

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 13 May 2003

on the State aid implemented by Germany for Kahla Porzellan GmbH and Kahla/Thüringen Porzellan GmbH

(notified under document number C(2003) 1520)

(Only the German version is authentic)

(Text with EEA relevance)

(2006/239/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 ⁽¹⁾ and having regard to their comments,

Whereas:

I. PROCEDURE

- (1) On 16 November 1998 and 24 March 1999 the Commission received complaints from competitors alleging misuse of state aid purportedly granted by the *Land* of Thuringia to Kahla Porzellan GmbH (Kahla I) and Kahla/Thüringen Porzellan GmbH (Kahla II), both in Thuringia, Germany.
- (2) After an extensive exchange of correspondence and meetings with representatives of Germany, the Commission initiated the formal investigation procedure on 15 November 2000 in respect of the ad hoc aid granted to the companies. At the same time, Germany was requested to provide sufficient information and data to make it possible to assess whether a number of aid measures complied with the terms of approved aid schemes under which they had allegedly been granted.
- (3) The Commission's decision to initiate the procedure was published in the *Official Journal of the European Communities* ⁽²⁾. The Commission invited interested parties to submit comments on the aid. On 31 July 2001 the Commission received comments from Kahla II, which were forwarded to Germany by letter dated 7 August 2001.

⁽¹⁾ OJ C 272, 23.9.2000, p. 45, and OJ C 26, 30.1.2002, p. 19.

⁽²⁾ OJ C 185, 30.6.2001, p. 45.

- (4) On 26 March 2001 Germany responded to the request for information, submitting information on the aid and informing the Commission of further aid to the company, the existence of which had not been notified before. The Commission requested additional documentation on 28 May 2001, which was received by the Commission on 31 June 2001. Additional information was submitted on 9 August 2001.
- (5) By letter dated 30 November 2001 the Commission informed Germany that it had extended the procedure laid down in Article 88(2) of the EC Treaty to include those aid measures which did not comply with the terms of the approved aid schemes under which they had allegedly been awarded and those aid measures of which the Commission had not been informed before.
- (6) On 10 December 2001 the case was discussed at length with representatives of Germany and of the company.
- (7) The Commission's decision to extend the procedure was published in the *Official Journal of the European Communities* ⁽³⁾. The Commission invited interested parties to submit their comments on the aid. The Commission received comments from the aid recipient (Kahla II). These comments were forwarded by letter dated 6 March 2002 to Germany, which was given the opportunity to react.
- (8) On 30 January 2002 Germany responded to the extension of the formal investigation procedure, submitting extensive information. Additional information was requested by letter dated 30 April 2002. Germany submitted its reply by letter dated 29 May 2002, which was registered as received on the same day.
- (9) By letter dated 28 February 2002 the Commission received comments from Kahla II, which were transmitted to Germany by letter dated 6 March 2002. On 18 March 2002 a new complaint was received alleging that Kahla II had received new aid. This information was sent to Germany by letter dated 30 April 2002. Germany's response to this complaint was received on 29 May 2002.
- (10) On 24 July 2002 the case was discussed again with representatives of Germany. Following this meeting, Germany submitted further comments on 7 August 2002. On 30 July 2002 Kahla II indicated that it was adhering to its previous arguments. By letter dated 1 October 2002, registered as received on the same day, Germany submitted further comments.

II. DESCRIPTION

A. The relevant undertaking

- (11) Kahla II is the successor to Kahla I. Both Kahla I and Kahla II are active in the production of porcelain dishes and china. They are located in a region eligible for aid under Article 87(3)(a) of the EC Treaty.

Kahla I

- (12) The company was created on 1 March 1990 by transforming VEB Vereinigte Porzellanwerke Kahla into two private limited companies, one of which was Kahla I, in accordance with the German regulation on the conversion of state-owned combines, enterprises and installations into companies with share capital (*Verordnung zur Umwandlung von volkseigenen Kombinat, Betrieben und Einrichtungen in Kapitalgesellschaften (UmwandVO)*). On 23 April 1991 the Treuhandanstalt (THA) privatised Kahla I by selling it for DEM 2 to a Mr Hoffmann (75,1 % of the shares) and a Mr Ueing (24,9 % of the shares). The privatisation contract was concluded with the sole bidders after the THA published the intended sale in its list of companies for sale (Hoppenstedt) and contacted associations in the ceramics industry and chambers of commerce. Germany states that the company's liquidation would have implied higher costs for the THA. Germany further states that the privatisation contract became effective only on 11 December 1992.

⁽³⁾ OJ C 26, 30.1.2002, p. 19.

- (13) The following data on the company's operation were submitted by Germany (turnover and operating result in DEM million):

Table 1

| | 1991 | 1992 | 1993 |
|------------------|-------|-------|-------|
| Employees | 1 561 | 827 | 696 |
| Turnover | 25,4 | 29,3 | 27,9 |
| Operating result | -29,5 | -25,8 | -13,4 |

- (14) The company filed for bankruptcy on 9 August 1993. Bankruptcy proceedings were opened on 29 September 1993.
- (15) According to Germany, following the initiation of bankruptcy proceedings the administrator in bankruptcy sought investors to take over the assets. The administrator in bankruptcy considered that the best price for the assets would be obtained by selling the company as a going concern.

Kahla II

- (16) In November 1993 Kahla II was created by a private investor, Mr G. Raithel. In January 1994 the administrator in bankruptcy sold the real estate, plant, machinery and stock in trade of Kahla I in bankruptcy to Mr Raithel. A total of 380 employees were kept on.
- (17) The total price amounted originally to DEM 7,391 million. The contract was amended on 5 October 1994, providing in its new form that the price of DEM 2,05 million payable for plant - which was to be financed by a grant of DEM 2,5 million (see measure 15) - was to be paid upon signature of the contract as amended. Legal rights, trademarks, registered patterns and know-how were transferred for DEM 1. The list of customers and the order book were taken over free of charge. The price of DEM 2,136 million for stocks was to be paid in ten instalments starting on 1 March 1994. The real estate, which was to be free of charges, was sold for DEM 3,205 million, payable within 14 days.
- (18) Germany states that part payments were made until 1996. An amount of DEM 1 million was finally paid in 1999, after the administrator in bankruptcy had lifted a mortgage on part of the real estate. The total price finally paid amounted to DEM 6,727 million. Germany states that a reduction in the price for the stocks of DEM 0,664 million took place owing to defects found after the sale. The available information shows that the sale was financed mainly through state aid. Own resources not containing any element of state aid amounted to only DEM 55 000.
- (19) The sale of the real estate was approved by the THA on 18 July 1994 ⁽⁴⁾ and by its legal successor, the Bundesanstalt für vereinigungsbedingte Sonderaufgaben (BvS) on 19 October 1995.
- (20) The sale contract also provided that Thüringer Industriebeteiligungs GmbH & Co. KG (TIB), a state-owned undertaking set up by the *Land* of Thuringia and controlled by it through a foundation, would acquire a silent participation of 49 % in Kahla II. This occurred on 5 March 1994.

⁽⁴⁾ In the event of the bankruptcy of companies formerly held by the THA, their real estate was to be transferred back to the THA, which in turn had to incorporate its value into the estate in bankruptcy.

- (21) The following data on the company's operation were supplied by Germany (turnover and operating result in DEM million):

Table 2

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---------------------------|------|------|------|------|------|------|------|
| Employees | 380 | 369 | 327 | 323 | 307 | 327 | 322 |
| Turnover | 23 | 29 | 32 | 39 | 34 | 35,8 | 41,6 |
| Operating result[...] (*) | | | | | | | |

(*) Confidential information. Indexed (in relation to year 1994):

| 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|------|------|------|------|------|------|------|
| -100 | -181 | 3 | 70 | 78 | 11 | 186 |

B. Financial measures

(a) *Financial measures in favour of Kahla I*

- (22) The following financial measures were granted by the public authorities to Kahla I from the time of its creation until its bankruptcy (amounts in DEM million):

Table 3

Measures in favour of Kahla I

| | | | | Amount |
|--------------------------------------|-----------|---------------------|---|----------------|
| Measures before privatisation | | | | |
| 1 | | THA | Export guarantee | 4,5 |
| Measures during privatisation | | | | |
| 2 | 23.4.1991 | THA | Assumption of environmental liabilities | 37,7 |
| 3 | 23.4.1991 | THA | Taking-over of old debts | 31,1 |
| 4 | 23.4.1991 | THA | Guarantees | 24,9 |
| Measures after privatisation | | | | |
| 5 | 12.1991 | Land | Direct investment grants | 1,825 |
| 6 | 5.10.1992 | THA | Loan | 4,3 |
| 7 | 1.12.1992 | THA | Loan | 1,8 |
| 8 | 1993 | THA | Revenue from exploitation of property | 5,676 |
| 9 | | Stadtsparkasse Jena | Credits | 3,9 |
| 10 | 1992-1995 | Land | Investment allowances | 0,035 |
| Total | | | | 115,736 |

- (23) Measure 1: An export guarantee granted before privatisation which, according to Germany, was never called.
- (24) Measures 2 and 3: A taking-over by the THA of debts relating to credits from Dresdner Bank AG dating from before 1 July 1990 and to loans granted by the THA before privatisation.

- (25) Measure 4: Germany has indicated that these guarantees from the THA were granted to secure investments, loss cover and credits granted by Dresdner Bank AG. In support of these guarantees, the company put up several securities, which the THA refrained from availing itself of following the opening of bankruptcy proceedings. As an additional security, the THA was entitled to receive the revenues from the exploitation of that part of the company's real estate which was not directly related to the business. This real estate was valued at DEM 13,3 million. The expected revenues were to have been used to repay those credits which were backed by the THA's guarantees. Germany admits that, with the consent of the THA, the credits to which these guarantees related were never repaid. At the time they were availed of, these guarantees, including interest, totalled some DEM 24,9 million.
- (26) Measure 5: In December 1991 the company obtained direct investment grants (*Investitionszuschüsse*) of DEM 1,825 million from the *Land* of Thuringia.
- (27) Measure 6: On 5 October 1992 the THA granted a loan of DEM 4,2 million to avert insolvency.
- (28) Measure 7: A further loan of DEM 1,8 million was made available by the THA on 1 December 1992, also with the aim of averting insolvency.
- (29) Measure 8: The income from exploiting the company's real estate mentioned in measure 3 totalled DEM 5,676 million. In 1993 DEM 3,4 million of the total income was made available to Kahla I instead of being used to repay the credits guaranteed by the THA. Germany states that the payment of this amount to the THA was deferred but not waived as the whole amount of DEM 5,676 million was registered as part of the estate in bankruptcy. Consequently, the amount of the THA funds from which the company benefited instead of their being used to repay credits totalled DEM 5,676 million. Germany has not contested this fact.
- (30) Measure 9: Two credits from Kreis- und Stadtparkasse Jena totalling DEM 3,9 million. These credits bore an interest rate of 13,25 % and 17,25 % and were secured by mortgages of DEM 10 million.
- (31) Measure 10: Investment allowances of DEM 0,035 million granted during the period 1992–1995.
- (32) Kahla I benefited from financial support from the public authorities totalling DEM 115,736 million. Despite this financial support, bankruptcy proceedings were initiated on 29 September 1993. Germany states that the THA registered liabilities amounting to DEM 41,2 million as part of the estate in bankruptcy. This amount included measures 3, 6, 7 and 8, including interest.
- (33) On 27 September 1993 the THA decided not to avail itself of the securities put up by the company in support of the guarantees under measure 4. On 18 July 1994 the THA, or its successor the BvS, relinquished its legal right to take possession of the land. According to Germany, this would have meant compensating other creditors and hence additional costs.

(b) *Financial measures in favour of KAHLA II*

- (34) The following financial measures were granted by the public authorities to Kahla II from the time of its creation until 1999 (amounts in DEM million):

Table 4

Measures in favour of Kahla II

| | | | | Amount |
|-----------------------------------|--------------|--|---|---------------|
| Measures 1994-1996 | | | | |
| 11 | 5.4.1994 | TIB | Participation | 1,975 |
| 12 | 5.4.1994 | TIB | Shareholder loan | 6,0 |
| 13 | 25.3.1994 | Land | 90 % guarantee on loans (16, 18-22) | |
| 14 | 25.3.1994 | Land | 90 % guarantee on a loan of DEM 6,5 million from a private bank | 5,85 |
| 15 | 10.5.1994 | Land | SME investment security grant | 2,5 |
| 16 | 4/5.6.1994 | Deutsche Ausgleichsbank (DtA) – equity loan scheme (DTA-Eigenkapitalhilfe) | Loan | 0,2 |
| 17 | 5/6.1994 | ERP business start-up scheme (ERP-Existenzgründung) | Loan | 1,8 |
| 18 | 3/4.1995 | ERP reconstruction programme (ERP—Aufbau) | Loan 1 | 2,0 |
| 19 | 3/4.1995 | Kreditanstalt für Wiederaufbau (KfW) small business scheme (KfW-Mittelstand) | Loan | 1,0 |
| 20 | 6/26.4.1995 | DtA environment scheme (DtA-Umwelt) | Loan | 1,73 |
| 21 | 7/26.4.1995 | ERP energy saving scheme (ERP-Energiespar) | Loan | 3,45 |
| 22 | 3/25.4.1996 | ERP reconstruction programme (ERP-Aufbau) | Loan 2 | 2,0 |
| 23 | 13.2.1996 | Land | 90 % guarantee on a loan of DM 1 million from a private bank | 0,9 |
| 24 | 1994-1996/97 | Land | Direct investment grants | 3,36 |
| 25 | 1994-1996 | Land | Investment allowances | 0,838 |
| 26 | 1994-1996 | Labour Office | Employment Promotion Act grants | 1,549 |
| 27 | 1994-1996 | | Various grants | 0,492 |
| Measures from 1997 onwards | | | | |
| 28 | 1997-1999 | Land | Direct investment grants | 1,67 |
| 29 | 1997-1999 | Land | Investment allowances | 0,365 |
| 30 | 3./5.1999 | Land | 90 % guarantee on a loan of DM 2,32 million from a private bank | 0,042 |
| 31 | 1997-1999 | Labour Office | Employment Promotion Act grants | 0,851 |
| 32 | 1997-1999 | | Various grants | 0,352 |
| 33 | 1994-1999 | | Special depreciation | 0,104 |
| Total | | | | 39,028 |

- (35) Measure 11: In March 1994 TIB took a 49 % stake in Kahla II for DEM 1,975 million. TIB put an end to its participation on 31 December 1999 and transferred its shares in Kahla II to Mr G. Raithel and his son, Mr H. Raithel, for [...] (*).
- (36) Measure 12: In March 1994 TIB granted a shareholder loan of DEM 6 million. Germany states that this loan did not confer on TIB any further voting rights. The loan bore an interest rate of 12 %, the amount of interest being capped at 50 % of annual profits. The Commission notes that Kahla II only started generating modest profits as from 1996. No risk premium was agreed. Germany states that the loan was paid back on 29 December 1999 with interest totalling DEM 1,613 million.
- (37) Measures 13 and 23: The *Land* of Thuringia provided a 90 % fallback guarantee in March 1994 to cover investment credits up to a total of DEM 13,5 million. When the credits finally matured, the guarantee under measure 13 covered credits 18-22. The guarantee under measure 23 covered a credit of DEM 1 million granted by a private bank in February 1996 at an interest rate of 6,1 %.
- (38) Measure 14: A further 90 % fallback guarantee provided by the *Land* of Thuringia in March 1994 to cover working capital credits of DEM 6,5 million. The credit was granted by a private bank in September 1995 at an interest rate of 8,5 %. The guarantee was gradually reduced and expired on 31 December 1999.
- (39) For these guarantees the company paid a fee of 0,75 % p.a., reduced as from June 1995 to 0,5 %.
- (40) Measure 15: An SME (small and medium-sized enterprise) grant of DEM 2 million, subsequently increased to DEM 2,5 million, granted on 10 May 1994.
- (41) Measure 16: An equity loan of DEM 0,2 million, allegedly awarded under an aid scheme ⁽⁵⁾ in June 1994 to the investor, Mr Raithel, in the context of the creation of Kahla II. According to the scheme, the investor had to provide this amount to the company in the form of equity capital. According to Germany, the loan was paid back on 30 September 2001.
- (42) Measure 17: A loan of DEM 1,8 million purportedly granted in May 1994 under the European Recovery Programme business start-up scheme ⁽⁶⁾.
- (43) Measure 18: An investment loan of DEM 2 million allegedly granted in March 1995 under the ERP reconstruction programme ⁽⁷⁾.
- (44) Measure 19: An investment loan of DEM 1 million granted in March 1993 by Kreditanstalt für Wiederaufbau under its small business scheme ⁽⁸⁾.
- (45) Measure 20: An investment loan of DEM 1,73 million granted in April 1995 under an aid scheme for environmental investment (*DtA-Umweltprogramm*).
- (46) Measure 21: An investment loan of DEM 3,45 million allegedly granted in April 1995 under the ERP environmental programme ⁽⁹⁾.

(* Confidential information, 30-40 % higher than the price previously paid by the TIB.

⁽⁵⁾ N 213/93, (OJ C 302, 9.11.1993, p. 6).

⁽⁶⁾ ERP-Existenzgründungsprogramm, N 108c/1994, SG (94) D/17293 of 1.12.1994; OJ C 390, 31.12.1994, p. 14.

⁽⁷⁾ ERP-Aufbauprogramm, N 108b/1994, SG (94) D/17293 of 1.12.1994; OJ C 390, 31.12.1994, p. 13.

⁽⁸⁾ KfW-Mittelstandsprogramm, NN 109/93, SG (94) D/372 of 14.1.1994, OJ C 373, 29.12.1994, p. 3.

⁽⁹⁾ ERP-Umweltprogramm, N 563d/94, SG (94) D/17530 of 5.12.1994; OJ C 390, 31.12.1994, p. 16.

- (47) Against a background of falling interest rates, on 30 March 1998 the outstanding amount of the loans under measures 18-21 (DEM 7,329 million) was converted into a loan on market terms from Hypovereinsbank. This new loan carried an interest rate of 5,9 %, which was above the applicable reference rate of 5,49 %. The Commission notes, however, that the 90 % guarantee under measure 13 was made available for this new market loan.
- (48) Measure 22: An investment loan of DEM 2 million allegedly awarded in March 1996 under the ERP reconstruction programme ⁽¹⁰⁾.
- (49) Measure 23: See paragraph 37.
- (50) Measure 24: In October 1994 Kahla II obtained direct investment grants of DEM 3,36 million from the *Land* of Thuringia for investments to be carried out during the period 1994-1996 ⁽¹¹⁾.
- (51) Measure 25: Between 1994 and 1996 the company received investment allowances amounting to DEM 0,838 million ⁽¹²⁾.
- (52) Measure 26: Employment promotion grants amounting to DEM 1,549 million during the period 1994-1996.
- (53) Measure 27: Between 1994 and 1996 the company received grants for fair attendance amounting to DEM 122 414, grants for advertising amounting to DEM 0,03 million, grants for R&D amounting to DEM 0,318 million and employee integration grants amounting to DEM 0,021 million.
- (54) Measure 28: Further direct investment grants amounting to DEM 1,67 million were made available in December 1996 for the years 1997-1999.
- (55) Measure 29: The company received investment allowances amounting to DEM 0,365 million for the years 1997-1999.
- (56) Measure 30: A loan of DEM 2,32 million was granted by a private bank in May 1999; this loan was also covered by the 90 % fallback guarantee made available in March 1994 by the *Land* of Thuringia for investment credits up to DEM 13,5 million (see measures 13 and 23). The loan was granted at an interest rate of 4,6 %.
- (57) Measure 31: Further employment promotion grants amounting to DEM 0,851 million.
- (58) Measure 32: Between 1997 and 1999, according to its annual reports the company received grants for fair attendance, advertising and employee integration amounting to DEM 342 910 and grants for R&D-related personnel costs amounting to DEM 8 602. The total amount of the grants thus came to DEM 0,352 million.
- (59) In addition, after the extension of the formal investigation procedure Germany explained that the company had participated in a scheme allowing it to write off investments substantially in the beginning but decreasingly over time (special depreciation). Germany admits that this measure did in fact confer an advantage on the company as it resulted not only in losses during the first few years but also in smaller tax payments. The loss of income to the State stemming from the reduced taxes must also be regarded as a financial measure of the State in favour of Kahla II (hereinafter: measure 33).

⁽¹⁰⁾ See footnote 7.

⁽¹¹⁾ 23. *Rahmenplan der Gemeinschaftsaufgabe zur Verbesserung der Wirtschaftsstruktur*, N 157/94, SG (94) D/11038, 1.8.1994.

⁽¹²⁾ N 561/92, SG (92) D/16623 of 24.11.1992 and N 494/A/1995, SG (95) D/17154, 27.12.1995.

C. The project

- (60) According to Germany, on 25 March 1994 a plan was drawn up to finance the needs of Kahla II. The costs originally planned were reduced slightly by some DEM 2 million, as detailed in Table 5 below, which has been extracted from the information submitted by Germany (amounts in DEM million):

Table 5

| Costs | Planned | Implemented (1994-96) |
|-------------------------|---------------|--------------------------|
| Land | 3,200 | 3,200 |
| Buildings | | |
| Plant/machinery | 2,050 | 2,050 |
| Goods | 2,136 | 1,472 |
| Renovation of machinery | 14,650 | 14,977 |
| Intangible assets | | |
| Working capital | 14,854 | 12,709 |
| Total | 36,890 | 34,408 |

- (61) In order to cover those costs, a financial plan was drawn up in March 1994 and amended on several occasions. Table 6 below has been extracted from the information submitted by Germany (amounts in DEM million). The measures in italics indicate alleged private resources:

Table 6

| Measure | Financing plan | 25.3.1994 | 26.4.1995 | 25.4.1996 | Implemented |
|---------|--|---------------|---------------|---------------|---------------|
| 11 | TIB participation | 1,950 | 1,975 | 1,975 | 1,975 |
| 12 | Shareholder loan (TIB) | 6,000 | 6,000 | 6,000 | 6,000 |
| 15 | SME grant | 2,000 | 2,500 | 2,500 | 2,500 |
| | Loans | 13,500 | | | |
| 18 | — KfW-ERP reconstruction programme | | 2,000 | 2,000 | 2,000 |
| 19 | — KfW small business scheme | | 1,000 | 1,000 | 1,000 |
| 20 | — DtA environment scheme | | 1,730 | 1,730 | 1,730 |
| 21 | — ERP energy saving scheme | | 3,450 | 3,450 | 3,450 |
| 22 | — KfW-ERP reconstruction programme | | | 2,000 | 2,000 |
| | — Bank loan | | 5,320 | 3,320 | 1,000 |
| (14) | Working capital credit granted by a bank | 6,500 | 6,500 | 6,500 | 6,500 |
| 24 | Investment grants | 3,370 | 3,340 | 3,340 | 3,360 |
| 25 | Investment allowances | 1,020 | 1,020 | 1,020 | 0,838 |
| | Mr Raitzel (owner) | 2,550 | 0,055 | 0,055 | 0,055 |
| 16 | — DtA equity loan scheme | | 0,200 | 0,200 | 0,200 |
| 17 | — KfW-ERP business start-up scheme | | 1,800 | 1,800 | 1,800 |
| | Total | 36,890 | 36,890 | 36,890 | 34,408 |

- (62) It is noted that the TIB participation (measure 11) was increased by DEM 0,025 million in 1995 compared with what had originally been planned. It is also noted that under the original plan loans were to be granted for an amount of DEM 13,5 million. For these loans and for a working capital credit of DEM 6,5 million which was to be extended by a private bank, the *Land* provided 90 % guarantees (measures 13 and 14). In 1994 the working capital credit was brought in. The loans totalling DEM 13,5 million were provided in 1995 (measures 18-22) and effectively covered by the 90 % guarantee.
- (63) Regarding the alleged private resources, it is noted that the initially planned contribution from the investor was reduced from DEM 2,555 million to 2,055 million, i.e. by DEM 0,5 million. The SME grant (measure 15) was increased by DEM 0,5 million, precisely the same amount by which the contribution which was to be brought in by the investor decreased. In addition, when the alleged private investor contribution was effectively brought in, it consisted of DEM 0,055 million in cash from the investor's own resources and two loans totalling DEM 2 million granted by public banks under approved aid schemes (measures 16 and 17).
- (64) It is noted that Table 6, as provided by Germany, does not include any reference to the grants under measures 26 and 27 or to the special depreciation scheme from which Germany admits the company benefited (measure 33). In a separate table submitted on 30 January 2002, Germany indicated that investments written off in 1994 and 1995 totalled DEM 3,603 million.
- (65) Germany has provided the following additional table with different investments carried out by the company in 1997 and 1998 (amounts in DEM million):

Table 7

| Costs | Planned | Implemented |
|-------------------|--------------|--------------|
| Plant/machinery | 5,580 | |
| Intangible assets | 0,150 | |
| Total | 5,730 | 6,769 |

- (66) These costs were financed as detailed in the table below submitted by Germany (amounts in DEM million):

Table 8

| Measure | Financing | Planned | Implemented |
|---------|-----------------------|--------------|--------------|
| | Own contribution | 1,318 | 2,406 |
| 28 | Investment grants | 1,670 | 1,670 |
| 29 | Investment allowances | 0,279 | 0,292 |
| | Other sources | 2,400 | 2,400 |
| | Total | 5,730 | 6,769 |

- (67) It is noted that Table 8, as provided by Germany, does not include any reference to the grants under measures 31 and 32. However, for the financing of the costs under Table 7 Germany indicates that under the special depreciation scheme (measure 33) the company wrote off investments up to DEM 0,743 million. This latter amount is presumably included in the item "other sources" in Table 8.

- (68) Germany has also provided a further investment plan⁽¹³⁾ detailing investments carried out from 1994 until 2000 together with investments to be carried out during the period 2000–2003. This plan mentions a large amount of mainly plant and machinery in which the company invested. The overall costs for the period 1994–2000 are summarised in Table 9 as submitted by Germany (amounts in DEM million):

Table 9

| 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | Total |
|-------|-------|-------|-------|-------|-------|-------|--------|
| 8,504 | 4,540 | 1,933 | 1,846 | 4,923 | 1,370 | 0,790 | 23,906 |

- (69) The Commission notes that this latter investment plan comprises part of the investments described in Tables 5-8. In this respect, investments carried out during the period 1994-1996 totalled DEM 14,977 million, which corresponds to the investments actually implemented under the item “renovation of machinery” set out in Table 5. For the years 1997 and 1998, the total investments correspond to the amount of investments carried out according to Table 7.

D. Market analysis

- (70) Both Kahla I and Kahla II produce china and porcelain for household use. Kahla II has expanded into the professional sector, in particular hotels and decorators. Products are also exported.
- (71) In the relevant economic sector of household goods and decorative porcelain there is intensive trade among Member States. While ornamentalware is produced throughout Europe, important regional concentrations of tableware producers exist in northern Bavaria (Germany), Staffordshire (United Kingdom) and Limousin (France). Besides a plethora of SMEs, there are a number of large undertakings. These include Villeroy & Boch (Germany/Luxembourg), Hutschenreuther and Rosenthal (Germany), and Royal Doulton and Wedgwood (United Kingdom), which account for over a third of all production in the Community. Special requirements of the hotel and catering trades have given rise to the “hotelware” sector, with specially designed hard-wearing ceramics. The UK, Germany and Italy are the main producing and consuming countries. A close relationship with the final consumer and the need to compete on design are what distinguish this highly labour-intensive industry, with its enormous array of products. Sales to third countries exceed Community imports in terms of value, but in volume terms imports exceed exports owing mainly to extremely cheap imports from China⁽¹⁴⁾.
- (72) The porcelain industry is in overcapacity. Production and consumption both registered continuing growth between 1984 and 1991, but contracted during 1992 and 1993. The recovery expected for 1994 did not occur. The trade balance of recent years has been positive, but the share of imports has increased markedly, in particular for household china. Export growth is not sufficient to offset the increasing competition in the sector. On the contrary, strong competition and overcapacities are being reinforced owing to new market entrants from south-east Asia and eastern European countries, in particular the Czech Republic and Hungary, all of which benefit from preferential trading arrangements with the European Union⁽¹⁵⁾.

⁽¹³⁾ Submitted as Annex 17 to the letter of 15 March 2001, registered as received by the Commission on 26 March 2001 (A/32477).

⁽¹⁴⁾ Data extracted from the website of Cerame-Unie (<http://www.cerameunie.org>).

⁽¹⁵⁾ Panorama of EU Industry 1997, 9-20; NACE (Revision 1). See also Commission Decision 1999/157/EC in Case C 35/97 *Triptis Porzellan GmbH* (OJ L 52, 27.2.1999, p. 48).

III. REASONS FOR THE INITIATION AND EXTENSION OF THE FORMAL INVESTIGATION PROCEDURE

- (73) In its decision to initiate the formal investigation procedure, the Commission analysed the financial measures in favour of Kahla I and Kahla II in the light of Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement. The measures derived from state resources and distorted or threatened to distort competition, affecting trade between Member States and conferring advantages on these companies. In its preliminary assessment the Commission considered that Kahla I and Kahla II were companies in difficulty. The Commission doubted, moreover, whether the State had behaved like a private investor in a market economy when it made financial resources available to them. In the preliminary assessment, these measures were regarded as state aid.
- (74) The Commission had serious doubts as to whether the aid was compatible with the common market, and it therefore initiated the formal investigation procedure in respect of the ad hoc aid granted to Kahla I and Kahla II. In addition, Germany had claimed that a number of aid measures had been granted under approved aid schemes. On the basis of the information available to it, the Commission was not in a position to determine whether these aid measures complied with the terms of the approved aid schemes under which they were purportedly granted. Therefore, within the context of the initiation of the formal investigation procedure, an information order was addressed to Germany in order to verify this point.
- (75) The information submitted in response to the order dispelled the Commission's doubts about the existing-aid character of only a number of measures allegedly granted under approved aid schemes. In addition, the Commission discovered details of several measures of which it had not been informed before. Consequently, the Commission extended the investigation procedure to assess the measures which still did not seem to comply with approved aid schemes and those measures of which it had been informed only after initiating the formal investigation procedure.

IV. COMMENTS FROM GERMANY

- (76) In its letter of 11 November 1999, Germany considered that it need not notify any of the above financial measures to the Commission. According to Germany, as from February 1994 Kahla II was an entirely new company and there was no continuity with Kahla I. Germany stated that Kahla II was not in difficulty. It insisted on this point throughout the procedure. In support of this argument, Germany first submitted two consultants reports dated 29 November 1993 and 11 January 1994. Following the extension of the investigation procedure, Germany submitted a third report by a further consultant, dated 21 January 2002.
- (77) Germany stated first of all that most of the financial measures from public entities should not be considered aid because the public authorities had acted like a market economy investor when offering financial support to Kahla II. As regards those financial measures in favour of Kahla II which would not fall under the private investor principle, Germany stated that they were either covered by approved aid schemes or fell under the *de minimis* rules. Germany submitted extensive information and documentation.
- (78) After the initiation of the formal investigation procedure, Germany acknowledged that some of the measures might constitute aid and that others might fall outside the *de minimis* rules as set out in the Commission notice on the *de minimis* rule for state aid⁽¹⁶⁾ and Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid⁽¹⁷⁾ or outside approved aid schemes. However, Germany considered that, in that case, the aid would be investment aid complying with the regional ceilings. In addition, Germany submitted several investment plans and supplementary information in this respect, including an estimate of the aid intensity of the measures.

⁽¹⁶⁾ OJ C 68, 6.3.1996, p. 9.

⁽¹⁷⁾ OJ L 10, 13.1.2001, p. 30.

- (79) Germany argued finally that, if it would not accept any of the arguments advanced, the Commission should verify – particularly in the case of measure 26 - whether the aid could not be regarded as employment aid compatible with the common market.
- (80) In its letter of 1 October 2002 Germany stated that if, in the face of all previous arguments, the Commission were to regard Kahla II as a company in difficulty, the aid measures in question should be assessed as restructuring aid on the basis of the Community guidelines on state aid for rescuing and restructuring firms in difficulty⁽¹⁸⁾ (restructuring aid guidelines).

V. COMMENTS FROM INTERESTED PARTIES

- (81) After initiating and extending the proceedings, the Commission received comments from Kahla II, which were forwarded to Germany by letters dated 7 August 2001 and 6 March 2002. Kahla II's arguments are basically the same as Germany's.
- (82) In addition, a new complaint was received alleging that Kahla II had received fresh aid. This information was sent to Germany by letter dated 30 April 2002. On 29 May 2002 Germany replied, stating that the company had not received any grants other than those of which the Commission had been informed.
- (83) On 30 July 2002, Kahla II submitted further comments to the Commission which contained no new facts or evidence but in which Germany stood by its previous arguments to the effect that the company had never been in difficulty, that certain measures did not constitute aid and that the ad hoc aid should be regarded as compatible regional aid.

VI. ASSESSMENT

A. The relevant undertaking

- (84) In its decision to initiate the formal investigation procedure, the Commission could not determine, on the strength of the information available, whether Kahla I and Kahla II were independent undertakings or to what extent Kahla II should be regarded as the successor to an undertaking or as an *Auffanglösung*. Germany was therefore requested to provide sufficient information to clarify this point.
- (85) In its decision to extend the formal investigation procedure, the Commission concluded that Kahla I and Kahla II were different legal entities. Kahla II was regarded as an *Auffanggesellschaft* as it had been created by Mr G. Raithel as a shell company to continue the activities and to take over the assets of Kahla I in liquidation. The documents submitted often refer to Kahla II as an *Auffanggesellschaft* and the Commission noted that a change of control, ownership and legal personality took place. Germany has not contradicted this view.
- (86) The sale of the assets to Kahla II did not take place according to an open, unconditional bidding procedure. Germany states that the industry was aware that the assets were being offered for sale. According to Germany, following negotiations with two potential investors, Mr G. Raithel was chosen by the administrator in bankruptcy as the best bidder. The reasons for choosing him were, according to the administrator in bankruptcy, both his experience of the porcelain market and the fact that he made a substantially higher offer than the other candidate, who according to Germany offered DEM 1. The Commission notes, however, that, although Mr Raithel did indeed make an offer which was higher than DEM 1, the price he offered was to be financed through state resources. None the less, the information available indicates that Mr Raithel brought in DEM 55 000 from his own resources, which is higher than DEM 1. On the basis of the information available, the Commission will follow Germany's view that Mr Raithel was the best bidder.

⁽¹⁸⁾ OJ C 368, 23.12.1994, p. 12 and OJ C 288, 9.10.1999, p. 2.

- (87) The Commission acknowledges that the value of Kahla I's real estate was based on studies by independent experts. According to Germany, the value of plant and stocks – together some DEM 3,5 million – was not determined on the basis of a study owing to practical difficulties and because much of the plant was in poor condition and would need to be replaced. Taking these facts into account, the Commission concludes that there are no reasons to doubt that the price paid for Kahla I's assets did not correspond to the market price.
- (88) As regards the subsequent sale of TIB's 49 % stake in Kahla II, the question whether this amounted to the behaviour of a market economy investor will be examined in the sections below. The Commission notes, however, that the sale of the stake to Mr Raithel and his son on 31 December 1999 did not take place after any open, transparent and unconditional call for tenders.
- (89) TIB is a state-owned financial institution. According to the established case law of the Court of Justice of the European Communities and Commission policy, the Commission considers that the sale price for a public shareholding does not contain any state aid elements where it is sold in an open, unconditional and non-discriminatory tender procedure. Member States are, however, not obliged to follow such a procedure when disposing of their public shareholdings.
- (90) In the absence of such a procedure, the price may involve state aid elements and the Commission may therefore verify, where appropriate, whether the price represents fair value for the public shareholding. The Commission notes in this respect that the price at which the shares were sold to Mr Raithel and his son was higher than the price which TIB had itself paid almost six years earlier. It is also noted that the stake represented a minority shareholding. It should finally be stressed that, in the context of the initiation or the extension of the formal investigation procedure, no interested party has claimed arbitrary exclusion from the sale and none ever made any offer for the shareholding. Consequently, the Commission does not have any evidence of aid in this share deal.

B. Aid within the meaning of Article 87(1) of the EC Treaty

- (91) Financial assistance deriving from public resources was awarded to Kahla I and Kahla II, conferring on these companies advantages over their competitors. It is on record that state-controlled entities grant loans to and acquire shareholdings in private enterprises, as did TIB in the case of Kahla II, and their activities are clearly to be classed as state activities. In this connection reference is made to a consultants report dated 29 November 1993, according to which the entire Kahla restructuring plan is to be viewed in the light of the regional government's efforts to safeguard jobs at Kahla ⁽¹⁹⁾. As the porcelain market is a highly competitive European product market suffering from overcapacity, financial advantages favouring one company over its competitors threaten to distort competition and affect trade between Member States.
- (92) As regards Kahla I, in its decision to extend the formal investigation procedure the Commission came to the conclusion that measures 2, 3 and 9 did not constitute aid. The remaining measures granted by Germany were still regarded as aid within the meaning of Article 87(1) of the EC Treaty. Germany has not challenged this point of view, and it is therefore maintained.

⁽¹⁹⁾ The plan of *Auffanggesellschaft Kahla* has to be seen against the background of the special structural policy conditions obtaining in the *Land* of Thuringia, in particular the efforts of the regional government to safeguard jobs within the limits of the funding possibilities' (*Das Konzept der Auffanggesellschaft Kahla muß unter den speziellen strukturpolitischen Bedingungen des Landes Thüringen gesehen werden, insbesondere unter dem Aspekt der Bemühungen der Landesregierung, im Rahmen von Förderungsmöglichkeiten bestehende Arbeitsplätze zu erhalten*), report by Röls Bühler Stüppes Hauck & Partner, transmitted as Annex 1 to the letter of 31 January 2000, registered as received on 3 April 2000 under No A/32839.

- (93) As regards Kahla II, Germany persists in its view that this is a new company which provides no continuity with Kahla I and which was never in difficulty. Therefore, when offering financial support to it, the public authorities acted like market economy investors. The Commission will analyse first of all whether the public entities which provided financial support to Kahla II acted like market economy investors. It will then examine the issue of the company's difficulties.

Market economy investor

- (94) Germany has provided two consultants reports in support of its contention that the public entities which provided financial support to Kahla II acted like market economy investors.
- (95) As indicated in paragraph 91, the first report, dated 29 November 1993, proposes a restructuring plan for the *Auffanggesellschaft* in the light of the regional government's efforts to preserve jobs at Kahla ⁽²⁰⁾. Restructuring was to take place over the period 1994-1997 and to cost a total of DEM 18,779 million. The break-even point was to be reached in 1996, with a positive result of DEM 0,101 million.
- (96) The second report was prepared for TIB on 11 January 1994, i.e., before it took its 49 % stake in the company. The study explains that TIB's objective is to maintain and create jobs in Thuringia ⁽²¹⁾. It points out that viability can be restored only through a restructuring drive enjoying the support of the public authorities. Break-even should be achieved in 1996, with a positive result of DEM 1,394 million. In addition, the study points out that the public commitment towards Kahla II involves substantial risks, and any possibility of the company paying back any financial support before 1998 is ruled out.
- (97) In the light of these reports, the Commission concludes that the public financial institutions – particularly TIB – did not act like market economy investors in offering financial support to Kahla II. The reports clearly state that the objective of the regional government and its financial institutions was to preserve jobs, which is not the main aim of a market economy investor. Moreover, the reports forecast losses for at least two years and do not analyse any potential *quid pro quos* for the authorities' participation, something that would have been a must for any private investor.
- (98) As regards more specifically the TIB participation, the Commission cannot but adhere to its view that it is not in keeping with the private investor principle and that, consequently, it must be regarded as aid. The fact that five years later TIB sold its stake to the majority shareholders, Mr G. Raithel and his son, for more than it had itself paid in 1994 does not alter this conclusion. TIB's behaviour must be assessed *ex ante*, taking the potential risks and expected revenues into account. On the basis of the reports available at that time, those risks were high ⁽²²⁾, no measures were taken to address them and no analysis of future revenues was undertaken. What is more, the profit actually made by TIB was small.

⁽²⁰⁾ See footnote 19.

⁽²¹⁾ 'Zielsetzung der TIB ist die Erhaltung und Schaffung industrieller Arbeitsplätze im Freistaat Thüringen', report by Arthur Andersen, submitted as Annex 2 to the letter of 31 January 2000, registered as received on 3 April 2000 under No A/32839.

⁽²²⁾ 'There are, however, a number of risks which might result in the plan failing' ('Es bestehen jedoch eine Vielzahl von Risiken, die zum Scheitern des Konzepts führen können') and 'A decision in favour of a participation in Kahla/Thüringen Porzellan GmbH can therefore be recommended in principle, bearing in mind the continuing high risk. But this will mean at the same time having to say 'no' to other Thuringian porcelain manufacturers so as not to further jeopardise the plan's success' ('Eine Entscheidung für eine Beteiligung an der Kahla/Thüringen Porzellan GmbH kann daher grundsätzlich befürwortet werden, wenn man sich des verbleibenden, hohen Risikos bewusst ist. Es bedeutet zugleich aber auch eine Absage an andere thüringische Porzellanhersteller, um den Erfolg des Konzepts nicht weiter zu gefährden'), Arthur Andersen report (see footnote 23).

- (99) Contrary to what Germany maintains, the terms of the TIB participation are not comparable to the terms offered by the private investor, Mr Raithel. Raithel allegedly invested DEM 2,055 million in the company. However, only DEM 0,055 million came out of his own pocket. The remaining DEM 2 million came from state resources in the form of two loans granted to Raithel (measures 16 and 17). Moreover, one of the loans (measure 16) was included in a Federal Government guarantee to the granting Deutsche Ausgleichsbank, while the other (measure 17) was secured by a first mortgage on Kahla II's land ⁽²³⁾. TIB, on the other hand, made available to the company DEM 1,975 million of its own resources in the form of a holding. This amount constituted capital which in the event of insolvency would be treated as junior ranking. The risk assumed by TIB is therefore much higher than that assumed by the private investor. As will be explained in paragraph 111, Mr Raithel was entitled, furthermore, to withdraw from the agreement if the TIB participation and/or other measures did not materialise, whereas TIB did not have that right. The TIB participation is therefore not in keeping with the private investor principle.
- (100) As regards the remaining measures taken by Germany, in view of the particular situation of the company and of the fact that it operated in a market suffering from structural overcapacity, a market economy investor would have granted financial support only under conditions which reflected those facts.
- (101) The Commission will first analyse the loans granted by TIB and state-owned banks. These loans are summarised in Table 10.

Table 10

| Measure | Amount (DEM) | Interest rate | Reference rate | Securities |
|---------|--------------|-------------------------|----------------|--|
| 12 | 6 million | 12 % ⁽²⁴⁾ | 6,62 % | — |
| 16 | 0,2 million | 0 %-5 % ⁽²⁵⁾ | 6,62 % | Federal Government guarantee |
| 17 | 1,8 million | 5,5 % | 6,62 % | 1st mortgage on real estate for DEM 1,8 million; secondary mortgage on real estate for DEM 20 million |
| 18 | 2 million | 6,5 % | 8,28 % | 2nd mortgage on real estate for DEM 1,8 million, 2nd and 3rd mortgages for DEM 20 million, cession of machinery and rights over third parties, cession of stock, cession of claims against customers, 90 % guarantee from <i>Land</i> of Thuringia |
| 19 | 1 million | 6,75 % | 8,28 % | As measure 18 |
| 20 | 1,73 million | 6,65 % | 8,28 % | As measure 18 |
| 21 | 3,45 million | 6,65 % | 8,28 % | As measure 18 |
| 22 | 2 million | 5 % | 7,33 % | As measure 18 |

⁽²³⁾ It will be recalled that the acquisition of Kahla II's assets was financed predominantly by aid.

⁽²⁴⁾ The loan carried an interest rate of 12 %, but interest payments were capped at 50 % of annual profits.

⁽²⁵⁾ Interest during the first three years was taken over by the Federal Government. The interest rate was 2 % during the 4th year, 3 % during the 5th and 5 % during the 6th.

- (102) Table 10 proves that the public financial institutions did not behave like market economy investors. Specifically, as regards the shareholder loan from TIB (measure 12), it is noted that the agreed rate of interest was 12 % but that the amount of interest was capped at 50 % of annual profits. The reports had already pointed out that Kahla II would not generate any profits during at least the first two years, which is what in fact happened. No increased interest rate was agreed to compensate for the years for which interest payments were improbable. Consequently, TIB knowingly granted a shareholder loan which did not give it any additional voting rights, without demanding any security and at 0 % interest for at least two years. No risk premium was agreed to offset the risks forecast in the report on the basis of which the shareholder loan (and the holding) was agreed. As regards the remaining loans, the table shows they were all granted below the reference interest rate. Moreover, when security was provided, it either came from the public authorities or the same assets were used repeatedly to secure all loans. These assets were not independently valued, so their actual value is uncertain. It must also be remembered that they were financed with state support.
- (103) The guarantee agreement provided that a subsidiary guarantee amounting to DEM 0,7 million should be given by Mr G. Raithel, unless it could be proved that he had given a personal guarantee for the equity loan (measure 16). The loan agreement for measure 16 does not mention any provision of a personal guarantee, but refers to a Federal Government guarantee. The Commission was never informed that such a DEM 0,7 million guarantee was ever given. Rather, according to the Commission's information, the loan was secured by a Federal Government guarantee and not by a personal guarantee. Even if it had been given, it would rank lower than every other security and would cover only a very small part of the potentially high risk of non-payment. In view of the above, the Commission can only conclude that the public banks and institutions did not act like market economy operators. Moreover, as regards the loans under measures 16-22, Germany itself describes them as aid⁽²⁶⁾, albeit of the existing variety. The Commission shares Germany's view that they constitute aid. As regards their classification as existing aid, this issue will be analysed in the sections that follow.
- (104) Regarding the grants (measures 15, 24-29 and 31-32), the Commission considers that a market economy investor would not have granted non-reimbursable subsidies. Germany has not contested this point. Finally, as regards the 90 % state guarantees (measures 13, 14, 23 and 30), Germany itself accepts that they constitute aid. In view of the related high risk and the lack of an appropriate risk premium, the Commission fully shares this view. There is therefore no need to analyse this issue further. Germany asserts that these guarantees fall under the *de minimis* rules. This will be examined in Section D.
- (105) In view of the above, the Commission cannot conclude that the public financial institutions offered support to Kahla II under conditions comparable to those of a market economy investor. Consequently, all Germany's measures are still regarded as aid within the meaning of Article 87(1) of the EC Treaty.

⁽²⁶⁾ Following the extension of the procedure Germany altered its stance, stating that the loans under measures 16 and 17 were not aid since, despite their having nominally been granted under an approved aid scheme, they had been paid direct to Mr G. Raithel.

Company in difficulty

- (106) Kahla II is an *Auffanglösung*, this is, a new set-up which has taken over the assets of a bankrupt company. Although they are newly created companies, *Auffanglösungen*, a peculiar eastern German creation, can be regarded as companies in difficulty. The reason for this is that these shell companies take over the assets of a company which has gone bankrupt and continue their business, usually without undergoing any acceptable restructuring. *Auffanglösungen* therefore “inherit” a number of structural deficiencies and need substantial changes if they are to operate in a market economy. Among these changes are investments to replace and update old plant and machinery, changes in the company’s structure (traditionally large conglomerates operating under a planned economy), personnel reduction (eastern German conglomerates usually operated with an excessively large workforce), a new product orientation, marketing, etc. In addition, the confidence of customers, suppliers and credit institutions needs to be regained since the *Auffanggesellschaft* is the successor to a failed company. In this sense they are not comparable to other newly created companies.
- (107) The adjustment usually takes place through a restructuring involving, in most cases, state aid. Taking the specific situation of the former eastern Germany into account, the Commission has adopted a flexible, generous approach allowing *Auffanglösungen* to benefit from restructuring aid until the end of 1999. This approach is codified in footnote 10 of the restructuring aid guidelines ⁽²⁷⁾. In view of their specific situation, *Auffanggesellschaften* form an exception to the rule that newly created companies are ineligible for rescue and restructuring aid under the restructuring aid guidelines.
- (108) In separate proceedings ⁽²⁸⁾, Germany expressly stated in letters dated 5 March and 6 May 1999 that Kahla II was a company in difficulty. However, two years later, in a letter dated 26 September 2001, Germany contradicted its earlier statements, asserting that Kahla II had never been in difficulty. In the context of these proceedings, Germany considers that Kahla II cannot be regarded as a firm in difficulty as not all the conditions of the restructuring aid guidelines are met.
- (109) The Commission would point out that the restructuring aid guidelines do not give a precise definition of a company in difficulty, but instead mention typical symptoms. In the case of Kahla II, the general criterion set out in point 2.1 of the (1994) restructuring aid guidelines, by which it is determined whether a firm is in difficulty, is fulfilled: it is a firm “unable to recover through its own resources or by raising the funds it needs from shareholders or borrowing”. This is stated in the reports available at the time Kahla II was created ⁽²⁹⁾ and when the aid was awarded (relevant moment for the assessment), which consider Kahla II to be a company in difficulty and describe a restructuring intended to restore its viability ⁽³⁰⁾. *Ex post* this is confirmed by the fact that, according to the information available, the company never obtained any external bank finance without state support ⁽³¹⁾.

⁽²⁷⁾ Although, as is explained in paragraph 163, these are not applicable to aid granted during the period 1994-96. Footnote 10 of the 1999 restructuring guidelines codifies the Commission’s approach, stating that the only exceptions to the rule that a newly created company is not eligible to receive rescue or restructuring aid are ‘any cases dealt with by the BvS in the context of its privatisation remit and other similar cases in the new *Länder* involving companies emerging from a liquidation or a take-over of assets occurring up to 31 December 1999’.

⁽²⁸⁾ C 69/98, SG (98) D/11285 of 4.12.1998.

⁽²⁹⁾ The calculations in the business plan show that the company ... [is] not in a position to bear the costs of restructuring, which are enormous compared with the projected turnover, on its own’ (*Die Berechnungen des Geschäftsplanes zeigen, daß die Auffanggesellschaft (...) nicht in der Lage (ist), die im Verhältnis zum geplanten Umsatz enormen Finanzierungskosten den Umstrukturierungsprozeß alleine zu tragen*), Röls Bühler Stüppes Hauck & Partner report (see footnote 21).

⁽³⁰⁾ The purpose of our study is to assess the capacity and need for reorganisation of the company whose activity is being continued within the *Auffanggesellschaft*, having particular regard to the jobs that can be safeguarded in the long term and the financial resources available to TIB as a potential shareholder’ (*Ziel unser Arbeiten sollte sein, die Sanierungsfähigkeit und Sanierungswürdigkeit des in der Auffanggesellschaft fortgeführten Unternehmens unter besonderer Berücksichtigung der dauerhaft erhaltbaren Arbeitsplätze und der von der TIB als potentielltem Gesellschafter zur Verfügung zu stellenden Finanzmittel zu beurteilen*), Arthur Andersen report (see footnote 23).

⁽³¹⁾ All loans from private banks of which the Commission has been informed were covered by 90 % state guarantees.

- (110) Effectively some of the indicators set out in the restructuring guidelines are not envisaged for *Auffanglösungen* since, as start-ups, the past cannot be looked into. Consequently, at the time of their creation they do not suffer from deteriorating profitability, increasing losses, diminishing turnover, growing inventories, declining cash flow, rising interest charges, etc. The Commission here recalls that *Auffanglösungen* are the exception to the rule that under the restructuring aid guidelines newly created companies cannot be considered firms in difficulty and therefore are not eligible for restructuring aid.
- (111) On the other hand, other indicators do apply to *Auffanglösungen*, particularly low net asset value. In the case of Kahla II, the Commission would point out that it is the successor to a bankrupt company and is therefore likely to have lost the confidence of a number of customers, suppliers and financial institutions. Even the acquisition of assets was thus dependent on state support. The contract for the sale of Kahla I's assets stipulated that the new investor, Mr G. Raithel, was entitled to withdraw from the contract if the financing, including as it did various state measures (such as the TIB participation and state loans), was not assured ⁽³²⁾. Moreover, Kahla II took over the assets of Kahla I, which never underwent a successful restructuring, a fact which led to its bankruptcy. *Ex post* it is clear that structural difficulties were passed on as Kahla II received no private financing without state support.
- (112) Another indicator is the excessive size of the workforce. As the state support granted to *Auffanglösungen* is usually conditional on the safeguarding of jobs, this implies that during a certain period they endure the additional handicap of preserving a certain number of jobs. As evidenced by the reports referred to in paragraph 91, the main aim of the regional government was to preserve jobs. In the years that followed, Kahla II reduced the number of its employees, from which it can be deduced that it started off with too many.
- (113) Moreover, since *Auffanglösungen* are forced to restructure in order to be able to operate in a market economy, losses are incurred and cash flow does not increase during the first few years and the necessary investment translates into substantial debts and high interest rates. This, again, was the case with Kahla II. Although Germany has never characterised the process undergone by Kahla II as a restructuring of a firm in difficulty, the Commission notes that both reports, that of November 1993 and that of January 1994, proposed a restructuring as being necessary to restore the company's viability. Moreover, a report by Project Management Eschbach (PME) submitted by Germany in connection with another proceeding ⁽³³⁾ described Kahla II as a company undergoing a restructuring process which would not be completed before the end of 1996 ⁽³⁴⁾. In the Commission's view, such a process is not typical of a healthy firm.

⁽³²⁾ 'The purchaser may rescind the entire contract without any financial consequences ... if ... the financing referred to below is not confirmed by 31.12.1994; he may also do so if the financing is only partly forthcoming' ('Der Käufer hat das Recht ohne weitere Kostenfolge (...) vom gesamten Vertrag zurückzutreten, wenn (...) die nachfolgende Finanzierung nicht bis zum 31.12.1994 zugesagt ist; dies gilt auch, wenn die Finanzierung nur teilweise zustande kommt'). The financial measures in this contract concern ERP and KfW loans of DEM 2,5 million, a TIB participation worth DEM 7,95 million, bank loans amounting to DEM 13,35 million and a 90 % *Land* guarantee for DEM 20 million (sale contract between the administrator in bankruptcy of Kahla I and Günter Raithel, negotiated on 26 January 1994).

⁽³³⁾ C 36/2000, *Graf von Henneberg Porzellan GmbH*.

⁽³⁴⁾ 'Since Kahla is currently undergoing reconstruction and will certainly still need the whole of 1996 in which to consolidate, an early transfer of production volumes is out of the question' ('Da auch Kahla sich aktuell im Wiederaufbau befindet und zur Konsolidierung sicherlich noch das volle Jahr 1996 benötigt, sei eine frühere Verlagerung von Produktionsmengen kaum zu denken'), PME report dated 24.8.1995.

- (114) Germany also considers that the losses which Kahla II incurred during the first few years were due only to the application of a special depreciation scheme (measure 33). The Commission takes the view, however, that, while it may be true that higher losses were incurred owing to the application of this depreciation scheme, without state support the company would certainly have incurred much higher losses and would probably have been driven out of the market. It should be noted that the 1993 and 1994 reports supplied by Germany regarded state support as essential to the company's survival and to the restoration of viability.
- (115) Germany has provided a report drawn up by a consultant on 21 January 2002 in support of its argument that Kahla II was never in difficulty.

Table 11

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|-----------|-------|-------|-------|-------|-------|-------|
| Turnover (DEM million) | 23,19 | 28,95 | 31,46 | 39,10 | 34,34 | 35,81 | 41,60 |
| Operating result before tax (DEM million) | [...] (*) | | | | | | |
| Cash flow (DEM million) | [...] | | | | | | |
| Stocks | [...] | | | | | | |
| % capacity utilisation | [...] | | | | | | |
| % own capital | [...] | | | | | | |
| % outside capital | [...] | | | | | | |

(*) Confidential information. See Table in paragraph. (21).

- (116) The Commission notes that Table 11 is an *ex post* evaluation of the company's history. It is useful in that it confirms that the main forecasts of the reports available in 1994 were correct: losses were to be incurred during at least the first two years. However, the Commission must make its assessment from an *ex ante* point of view, that is, it must establish whether from 1994 Germany fulfilled its obligations under the EC Treaty and notified the aid. Had Germany fulfilled its obligations, the Commission would have based its assessment on the reports available at that time. As already stated in paragraphs 95, 96 and 113, those reports are based on the premiss that the company had to restore its viability and concluded that state support was absolutely essential to achieve that aim. In the light of those reports, the Commission would have followed its established practice and regarded Kahla II (an *Auffanglösung*) as a firm in difficulty. This conclusion cannot be altered, *ex post*, by the fact that, thanks to substantial aid awards, these difficulties were surmounted within a short space of time.
- (117) To sum up, on the basis of the reports available at the relevant point in time, the Commission concludes that Kahla II was unable to recover through its own resources or by raising financing on the market. The Commission notes in particular that Germany expressly admitted this back in 1999. Moreover, without state support the company would probably have been driven out of the market. The fact that not every indicator in the restructuring aid guidelines applies to Kahla II is irrelevant: the guidelines contain a non-exhaustive list of typical symptoms and not an exhaustive, cumulative list of criteria.

- (118) Consequently, the Commission adheres to its view that Kahla II was a company in difficulty during the period from 1994 to the end of 1996, when, most likely thanks to the aid injected, a slightly positive result was first achieved and the share of own capital began to increase. The Commission considers that the lack of private financing without state support and the available data bear this out.

C. Aid purportedly covered by approved aid schemes

- (119) Part of the aid to Kahla I and Kahla II was allegedly granted under approved aid schemes. Since the Commission had serious doubts about the compliance of these aid measures with the terms of the schemes under which they had allegedly been awarded, it issued an information order under Article 10(3) of Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽³⁵⁾, requiring Germany to supply all documentation, information and data necessary for their assessment. In so far as the information transmitted by Germany is an insufficient basis on which to conclude that these measures are covered by the relevant schemes, the Commission is accordingly empowered to take a decision on the basis of the information available.
- (120) In its decision to extend the formal investigation procedure, the Commission concluded that measures 1, 4, 5, 6, 7 and 10 in favour of Kahla I constituted existing aid which did not need to be reassessed. It still considers that measure 8 was not granted under any approved aid scheme and falls to be assessed as ad hoc aid.
- (121) As regards Kahla II, in its decision to extend the formal investigation procedure the Commission concluded that measures 28 and 29 in favour of Kahla II constituted existing aid which did not need to be reassessed. It still considers that measures 11, 12 and 20 were not granted under any scheme approved by it. As regards the remaining measures allegedly granted under approved aid schemes, the Commission will partially review the provisional assessments made in the decisions to initiate and extend the formal investigation procedure.
- (122) *Measures 13, 14, 23 and 30:* These 90 % state guarantees were based on a scheme which was never notified to the Commission. The scheme was registered under number NN 46/97 and was never approved by the Commission. Consequently, as stated in the decision to extend the formal investigation procedure, these guarantees fall to be assessed as ad hoc aid. Moreover, in its decision on the guarantee guidelines of the *Land* of Thuringia ⁽³⁶⁾, the Commission noted Thuringia's commitment no longer to apply this non-notified scheme.
- (123) In respect of the aid element in these guarantees, Germany claims that, according to an agreement between Germany and the Commission, the aid element in the guarantee should be 0,5 % of the amount covered by the guarantee. The Commission would point out, however, that this agreement concerned 80 % state guarantees complying with approved aid schemes. The guarantees here exceed this limit by 10 % and were based, not on approved aid schemes, but on a non-notified scheme never approved by the Commission. Moreover, the agreement excluded companies in difficulty from its scope. Consequently, despite Germany's claims, the rate of 0,5 % cannot be applied to these guarantees.

⁽³⁵⁾ OJ L 83, 27.3.1999, p. 1.

⁽³⁶⁾ NN 25/95, SG (96) D/11031 of 16.12.1996.

- (124) In respect of the guarantees under measures 13, 14 and 23, according to the Commission notice on the application of Articles 87 and 88 of the EC Treaty to state aid in the form of guarantees, the following applies: "Where, at the time the loan is granted, there is a strong probability that the borrower will default, e.g. because he is in financial difficulty, the value of the guarantee may be as high as the amount effectively covered by that guarantee" ⁽³⁷⁾. As stated in Section B of the Assessment (paragraphs 106 to 118), Kahla II was a company in difficulty at the time of the granting of these measures. This means that for guarantees provided until 1996, the aid element in these guarantees is potentially 90 % of the credits to which they relate.
- (125) As regards measure 30, which was granted when the company was no longer in difficulty, Germany again considers that, on the basis of the agreement with the Commission referred to in paragraph 123, the aid equivalent should be set at 0,5 %. The Commission would point out once more, however, that the agreement concerned 80 % guarantees provided under approved aid schemes. The guarantee here exceeded the 80 % limit by 10 % and was not provided under an approved aid scheme. Consequently, the 0,5 % aid equivalent cannot be applied here. At the time of the provision of this guarantee, the Land of Thuringia had agreed to make guarantees subject to the Commission decision on the guarantee guidelines of the Land of Thuringia ⁽³⁸⁾, according to which, for 80 % guarantees provided under approved aid schemes, the aid element in these guarantees would be set at between 0,5 % and 2 %. Although that decision again concerns 80 % guarantees provided under approved aid schemes, the Commission considers it appropriate to apply this rule here by analogy. Nevertheless, in view of the fact that the guarantee covered a large part of the risks inherent in the loan, which is reflected by the low interest rate fixed by the private bank, the Commission will apply the maximum percentage allowed for guarantees in the scheme, i.e., 2 %.
- (126) Similarly, the Commission considers it appropriate to apply a 2 % aid element to the 90 % guarantee under measure 13, and this from 30 March 1998, when the loans under measures 18-21 were converted into a market loan. The interest rate of the market loan came to 5,90 %. Before the loans under measures 18-21 were converted, their interest rate came to between 6,5 % and 6,75 %. The loans, which were obtained from state resources, were thus converted into a private loan at the precise time when it was possible for the company to secure a lower interest rate for a private loan on the market than was payable on loans obtained from state resources. It should be pointed out in this connection that the conversion was possible only because a 90 % state guarantee had been provided in respect of this new loan.
- (127) Germany states that these guarantees fall under the *de minimis* rules. The application of the *de minimis* rules will be verified in Section D of the Assessment.
- (128) *Measure 15*: A grant of DEM 2,5 million was allegedly granted under an approved aid scheme ⁽³⁹⁾. In its decision to extend the formal investigation procedure, the Commission erroneously stated that this scheme was intended only for SMEs. Germany correctly pointed out that large companies were also eligible for aid under this scheme under certain circumstances. However, the scheme expressly excludes companies in difficulty from its scope.

⁽³⁷⁾ OJ C 71, 11.3.2000, p. 14, point 3.2.

⁽³⁸⁾ NN 25/95, SG (96) D/11031 of 16.12.1996.

⁽³⁹⁾ N 408/93, SG (93) D/19245, 26.11.1993 (OJ C 213, 19.8.1992, p. 2).

- (129) The Commission recently reached a negative decision in respect of this scheme on grounds of misuse, since it had been used for, amongst others, companies in difficulty⁽⁴⁰⁾. In its decision the Commission specifically noted that Germany had included Kahla II amongst the companies in difficulty which had benefited from this scheme, contrary to the specific provisions approved by the Commission. In its decision concerning this scheme, the Commission stated that its decision on the scheme was without prejudice to its decision in the present case, in the context of which this individual application was being examined. In the present decision, the Commission considers that Kahla II was in difficulty at the time of the granting of this aid measure. Consequently, the view that the aid here must be regarded as new aid is maintained.
- (130) *Measure 16*: A loan of DEM 0,2 million was allegedly granted under an approved equity loan scheme⁽⁴¹⁾. This scheme was intended only for SMEs. However, since Kahla II had more than 250 employees and therefore did not qualify as an SME at the time of the granting of this measure, the aid manifestly does not comply with the scheme. Germany recently argued that the loan was granted to Mr G. Raithel and not to the company. However, according to the Commission's approval of the scheme on the basis of which the loan was awarded, investors may receive such support only on condition that they bring it into the company as capital. This is what Mr Raithel did. Consequently, although directly granted to a private person, the purpose of the loan was to support an undertaking. Hence the loan is regarded as new aid to Kahla II.
- (131) *Measures 17, 18, 19 and 22*: In the course of its examination the Commission came to the conclusion that the conditions set out in the scheme under which these loans were granted⁽⁴²⁾ were fulfilled in the present case. Consequently, these credits constitute existing aid which does not need to be reassessed by the Commission.
- (132) *Measure 21*: This loan was allegedly granted under an approved aid scheme⁽⁴³⁾. However, the scheme provided for loans of a maximum of DEM 2 million for companies in the new *Länder*. The loan here exceeds this limit. Consequently, the Commission cannot conclude that the conditions of the relevant scheme were complied with. Taking into account the subsidised rate of interest, the reduced value of the collateral provided and the presence of a 90 % guarantee covering almost the whole risk of default, the Commission considers that at the time they were granted these loans constituted aid potentially to their full amount.
- (133) *Measures 24 and 25* were granted under approved aid schemes for the purpose of covering the investments detailed in Table 5. In addition, the information provided by Germany indicates that part of the investment aid granted under the special depreciation scheme (*measure 33*) also contributed to the coverage of these investments. Germany has provided evidence that all these measures comply with the terms of the schemes under which they were allegedly granted. Consequently, measures 24, 25 and 33 constitute existing aid, which the Commission does not need to reassess.

⁽⁴⁰⁾ C 69/98, SG (2002) D/34461 of 19.6.2002 (not yet published).

⁽⁴¹⁾ ERP-Eigenkapitalhilfeprogramm, N 213/93, SG (93) D/16665 of 13.10.1993.

⁽⁴²⁾ ERP-Existenzgründungsprogramm, N 108c/1994 (see footnote 6).

ERP-Aufbauprogramm, N 108b/1994 (see footnote 7).

KfW-Mittelstandsprogramm, NN 109/93 (see footnote 8).

⁽⁴³⁾ ERP-Umweltprogramm, N 563d/94 (see footnote 9).

- (134) *Measure 26*: Grants for the promotion of employment in connection with environmental investments, allegedly awarded under an approved scheme, do not count as aid⁽⁴⁴⁾. However, as stated in the decision to extend the formal investigation procedure, the scheme was intended - as far as its environmental aspects are concerned - for the cleaning-up of environmental hazards in state-owned enterprises. The grants are therefore clearly not in keeping with the scheme on the basis of which they were allegedly granted. By letter dated 29 July 1994⁽⁴⁵⁾, Germany explained to the Commission how this provision was to be interpreted. Germany clearly stated that such measures could be carried out only in municipalities, towns, etc. Companies held by the THA were also eligible for such aid before their privatisation, as up to that point they were to be regarded as state-owned enterprises⁽⁴⁶⁾. The Commission considered that such measures did not constitute aid as they did not confer an advantage on any one company⁽⁴⁷⁾.
- (135) When it benefited from these measures, Kahla II was a private company and hence ineligible. Moreover, part of these grants were awarded by the *Land* of Thuringia, whereas according to the relevant scheme only the Bundesanstalt für Arbeit was entitled to award such grants. Consequently, the Commission is unable to find that these measures constituted existing aid⁽⁴⁸⁾.
- (136) Following the extension of the formal investigation procedure, Germany changed tack, arguing that these measures did not confer any advantage on the company. It stated first of all that the measures had been granted for the clearance of old installations, which was ostensibly of importance to the environment. However, the Commission cannot accept that the clearance of old installations did not confer an advantage on the company. Any such works would necessarily lead to an increase in the available surface area and in the value of the company.
- (137) Germany recently stated that the measures were intended for the removal of environmental hazards dating from July 1990. According to the Commission's practice, such measures do not constitute aid. However, Germany has not provided any evidence that there were any hazards dating from before July 1990. In addition, those hazards had supposedly been removed by Kahla I, which already benefited from such support in 1991 (measure 2) for the amount needed to remove them. Germany has never furnished any proof that the environmental hazards had still not been removed when the assets were purchased by Kahla I. Even if this were the case, the acquirer might reasonably be expected to have verified that the assets were free of this type of hazard. If it were not the case, he did not exercise the necessary care and it is therefore unacceptable that state support was subsequently provided for the purpose. If suitable checks had been carried out, the existence of these risks and the need to earmark resources for their removal would have been taken into account in the purchase price and there would have been no subsequent recourse to state support.

⁽⁴⁴⁾ NN 117/92, SG (95) D/341 of 13.1.1995.

⁽⁴⁵⁾ Registered under number A/33865 on 29.7.1994.

⁽⁴⁶⁾ The beneficiaries of measures pursuant to Article 124h of the Employment Promotion Act in the area of decontamination and improvement of the environment shall be public law entities, and in particular territorial authorities (towns, districts, municipalities, etc.) and public undertakings owned by the Treuhandanstalt ('Träger der Massnahmen nach § 124 h AFG im Bereich Umweltsanierung und Umweltverbesserung sind juristische Personen des öffentlichen Rechts, vor allem die Gebietskörperschaften (Städte, Kreise, Gemeinde u.a.), sowie Regiebetriebe der Treuhandanstalt'. Letter dated 29.7.1994 (see footnote 52).

⁽⁴⁷⁾ 'In other words, measures which are in the interest of a particular company are ineligible for aid' ('Das bedeutet, dass Massnahmen die im Interesse eines Unternehmens sind, nicht förderfähig sind'). Letter dated 29.7.1994, referred to in footnote 52.

⁽⁴⁸⁾ See also the decision in Case C 36/2000, SG (2001) D/292014.

- (138) Germany also stated that, if the company had known that these measures constituted aid, it might not have carried out the relevant work or it would have employed its own personnel or fewer or different personnel. Germany claims that the fact that the Commission had classified the scheme as non-aid and had approved it was enough to raise legitimate expectations that the measures were not aid. The Commission cannot accept this argument as its clearance of the scheme was effected on the basis of the notification and of the additional information submitted by Germany. Hence Germany cannot consciously act in contradiction of the notification and claim breach of legitimate expectations. Nor can the beneficiary claim such expectations when it is clearly stipulated in the German scheme that these measures cannot be implemented in the interests of an individual company and that only the Bundesanstalt für Arbeit was entitled to award such grants, whereas here part of the support was granted by the *Land* of Thuringia.
- (139) Germany finally argued that the grants constituted a general measure from which all companies in Germany could benefit without discrimination. The Commission notes, however, that this claim contradicts all the information previously submitted. It is clear from the relevant German legal provisions (Article 249h of the Employment Promotion Act) and from all the documents transmitted to the Commission, which enabled the Commission to classify the scheme as non-aid and to approve it, that not all companies can benefit from such measures. On the contrary, the German act and all the documents transmitted by Germany, which were intended to enable the Commission to assess the provisions, refer to public law entities and expressly exclude measures in favour of an individual company. This provision involves a clear element of selectivity, which means that the measure cannot be considered a general measure.
- (140) *Measure 27*: Grants for various purposes awarded in 1995 and 1996. Since no legal basis was invoked, the Commission provisionally regarded them as new aid. Germany then claimed that grants for research and development amounting to DEM 0,318 million had been awarded under an approved aid scheme⁽⁴⁹⁾. On the basis of the information available, the aid here complies with the terms of this scheme and thus constitutes existing aid which does not need to be reassessed.
- (141) As for the employee integration grants amounting to DEM 0,021 million, Germany considers that they do not constitute aid within the meaning of Article 87(1) of the EC Treaty as they were simply intended for the promotion of the employment of handicapped people. The Commission would point out, however, that, for such measures not to constitute aid, they must be granted in accordance with the guidelines on aid to employment⁽⁵⁰⁾ (employment aid guidelines) on the basis of objective criteria to individuals and without favouring certain undertakings or the production of certain goods. In spite of the information order relating specifically to this point, Germany has not provided any evidence in this respect. Consequently, the Commission concludes on the basis of the information transmitted that these measures constituted state aid within the meaning of Article 87(1) of the EC Treaty.
- (142) The remaining grants for fair attendance totalling DEM 0,122 million and the grants for advertising amounting to DEM 0,030 million are claimed to fall under the *de minimis* rules. Their compliance with the *de minimis* rules will be assessed below.
- (143) *Measures 28 and 29*: As stated in the decision to extend the formal investigation procedure, on the basis of the information available these measures are regarded as existing aid. In addition, the information provided by Germany states that part of the investment aid granted under the special depreciation scheme (*measure 33*) also contributed to the coverage of these investments. Germany has provided evidence that these measures comply with the terms of the schemes under which they were allegedly granted. They consequently constitute existing aid which the Commission does not need to reassess.

⁽⁴⁹⁾ N 660/93, SG D/21632 of 31.12.1993 and N 477/91, SG (91) D/22704 of 25.11.1991.

⁽⁵⁰⁾ OJ C 334, 12.12.1995, p. 4.

- (144) *Measure 31*: Further grants for the promotion of employment awarded under an approved aid scheme ⁽⁵¹⁾. On the basis of the information submitted by Germany, the Commission considers that these grants comply with the terms of the scheme under which they were awarded. Consequently they constitute existing aid which does not need to be reassessed by the Commission.
- (145) *Measure 32*: Grants for various purposes. Since no legal basis was invoked, the Commission provisionally regarded them as new aid. Germany claims, however, that the grants for research and development amounting to DEM 0,009 million were awarded under an approved aid scheme ⁽⁵²⁾. However, this scheme is intended only for SMEs. On the basis of the information available, Kahla II never qualified as an SME between 1997 and 1999, mainly because it always exceeded the ceiling of 250 employees, even after deducting the number of trainees. Consequently, the aid manifestly does not come under the scheme under which it was allegedly granted and falls to be assessed as new aid.
- (146) As regards the employee integration grants, Germany again explained that they do not constitute aid within the meaning of Article 87(1) of the EC Treaty as they were intended for the promotion of employment of handicapped people. However, as in the case of the grants under measure 27 above, Germany has not provided any evidence in this respect in spite of the information order relating specifically to this point. According to the figures in the company's annual reports ⁽⁵³⁾, the employee integration grants amounted to DEM 0,119 million in 1997 and 1998 and to an unknown proportion of the grants for fair attendance and job familiarisation amounting to DEM 0,121 million for 1999 listed in the 1999 annual report. Consequently, the Commission concludes on the basis of the information available that these measures constituted state aid within the meaning of Article 87(1) of the EC Treaty.
- (147) The remaining grants for fair attendance and grants for advertising amounting to DEM 0,103 million for 1997 and 1998 and an unknown proportion of the grants for fair attendance and job familiarisation amounting to DEM 0,121 million for 1999 listed in the 1999 annual report are claimed to fall under the *de minimis* rules. Their compliance with the *de minimis* rules is assessed in Section D of the Assessment.
- (148) In view of the above, measures 17, 18, 19, 22, 24 and 25, part of measure 27, and measures 28, 29, 31 and 33 constitute existing aid which the Commission does not need to reassess.

D. Measures claimed to be *de minimis*

- (149) Measures 13, 14, 23, part of measure 27, measure 30 and part of measure 32 are claimed to fall under the *de minimis* rules ⁽⁵⁴⁾. This rule stipulates that the ceiling for aid to be considered *de minimis* will be €100 000 over a three-year period beginning when the first *de minimis* aid was granted. This ceiling will apply to the total of public assistance considered to be *de minimis* aid and will not affect the possibility of the recipient obtaining aid under schemes approved by the Commission. The relevant periods are 25 March 1994 to 25 March 1997 and 25 March 1997 to 25 March 2000.
- (150) As regards the first period from 1994 to 1997, the measures claimed to fall under *de minimis* rules are 13, 14, 23 and part of measure 27.

⁽⁵¹⁾ NN 107/97, in force since 1 April 1997, approved by letter SG (98) 1049 of 6.2.1993.

⁽⁵²⁾ NN 331/96, SG (97) D/482, of 23.1.1997.

⁽⁵³⁾ Reports on the auditing of the annual accounts of Kahla/Thüringen Porzellan GmbH for 1997, 1998 and 1999.

⁽⁵⁴⁾ See footnotes 16 and 17.

- (151) Although the part of the grants under measure 27 claimed to be *de minimis*, i.e., grants for fair attendance of DEM 122 000 and grants for advertising of DEM 30 000, totals 152 000 (€77 716), this amount should be combined with the aid equivalent of the guarantees under measures 13, 14 and 23. As stated in paragraph 124, the value of the guarantee may be as high as the amount effectively covered by that guarantee ⁽⁵⁵⁾. This implies that the aid element in these guarantees was, at the time of their award, potentially 90 % of the credits to which they relate, which largely exceeds the *de minimis* limit. Consequently, it cannot be accepted that all these measures fall under the *de minimis* rules.
- (152) As regards the period 1997-2000, the guarantee under measure 30 and part of measure 32 are claimed to fall under the *de minimis* rules.
- (153) As regards the guarantee under measure 30, applying a 2 % aid equivalent as explained in paragraph 125, the aid element in this guarantee can be put at DEM 41 760. The part of measure 32 claimed to be *de minimis* consists of grants for fair attendance of DEM 294 000 and grants for cost reduction of DEM 114 000. In addition, the new value of the guarantee under measure 13, as from the moment it covered the market loans, should be added. As explained in paragraph 47, these loans totalled DEM 7,329 million. Applying again a 2 % aid equivalent to the amount of the loans covered by the guarantee, this results in an aid equivalent of DEM 131 922. Hence the measures claimed to be *de minimis* for the period 1997-2000 total DEM 581 682, which far exceeds the *de minimis* limit.
- (154) In view of the above, the Commission cannot accept that the *de minimis* rules apply to all these measures. Consequently, they constitute aid within the meaning of Article 87(1) of the EC Treaty.

E. New aid

- (155) In view of the foregoing, measure 8 in favour of Kahla I and measures 11, 12, 13, 14, 15, 16, 20, 21, 23, 26, 27, 30 and 32 in favour of Kahla II fall to be assessed as new aid. On the basis of the information available, the Commission cannot conclude that they comply with the terms of approved aid schemes.

F. Compatibility with the common market

- (156) The EC Treaty provides for several exceptions to the principle of the general incompatibility of state aid with the common market. The exemptions in Article 87(2) of the EC Treaty do not apply in the present case because the aid measures neither have a social character and are granted to individual consumers, nor do they make good the damage caused by natural disasters or exceptional occurrences, nor are they granted to the economy of certain areas of the Federal Republic of Germany affected by its division. Further exemptions are laid down in Article 87(3)(a) and (c) of the EC Treaty. Article 87(3)(a) allows the Commission to authorise aid for the economic development of certain areas. Article 87(3)(c) provides for the authorisation of state aid that is granted to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has issued various guidelines to spell out the conditions under which aid can be authorised on the basis of this provision.

⁽⁵⁵⁾ *Loc. cit.*, see footnote 37.

Aid granted until the end of 1996

- (157) Germany does not contest the fact that, despite the company concerned being located in an area where regional aid may be granted in accordance with Article 87(3)(a) of the EC Treaty, the aid to Kahla I falls to be assessed under the 1994 restructuring aid guidelines as the primary objective of the aid was not regional but concerned the restoration of the long-term viability of an undertaking in difficulty. The Commission would make clear here that only the aid granted under measure 8 falls to be assessed.
- (158) With regard to Kahla II, Germany claims that the objective of the measures found to constitute aid not covered by approved aid schemes or falling outside the *de minimis* rules was regional. The Commission would make clear here that the ad hoc aid to be assessed is constituted by measures 11, 12, 13, 14, 15, 16, 20, 21, 23, 26, 27, 30 and 32.
- (159) The Commission considers that the guidelines on national regional aid ⁽⁵⁶⁾ (regional aid guidelines) are not the appropriate provision for the assessment of the compatibility of the aid awarded from 1994 to 1996. According to footnote 10 of the guidelines, "ad hoc aid for firms in difficulty is governed by specific rules and is not conceived as regional aid as such". These specific rules are the restructuring aid guidelines.
- (160) The Commission would point out that the current regional aid guidelines were not applicable at the time the aid was granted. However, the rules in force at the time of the award, i.e., those referred to in footnote 2 of the current guidelines, also clearly state that such aid must not be granted in violation of the specific rules on aid granted to companies in difficulty. As explained in Section B of the Assessment (paragraphs 106-118), the Commission has come to the conclusion that, until 1996, Kahla II was a company in difficulty. Consequently, the ad hoc aid cannot be assessed under these provisions. This is also clear in the light of the kind of costs which were covered by the aid. The Commission would point to Table 5, according to which 80 % of expenditure went on renovation of machinery and working capital. These are typical expenditures within a restructuring project but not within an investment project.
- (161) In view of the above, the Commission cannot conclude that all the ad hoc aid to Kahla II until 1996 can be regarded as regional aid compatible with the common market.
- (162) Germany recently argued that the aid under measure 26 should be regarded as employment aid. The employment aid guidelines ⁽⁵⁷⁾ provide for aid for the creation of new jobs. According to Germany, the grants were used for the clearance of part of Kahla II's installations. This work was carried out by unemployed people and consequently led to the provisional employment of unemployed people. However, it did not lead to any lasting employment. Nor can the aid be regarded as aid to preserve jobs as the size of the company's workforce was reduced considerably (from 380 in 1994 to 327 in 1996). Moreover, Germany's explanations concerning the utilisation of the aid, namely, the temporary employment of unemployed people, clearly reinforce the view that no jobs at Kahla II were safeguarded. The Commission therefore considers that measure 26 cannot be authorised as employment aid on the basis of the employment aid guidelines. This view of the Commission's also holds true with respect to the aid granted prior to the entry into force of the guidelines inasmuch as the guidelines simply confirmed existing practice, and in any event employment aid cannot be approved where jobs are neither created nor preserved.

⁽⁵⁶⁾ OJ C 74, 10.3.1998, p. 9.

⁽⁵⁷⁾ See footnote 50.

- (163) Since the company was in difficulty at the time the ad hoc aid was granted, it must now be examined whether the aid to Kahla II until 1996 and the aid to Kahla I can be regarded as compatible with the common market under the restructuring aid guidelines. The Commission considers that none of the other Community guidelines, such as those on aid for research and development, environmental protection, small and medium-sized enterprises, or training, can apply. Since all the aid measures were granted before the revised version of the restructuring aid guidelines entered into force, the guidelines of 23 December 1994 are applicable⁽⁵⁸⁾. The fulfilment of the main conditions set out in these guidelines will be assessed in turn.
- (164) Restructuring aid is usually a combination of operating aid to cover losses, social costs, working capital, etc., and material investments. This can be clearly verified by looking at the purpose of the aid measures in favour of Kahla I and of those in favour of Kahla II until 1996⁽⁵⁹⁾.
- (165) As regards the aid to Kahla I, as pointed out in the decisions to initiate and to extend the formal investigation procedure, no restructuring plan has ever been submitted to the Commission. In the absence of a restructuring plan, the conditions which must be met if the restructuring is to be approved in accordance with the restructuring aid guidelines, in particular the existence of a sound restructuring plan when the aid was granted, are not fulfilled⁽⁶⁰⁾. Consequently, the aid granted under measure 8 must be considered incompatible with the common market.
- (166) As regards the aid granted from 1994 until 1996 to Kahla II, in its decisions to initiate and to extend the formal investigation procedure the Commission noted that there were indications that the company had undergone restructuring. The reports submitted by Germany describe the following measures aimed at restoring viability: new product orientation, personnel reduction, the replacement of old plant and machinery, the closure of production facilities, investments aimed at meeting technical and environmental standards, and the setting-up of a distribution network. During the formal investigation procedure, Germany stated that these measures formed part of the original business plan, which was subsequently further developed, and it refused to describe them as a restructuring plan. In its letter of 1 October 2002, Germany finally declared that, if the Commission were to consider Kahla II to be a company in difficulty, these measures should be regarded as a restructuring plan.
- (167) It is not clear, however, which of the documents transmitted is to be considered the relevant restructuring plan. The Commission notes that the first report was drawn up before the assets sale took place, and what is more it was intended only for TIB to help it decide whether to acquire a stake in the company. Although both suggested a number of measures that were necessary for the company's viability, these measures were, according to Germany, developed further by the investor. If the reports were to be considered a restructuring plan, clearly the proposed measures do not represent the final version of the plan, especially as far as the analysis of the cost of the proposed measures is concerned. The first report provided for total costs of DEM 30,945 million, consisting of investments, acquisition of the assets, loss coverage and interest payments on loans. The second report proposed restructuring measures costing a total of DEM 27,727 million, consisting of investments (including the taking-over of the assets), loss coverage

⁽⁵⁸⁾ Point 7.5 of the 1999 restructuring aid guidelines states that 'the Commission will examine the compatibility with the common market of any rescue or restructuring aid granted without its authorisation and therefore in breach of Article 88(3) of the Treaty ... on the basis of the Guidelines in force at the time the aid is granted'.

⁽⁵⁹⁾ See, in particular, Table 5.

⁽⁶⁰⁾ Judgment of the Court of Justice of the European Communities in Case 17/99 *France v Commission* [2001] ECR I-2481, paragraph 27.

and working capital. Neither the costs provided for in the first report nor those provided for in the second report correspond to those described by Germany in the 'investment plan' and set out in detail in Table 5, on the basis of which the aid was allegedly granted. In both reports, the list of measures intended for financing these costs omits numerous aid measures that were actually granted to the company (see Table 4), something which also holds true for the 'investment plan' (Table 5). If one of these documents were to be considered the restructuring plan, the Commission can only conclude that either the plan was not the final plan or the company received excessive aid.

- (168) Even if it were possible to regard these documents as a restructuring plan, they cannot be considered the final version of such a plan. It is not clear, moreover, to what extent the proposed measures were actually implemented.
- (169) In order to establish whether the criteria set out in the restructuring aid guidelines have been fulfilled, the Commission needs to know first of all precisely what restructuring measures were taken to restore the company's long-term viability.⁽⁶¹⁾ Despite repeated requests from the Commission, Germany has never submitted the final version of a restructuring plan for Kahla II or indicated which restructuring measures were effectively implemented. In the absence of such a plan, the criteria of these guidelines cannot be verified.
- (170) The Commission notes, moreover, that the private contribution to the overall costs cannot be regarded as substantial. It will be recalled that the Commission formally ordered Germany to furnish information about any contribution made or to be made by a private investor. In its letter of 1 October 2002, Germany describes the supposed private financing in accordance with the report of 29 November 1993. It consists of a contribution by Mr G. Raithel worth DEM 2,055 million, DEM 0,986 million of interest on the loans granted to Mr Raithel, cash flow of DEM 2,217 million and the DEM 7,975 million capital injection by TIB.
- (171) The alleged investor contribution consisted of two soft loans granted by the State (measures 16 and 17) worth a total of DEM 2 million, and DEM 0,055 million which the investor brought into the company from his own resources by way of own capital. Only the latter contribution was fully private. The DEM 0,2 million loan under measure 16 was secured by a Federal Government guarantee. The DEM 1,8 million loan under measure 17 was secured by a mortgage on Kahla II's land. The purchase of these assets was financed by state aid. In view of the fact that these loans were granted out of state resources and bearing in mind the security provided, the loans under measures 16 and 17 clearly cannot be considered a contribution by a private investor. As for the alleged new interest payments amounting to DEM 0,986 million, the Commission has never received the slightest piece of information about this. Presumably they relate to the interest paid by Mr Raithel on the two loans under measures 16 and 17. However, these interest payments do not finance any restructuring costs. As regards cash flow, the Commission would point out that the forecast profit the company was to earn cannot be considered a substantial contribution within the meaning of the restructuring aid guidelines. What is more, the Commission has not been informed whether this cash flow was actually achieved or whether it was used to cover restructuring costs.

⁽⁶¹⁾ See footnote 60.

- (172) As the company started generating some profits, on 30 March 1998 the investor converted part of the public loans into private loans. However, this contribution was uncertain at the time of the granting of the aid and was not made until after the restructuring. It can therefore be assumed that the subsequent contribution was possible thanks only to the improvement in the company's financial situation due to the state aid. The Commission would go further and say that the contribution was possible thanks only to a 90 % guarantee provided to cover these loans⁽⁶²⁾. What is more, this happened after the restructuring was completed, and it was unclear at the time of the granting of the aid and it is still unclear what resources were used for the purpose. Lastly, in the absence of a precise breakdown of the restructuring costs, it cannot be concluded that the private contribution was substantial.
- (173) Restructuring aid may be granted only on the basis of a viable restructuring plan, which must include measures to mitigate as far as possible any adverse effects of the aid and a substantial contribution from private resources. Since, despite the information order, there is no proof that the aid was granted under these conditions, it is safe to assume that these conditions were in fact not satisfied. Consequently, the ad hoc aid granted to Kahla II until 1996 constitutes restructuring aid incompatible with the common market.
- (174) In view of the above, the Commission cannot conclude that the ad hoc aid granted to Kahla II until 1996 can be considered compatible with the common market.

Aid to Kahla II granted as from 1997

- (175) In view of the modest positive operating results obtained, the Commission considers that, as from 1997, Kahla II can no longer be regarded as a company in difficulty. In accordance with Germany's request, the Commission will assess the aid to Kahla II in the light of the regional aid guidelines. The Commission would recall that this relates only to measures 30 and 32, which fall to be assessed as ad hoc aid, since the remaining measures constitute existing aid.
- (176) The regional aid guidelines state that an individual ad hoc aid payment made to a single firm may have a major impact on competition in the relevant market and its effects on regional development are likely to be too limited. Such aid generally comes within the ambit of specific or sectoral industrial policies and is often not in keeping with the spirit of regional aid policy as such. Consequently, unless it can be shown otherwise, such aid does not fulfil the requirements set out in the regional aid guidelines. The Commission notes that the porcelain market is saturated and that the porcelain industry is suffering from overcapacity. This adds to the negative presumption concerning ad hoc aid, as any investment aid would be likely to have a negative impact on the sector.
- (177) The object of regional aid is to secure either productive investment (initial investment) or job creation which is linked to investment. By 'initial investment' is meant an investment in fixed capital relating to the setting-up of a new establishment, the extension of an existing establishment, or the starting-up of an activity involving a fundamental change in the product or production process of an existing establishment (through rationalisation, diversification or modernisation).
- (178) The Commission notes first of all that part of the aid at issue here (measure 32) is made up of grants allegedly awarded for research and development, employee integration, fair attendance and cost reduction. Such expenditures do not constitute investments. On the other hand, measure 30 is a guarantee for a loan which could have been used for investments, although this point has never been made by Germany.

⁽⁶²⁾ The loan agreement provided by way of secondary security for the same mortgages as in Table 10 and for the assignment of Mr G. Raithel's life assurance policy worth DEM 1,8 million.

- (179) The Commission has expressly and formally ordered Germany to furnish a description of the investments undertaken or to be undertaken. In order to verify whether an initial investment was carried out, the sole data submitted by Germany are the investment plans detailed in Tables 7 and 9. Germany has not provided any description of the alleged investment project. According to these plans, machines were acquired and investments were made in existing installations. In the absence of any further explanation, the Commission cannot conclude that the investments relate to the extension of the establishment, or the starting-up of an activity involving a fundamental change in the product or production process.
- (180) Even if they did, the Commission does not have any information to draw on in this connection. Consequently, the overall eligible costs cannot be determined. In the absence thereof, it is impossible, given the combination with the other investment aid measures covered by approved aid schemes (measures 28 and 29 and part of measure 33), to establish whether the maximum allowable 35 % aid intensity is being complied with.
- (181) Moreover, according to point 4.2 of the regional aid guidelines, to ensure that the productive investment aided is viable and sound, the recipient's contribution to its financing must be at least 25 %. This minimum contribution must not contain any aid. This is not the case, for instance, where a loan includes an interest rate subsidy or is backed by government guarantees containing elements of aid.
- (182) The Commission has expressly and formally ordered Germany to inform it of any contribution made or to be made by the investor. According to the information available, on 30 March 1998 the investor converted the public loans into market loans. However, it is doubtful whether these loans could be regarded as a private contribution completely free of aid since they relate to aid measures granted previously. In addition, these market loans continued to be covered by a 90 % state guarantee. According to Table 8, the own contribution to the alleged investments carried out between 1997 and 1998 totalled DEM 2,406 million. However, no explanation has been provided as to the origin of this contribution. In the absence thereof, the Commission cannot conclude that the recipient contributed at least 25 % of the overall investment costs.
- (183) These measures can likewise not be regarded as operating aid compatible with the common market because the conditions set out in the regional aid guidelines are not fulfilled. These conditions are that such aid must be justified in terms of its contribution to regional development and its nature and that its level must be proportional to the handicaps it seeks to alleviate. Germany has not demonstrated any such points. Nor has it shown that the aid is limited in time and progressively reduced.
- (184) To sum up, the Commission cannot conclude that the alleged investments carried out by Kahla II as from 1997 constitute eligible investments within the meaning of the regional aid guidelines. Nor is there any evidence that 25 % of the overall costs were free of aid and covered by the aid recipient. Finally, the Commission cannot conclude that the aid had a beneficial effect on the region or on the market. Consequently, the Commission is unable to find that the aid can be regarded as compatible with the common market within the meaning of the regional aid guidelines.

CONCLUSIONS

- (185) The Commission finds that Germany has unlawfully implemented the aid in question in breach of Article 88(3) of the EC Treaty. On the basis of the information available, the Commission cannot conclude that the ad hoc aid in favour of Kahla I and Kahla II can be considered compatible with the common market.

- (186) Pursuant to Article 14 of Regulation (EC) No 659/1999⁽⁶³⁾, aid which is incompatible with the common market must be recovered unless recovery would be contrary to a general principle of Community law. In the Commission's view, that is not the case here. In particular, the facts of this case do not suggest that the recipient could claim legitimate expectations.
- (187) Consequently, all illegal and incompatible aid granted to Kahla I and Kahla II must be recovered. As far as those aid measures which have already been repaid are concerned, recovery must nevertheless be effected to the extent that the amount repaid is smaller than the amount owed inclusive of interest at the reference rate applicable to regional aid.
- (188) The aid to be recovered must include interest from the date on which it was at the disposal of the recipient until the date of its recovery. Interest must be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid,

HAS ADOPTED THIS DECISION:

Article 1

1. The state aid implemented by Germany for Kahla Porzellan GmbH under measure 8 – income from exploiting the company's real estate to be used to repay loans guaranteed by the Treuhand – is incompatible with the common market.
2. The following state aid granted by Germany to Kahla/Thüringen Porzellan GmbH is incompatible with the common market:
 - (a) Measure 11: a capital participation by TIB;
 - (b) Measure 12: a shareholder loan from TIB;
 - (c) Measures 13, 14, 23 and 30: 90 % guarantees of the *Land* of Thuringia;
 - (d) Measure 15: a grant from the *Land* of Thuringia;
 - (e) Measure 16: an equity loan from a state-owned bank;
 - (f) Measure 21: a loan from a state-owned bank;
 - (g) Measure 26: employment promotion grants;
 - (h) Measure 27: measures for employee integration, fair attendance and advertising;
 - (i) Measure 32: measures for research and development, employee integration, fair attendance and cost reduction.

⁽⁶³⁾ OJ L 83, 27.3.1999, p. 1.

Article 2

1. Germany shall take all necessary measures to recover from the recipient the aid referred to in Article 1 and unlawfully made available to the recipient. If the aid has already been paid back, recovery shall be effected to the extent that the amount paid back is smaller than the amount including interest calculated on the basis of the reference rate for regional aid applicable on the date on which the aid was granted.

2. Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient until the date of its recovery. Interest shall be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid.

Article 3

Germany shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it.

Article 4

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 13 May 2003.

For the Commission
Mario MONTI
Member of the Commission
