 2005/2006 provided for in the statute, only the agricultural distilleries are eligible for aid.
- (23) The industrial distilleries, which under Article 58a of the Spirits Monopoly Law as amended by the HsanG may no longer be part of the monopoly at all after the 2006/2007 operating year, i.e. after 30 September 2006, may, however, already leave the monopoly voluntarily as from 2001. To offset the inevitable losses of the industrial distilleries, the legislator has provided that those who leave the monopoly early will receive compensatory payments. For this reason, many of the industrial distilleries have opted to leave the monopoly early.
- (24) On grounds of equal treatment, agricultural distilleries too may apply under the Law to leave the monopoly, in which case they receive the same compensatory payments as the industrial distilleries.
- (25) DKV will carry out the task transferred to it by the Law of 2 May 1976 up to 30 September 2006; thereafter the BfB could take over its role.

B. Description of the aid

Offsetting production costs

- (26) The dismantling of the spirits import monopoly in the second half of the 1970s and the opening-up of the market led immediately to a significant increase in German imports of spirits and at the same time to a significant decline in the selling price of spirits, without a noticeable fall in the manufacturers' prices.
- (27) The monopoly adapted (through DKV and the BfB) to the new market conditions and lowered its own selling prices to a competitive level. Thus the selling price of alcohol declined from an average of DEM 333/hl in 1976 to DEM 115/hl in 1999/2000.

⁽¹³⁾ The civil-law partnership DKV (GmbH), set up in 1930 by regulation of the Reichsmonopolamt (now the Bundesmonopolbehörde - Federal Monopolies Authority) and today coming under the Ministry of Finance, holds the exclusive selling rights for grain brandy.

⁽¹⁴⁾ Until the entry into force of the Law of 28 December 1999.

⁽¹⁵⁾ According to DKV, in the 2000/2001 operating year (i.e. one year after the entry into force of the HsanG) 24 %, and in the 2000/2001 operating year 40,6 %, of grain brandy output was produced in the open market.

⁽¹⁶⁾ The operating year starts on 1 October of each year and ends on 30 September of the following year.

(28) For 1999/2000, the statutory purchase price which DKV had to pay the grain distilleries was DEM 263 per hl alcohol (compared with DEM 296/hl paid by the BfB to producers of other spirit). The purchase price is calculated in such a way as to cover the producers' costs. The reference costs are the average production costs of a conscientious producer per hectolitre of alcohol. In the same period, the selling price for grain brandy through DKV was DEM 157/hl alcohol (as against DEM 93/hl for neutral alcohol).

(29) The compensation system is thus clearly intended to soften the impact of a shortfall on affecting the spirits distribution monopoly and hence DKV as well. According to Germany, the subsidies paid to the grain distilleries for the period 1 October 1999 to 30 September 2000 amounted to DEM 36,6 million (EUR 18,7 million).

(30) The difference between the purchase price and the selling price in the market (market price) clearly constitutes an aid. This is not disputed by Germany.

Compensatory amounts in the event of early withdrawal from the monopoly

(31) The system provided for in Article 58a of the Spirits Monopoly Law will make it easier for the grain distilleries to leave the monopoly. As already explained above (see paragraph 22), distilleries which are prepared to leave the monopoly early receive, in return for leaving of their own free will and instead of the operating aid for offsetting production costs, degressive compensatory amounts up to September 2006, which in each case are paid out in the first four months of an operating year. The compensatory amounts enable producers which would like to do so to continue operating in the 'open' grain brandy market despite leaving the monopoly⁽¹⁷⁾. This is therefore a deflection of existing aid, which can be used by the producers in whatever way they want.

(32) It will be noted that virtually all industrial and some agricultural distilleries have chosen this alternative.

⁽¹⁷⁾ The 'open' grain brandy market constituted 40,8 % of the market in the 2001/2002 operating year.

Funding the aid

(33) The deficit from the difference between the purchase price and the sale of the products at the market price in Germany is covered from Federal budget resources. To offset this, alcohol duty was raised. This is a consumption tax which is levied on both domestic and imported alcohol.

Market in figures

(34) At the end of the 1999/2000 operating year (before the Law was introduced) there were 68 industrial and 409 agricultural distilleries, which produced a total of 253 000 hectolitres of grain brandy. At 1 October 2001, in the wake of the reform, there were only 11 industrial distilleries still operating in the market, with a total production of 5 000 hectolitres. The number of agricultural distilleries had fallen to 340, with a total production of 142 000 hectolitres.

(35) The 57 industrial distilleries that had left the monopoly early had received compensatory amounts totalling EUR 5,9 million at the end of the 2001/2002 operating year, the six agricultural ones EUR 0,6 million. The 47 distilleries that market their output themselves (total of 5 400 hl grain brandy) received EUR 315 000 in aid for this purpose. Lastly, in the 2001/2002 operating year, DKV received a grant of EUR 6,6 million.

C. Comments from third parties

(36) After publication of the decision to initiate the procedure, the Commission received 54 replies from third parties, including natural persons, undertakings, federations and trade associations. The overwhelming majority (47) reject the measures proposed by the Commission, which form the starting point for the procedure; three replies were positive in part, and four wholly so.

(37) The four positive replies were submitted by representatives of the spirits industry. They even consider that the Commission did not go far enough in its decision to initiate the procedure and that the German spirits monopoly must be thoroughly reformed.

Agricultural producers

- (38) All 35 agricultural distilleries reject the Commission's position. Most are small family farms. The Commission's view that grain brandy is an industrial product is disputed by all. In their opinion it is clearly an agricultural product. Also criticised is the concept 'grain brandy' used by the Commission: a more appropriate name for the product delivered to DKV would be 'raw alcohol' or 'grain raw alcohol'. The alcohol delivered to DKV is not a drinkable product but must be processed further or rectified. Some also argue that the situation of the agricultural producers cannot be compared with that of the industrial firms, because they are not subject to the same constraints. In this respect, a detailed description is given of the different stages of grain brandy production, which is based on a recycling system (grain cultivation, distillation, use of the stillage as cattle feed, use of the slurry as fertiliser for grain cultivation) that requires strictly ecological methods. The agricultural distilleries therefore consider that in their case the provisions of the EC Treaty relating to agricultural products must continue to apply and that they would inevitably be at a disadvantage compared with agricultural firms which deliver their alcohol to the BfB if, instead, the stricter competition rules in the EC Treaty were to apply to them. The end of the monopoly from 1 January 2004 would certainly be disastrous for them, since many of them had made investments which they would then no longer see mature. In addition, in some cases, the distillery was the centre of the farm and if it ceased to operate, the whole business would fold. A trade association representing the agricultural distilleries which market their own grain brandy also classifies grain brandy as an agricultural product and thinks that the Commission should accept this. Lastly, several replies argue that the aid measures could not distort competition and affect trade between Member States, since grain brandy is an alcohol that can be produced only in the German language area.

The complainant and the industrial distilleries

- (39) The Association of Industrial Grain Distilleries criticises the initiation of the procedure because it is proposed to do away with all aid of whatever type, both for agricultural and industrial distilleries. They set the procedure in motion but regret that the Commission should call into question the compensatory amounts for industrial distilleries, which were conceived as an incentive for leaving the monopoly early. In the complainant's view, the compensatory amounts did not constitute state aid within the meaning of Article 87(1). Rather, they are the counterpart of the distillation rights, which in contrast to the agricultural distilleries they would have to surrender. The authorisation of the compensatory amounts provided for in the HsanG was desirable simply in order to protect legitimate expectations and was also essential for giving the distilleries

concerned the opportunity, until the expiry of the transitional period, to convert their operations under economically acceptable conditions, especially as the amounts were not anything like as large as the losses caused by the new Law. Moreover, trade between Member States was not restricted by the payments, since there was no distortion of competition: all members of the trade association had ceased production of grain brandy, since it was impossible to survive in a subsidised market without receiving grants oneself. The complainant, however, maintains its point of view that the aid for the agricultural distilleries is unlawful because of the unequal treatment. Three industrial distilleries have bluntly called for the provisions of the HsanG on the payment of compensatory amounts as compensation for early departure from the monopoly to be kept.

Other comments

- (40) The other comments, including those of an expert who claims to have been involved in the preparatory work on Council Regulation (EEC) No 1576/89 of 29 May 1989 laying down general rules on the definition, description and presentation of spirit drinks⁽¹⁸⁾ or those of a consumer association which has collected 2 000 signatures, categorically reject the position taken by the Commission in initiating the procedure, mostly using the same arguments and contending in particular that grain brandy must continue to be classified as an agricultural product and that the Commission should not call into question the traditional methods of manufacturing that product. DKV claims that if the Commission, in its final decision, should insist on the appropriate measures which it proposes, it should observe the principle of proportionality when setting the time limit for their implementation and extend the transitional deadline beyond 1 January 2004 to give the undertakings concerned the opportunity to convert their operations.

D. Germany's comments

- (41) Germany does not dispute that the system of refunding the manufacturing costs by DKV has the character of operating aid. It considers, however, that grain brandy should continue to be caught by the provisions of the EC Treaty applying to agricultural products and should not be treated by the Commission as an industrial product. It does not share the Commission's view at all that the grain distillates produced under the monopoly are not an agricultural product that comes under the umbrella concept of ethyl alcohol but a spirituous

⁽¹⁸⁾ OJ L 60, 12.6.1989, p. 1; as last amended by Regulation (EC) No 1882/2003 of the European Parliament and of the Council (OJ L 284, 31.10.2003, p. 1).

beverage designated as a spirit and therefore an industrial product. It bases its position on the fact that the wording of Annex I of the EC Treaty is clear and that the substance of an EC Treaty text cannot be called into question by a provision of secondary legislation, as it describes Regulation (EEC) No 1576/89.

(42) In support of its arguments, Germany submits that by confirming the non-discriminatory character of alcohol duty in several judgments (*inter alia* Case 91/78 Hansen v Hauptzollamt Flensburg⁽¹⁹⁾ and Case 253/83 Sektkellerei C.A Kupferberg v Hauptzollamt Mainz)⁽²⁰⁾ the Court of Justice has acknowledged the compatibility of the duty with the provisions of Articles 37 and 95 (now Articles 31 and 90)⁽²¹⁾ and hence indirectly with Articles 87 and 88 of the EC Treaty.

(43) With regard to the compensatory amounts for distilleries which have decided to leave the monopoly early, Germany explains that these are necessary incentives on account of the long-standing involvement of the distilleries in the spirits monopoly, having first made it clear that, contrary to what the complainant maintains, the distillation rights are not an asset. Moreover, it was also possible for the agricultural distilleries, for reasons of equal treatment, to leave the monopoly, and under the same conditions as the industrial distilleries.

(44) Germany points out that – should the Commission maintain its assessment – in the case of both operating aid for the distilleries remaining in the monopoly and compensatory amounts in return for leaving the monopoly early, a transitional period of several years is essential on account of the traditional involvement of grain brandy producers in the spirits monopoly and the associated protection of legitimate expectations. The distilleries, whether industrial or part of a farm, needed the time to adjust their production structures to the open market or to convert their operations to other types of production. Germany has therefore proposed a transitional time limit of 30 September 2006. It has given the Commission concrete reasons why the original time limit of 1 January 2004 laid down by the Commission in the appropriate measures should be extended to at least the 2005/2006 operating year. Any other decision would result in the closure of numerous industrial and agricultural distilleries and the loss of many jobs.

(45) Germany disputes the complainant's contention that the HSanG of 22 December 1999 has led to discrimination

against the industrial grain distilleries, since it is limited to reorganising the monopoly through a minimal reduction of the number of aid recipients and with a transitional period of six years and appropriate financial compensation, which is paid to industrial and agricultural distilleries alike.

III. LEGAL ASSESSMENT

A. Applicability of the competition rules

Grain brandy not covered by Annex I to the EC Treaty

(46) It was explained above that the processing of grain brandy was organised separately from the other alcohol products of agricultural origin covered by the monopoly (see paragraphs 16 to 24). In 1930, an agency with its own legal personality, DKV, was set up specifically for this product under the spirits monopoly. With the Law of 2 May 1976, Germany again confirmed the special treatment of grain brandy by maintaining the coexistence of two different market organisation agencies – the BfB and DKV.

(47) The majority of the basic alcohol products (distillates) delivered to the BfB are plainly intended for the manufacture of neutral alcohol which is not ready for use, while the distillates transferred to DKV (described by Germany as 'grain fine distillate') are distinguished by their aromatic properties and therefore suited for human consumption

(48) The main reasons for this distinction are the condition in which the basic production of the distilleries is delivered to the two marketing organisations, and the quality of the marketed product after conversion and/or rectification by the two agencies.

(49) The BfB receives mainly raw alcohol (*inter alia* fruit-, potato-, molasses- or cereals-based) and sells it generally after rectification and/or conversion as neutral alcohol.

(50) DKV receives a distillate – "grain fine distillate" – which is already regarded as a spirit drink within the meaning of Regulation (EEC) No 1576/89. The rectification of the distillate carried out by DKV consists in particular in standardising the alcohol content of the end product (32 % in the case of the product known as 'Korn', and 37,5 % in the case of 'Kornbrand').

⁽¹⁹⁾ [1979] ECR 935.

⁽²⁰⁾ [1985] ECR 157.

⁽²¹⁾ Article 90 (ex Article 95) states: 'No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. ... no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.'

- (51) Annex I to the Treaty as amended by Council Regulation No 7a adding certain products to the list in Annex II to the Treaty establishing the European Economic Community ⁽²²⁾ refers to 'ethyl alcohol or neutral spirits, whether or not denatured, of any strength, obtained from agricultural products listed in Annex I to the Treaty, excluding liqueurs and other spirituous beverages and compound alcoholic preparations (known as "concentrated extracts") for the manufacture of beverages'. This text can be interpreted with the aid of headings ex 22.08 and 22.09 (now 22.07 and 22.08) of the Harmonised System Tariff Nomenclature, where undenatured ethyl alcohol, spirits, liqueurs and other spirituous beverages are defined.
- (52) In the Explanatory Notes to the Harmonised System, spirits, which are thus not covered by Annex I, are defined as follows: 'Spirits produced by distilling wine, cider or other fermented beverages or fermented grain or other vegetable products, without adding flavouring; they retain, wholly or partly, the secondary constituents (esters, aldehydes, acids, higher alcohols, etc.) which give the spirits their peculiar individual flavours and aromas.'
- (53) The heading also includes 'undenatured ethyl alcohol with an alcoholic strength by volume of less than 80 % ...'. Concerning this product, the Explanatory Notes state '... contrary to those at (A) [e.g. spirits], these spirits are characterised by the absence of secondary constituents giving a flavour or aroma, whether intended for human consumption or for industrial purposes'.
- (54) Grain brandy is therefore a spirit which is characterised by the presence of aromatic components, and hence cannot be regarded as ethyl alcohol. This is also supported by point (C)(4) of the explanatory notes to heading ex 22.09 (now 22.08, point (C)(2)), which stresses that this heading, as well as ethyl alcohol, covers 'Whiskies and other spirits obtained by distilling fermented mash of cereal grains (barley, oats, rye, wheat, corn, etc.)'.
- (55) In its replies to the Commission, Germany confuses grain alcohol (*Kornalkohol*), which under the above-mentioned conditions (see paragraph 53) can be regarded as ethyl alcohol, with the spirit drink grain brandy (*Kornbranntwein*). Judging by the wording of the Spirits Monopoly Law as amended by the Hsanc of 22 December 1999, the German legislator has in fact treated grain alcohol and grain brandy differently, precisely because they are different products.
- (56) The Commission, consequently, sticks to its view that these are different products; the former is used for producing neutral alcohol, while the latter, which is the subject of these proceedings, has components which give it aroma and taste.
- (57) Article 1(1) of Regulation (EEC) No 1576/89 states that the Regulation covers the definition, description and presentation of spirit drinks.
- (58) Article 1(4) of the said Regulation lists the different categories of spirit drinks. In subparagraph (c), 'grain spirit' is defined as:
- '(1) A spirit drink produced by the distillation of a fermented mash of cereals and having organoleptic characteristics derived from the raw materials used.'
- 'Grain spirit' may be replaced by Korn or Kornbrand, for the drink produced in Germany and in regions of the Community where German is one of the official languages provided that this drink is traditionally produced in these regions and if the grain spirit is obtained there without any additive:
- either exclusively by the distillation of a fermented mash of whole grains of wheat, barley, oats, rye or buckwheat with all their component parts,
 - or by the redistillation of a distillate obtained in accordance with the first subparagraph.
- (2) For a grain spirit to be designated 'grain brandy', it must have been obtained by distillation at less than 95 % vol from a fermented mash of cereals, presenting organoleptic features deriving from the raw materials used.'
- (59) In the present case, the grain brandy producers deliver to DKV a product (grain fine distillate) obtained in accordance with the procedure described in Regulation (EEC) No 1576/89 which, if necessary, is subsequently rectified and/or transformed by DKV so that it can then be marketed.

⁽²²⁾ OJ 7, 30.1.1961, p. 71/61.

- (60) Germany takes the view that the Commission should not rely on this text, because it only establishes rules for the sale of spirit drinks in the interests of consumer protection. The Commission does not dispute that such is the purpose of the Regulation, but this by no means prevents the text from being used to describe and define grain brandy as a spirit drink, which as such is directly subject to the competition rules. It therefore considers, without wanting to give a definitive ruling on the matter, that this passage taken from secondary legislation supports its view as regards the classification of the product in question.
- (61) In one of its communications to the Commission, Germany points out that the wording of Annex I to the EC Treaty varies according to the language version. Thus the word 'spirits (*Branntwein*)' is missing in the English and Dutch versions, where there is only mention of 'liqueurs' and 'spirituous beverages'. The Commission would comment in this respect that the German and other language versions are clear in this connection and that 'spirits' are undoubtedly mentioned in them. The language versions which, like the English and the Dutch, do not specifically exclude spirits must be interpreted and applied in the light of the other language versions and can only be understood in such a way that spirits are among the alcoholic beverages which are also excluded from the scope of Annex I.
- (62) As part of the operation and development of the common market in agricultural products, the Council on 8 April 2003 adopted Council Regulation (EC) No 670/2003 laying down specific measures concerning the market in ethyl alcohol of agricultural origin⁽²³⁾. The Regulation creates for the first time a common organisation of the market for alcohol of agricultural origin.
- (63) In its decision to introduce the procedure the Commission used some points from the Regulation, which was still in the preparation stage at the time, to support its arguments. It believes it is still appropriate to refer to the preparatory work on this legal instrument as well as to the final version of the Regulation in order to support, where necessary, its analysis that grain brandy is an industrial product. Thus, in a first draft of Article 1, spirit drinks within the meaning of Regulation (EEC) No 1576/89 were explicitly excluded from the scope of the Regulation. In the final version of the Regulation, the agricultural products concerned are defined with reference to Annex I to the EC Treaty. In the Combined Nomenclature headings mentioned in Article 1 to which the Regulation applies, spirits in the form of grain brandy are not listed, but only undenatured and denatured ethyl alcohol and denatured other spirits.
- (64) The Commission therefore concludes that grain brandy is a spirit drink which is excluded from the scope of Annex I to the EC Treaty and is hence subject to the Community competition rules.
- B. The measures in question should be regarded as existing aid within the meaning of Article 87(1) of the EC Treaty**
- (65) The Commission has shown that grain brandy is an industrial product to which Articles 87 and 88 of the EC Treaty apply.
- (66) Under Article 87(1), 'save as otherwise provided in this 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'.
- Covering the production costs*
- (67) The measures in question confer an advantage on the producers of grain brandy, since they ensure that they will cover their manufacturing costs in the context of the distillation rights granted to them irrespective of the price at which the product finally comes onto the German market. It will be noted that grain brandy was purchased by DKV in the 1999/2000 operating period at a price of DEM 263/hl, to be marketed subsequently at a price of DEM 157/hl, which constitutes aid for the period amounting to DEM 36,6 million (EUR 18,7 million). Thus German grain brandy producers can sell their production on financial terms which are substantially more favourable than those that would apply if they had to sell their production direct under normal market conditions – i.e. without the considerable subsidies of the monopoly.
- (68) In those cases where DKV is not itself involved in the grain brandy manufacturing process, the producers concerned receive an indemnity in accordance with their distillation rights for the grain brandy rectification, marketing, storage, etc. costs which DKV has saved.
- (69) As a result of this aid, the German producers can sell that part of the grain brandy production not covered by the distillation rights, which they have to market directly, at prices which they could not demand if, thanks to the monopoly, they did not receive an excessive purchasing price for the remaining production delivered to DKV.

⁽²³⁾ OJ L 97, 15.4.2003, p. 9.

- (70) This preferential treatment affects the current manufacturing and marketing costs, i.e. the operating costs, of each undertaking.

Compensatory amounts

- (71) The producers also receive an advantage from the compensatory amounts, which are granted to them instead of their manufacturing costs being refunded if they leave the monopoly early, so that if necessary they can survive in the 'open' grain brandy market. The funds granted replace the subsidies for manufacturing and marketing a particular product, but are by nature akin to subsidies. It is immaterial that the compensatory measures can also be used for purposes other than remaining in the 'open' grain brandy market, e.g. for closing or restructuring distilleries.

- (72) The HsanG, which is supposed overall to reduce the subsidies under the spirits monopoly, is plainly intended to create balanced transitional arrangements which will meet the needs of all producers in accordance with their respective particularities and objectives. It will be noted in this respect that not all producers are subject to the same constraints: the agricultural producers, for example, are obliged by law to use the ecological principle of recycling in their production.

- (73) The compensatory amounts are not linked to investments and hence concern the day-to-day running of the assisted distilleries.

- (74) The measures are financed from state resources, whether in the form of subsidies for manufacturing costs or of compensatory amounts. The shortfall from the difference between the purchase price and the sale of the products at market price in Germany is met from Federal budget resources; this also applies to the compensatory amounts for producers which leave the monopoly early.

- (75) The aim of the measures is to support grain brandy production. They have the following selective character.

- (76) The measures quite clearly distort competition in the common market and restrict trade between Member States, since German producers compete with those from other Member States, who would like perhaps to sell the same alcohol on the German market. As various third parties have noted, the designation 'grain brandy' may be used, pursuant to the already cited Regulation (EEC) No 1576/89, 'for the drink produced in Germany and in regions of the Community where German is one of the official languages⁽²⁴⁾ provided that this drink is traditionally produced in these regions ...'. Moreover, grain

brandy competes with other spirits and spirituous beverages from other Member States. The fact that the Court of Justice held in *Hansen and Sektellerei C.A. Kupferberg* that Articles 95 and 37 of the EEC Treaty must be interpreted as not precluding the de facto reduction made in the selling price of spirit sold by the federal monopoly administration in a given period 'provided that the rate of taxation actually applied to imported products during that period did not exceed the rate of taxation actually levied on corresponding domestic products' does not anticipate the assessment of the state aid by the Commission.

- (77) There is no doubt therefore that the measures in question are likely to affect trade between Member States.

- (78) Consequently, the measures in question constitute state aid within the meaning of Article 87(1) of the EC Treaty. Since the aid is meant to cover the day-to-day running costs of the undertakings concerned, it is operating aid.

- (79) After examining the documents submitted by Germany, the complainants and interested third parties, the Commission finds that the aim in the HsanG of 22 December 1999 was to reform the spirit monopoly as amended by the Law of 2 May 1976 so as generally to reduce the subsidies for the manufacture of grain brandy. The Commission also notes that Germany notified the measures arising out of the 1976 Law in April of that year on the basis of the provisions applying to agricultural products and that the notification prompted no further comments at the time.

- (80) Pursuant to Article 88(1) of the EC Treaty and Article 18 of Regulation (EC) No 659/1999, the Commission recommended by decision of 19 June 2002 that Germany take appropriate measures, after it had reached the conclusion that grain brandy should be regarded as an industrial product and that the measures concerned constitute aid which is no longer compatible with the common market; however, Germany objected to this.

- (81) The state aid resulting from the Spirits Monopoly Law, including the aid measures for grain brandy under the Law of 2 May 1976 had been duly notified by Germany without the Commission expressing reservations at the time about its compatibility with the Community competition rules. Germany informed the Commission at that time that it was proposing to implement the measures. Consequently, the aid is existing state aid within the meaning of Article 1(b)(iii) of Regulation (EC) No 659/1999.

⁽²⁴⁾ Commission italics.

- (82) Thus, in its decision of 19 June 2002 on appropriate measures, the Commission did not classify the measures resulting from the Law of 22 December 1999 as new aid.
- (83) The HsanG of 22 December 1999 is actually intended to reduce the number of recipients and the level of the subsidies granted. It changes nothing at the heart of the system introduced by the Law of 2 May 1976, under which the producers' costs are covered irrespective of the market price of grain brandy. The same applies to the compensatory amounts, which are granted in return for leaving the monopoly early and replace the subsidies for a certain period.
- (84) The HsanG 1999, therefore, did not need to be notified to the Commission before its entry into force.
- (85) This view accords with the decision of the Court of Justice in Case C-44/93 *Namur-Les assurances du crédit SA* ⁽²⁵⁾. Here, a public undertaking had decided to expand its activity so that the public aid it had been granted under legislation predating entry into force of the Treaty would also benefit the expanded operations. The Court held that it was impossible to argue that this is a case of granting or altering aid, as envisaged in Article 93(3), since the decision was taken without any amendment of the aid scheme established by the legislation.
- (86) Accordingly, aid which is granted under an aid scheme predating entry into force of the Treaty is not subject either to the duty of prior notification or the ban on implementation under Article 93(3), but must be kept under constant review in accordance with paragraph 1 of the same Article.
- 'A factor of legal uncertainty would be introduced if Member States were to be required to notify to the Commission and submit for its preventive review not only new aid or alterations of aid properly so-called granted to an undertaking in receipt of existing aid but also all measures which affect the activity of the undertaking and which may have an impact on the functioning of the common market or on competition.'
- (87) The Commission shares this assessment.
- (88) In the light of the above, the Commission initiated the procedure provided for in Regulation (EC) No 659/1999.
- (a) Preparatory measures pursuant to Regulation (EC) No 659/1999
- (89) Article 17 of Regulation (EC) No 659/1999 reads, under the heading 'Cooperation pursuant to Article 93(1) of the Treaty':
- '1. The Commission shall obtain from the Member State concerned all necessary information for the review, in cooperation with the Member State, of existing aid schemes pursuant to Article 93(1) of the Treaty.
2. Where the Commission considers that an existing aid scheme is not, or is no longer, compatible with the common market, it shall inform the Member State concerned of its preliminary view and give the Member State concerned the opportunity to submit its comments within a period of one month. ...'
- (90) By letter dated 22 February 2002 the Commission duly informed Germany that it had reached the conclusion, after examining its replies and the facts submitted by the complainants, that the Community competition rules apply to the aid measures in question and that the special provisions on agricultural products cannot be invoked, since grain brandy is an industrial product, which as such does not fall within Annex I to the EC Treaty.
- (91) After the Commission had established that Germany's measures in support of the grain distilleries constitute existing aid whose compatibility with the provisions of the EC Treaty is doubtful, it requested Germany under Article 17 of Regulation (EC) No 659/1999 to state its views on this within one month of receiving the letter of 22 February 2002. Germany was also requested to submit appropriate measures amending its monopoly legislation to make it compatible with Article 87 of the EC Treaty.
- (92) By letter dated 19 March 2002 Germany objected to the Commission's assessment and again submitted that grain brandy should be covered by the provisions applying to agricultural products.
- (b) Proposal of appropriate measures
- (93) Article 18 of Regulation (EC) No 659/1999 states with regard to appropriate measures:
- 'Where the Commission, in the light of the information submitted by the Member State pursuant to Article 17, concludes that the existing aid scheme is not, or is no longer, compatible with the common market, it shall issue a recommendation proposing appropriate measures to the Member State concerned. The recommendation may propose, in particular: (a) substantive amendment of the aid scheme, or (b) introduction of procedural requirements, or (c) abolition of the aid scheme.'

⁽²⁵⁾ [1994] ECR I-3829.

(94) Pursuant to Article 88(1) of the EC Treaty read in conjunction with Article 18 of Regulation (EC) No 659/1999, the Commission recommended in the decision of 19 June 2002 that Germany take appropriate measures to reform the relevant provisions of German grain brandy legislation (Law of 2 May 1976 and Law of 22 December 1999) as follows:

- (a) agricultural and industrial distilleries may no longer receive any operating aid in the form of subsidies for maintaining statutorily guaranteed prices;
- (b) they may no longer claim other aid of whatever kind as compensation for any early departure from the system;
- (c) the legislative amendments must ensue as soon as possible after the start of the 2002/2003 operating year and enter into force at the latest on 1 January 2004;
- (d) Germany must inform the Commission of the measures taken in a report to be submitted at the latest at the end of the first quarter of 2003. A second report on the actual implementation of the measures should be submitted to the Commission at the latest by the end of November 2003.

C. Assessment of the case law cited by Germany as justification for the aid measures

- (95) The Court of Justice has ruled many times on the compatibility of the statutory provisions on the German spirits monopoly with certain provisions of the EC Treaty (in particular in *Hansen and Sektkellerei C.A. Kupferberg*, see paragraph 42).
- (96) Germany invokes this case law in its replies to the Commission and infers from it that the provisions of the Spirits Monopoly Law of 2 May 1976 have already been examined and confirmed by the Court. Consequently, the Spirits Monopoly Law (as amended by the Law of 22 December 1999) cannot be called into question by the Commission, since the Court did not object to it.
- (97) It is therefore appropriate to go into the operative provisions of this case law in more detail.
- (98) In the cases cited in this context the Court was asked for a preliminary ruling on the validity in the light of Articles 37 and 95 (now Articles 31 and 90) of the EC Treaty of

the tax provisions introduced by the German spirits monopoly. The Court on this occasion gave its view on the compatibility of the tax measures resulting from the Spirits Monopoly Law with the EC Treaty.

- (99) In its judgment it limited itself to pointing out that 'the intervention of the Commission plays a large part in the implementation of Articles 92 and 93 whilst Article 37 is intended to be directly applicable', i.e. it confirmed that the Commission is authorised by the EC Treaty to assess the measures in question from the standpoint of the aid rules.
- (100) The Court explains, moreover, that while Articles 92 and 93 and Article 37 have the common objective of preventing the Member States from distorting the conditions of competition within the common market and creating a discrimination against the products or trade of other Member States through 'action by a state monopoly and the granting of aids', 'the application of those provisions presupposes distinct conditions peculiar to the two kinds of state measure which they are intended to govern'. Lastly, the Court explained that there was no need in the particular case to examine how far Articles 92 and 93 were applicable to the production of the agricultural products concerned and to trade in them.
- (101) It cannot be inferred from this justification that the Court considered that the aid provisions of the EC Treaty are not applicable to the subsidies granted in the context of the grain brandy monopoly.
- (102) While Germany acknowledges that the Court did not comment directly on the legality of the monopoly as regards Articles 92 and 93, it claims that there is no doubt that the Court classified the product in question as an agricultural product which may be subject to a common organisation of the market.
- (103) The Commission observes that the Court did not comment on the state aid in question. It therefore considers that the Court's judgments which Germany invokes in this case do not anticipate either the classification of the product in question or the assessment of the aid to German grain distilleries. The case law cited is therefore not relevant in the present case.

D. Compatibility of the aid

- (104) Article 87(2) of the EC Treaty lists certain types of aid that are compatible with the EC Treaty. Given the type and composition of the aid, however, it is clear that the exemptions in Article 87(2)(a), (b) and (c) do not apply in the present case.

- (105) Article 87(3) lists the types of aid that may be regarded as compatible with the common market. It is clear that the scheme in question does not serve to promote important projects of common European interest or to remedy a serious disturbance in the economy of a Member State or to promote culture and heritage conservation within the meaning of the exemptions in Articles 87(3)(b) and (d).
- (106) As regards the exemptions in Article 87(3)(a) and (c), provided for in the interests of regional development, it should be noted that the aid in question applies to all regions of Germany without distinction. There is also no doubt that the aid is not intended to promote measures within the meaning of the exemption on facilitating the development of certain economic activities (Article 87(3)(c)) in the fields of research and development, environmental protection, employment or training in accordance with the relevant Community frameworks or guidelines. Since no other reason concerning the development of certain economic activities can be given, the aid in question should be regarded as incompatible with the common market.
- (107) The Commission considers, however, that there are quite specific reasons for allowing the system practised in Germany to be maintained for a certain transitional period.
- (108) After the initiation of the procedure, all circles concerned, with the exception of the spirit drinks industry, protested against the time limit proposed by the Commission. Germany explained to the Commission that a period of several years was essential, so that the aid in question could be dismantled under acceptable conditions without threatening the existence of the producers concerned, who had thus far benefited from the duly notified subsidy system, which the Commission had not complained of in several decades.
- (109) The Commission notes first of all that in grain brandy production the operating year starts on 1 October and ends on 30 September of the following year. It will take account of this in setting the time limit by which Germany must have implemented the statutory reform.
- (110) Germany has convincingly explained to the Commission that the industrial and agricultural distilleries, which have hitherto delivered the distillates manufactured under the monopoly to DKV and would like in future to market the grain brandy themselves under the new system, have to make considerable investments. These include, for example, the purchasing of new distillation equipment or the construction of new buildings and storage areas (steel vats, wooden barrels, laboratory equipment, bottling plant, storage area for packaged goods, application for building permits, etc.). Germany estimates that a distillery with an annual production of 1 000 hl grain alcohol must invest at least EUR 400 000 a year in marketing that quantity of alcohol.
- (111) Clearly, the necessary restructurings are not feasible unless an additional period is granted in which the existing financial aid, whether in the form of a refund of production costs or of compensatory amounts, is maintained. This applies in particular to the small distilleries, which make up the overwhelming majority of the undertakings and/or farms.
- (112) The Commission accepts the justification for Germany's request, since it can be shown that abruptly stopping aid which has been granted for decades would threaten the existence of most of the firms affected by the measures, especially the agricultural distilleries. A transitional period should therefore be provided which is determined in such a way that the distilleries can adjust their production in that period to the new situation.
- (113) The Commission also notes that grain brandy competes with other products that come under Annex I and receive aid. Since the present case concerns operating aid, however, the latter must be terminated within an appropriate period: in view of the above explanations, it would probably be appropriate to preserve the scheme for a further two and a half years approximately (until 30 September 2006) in this respect. Thereafter Germany must abolish the scheme and all its consequences.
- (114) The Commission therefore determines as follows:
- (a) agricultural and industrial distilleries may no longer receive any operating aid in the form of subsidies for maintaining statutorily guaranteed prices;
 - (b) they may no longer claim other aid of whatever kind as compensation for any early departure from the system;
 - (c) the legislative amendments must ensue as soon as possible after the start of the 2005/2006 operating year and enter into force at the latest by 30 September 2006;
 - (d) Germany must inform the Commission of the measures taken in a report to be submitted at the latest at the end of the second quarter of 2005. A second report on the actual implementation of the measures should be submitted to the Commission at the latest by the end of 2006,

HAS ADOPTED THIS DECISION:

By 31 December 2006 at the latest Germany shall report to the Commission on the actual application of the measures taken.

Article 1

The aid scheme for grain brandy producers contained in Germany's Spirits Monopoly Law is incompatible with the common market.

Article 4

This Decision is addressed to the Federal Republic of Germany.

Article 2

Germany shall take all necessary measures to abolish the aid scheme referred to in Article 1 as from 30 September 2006.

Brussels, 16 November 2004.

Article 3

By 30 June 2005 at the latest Germany shall report to the Commission on the measures for abolishing the aid scheme.

For the Commission

Mario MONTI

Member of the Commission
