

## STATE AID

C 16/95 (NN 50/94)

Germany

(95/C 215/05)

(Text with EEA relevance)

*(Articles 92 to 94 of the Treaty establishing the European Community)*

**Commission notice pursuant to Article 93 (2) of the EC Treaty to other Member States and interested parties concerning aid the German Government intends to grant to SKET Schwermaschinenbau Magdeburg GmbH**

In the letter reproduced below, the Commission informed the German Government of its decision to initiate the procedure provided for in Article 93 (2) of the EC Treaty.

'By letter dated 13 June 1994 the German Government notified aid that the Treuhandanstalt (THA) had decided to grant to SKET Schwermaschinenbau Magdeburg GmbH (SKET). At the Commission's request on 20 June 1994 the German Government provided additional information by letter of 19 July 1994.

Further to a request of the German authorities of 31 October 1994, to postpone a decision because of the expected notification of additional aid involved in the privatization, it was decided to postpone the decision, of which the German Government was informed by letter dated 9 November 1994.

The additional aid involved in the privatization of SKET of 51 % (privatization contract of 26 October 1994) was belatedly notified by the German Government by letter dated 25 November 1994.

By a third notification, submitted to the Commission dated 9 December 1994, registered 12 December 1994, the waiving of shareholders' loans by the THA (reduction of indebtedness) was announced, which according to the German Government had to be carried out by 31 December 1994 pursuant to the provisions of Article 64 GmbHG because of the company's indebtedness which otherwise would have forced SKET into bankruptcy.

1. The guarantees and loans previously awarded by the THA to SKET had been approved by the Commission by letters dated 4 May 1993 and 30 July 1993.

This concerned aid to SKET Schwermaschinen- und Anlagenbau AG, the former holding and SKET SMM, the core company of the concern and its subsidiaries.

2. The aids notified on 13 June 1994 comprised:
  - a further prolongation of loans and guarantees of DM 290,7 million for SKET SMM until 31

December 1994, to provide for the working capital,

- a new loan in the amount of DM 65,6 million for the covering of liquidity needs to be granted until 31 December 1994,
- a Treuhand-guaranty for a bank loan of DM 102,1 million for investment purposes,
- a THA-guaranty for an additional facility of bank guaranties in the amount of DM 30 million to secure SKET's contractual obligations out of their normal business activities.

Accordingly, a total of DM 488,4 million was awarded to SKET before the privatization.

3. In connection with the privatization the German government provided in its notification of 25 November 1994 the following information:
  - A majority stake of 51 % was sold to the purchasers' group of Oestman & Borchert Industriebeteiligung (Oe & B) at a price of DM 10,2 million, economically effective from 1 January 1994. Another share of 23,9 % was transferred to the same group in a fiduciary capacity under the terms of granting this portion to some members of the management to be determined, for the price of DM 4,8 million. In case a management participation cannot be reached this part will fall back to the THA. For the remaining 25,1 % interest, the THA's successor still holds, a sale to other participants or employees is envisaged.
  - The buyers' concept provides for the acquisition of all SKET companies within one independent company unit (SKET Schwermaschinenbau Magdeburg — SMM). SMM owns two producing subsidiaries, DZM and ETM, besides some trading companies.

— The forge, foundry, transmission construction and parts of the steel construction will be closed down permanently.

— A concentration of the production sites will be achieved by relocating the remaining productions from the former 1,6 million m<sup>2</sup> to eventually 200 000 m<sup>2</sup>.

— The manufacturing capacity will be decreased from formerly 1,2 million manufacturing hours to 352 000, a further reduction in relation to the initial restructuring concept.

— More than 300 machines and installations will be shut down until the end of 1996. The restructured production will be equipped with 110 machines and plants.

— The THA will create capital reserves by waiving their shareholders' credits and by taking over and waiving bank credits in the amount of DM 371,5 million as an initial financial allocation for the key-date of the contract (effective date), 1 January 1994.

Included in this sum of the waiver of credits are DM 16,8 million for employment schemes, DM 22,8 million *Altcredite* (old financial claims exclusively originated in the arbitrariness of the former planned economy) dating from before 1 July 1990 and DM 5 million equalization charges (*Ausgleichsverbindlichkeiten* in the "opening" balance sheet after 1990) between SMM and its subsidiary DZM.

— The financial needs of SKET during the restructuring period, including liquidity means to cover the operating losses and investments, will be compensated by the THA in the form of maximum guarantees (*Höchstbürgschaften*) of DM 413,9 million at commercial conditions. Every year, that part of the maximum guarantees, annually granted, which corresponds to the projected annual loss, will be waived by the THA, i.e. its successor BVS.

The amount of maximum guarantees covering the projected losses 1994 to 1996 include old financial claims (*Altcredite*) of the subsidiary DZM of DM 17 million.

After the clearance of most of the guarantees at the end of the restructuring period there will eventually remain an amount of DM 33,1

million of the maximum guarantees, of which the purchasers are obliged to release the THA successor.

The projected losses (*Planverluste*), totalling DM 331,7 million, covered by the maximum guarantees of DM 413,9 million will be annually cleared as follows:

— 31 December 1994: DM 106,3 million (already cleared; see point 4),

— 31 December 1995: DM 108,1 million,

— 31 December 1996: DM 117,3 million.

In case the real losses surmount the projected losses, there will be no additional loss compensation.

If, according to the privatization contract, the real annual losses surmount the projected losses by more than 25 % or if the losses are by DM 10 million higher than the projected losses of the liquidity plan, the THA may decide to refuse any further guarantees or reduction of indebtedness.

— The purchasers' investment plan amounts to DM 187,1 million.

— A prolongation of the guaranty for the facility of bank guarantees to secure SKET's contractual obligations out of their normal business activities, increased from DM 30 million to DM 34,7 million, was arranged until 31 December 1996.

— Furthermore, the THA had previously granted a counter-security (mostly for Hermes guarantees) for export-guarantees which had never been notified before. The German Government announced a prolongation of the old counter-security and indicates that on a case by case evaluation new guarantees will be granted. In the notification of the privatization an exact amount of these guarantees or a ceiling has not been mentioned. These counter-securities are limited until 31 December 1996.

— Expenses that might be incurred by the SKET-companies in connection with the elimination of environmental pollution caused before 1 July 1990 will be borne by them up to DM 1,5 million. About liabilities of the THA nothing

has been said. The privatization contract instead refers to environmental liabilities to be borne by the THA. It will carry 90 % of up to DM 15 million, ergo DM 13,5 million.

- The comparison of the two rivalry bids included in the notification refers to a counter-security by the Land Sachsen-Anhalt for a NordLB bank guaranty for DM 14,98 million for the buyers' purchase price.

- Redundancy payments in the amount of DM 54,8 million are earmarked for the further reduction of workers and will be borne by the THA. They are not included in the financial assistance of the THA as mentioned above.

- Point 6.8 of the privatization contract refers to other public grants in the total amount of DM 25,5 million.

- The comparison of the two rivalry bids based on an open bidding procedure resulting in a decision of the THA allegedly honouring the highest bid show that due to the subsequent negotiations further financial concessions were received by the purchasers beyond those on which the highest bid was honoured. These modifications consequently put the formerly excluded bidders at a disadvantage since now their formerly lower bid is higher than the one chosen by the THA.

The net-cash-result was at the time of the comparison of the two offers in June 1994 for the purchasers — DM 534 million and the rivalry group — DM 596 million. After renegotiations of the purchasers with the THA their net-cash-result was — DM 606 million, a lower figure than the rivalry group.

4. The third notification, submitted to the Commission dated 9 December 1994, describes the waiving of shareholders' loans by the THA (reduction of indebtedness) of DM 477,8 million, which according to the German Government had to be carried out by 31 December 1994 pursuant to the provisions of Article 64 (1) GmbHG because of the company's indebtedness which otherwise would have forced SKET into bankruptcy. The manager of SKET GmbH is obliged by law in case of insolvency or heavy indebtedness (*Überschuldung*) of the company to file a petition in bankruptcy without any culpable delay, at the latest three weeks after the insolvency occurs. A company is

insolvent when the assets are considered not to cover the liabilities anymore (Article 64 (1) second sentence GmbHG). It can be assumed that the THA has already carried through the waiving of the loans as of 31 December 1994.

The total waiver of DM 477,8 million is covered by the aid contained in the notification of the privatization.

- DM 371,5 million mentioned in point 3,

- DM 106,3 million as a further waiver to partially cover the projected losses of 1994 (point 3).

## 5. Quantification of aid

From the waiver of shareholders' credits of DM 371,5 million an amount of old financial claims of DM 22,8 million has to be deducted, since they are not to be considered as aid according to the Commission's decisions of 1991/92 on the THA activities, ergo the aid element of the waiver amounts to DM 348,7 million.

Another amount of old financial claims of DM 17,0 million has to be deducted from the maximum guarantees of DM 413,9 million, ergo the aid element of the guarantees amounts to DM 396,9 million.

The total financial means the THA provided for SKET for its privatization in the following summary was scrutinized as to their compatibility with the common market:

— waiving of shareholders' credits	DM	348,7 million
— maximum guarantees	DM	396,9 million
— additional redundancy payments	DM	54,8 million
— reinsurance of bank guarantees	DM	34,7 million
— counter-security by Sachsen-Anhalt of around	DM	15,0 million
— further public means	DM	25,5 million
— counter securities for bank guarantees	DM	> 68,0 million
— waiving of environmental liabilities (maximum)	DM	13,5 million
<b>TOTAL</b>	<b>DM</b>	<b>&gt; 957,1 million</b>

## 6. Trade and competition

Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement concern aid granted by public authorities which distorts or threatens to distort competition between Member States by favouring certain undertakings or the production of certain goods. The proposed aid, provided by the German authorities, will favour the company SKET, wholly owned by the THA before the privatization, and could affect trade and competition between Member States since its product range is traded between Member States (see points 7.1 and 7.2). As set out above, your Government only belatedly supplied the information about its financings to SKET and therefore did not fulfil its obligations pursuant to Article 93 (3) of the EC Treaty. The aid is therefore illegal under EU law. Our letter dated 20 January 1995 informed your Government that it was decided to combine the three aids under one NN-number.

## 7. Derogations

Though the aid is in principal incompatible according to Article 92 (1) of the EC Treaty, a number of exceptions to this general rule are provided for in Article 92, where aid can be regarded as compatible with the common market. Pursuant to Article 92 (3), aid may be authorized where it promotes the economic development of an area where there is serious underemployment or facilitates the development of certain economic activities or economic areas where the aid does not adversely affect trading conditions to an extent contrary to the common interest. Such aids may be considered compatible with the common market.

### 7.1. Products and markets

SKET SMM is still the biggest producer of machinery and equipment in the new German *Länder*. By large the most important division in terms of number of employees and share of the turnover (2/3) is the heavy machinery department that foremost produces rolling mills.

Research done by consultants McKinsey & Comp., revealed that the world market for rolling mills has an annual volume of DM 3 to 4 billion, more or less stagnant; the main markets are located in the CIS, Asia and the new developed countries. There are three to four global companies and 10 to 15

regional suppliers competing. Of the market volume, SKET plans to capture a fraction of DM 200 to 250 million.

For cable-stranding machines and wire-drawing machines, concentrated in DZM, McKinsey expected a market volume of approximately DM 1,9 billion in 1994, with demand slightly increasing. The CIS countries and Asia have an extensive demand. Even if 20 % of them will be closed down, the marked volume is estimated to be DM 2,5 billion. SKET strives for a turnover of DM 100 million in these markets. The area of glass fibre cable machines will be built up.

For the rest of SKET's activities, i.e. vegetable oil extraction plants, high-grade cranes for the steel-technology and metallurgical engineering and environmental technologies, in the future to be concentrated in the subsidiary ETM, ("de-dusting"), wind-energy technology (the construction of installations of currently 100 kW will be expanded to 500 kW plants in the future), wind parks are considered to be erected, biological and other sewage treatment plants (machinery and electronical equipment) an annual turnover of DM 30 to 50 million has been planned.

Orders and offers to be realized are expected in a volume of DM 1,2 billion until 1998. An annual turnover of DM 300 million is expected for the coming years.

### 7.2. SKET's position within the common market

In 1990 in the area of mechanical engineering 120 000 companies were active within the EU. Only 4 % of these had more than 100 employees. Accordingly, the sector of mechanical engineering is the least concentrated sector in the EU. Within the Member States, West Germany accounted for more than 50 % of EU production in 1992. East Germany accounted for 5 % of West German production. In West Germany e.g., the largest six companies had only a share of the total sector-turnover of 8,2 % in 1990. SKET's share in the EU (total EU production in this sector of ECU 210 billion) is almost negligible. Furthermore, SKET is in none of its areas in a leading position in the global market.

It would seem that after the substantial reduction in capacity and personnel the formerly important position of SKET in this sector does not exist

any more. Comparing its present size to the largest 15 companies in the EU (in 1992 turnover between ECU 1,7 billion and ECU 13,9 billion and employees between 17 000 and 137 000) SKET is by far a smaller company with its expected turnover for 1996 of ECU 200 million and less than 2 000 employees. Furthermore, it still competes predominantly in third markets (turnover in CIS countries around 50 % between 1994 and 1998). The enlargement of its former global marketing organization shows that its markets will be more and more outside Europe. In addition it will benefit from the expected growth rates.

8. The appraisal of all three notifications was dealt with in a combined assessment since they partly cover the same aid. The prolongations and new loans of the first notification are mentioned in the privatization and the waiving of debt by 31 December 1994 is also a part of the privatization.

It should be recalled that the unprecedented case in the Community of a transformation of a planned economy into a market economy results in difficult economic, industrial and social circumstances for companies in the former GDR. Without the THA commitment to cover the company's losses and enabling SKET to make up for the company's future important investments resulting in necessary adjustments to the market, SKET would have had to close down immediately before a privatization would have been achieved. Furthermore, the new *Länder* belong to the regions eligible for regional assistance pursuant to Article 92 (3) (a) of the EC Treaty.

The prolongation of the existing aid of DM 290,7 million (Treuhand-guarantee and loan) until the end of this year (first notification) was needed to allow for the final negotiations of the privatization contract.

The other Treuhand-loan of DM 65,6 million was deemed necessary to secure the liquidity constraints until the end of 1994.

The extension of the guarantee for the investment loan of another DM 35,1 million was in line with the restructuring plan, raising the overall guarantee of the THA to DM 102,1 million. DM 67 million of the first investment-phase had already been provided by the THA.

Together with the reinsurance of bank guarantees of DM 30 million the total THA assistance amounted to DM 488,4 million before the privatization and was as a part of the notified privatization dealt with in the following chapter, since it is contained in those financings.

## 9. Privatization contract

The Commission has analysed the aid on the basis of its decisions of 1991/92 on the activities of the THA and has taken into account the principles underlying the Community guidelines on State aid for rescuing and restructuring firms in difficulty of 1994.

Based on the information currently available, the exact amount of aid cannot be quantified at this stage but, as set out in point 5, the privatization itself involves a total aid of at least DM 957,1 million.

10. On the basis of available information, the total means spent by the THA in connection with the privatization of SKET, thereby guaranteeing 1 625 jobs, boil down to an amount of almost DM 600 000 per worker. This is certainly an enormous amount of financial assistance, also in comparison with other THA-cases dealt with by the Commission, and considering that the creation of jobs in a sector of construction of heavy machinery is not as capital-intensive as in a sector of high technology or where extensive capital for investments is required as e.g. in the construction of a refinery.
11. The Commission has decided to initiate the procedure pursuant to Article 93 (2) of the EC Treaty against the total amount of aid for the following reasons:

— The notifications do not allow for the conclusion that the aid spent for the privatization is limited to the absolute minimum necessary, as stated in the Commission communication on the THA in 1992. Furthermore, it would seem that the THA covers the entire restructuring costs. The amount and intensity of the aid must be limited to the strict minimum needed to enable restructuring to be undertaken.

The THA has financed all essential items in connection with the restructuring of SKET such as:

- clearance of former credits and guarantees,
- loss coverage during the restructuring,
- all investments,
- almost all possible environmental liabilities,
- redundancy payments,

- reinsurance of bank guarantees for trading,
- counter securities for export guarantees.

Normally, the aid beneficiaries will be expected to make a significant contribution to the restructuring plan from their own resources or from external financings at commercial conditions. Here, according to the notification (mentioned only in the comparison of the rivaling bidding groups), even for the financing of their purchase price of DM 10,2 million the guaranty of a State owned bank will be secured by a counter security of the Land Sachsen-Anhalt (DM 14,98 million). Accordingly, based on the available information, all financings for the acquisition have been covered or secured by public financings. The purchasers are not obliged to carry any financial burden and entrepreneurial risk.

The fear that the aid is not limited to the absolute minimum necessary is underlined by the conclusion that SKET was not sold to the highest bidder. Consequently, more aid seems to have been awarded than would be strictly necessary for privatizing SKET.

- It does not seem conclusive, how SKET's long-term viability can be achieved if even at the end of the restructuring period heavy losses are calculated (DM 117,3 million in 1996).
- The aid may adversely affect trading conditions to such an extent as would be contrary to the interests of the Community (Article 92 (3) (c)). The privatization contract does not contain any guaranty against SKET selling its products at artificially low prices from 1994 to 1996 to the detriment of its competitors in the European Union and European Economic Area.
- In view of the preceding points, competitors should have the opportunity to submit their observations to the Commission.
- The notifications and the privatization contract contain conflicting data, which need to be clarified by the German authorities. All factual information requested by the Commission is set out in the Annex I to the present letter.

As part of the procedure, the Commission hereby gives your Government the opportunity to present within one month of being notified of this letter, its comments and any information relevant to the aid.

The Commission would remind you of the suspensory effect of Article 93 (3) of the EC Treaty and would draw your attention to the communication published in the *Official Journal of the European Communities* No C 318, 24. 11. 1983, p. 3, in which it was stipulated that any aid granted unlawfully, i.e. without prior notification or without awaiting the Commission's final decision under the procedure provided for in Article 93 (2) of the EC Treaty, may have to be recovered from the beneficiary.

A possible abolishment of the aid involves, in principle, repayment by the recipient firm in accordance with the procedures and provisions of German law, including interest, based on the interest rate used as reference rate in the assessment of regional aid schemes, starting to run on the date of which the unlawful aid was granted. This measure is necessary in order to restore the status quo by removing all the financial benefits which the firm, receiving the unlawful aid, has improperly enjoyed since the date on which the aid was paid.

The Commission also requests the German authorities to inform the recipient firm without delay of the initiation of the procedure and the fact that they may have to repay any aid improperly received.

The Commission hereby informs the German Government that it will publish a notice in the *Official Journal of the European Communities* (without Annex I) giving the other Member States and other interested parties concerned notice to submit their comments, and a notice (without Annex I) in the EFTA supplement to the *Official Journal of the European Communities* giving interested parties concerned notice to submit their observations.

The Commission regrets that the German Government failed to observe its obligations under the EC Treaty by not notifying the aid in advance pursuant to Article 93 (3) of the EC Treaty, so that the Commission would have had a chance to express its opinion before the granting of the aids.'

The Commission hereby gives the other Member States and interested parties notice to submit their comments on the measures in question within one month of the date of publication of this notice to:

Commission of the European Communities,  
Rue de la Loi/Wetstraat 200,  
B-1049 Brussels.

*The comments will be communicated to the German Government.*