ISSN 0378-6978

Official Journal

of the European Communities

L 193

Volume 42

26 July 1999

English edition

Legislation

Contents

([1]) Text with EEA relevance

EN

Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

The titles of all other acts are printed in bold type and preceded by an asterisk.

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 3 February 1999

concerning State aid which the Spanish Government has granted to the company Hijos de Andrés Molina SA (Hamsa)

(notified under document number C (1999) 41)

(Only the Spanish text is authentic)

(Text with EEA relevance)

(1999/484/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

Having given notice to the parties concerned to submit their comments in accordance with the above Article,

Whereas:

I. PROCEDURE

(1) By letter dated 1 July 1996, the Office of the Spanish Permanent Representative notified the Commission, in accordance with Article 93(3) of the EC Treaty, of aid granted to Hijos de Andrés Molina SA (hereinafter called Hamsa). Since these aids had been granted prior to being notified, they were transferred to the register of non-notified aids.

(2) By letter SG(97) D/3294 dated 29 April 1997, the Commission notified the Spanish Government of its decision to initiate the procedure provided for in Article 93(2) of the Treaty against the aids granted to Hamsa which fell within the scope of Article 92(1) of the Treaty without appearing to qualify for any of the exceptions provided for in paragraphs 2 and 3 of that Article.

(3) Under the abovementioned procedure, the Commission invited the Spanish Government to submit its comments.

(4) The Commission also issued a notice to the other Member States and interested parties to submit their comments, which it published in the *Official Journal of the European Communities* [1].

(5) Spain submitted comments by letters dated 4, 11 and 23 July and 21 August 1997 informing the Commission that Hamsa had also been granted other State aids.

(6) Other interested parties submitted comments by letters dated 27 January, 6 February, 26 May, 28 May and 22 July 1997. These were forwarded to the Spanish Government by letter dated 13 January 1998. By letter dated 16 March 1998, the Spanish Government in turn submitted its comments on the comments submitted by the other interested parties.

(7) By letter SG(97) D/8336 dated 10 October 1997, the Commission informed the Spanish Government of its decision to extend the procedure provided for in Article 93(2) of the Treaty against the aids granted to Hamsa after the Commission's letter dated 29 April 1997 which fell within the scope of Article 92(1) of the Treaty without appearing to qualify for any of the exceptions provided for in paragraphs 2 and 3 of that Article.

[1] OJ C 196, 26.6.1997, p. 10.

(8) Under the extension of the abovementioned procedure, the Commission invited the Spanish Government to submit its comments.

(9) The Commission also issued a notice to the other Member States and interested parties to submit their comments, which it published in the *Official Journal of the European Communities* ([1]).

(10) Spain submitted comments by letters dated 19 December 1997. The other interested parties submitted comments by letters dated 15 and 23 December 1997, which were transmitted to the Spanish Government by letter dated 13 January 1998. By letters dated 2 March, 16 March, 16 July, 8 September and 21 October 1998, the Spanish authorities submitted their comments on the comments submitted by the other interested parties and also sent other information.

II. **DESCRIPTION OF THE MEASURES**

(11) The notification from the Spanish authorities on 1 July 1996 concerns the aid granted to Hamsa between 5 May 1995 and June 1996. According to the Spanish authorities, this aid is an individual example of aid N 462/94, authorised by Commission letter dated 20 February 1995. However, aid N 462/94 introduces a rescue and restructuring aid scheme for SMEs only. Aids to other firms had to be notified to the Commission in advance in each specific case. Hamsa cannot be considered an SME, either on the basis of its turnover (ESP 7 612 million in 1994) or on the basis of the number of its employees (632 on 31 December 1994) ([2]).

(12) According to the Spanish authorities' notification, between May 1995 and June 1996 Hamsa received the following aid from the Instituto de Fomento de Andalucía (hereinafter called the 'IFA'), a body dependent on the Regional Government of Andalusia:

(a) rescue aid, between May and December 1995, in the form of:

(i) two guarantees approved on 16 June 1995, one for ESP 100 million for one year granted on 16 August, and the other for ESP 50 million for 10 months granted on 14 September 1995 (premiums of 1,2 % not paid, the guarantees are still in force);

(ii) three loans for:

— ESP 350 million, granted on 11 July 1995 and paid on 24 October 1995, for four years,

— ESP 125 million, granted on 2 October 1995 and paid on 24 October 1995, for one year,

— ESP 25 million, granted on 28 September 1995 and paid on 27 October 1996, for one year,

at an interest rate of 6 % (converted on 9 April 1996 to MIBOR plus 0,5 %) (these loans have not been repaid; the loans for ESP 125 million and 350 million have been capitalised, no interest has been paid);

(b) restructuring aid, between January 1996 and June 1996, in the form of:

(i) guarantees approved on 9 April 1996, of which ESP 100 million was granted on 8 October 1996, ESP 75 million on 20 August 1996 and ESP 21 748 150 out of ESP 25 million on 11 November 1997 (premiums of 1,5 % not paid, guarantees still in force);

(ii) loans for ESP 1 739 million, granted on 10 December 1995 and paid on 30 December 1995 for one year, at MIBOR plus 0,5 %, and ESP 850 million granted on 28 May 1996 and paid on 11 July 1996, for five years at an interest rate of 10,5 % (the loans have not been repaid but have been capitalised, interest not paid).

(13) Before May 1995, Hamsa had received other State aids not covered by the Spanish notification, as follows:

(a) a loan of ESP 375 million for two years at 10 % interest, approved on 25 May 1993 and paid on 12 August 1993 (loan not repaid, interest not paid) and a guarantee for ESP 375 million, approved on 25 May 1993 and granted on 18 June 1993 (guarantee called in, no premium paid);

(b) a loan of ESP 550 million at 6 % interest, approved on 26 May 1994 and paid on 28 June 1994 (loan not repaid, interest not paid) and a guarantee for ESP 200 million, approved on 28 April 1994 and granted on 28 June 1994 (guarantee called in, 1,2 % premium not paid).

([1]) OJ C 361, 27.11.1997, p. 3.

([2]) A small and medium-sized enterprise is defined as an enterprise employing no more than 250 people with a turnover of no more than ECU 20 million (see point 3.2.4 of the Community Guidelines on State aid for rescuing and restructuring firms in difficulty (94/C 368/05)(OJ C 368, 23.12.1994, P. 12)).

(14) Between the notification by the Spanish authorities on 1 July 1996 and the Commission's letter of 29 April 1997 informing them of its decision to open the procedure provided for in Article 93(2) of the Treaty, Hamsa received other State aids, in particular:

(a) a four-year loan of ESP 1 100 million at MIBOR plus 0,5 %, approved on 1 October 1996 and paid on 5 November 1996 (loan not repaid, all but ESP 7 million capitalised, interest not paid);

(b) a four-year loan of ESP 700 million at MIBOR plus 0,5 %, approved on 3 April 1997 and paid in two instalments, the first of ESP 400 million on 2 June 1997 and the second of ESP 300 million on 31 July 1997 (loan not repaid and still running, interest not paid) and two guarantees, approved on 3 April 1997, one for ESP 450 million granted on 6 February 1998, and one for ESP 300 million granted on 2 May 1997 (guarantees still in force, 1,2 % premium not paid);

(c) in addition, on 2 August 1996, the IFA, through its public-sector company Sociedad para la Promoción y Reconversión de Andalucía SA (hereinafter called Soprea), took over the debt of ESP 275 951 288 arising from a ESP 300 million loan granted to Hamsa by the financial institute Caixa d'Estalvis i de Pensions de Barcelona (hereinafter called 'La Caixa'), (payable from acquisition, without interest).

(15) Following the Commission's letter of 29 April 1997 informing the Spanish authorities of its decision to open the procedure provided for in Article 93(2) of the Treaty, Hamsa's creditors held a meeting on 28 May 1997 to discuss the firm's debts at the time of the declaration of cessation of payments in May 1995. At that meeting various State bodies granted the following remissions:

(a) the IFA granted a remission of ESP 2 192 754 000 on a debt of ESP 2 211 154 000;

(b) the Andalusia Regional Executive (Junta de Andalucía) granted a remission of ESP 69 000 000 on a debt of ESP 87 489 000;

(c) the Municipality of Jaén granted a remission of ESP 158 800 000 on a dept of ESP 177 199 000;

(d) the tax authorities granted a remission of ESP 338 589 000 on a debt of ESP 927 876 000;

(e) the Ministry of Labour granted a remission of ESP 789 938 000 on a debt of ESP 1 479 000 000 incurred through non-payment of social security contributions.

(16) In addition, on 28 May 1997 the IFA capitalised ESP 4 680 million, part of the amount Hamsa owed it from the period after May 1995.

III. SPAIN'S COMMENTS FOLLOWING OPENING OF THE PROCEDURE

(17) By letters dated 4, 11 and 23 July and 21 August 1997, the Spanish authorities submitted their comments on the Commission's decision to open the Article 93(2) procedure against the aid granted to Hamsa. Those comments are summarised in recitals 18 to 38 of this Decision.

(18) Hamsa consists of five different production divisions:

(a) meat products (prepared meat products, preserves, smoked sausage, pâté, cured ham) producing 12 100 (10th largest in Spain);

(b) slaughtering, with two slaughterhouses (ranking 43rd in Spain for pig slaughter);

(c) pig production, with five pig units (two being leased to the Molina family), with around 10 000 sows producing 175 000 piglets a year for slaughter (12 150 t);

(d) animal feedingstuffs, with two units (one rented to the Molina family), with a capacity of 100 000 t; and

(e) cheesemaking.

(19) Under an agreement concluded on 6 March 1995 between the Molina family (shareholders in Hamsa) and the IFA, the bare ownership of all Hamsa shares was transferred to the IFA for the symbolic price of ESP 1 from 5 May 1995 to 31 December 1997. On that date, the shares were to be transferred automatically back to their former owners. Relations between the Molina family and the IFA during that period were strained and resulted in a number of court cases.

(20) On 28 May 1997, Hamsa increased its capital by ESP 4 680 million by capitalising part of the debt to IFA and a reduction in the capital to ESP 500 million. These operations left the former owners, the Molina family, with a reduced shareholding of 20 % and the IFA owning the remaining 80 % of the company's shares.

(21) Before 1993 Hamsa had employed 1 000 people. That number was reduced to 750 in 1993. The workforce was restructured (early retirement) in 1994 and again in the last quarter of 1995, reducing the number of Hamsa employees to 450.

(22) The Spanish authorities claim that they had not notified the Commission of the aids granted before May 1995 because they had been granted under two general aid schemes already notified to and authorised by the Commission. Specifically:

(a) the ESP 375 million loan and the guarantee for ESP 375 million (called in on 29 September 1996 in an amount of ESP 401 932 206) were approved on 25 May 1993. The loan was paid on 12 August 1993 and the guarantee granted on 18 June 1993, under aid scheme N 624/92, approved by the Commission by letter dated 16 December 1992;

(b) the ESP 550 million loan approved on 26 May 1994 and paid on 28 June 1994 and the guarantee for ESP 200 million (called in on 29 January 1996 in an amount of ESP 207 578 082), approved on 28 April 1994 and granted on 28 June 1994 under aid scheme N 428/93, approved by the Commission by letter dated 2 September 1993.

(23) According to the Spanish authorities, the aid granted after May 1995 complied with the Community Guidelines on State aid for rescuing and restructuring firms in difficulty.

(24) Rescue aid was granted between July and December 1995 to keep the firm running while the restructuring plan was being prepared. The 6% interest rate on the loans granted on 24 October 1995 was converted on 9 April 1996 to the MIBOR rate plus 0,5% to bring it into line with the market rate.

(25) With regard to the restructuring aid, the restructuring measures in the plan involved improved and more professional management of the organisation and operation of the company (introducing computerised systems, a management board for each production division, etc.), investing in replacements, freezing the staff salaries (increases linked to productivity), introducing a production strategy, reorganising product supply in line with demand, reducing overheads and selling off unproductive assets. As for economic and financial equilibrium, although it will not be possible to achieve a positive accounting result, the planned measures are intended to achieve a level of activity and profitability that at least provides a positive cash flow to facilitate privatisation.

(26) The plan made the following provision for the different production divisions:

(a) for the cheesemaking division to achieve positive results, or at least to break even, production would have to be increased to 90 t/month, requiring investments worth ESP 26 million;

(b) for the feedingstuffs division and farms, the only viable alternative would be to relaunch production on the farms of pigs for slaughter at Hamsa's slaughterhouse. This would require investments worth ESP 50 million and working capital of ESP 280 million;

(c) for the slaughterhouse and cutting plant to be profitable, slaughters would have to be increased to 19 000 to 20 000 yearlings monthly, requiring financing worth ESP 320 million;

(d) for the meat-products division to be profitable, production would have to be increased to 1 250 t/month, at a cost of ESP 450 million;

(e) commercial network: if the company is to have a future, the production divisions must be geared to the market. The commercial network would have to be reorganised, a commercial policy introduced and new policies developed for products, ranges and remuneration;

(f) creation of a joint service division responsible for general, financial and human resource management.

(27) The plan makes the following forecast for the output of the different production divisions:

Division	Situation in 1995 (when the plan was drawn up)	Plan forecasts
Slaughter	8 500 piglets per month	18 000 piglets per month
Pigs	—	Relaunch production
Meat-products	900 t/month	1 250 t/month
Fresh meat	150 t/month	Reduced to the surplus
Animal feedingstuffs	500 t/month	1 700 t/month
Cheese	39 t/month	90 t/month
Cured ham	—	Relaunch production

(28) Fresh funds were needed to finance the operating fund, pay creditors and redundancy payments and cover continuing losses during restructuring.

(29) A loan of ESP 1 100 million, granted on 1 October 1996, was earmarked to finance the additional costs incurred because of swine fever and payments made to creditors with secured loans.

(30) An ESP 700 million loan approved on 3 April 1997 and guarantees for ESP 450 million and ESP 300 million approved on 3 April 1997 were earmarked to pay creditors under the agreement reached at the meeting of creditors held on 28 May 1997, to finance an increase in stocks of cured ham caused by supply outstripping demand, to cover additional costs incurred because of swine fever (an increase in pig prices and additional costs amounting to ESP 131 million), to cover investments needed to maintain the plants and to pay consultancy fees.

(31) The IFA, through Soprea, acquired ESP 275 951 288 of the debt arising from a ESP 300 million loan by the financial institute La Caixa on 2 August 1996 to prevent Hamsa from losing its main farm, which was mortgaged under that loan.

(32) The Spanish authorities take the view that the aids in question meet the conditions laid down in the Community Guidelines on State aid for rescuing and restructuring, as set out in recitals 33 to 38.

(33) The restructuring plan was drawn up in December 1995 to restore Hamsa's viability. It was based on the information available at that date, which was incomplete, insufficient and unreliable. The plan was also subject to the unforeseeable results of the suspension of payments procedure. The balance sheet therefore does not reflect the firm's real situation. For these reasons, a report was drawn up in April 1997 on the firm's situation at 31 December 1996. This report is not a new restructuring plan, but a revision of the 1995 plan. The management measures taken began to show results in the 1996 financial year, with sales increasing by 26 % , operating losses down by 31 % and cash flow up by 37 %. Losses in 1996 amounted to ESP 1 370 million, as against ESP 2 479 million in 1995, while the operating losses were ESP 2 337 million in 1996 as against ESP 3 702 million in 1995. In particular:

Percentage	1995	1996
Gross profit/sales	18,32 %	29,03 %
Operating margin/sales	−16,13 %	2,76 %
Result/sales	−43,71 %	−22,09 %
Cash flow/sales	−29,83 %	−11,29 %

(34) Neverthless the balance sheet at 31 December 1996 shows that sales and stocks failed to reach the predicted levels and expenditure was higher (1,96 %) than predicted.

(35) The report on the firm's situation at 31 December 1996 made the following forecasts for the different production divisions.

(a) The sales projected for the cheesemaking division were not achieved and stocks increased sharply. Production was accordingly reduced to 55 t/month. Investments worth ESP 33 million would also be necessary.

(b) For the feedingstuffs division and pig farms, relaunching pig production was a success since it mitigated the effects of the increase in pig prices. Production was lower than expected (5 388 pigs/month instead of 6 500). At 17 000 t/month, the production of feedingstuffs was close to full capacity.

(c) For the slaughterhouse and cutting plant, it was planned to reduce the number of slaughters because of the expected reduction in the company's overall sales. Investments of ESP 67 million would be needed to bring down costs. However, this division is expected to make a loss.

(d) For the meat-product division, production was geared to demand and amounted to 15 341 t. The investment required was calculated at ESP 224 million, and a profit of some ESP 100 million was expected.

(e) The sales network was to be reorganised, with incentive pay and marketing measures.

(36) In addition, the suspension of payments procedure was completed in June 1997, when the creditors reached the agreement required to restore the firm's viability.

(37) With regard to the adoption of measures to minimise the negative impact on competition, the Spanish authorities take the view that there is no overcapacity on the market in meat products, which is highly fragmented and strongly influenced by consumer habits. However, under the restructuring plan Hamsa gave up selling fresh products and concentrated all its production capacity on prepared meat products. It followed the same price policy after 1995 as before, and therefore did not cut prices. The gross margin increased from roughly 30 % in 1995 to about 39 % in 1997.

(38) With regard to the requirement that restructuring aid be in proportion to costs and benefits, the agreement to

transfer bare ownership was intended not to benefit the Molina family but to enable the IFA to take control of the firm until its restructuring was complete. The IFA agreed to capitalise part of its loan to Hamsa (ESP 4 680 million) accounting for 80 % of the shares, thereby reducing the Molina family's holding to 20 %. Furthermore, Hamsa's employees contributed to the restructuring exercise through the reduction of the workforce, as did its creditors by cancelling its debts.

IV. SPAIN'S COMMENTS FOLLOWING EXTENSION OF THE PROCEDURE

(39) By letter dated 19 December 1997, the Spanish authorities submitted their comments on the Commission's decision to extend the Article 93(2) procedure against the aid granted to Hamsa. Those comments are summarised in recitals 40 to 50 of this Decision.

(40) IFA's decision to capitalise part of Hamsa's debt (ESP 4 680 million) by converting loans granted after 1995 and then reducing the firm's capital to ESP 500 million, was taken on 29 April 1997, that is, before the creditors' meeting held on 28 May 1997. The capitalisation concerned all the existing loans not included in the suspension of payments procedure at that date, except for ESP 32 502 853 that was not included due to a miscalculation. This operation required no injection of new capital and was the only legal alternative to Hamsa's declaring bankruptcy, since its deficit in own resources at 31 December 1995 amounted to ESP 4 304 million, against a share capital of ESP 1 140 million. If the firm had gone bankrupt, its creditors would probably have lost 80 % all of the money owing to them. In addition, the capitalisation left the IFA owning 80 % of Hamsa's shares. According to the Spanish authorities, such behaviour is that of a private investor.

(41) According to the Spanish authorities, the actions of the public authorities in the context of the suspension of payments procedure cannot be regarded as State aid within the meaning of Article 92(1) of the Treaty. The remission of debts was approved under the legal procedure for suspension of payments, with legal authorisation, in the context of general economic measures applicable to all firms in all sectors of the economy. They acted as private creditors would have done in similar circumstances. Moreover, the social security and tax authorities are permitted by law to conclude individual agreements with creditors. The Spanish authorities take the view that the public authorities used the same criteria in their dealings with Hamsa that a private investor would have done to recover a maximum of assets under the best conditions.

(42) Hamsa's debt to the IFA comes from State aids granted prior to May 1995 in the form of loans amounting to ESP 375 and 550 million (which have not been repaid, nor has the interest been paid) and guarantees amounting to ESP 375 and ESP 200 million (which were called in) plus interest. According to the Spanish authorities, since the IFA already owned 80 % of Hamsa's shares on 28 May 1997, any remission of debts amounts to indirect capitalisation of 80 % of the cancelled amount, i.e. the shares are revalued in exactly the same way as if that percentage were applied to the remitted amount. The IFA's remission of the debt is therefore equivalent to increasing capital by offsetting the remitted portion of the loan and then reducing the capital by the same amount. Since the firm's deficit at 31 December 1996 amounted to ESP 6 814 million and, after capitalisation on 29 April 1997, to ESP 4 680 million, a deficit of ESP 2 134 million still remained; if the IFA had not written off Hamsa's debts, the firm would have remained in the same state of bankruptcy as in December 1996. Consequently, the IFA acted as any private creditor would have done who was at the same time also the majority shareholder.

(43) According to the Spanish authorities, the other public creditors apart from the IFA behaved in the same way as private creditors with similar debts. Of the private creditors, the Banco Atlántico held mortgage guarantees and public loans, the social security held mortgage guarantees worth ESP 630 million and the Junta de Andalucía held mortgage guarantees worth ESP 21 million. As for the creditors who did not hold mortgage guarantees (both privileged creditors like the State and normal creditors), because of the firm's deficit and the mortgage charges soaking up all its assets, their guarantees were practically worthless. The details of the debt remission by the major creditors are given below.

Creditors	Debt (in ESP)	Remission	Percentage of remission	Mortgage guarantees
Banco Atlántico [1]	25 818 000	14 629 000	56,66 %	yes
Molina family	53 000 000	34 600 000	65,28 %	no
Gedeco	55 079 000	36 679 000	66,59 %	no

Creditors	Debt (in ESP)	Remission	Percentage of remission	Mortgage guarantees
Ray lech	29 631 000	17 341 000	58,52%	no
Prats Nadal	16 037 000	8 274 000	51,59%	no
Productos Cárnicos la Estrella	12 310 000	5 852 000	47,54%	no
Roura y Cia	11 981 000	5 638 000	47,06%	no
Cepsa	10 901 000	4 936 000	45,28%	no
Remission by private creditors	214 757 000	127 949 000	59,58%	—
Municipality of Jaén	177 200 000	158 800 000	89,62%	no
Tax authorities	927 876 000	338 589 000	36,49%	no
Junta de Andalucia	87 489 000	69 089 000	78,97%	yes
Social security	1 479 053 000	789 938 000	53,41%	yes
Confederación Hidrográfica del Guadalquivir	11 221 000	5 144 000	45,84%	no
Remission by public creditors (other than the IFA)	2 682 839 000	1 361 580 000	50,75%	
Remission resulting from the creditors' meeting			53,24%	
IFA	2 211 154 000	2 192 754 000	99 %	no
Remission by public creditors (including the IFA)	4 893 993 000	3 554 334 000	%	—

([1]) Individual agreement concluded outside the creditors' meeting.

(44) The Spanish authorities have the following views on the applicability of the Community criteria to assessment of the aid in question:

(a) since the Commission does not refer explicitly to the rules on farms in difficulty, the Spanish authorities have no information with which to assess whether the aid is compatible;

(b) like the Commission, they do not consider that the rules on rescue aid apply to the aid in question;

(c) their opinion as to applicability of the rules on restructuring aid is as follows.

(45) With regard to restoring viability, the increase in capital and the remission of debts are provided for in the December 1995 restructuring plan. Although the aid had not yet been quantified at that time, the plan provided for the necessary external financing by increasing capital and referred to the importance of settling the suspension of payments procedure. Moreover, the capitalisation and debt remission restored some financial viability to the firm by substantially reducing its financial costs. Lastly, the IFA became owner of 80% of Hamsa, which will enable it to sell the firm to the private sector in the short term.

(46) With regard to reducing the negative impact on competition:

(a) Hamsa closed one of its slaughterhouses (with a capacity of 240 pigs/hour, – a reduction of approximately 15% in production capacity) and one of its two cutting plants (with a capacity of 3 870 t/month, i.e. a. 15% reduction in production capacity). It also closed its pâté production line, which had a production capacity of 430 t/month. It uses its slaughterhouse for its own requirements, its production of meat products accounts for under 1% of the national total and the region has a shortage of slaughter capacity compared to other regions (there are only three slaughterhouses in Andalusia; Catalonia has 75 to serve a similar population). The cost of animal and meat transport has a major impact on price, so any excess capacity is only relative. In this connection, point 2.10 of the Annex to Commission Decision 94/173/EC ([1]) provides that

([1]) OJ L 79, 23.3.1994, p. 29.

the exclusion of pigs, cattle, sheep and poultry should not apply in Objective 1 regions where there is insufficient capacity.

(b) One of the firms manufacturing feedingstuffs, with a capacity of 2,5 million kg/month, was allotted to the Molina family by court order for sale, resulting in a 25 % reduction in Hamsa's production capacity.

(c) There has been no surplus production capacity for pigs since 1995, since world demand for pigmeat is on the increase.

(d) Moreover, the Commission's Guidelines provide for a smaller reduction in capacity in less-favoured regions like Andalusia.

(47) As regards the criterion that aid must be in proportion to the restructuring costs and benefits, all the private creditors, including the Molina family, contributed to the financial restructuring of Hamsa by remitting its debts.

(48) By letter dated 16 March 1998, the Spanish authorities informed the Commission of future plans for Hamsa:

(a) to recover the farms rented to the Molina family;

(b) to liquidate unproductive assets;

(c) to transfer the manufacture of meat products to a new factory in the Molina industrial complex, without increasing production capacity;

(d) to vacate the current meat-products factory;

(e) to negotiate the cancellation of a loan to Hamsa by the financial institute 'la Caja General de Ahorros de Granada' by selling it Hamsa's meat-products factory and concluding an agreement to lease the factory to Hamsa for at least eight years.

(49) By letter dated 8 September 1998, the Spanish authorities sent the Commission the following information.

(a) The aid granted before May 1995 was regional in nature: owing to recent investments, the firm needed funds to refinance its liabilities. The Spanish authorities asked the Commission to examine separately the compatibility of the aid granted between 1993 and 1994 and that granted between 1995 and 1997, in order not to establish a cause and effect link between the two groups.

(b) The results achieved fully match the forecasts in the restructuring plan and the firm is now operating smoothly, with no need for further financial assistance. The ultimate goal of the restructuring plan is for the firm to be returned to the private sector under market conditions. Its purchaser would take over the guarantees currently granted by the IFA to Hamsa, and the IFA would recover the loans to Hamsa which are still in force. In addition, the cash accruing from the sale of Hamsa's productive and unproductive assets would enable it to pay off the rest of its debts and liquidate the firm. The workforce would be maintained at 450 and the buyer would undertake to make investments worth ESP 4 000 million. Consequently, the restructuring has been a success and, in view of the investments to be made by the party buying the productive assets, it will contribute to development in the region. The aids granted therefore meet the conditions laid down in the Guidelines for restructuring aid.

(c) If the Commission decides that this aid is illegal and incompatible, and if the amount to be repaid exceeds the firm's resources, its administrators will have to inform the monitoring committee that it will be impossible to implement the agreement reached with the creditors under the suspension of payments procedure, endorsed and approved by the judge on 3 November 1997. In that case, the monitoring committee would have to become a liquidation committee. Another alternative would be for the administrators to file for voluntary bankruptcy of the company. Either of these alternatives would make it very difficult for the firm to continue to operate and would almost certainly result in the loss of 450 jobs.

(50) By letter dated 21 October 1998, the Spanish authorities forwarded to the Commission the balance sheet and the following information:

	1995	1996	1997	(in million ESP) first quarter of 1998
Total sales	5 299	6 695	7 400	3 553
Gross margin	1 156	2 103	2 750	1 575
Total costs	3 437	4 099	3 518	1 557

	1995	1996	1997	(in million ESP) first quarter of 1998
Cash flow	−2 281	−1 996	−768	18
Depreciation	948	694	735	144
Net outturn ([1])	−3 229	−2 690	−1 503	−126

([1]) Not including exceptional expenditure and income.

(a) Hamsa's operating income was ESP 13 300 million in 1992, ESP 5 300 million in 1995, ESP 7 100 million in 1996 and ESP 7 400 million in 1997.

(b) The redundancy payments for staff reductions in the last quarter of 1995 were paid in the first quarter of 1996.

(c) A firm in the sector has made an offer for Hamsa's fixed assets relating to its meat processing activities and has an option on a farm. The offer is as follows.

(i) The puchaser would take over Hamsa's floating liabilities up to the value of the current assets given to offset the liabilities taken over (under no circumstances may the floating liabilities exceed the current assets).

(ii) The price for the fixed assets would be ESP 840 million, with payment staggered as follows: ESP 42 million on purchase, ESP 252 million on 31 December 1999, ESP 252 million on 31 December 2000 and ESP 294 million on 31 December 2001.

(iii) The purchaser would make the necessary investments, estimated at ESP 4 000 million, over a four-year period starting in January 1999.

(iv) The purchaser would undertake to keep the workforce at its current size and keep the centre of industrial operations in Jaén.

(v) Moreover, the purchaser would require assurances that if the Commission reaches a negative decision on the aid granted to Hamsa, the purchaser will not be required to reimburse the aid.

(vi) The purchaser would not be held liable for any amounts arising from Hamsa's debts to the social security or tax authorities, the Municipality of Jaén or Hamsa's own shareholders.

V. **COMMENTS FROM INTERESTED PARTIES**

(51) The Asociación Española de Empresas de la Carne (hereinafter called Asocarne), provided the Commission with information on the State aid granted to Hamsa. The association takes the view that these aids do not meet the conditions laid down in the Guidelines for rescue and restructuring aid, affect trade between Member States and distort competition by favouring a certain company to the detriment of other companies in the sector. They are therefore contrary to Article 92(1) of the Treaty and do not qualify for exemption under Article 92(3). Accordingly, they should be declared incompatible and recovered.

(52) The Asociación Nacional de Almacenes Frigorifícos de Carnes y Salas Despiece (National Association of Cold Meat Stores and Stripping Plants) shares the views of Asocarne.

(53) The Spanish authorities, in their comments to the third parties' comments, expressed surprise at the nature of the information Asocarne gave the Commission, which was highly confidential to the firm. They believe that the information must have been obtained illegally or supplied by one of Hamsa's administrators acting in breach of his duty of confidentiality.

VI. **EVALUATION**

Application of Article 92(1) of the Treaty

(54) Under Article 92(1) of the Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, in so far as it affects trade between Member States.

Characteristics of the aid granted to Hamsa

(55) In the Commission's view, Hamsa has benefited from aid granted by the State or through State resources in the form of guarantees, loans, capital injections and remission of debts.

(56) In the case of aid in the form of guarantees, the Commission regards all guarantees given by the State directly or by delegation through financial institutions as falling within the scope of Article 92(1) of the EC Treaty [1] in so far as the fact of receiving a guarantee, even if it is never called on, may enable a firm to continue trading, perhaps forcing competitors who do not enjoy such facilities to go out of business. Given Hamsa's financial difficulties at the time they were granted (rescue aid in 1995, indebtedness in 1996, see recital 42 of this Decision), the firm would not have been able to obtain such guarantees on the market. Hamsa must therefore be deemed to have benefited from support to the detriment of competitors, in other words it received aid which adversely affected competition [2]. The guarantees granted to Hamsa by the IFA therefore fall within the scope of Article 92(1) of the Treaty.

(57) In the case of the aid granted in the form of loans, the Commission takes the view that a firm has received aid if the perceived risk inherent in the loan is high and if this fact is reflected neither in the interest rate applied nor in the securities required before the loan can be contracted. Similar considerations apply where the assets of a company pledged by a fixed or floating charge would be insufficient to repay the loan in full [3]. A firm in Hamsa's position (on the brink of bankruptcy since 1995) would have been unable to secure a loan at any interest rate at all. The loans granted to Hamsa by the IFA did not offer the guarantees required to secure loans and the interest rates applied did not reflect the perceived risk inherent in the loans. Thus, Hamsa's assets were insufficient to repay the loans in full. The Commission takes the view that the IFA's loans to Hamsa therefore fall within the scope of Article 92(1) of the Treaty.

(58) The Commission regards the provision of capital as State aid when the injection of new capital into a firm is made in circumstances which would not be acceptable to an investor operating under normal market conditions. This occurs when:

(a) the financial position of the firm, and particularly the structure and volume of its debt, is such that a normal return cannot be expected within a reasonable time from the capital invested;

(b) because of its inadequate cash-flow the firm would be unable to raise the funds needed for an investment programme on the capital market.

(59) There is a presumption that aid is involved where the financial intervention by the public authorities takes the form of acquisition of a holding combined with other types of intervention which need to be notified pursuant to Article 93(3) of the Treaty [4].

(60) Hamsa's financial situation and its volume of debt (see recital 42 of this Decision), together with the financial intervention by the public authorities combining the acquisition of a holding with other types of intervention, lead the Commission to regard the capital injection as State aid. The State did not behave as a private investor, since in the absence of a valid and reliable restructuring plan, it had no prospect of any return on its capital, even in the long term [5], all the more so when the ultimate purpose of the operations was the rapid liquidation of the company (see recital 49 of this Decision). The IFA's capitalisation of Hamsa's debt is therefore tantamount to State aid and cannot be regarded as intervention in accordance with the principles of private investment. Capitalising debts worth ESP 4 680 million to acquire 80 % ownership of a company with a share capital of ESP 500 million can hardly be considered the normal behaviour of a private investor.

(61) With regard to the remission of debts, various State organisations cancelled part of Hamsa's debts: the IFA, the Municipality of Jaén, the tax authorities, the Junta de Andalusia, the social security and the Confederación Hidrográfica del Guadalquivir. Generally speaking, where funding is provided or guaranteed by the State to a firm in financial difficulties, the Commission presumes that the financial transfers involve State aid [6]. Writing off debts is a form of financing. In addition, Hamsa was clearly in financial difficulties, since the only alternative

[1] Letter SG(89) D/4328, of 5 April 1989, from the Commission to the Member States.

[2] Commission communication to the Member States (OJ C 307, 13.11.1993, point 38).

[3] Commission communication to the Member States (OJ C 307, 13.11.1993, points 39 and 40).

[4] Points 3.3 and 3.4, Public authorities' holdings in company capital – Bull. EC 9-1984.

[5] Judgement of the Court of Justice of 21 March 1991 in Case C-303/88, Italy v. Commission, [1991] ECR I-1433, at paragraphs 21 and 22.

[6] Community Guidlines on State aid for rescuing and restructuring firms in difficulty (OJ C 368, 23.12.1994, p. 12, and OJ C 283, 19.9.1997, p. 2, at point 2.3).

to the cancellation of most of its debts would have been bankruptcy.

(62) According to the Spanish authorities, the cancellation of debts by public bodies does not constitute State aid. The IFA's cancellation of 99% of Hamsa's debt would be normal behaviour for a private investor who is the majority shareholder and wishes to ensure the survival of the company. The Spanish authorities also point out that the other official bodies cancelled Hamsa's debts as part of a general operation involving both public and private creditors. The percentage of debt written off by public creditors (other than the IFA) was 50,75%, lower than the percentage written off by private creditors (59,58%). Under these circumstances, the cancellation of debts by public bodies should be seen as normal behaviour by private investors and cannot therefore be regarded as State aid.

(63) The arguments in recital 62 cannot be accepted.

(64) The IFA's cancellation of debts, together with Hamsa's capitalisation, was one of two parts of a plan for the financial recovery of Hamsa. Both operations were carried out within a month of each other. Under these circumstances, the Spanish authorities cannot justify the cancellation of debts by concluding that the IFA was acting as a Hamsa shareholder. Moreover, the Commission takes the view that a distinction must be drawn between the behaviour of the State as owner of share capital and its behaviour as a public authority [1]. Private companies and their private shareholders do not have the option of cancelling their debts towards the State. Consequently, the cancellation of the above debts cannot be regarded as being in conformity with the criteria of a private investor [2]. The Commission therefore considers that the IFA's cancellation of Hamsa's debts constitutes State aid within the meaning of Article 92(1) of the Treaty. However, for the reasons explained in point 89 of this Decision, the amount of this aid should not be taken into account when calculating the aid granted to Hamsa.

(65) With regard to the cancellation of debts by public bodies other than the IFA, the following points should be noted.

(a) Hamsa's debt to the private sector (ESP 214 757 000) accounted for only 4,4% of its total debt (ESP 4 893 993 000). Even if its debt to that IFA is ignored, Hamsa's debts to the private sector accounted for only 8% of its total debt (ESP 2 682 839 000).

(b) Of all the private creditors, only the Banco Atlántico was protected by mortgages. However, this debt accounted for only 0,5% of Hamsa's total debt. In addition, the Spanish authorities failed to provide the Commission with information on the amount of the mortgage which guaranteed the loan, on whether other mortgages had been taken out on the same assets or on the terms of payment of the amount of debt remaining uncancelled.

(c) The Commission takes the view that for public loans to be written of in accordance with the criteria of private investors and not to constitute State aid, the concomitant cancellation by private creditors must also be significant and real.

(66) Taking into account:

(a) the proportion of public debt in relation to private debt referred to above;

(b) the respective percentages of debt cancelled by the public and private creditors (see the table in recital 43 of this Decision, particularly the fact that the IFA cancelled 99% of the largest debt);

(c) the priority given to creditors of the State and its various territorial bodies in liquidation procedures;

(d) the mortgage guaranteeing the large social security debt;

the Commission concludes that the sacrifice made by the public creditors (insured or at least privileged, and which, in the case of the largest debt, involved writing off almost the entire amount) is very substantial, while that of the private creditors (in most cases not insured) is negligible or non-existent. These private creditors had practically no hope of recovering even a part of their loans if the firm went into liquidation, unlike the privileged or insured public creditors. Comparing the different types of creditors in this way makes it possible to dismiss the claim that the behaviour of public and private creditors are the same and that the remission of the firm's debts to the public authorities was therefore carried out in accordance with private investment criteria.

Under these circumstances, the Commission takes the view that the behaviour of private investors cannot be used to rule out the presumption that the cancellation of debts by public bodies constitutes State aid.

[1] Judgment of the Court of Justice of 14 September 1994 in Case C-278/92, Spain v. Commission, [1994] ECR I-4103, at paragraph 22.

[2] See the fifth indent of point 3.3 of the communication on public authorities' holdings in company capital – Bull. EC 9-1984.

Effects of the aid on competition

(67) These aids distort or threaten to distort competition and clearly afford to Hamsa advantages not enjoyed by other firms in the sector which have not received State aids. In addition, taking into account the value of the trade in products of the sector in which Hamsa concentrated its activity in 1997 and Spain's production as compared to that of the other Member States, this aid is likely to affect trade between Member States in so far as it favours national production to the detriment of production in the other Member States.

Declarant: Spain Partner: EU 1997	Quantity in tonnes Imports	Quantity in tonnes Exports	Value in thousand ECU Imports	Value in thousand ECU Exports
Cheese	79 500	17 599	283 938	52 938
Pigmeat	54 399	165 424	116 077	346 644
Ham, offal, liver, bacon	8 569	29 030	7 552	62 804
Pigs	466 000 head	708 000 head	31 049	89 660
Animal feedingstuffs	498 200	394 355	89 544	69 634

(68) For the reasons stated above, the Commission regards the aid granted to Hamsa as meeting the conditions laid down in Article 92(1) of the Treaty. Spain failed to fulfil its obligations under Article 93(3) of the Treaty, both by granting aid without having previously notified it to the Commission and, in the cases where it notified the aid, by granting it before the Commission could decide on its compatibility with the common market.

Calculation of the amount of aid granted to Hamsa

(69) Having examined the information provided by the Spanish authorities, the Commission considers that the factors dealt with in recitals 70 to 96 of this Decision must be taken into account when calculating the amount of State aid granted to Hamsa.

Before May 1995

(70) On 25 May 1993 the IFA decided to grant a loan of ESP 375 million, which it paid on 12 August 1993. This loan has not yet been repaid and no interest has been paid.

(71) On 25 May 1993, the IFA granted a guarantee of ESP 375 million, which was paid on 18 June 1993. No premium was paid for this guarantee, which was executed on 29 September 1996 in an amount of ESP 401 934 206.

(72) According to the Spanish authorities, these aids were granted under aid scheme N 624/92, which the Commission approved by letter dated 16 December 1992. However, aid scheme N 624/92 concerns only an amendment to the budget for scheme already approved by the Commission (aid N 71/88). That scheme provides for the IFA to grant aid in the form of guarantees generally not exceeding ESP 25 million to cooperatives and worker-owned limited companies and ESP 3 million for self-employed persons. The annual cost of these guarantees amounts to 1,2 %; in practice the IFA grants aid to viable companies in the form of loans to finance current assets and refinance liabilities at 11 % interest, for a maximum of two years. The loans for working assets are to supplement loans for financing fixed assets. The aid granted to Hamsa does not meet these conditions, and cannot therefore be regarded as having been authorised by the Commission under aid scheme N 624/92.

(73) On 26 May 1994 the IFA approved a loan of ESP 550 million, which was paid on 28 June 1994. This loan has not yet been repaid and no interest has been paid.

(74) On 26 May 1994, the IFA approved a guarantee for ESP 200 million, which was granted on 28 June 1994. Hamsa has not yet paid the 1,2 % premium and the guarantee was called in on 29 January 1996 in an amount of ESP 207 578 082.

(75) According to the Spanish authorities, this aid was granted under aid scheme N 428/93, which the Commission approved by letter dated 2 September 1993. This argument cannot be accepted, since aid under this scheme can be granted only to SMEs with a workforce of no more than 250, a turnover not exceeding ECU 20 million and a balance sheet of not more than ECU 10 million. Hamsa cannot be considered

an SME either on the basis of the number of its employees or on the basis of its turnover. Consequently, the aid granted by the IFA to Hamsa cannot be included under aid scheme N 428/93 and it was therefore not authorised by the Commission.

Between May 1995 and April 1997

Aid in the form of guarantees

(76) On 16 June 1995 the IFA approved a guarantee for ESP 100 million, which was granted on 16 August 1995. On 19 August 1996 and on 11 November 1997 it was replaced by a guarantee for the same amount which is still in force. The 1,2% premium for these guarantee was never paid.

(77) On 16 June 1995, the IFA approved a guarantee for ESP 50 million, which was granted on 14 September 1995. On 18 August 1996 and on 11 November 1997 it was replaced by a guarantee for the same amount which is still in force. The 1,2% premium for this guarantee was never paid.

(78) On 9 April 1996, the IFA approved three guarantees for the following amounts:

(a) ESP 100 million, granted on 8 October 1996;

(b) ESP 75 million, granted on 20 August 1996, and

(c) ESP 25 million, granted on 11 November 1997 in an amount of ESP 21 748 150 only.

These guarantees are still in force and the 1,5% premiums have not yet been paid.

(79) On 3 April 1997, the IFA approved three guarantees for the following amounts:

(a) ESP 450 million, granted on 6 February 1996, and

(b) ESP 300 million, granted on 2 May 1997.

These guarantees are still in force and the 1,2% premiums have not yet been paid.

Aid in the form of loans

(80) On 11 July 1995 the IFA approved a loan of ESP 350 million, which was paid on 24 October 1995.

(81) On 2 October 1995 the IFA approved a loan of ESP 125 million, which was paid on 24 October 1995.

(82) On 28 September 1995 the IFA approved a loan of ESP 25 million, which was paid on 17 October 1996.

(83) On 10 December 1995 the IFA approved a loan of ESP 1 739 million, which was paid on 30 December 1995.

(84) On 28 May 1996 the IFA approved a loan of ESP 850 million, which was paid on 11 July 1996.

(85) On 1 October 1996 the IFA approved a loan of ESP 1 100 million, which was paid on 5 November 1996.

(86) On 3 April 1997, the IFA approved a loan of ESP 700 million, which was paid in two parts: ESP 400 million on 2 June 1997 and ESP 300 million on 31 July 1997.

(87) In addition, on 2 August 1996 the IFA, through its public-sector company Soprea, took over a debt of ESP 275 951 288 from an ESP 300 million loan made to Hamsa by the financial institute 'La Caixa'. Hamsa has not repaid this amount to the IFA. The Commission therefore takes the view that this debt must be considered as a loan to Hamsa for ESP 275 951 288.

None of the above loans has been repaid, or has interest been paid.

Capitalisation of Hamsa's debts and remission of debts by the public authorities

Capitalisation of Hamsa's debts

(88) On 29 April the IFA capitalised part of Hamsa's debt corresponding to loans granted before May 1995, to the tune of ESP 4 680 million. This operation covered the loans of ESP 350 million (recital 79 of this Decision), ESP 125 million (recital 80), ESP 1 735 million (recital 82), ESP 850 million (recital 83) and ESP 1 000 million, (recital 84), all of which were capitalised, except for ESP 7 million due to an accounting error, and should in principle be treated as State aid. However, since this capitalisation concerns debts arising from loans already included in the total amount of aid granted to Hamsa, if has not been included in the total amount, in order to avoid double accounting.

Remission of debts

(89) On 28 May 1997, Hamsa received aid from State organisations in the form of remission of debts contracted prior to May 1995 for a total of ESP 3 554 334 000. This remission must be treated as State aid.

(90) However, to avoid double accounting, the IFA's cancellation of ESP 2 192 754 000 is not included in the calculation of the total amount of State aid granted to Hamsa, since the debt relates to the loans made and guarantees called in referred to in recitals 69 to 74 of this Decision, granted by the IFA prior to May 1995, which have already been included in the calculation.

(91) However, the remaining debt remissions, totalling ESP 1 361 580 000, must be included in the calculation of the total amount of State aid granted to Hamsa.

Conclusions

State aid in the form of guarantees

(92) For the purposes of this Decision, the Commission considers that the following State aid, granted to Hamsa in the form of guarantees, must be taken into account:

(a) the guarantee for ESP 375 million granted on 18 June 1993 and called in on 29 September 1996 in an amount of ESP 401 934 206;

(b) the guarantee for ESP 200 million granted on 28 June 1994 and called in on 29 January 1996 in an amount of ESP 207 578 082;

(c) the guarantee for ESP 100 million granted on 16 August 1995 and replaced on 19 August 1996 and 11 November 1997 by a guarantee for the same amount;

(d) the guarantee for ESP 50 million granted on 14 September 1995 and replaced on 19 August 1996 and 11 November 1997;

(e) three guarantees, one for ESP 100 million, granted on 8 October 1996, one for ESP 75 million, granted on 20 August 1996 and one for ESP 21 748 050, granted on 11 November 1997;

(f) two guarantees, one for ESP 450 million, granted on 6 February 1998 and the other for ESP 300 million, granted on 2 May 1997.

(93) The Spanish Government will have to calculate the amount of aid granted in the form of guarantees in accordance with point 38 of the Commission's communication to the Member States (OJ C 307, 13.11.1993), which stipulates that the aid element of guarantees is the difference between the rate which the borrower would pay in a free market and that actually obtained with the benefit of the guarantee, not including any premium actually paid for it. None of the premiums for these guarantees was ever paid.

(94) The aid granted in the form of guarantees before May 1995 must be counted twice: once as aid granted in the form of a guarantee, between the date it was granted and the date it was called in, and again, for the amount of the guarantees which were called in, with interest from the date of calling in.

State aid in the form of loans

(95) For the purposes of this Decision, the Commission considers that the following State aid, granted to Hamsa in the form of loans, must be taken into account:

(a) a loan of ESP 375 million paid on 12 August 1993;

(b) a loan of ESP 550 million paid on 28 June 1994;

(c) two loans, one of ESP 350 million and one of ESP 125 million, paid on 24 October 1995;

(d) a loan of ESP 25 million paid on 17 October 1996;

(e) a loan of ESP 1 739 million paid on 30 December 1995;

(f) a loan of ESP 850 million paid on 11 June 1996;

(g) a loan of ESP 1 100 million paid on 5 November 1996;

(h) a loan of ESP 700 million, paid in two parts: ESP 400 million on 2 June 1997 and ESP 300 million on 31 July 1997;

(i) a loan of ESP 275 951 288, corresponding to the IFA's taking over, through its public-sector company SOPREA, an ESP 300 million loan made by the financial institute 'La Caixa'.

(96) Since these loans have not been repaid and no interest has been paid, they must be treated as aid granted in the form of subsidies from the date on which they were paid. When a loan is made to a company which would normally be unable to obtain one, then that loan is really a grant, and the Commission will treat it as it such [1].

[1] Commission communication to the Member States (OJ C 307, 13.11.1993, point 41).

Remission of debts by State organisations

(97) The cancellation by State organisations of part of Hamsa's debts for the amounts detailed below, agreed at the meeting of Hamsa's creditors on 28 May 1997, must also be counted as State aid to Hamsa in the form of grants, as from the date of remission:

— Municipality of Jaén	ESP 158 800 000,
— Tax authorities	ESP 338 589 000,
— Junta de Andalucia	ESP 69 089 000,
— Social security	ESP 789 938 000,
— Confederación Hidrográfica del Guadalquivir	ESP 5 144 000.

Application of Article 92(2) and (3) of the Treaty

(98) There are a number of exceptions to the principle of incompatibility provided for in Article 92(1) of the Treaty.

(99) It is clear, however that the exceptions provided for in Article 92(2) do not apply; nor have the Spanish authorities invoked them.

(100) The exceptions provided for in Article 92(3) must be strictly construed at the time any regional or sectoral aid programme or individual case of application of a general aid scheme is examined.

(101) They apply only in cases where the Commission is able to establish that the aid is necessary for the attainment of one of the objectives in question. To apply any of these exemptions to aid not meeting this condition would be tantamount to allowing trade between Member States to be affected and competition to be distorted without any justification of Community interest and, accordingly, to granting undue advantages to economic operators in certain Member States.

(102) These are not measures to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State, within the meaning of Article 92(3)(b).

(103) According to the Spanish authorities, aid was granted to Hamsa under a plan to rescue and restructure the firm in order to facilitate the development of certain economic activities and, in so far as this firm is located in a less-favoured area, namely Andalusia, to promote the development of certain regions; the aid could therefore qualify for the exemptions in Article 92(3)(a) and (c) of the Treaty.

(104) The Commission takes the view that the aid in question was intended not as regional aid to encourage new investment or job creation, nor yet to remedy deficiencies in infrastructure across the board for all companies in the region, but to rescue and restructure a specific company. Consequently, the aid must be treated as sectoral aid and assessed in the light of Article 92(3)(c), which does not require that regional factors be taken into account in this context.

(105) The compatibility of the aid to Hamsa with the common market must therefore be evaluated according to the criteria set out by the Commission in the Community Guidelines on State aid for rescuing and restructuring firms in difficulty. Point 2.2 of the Guidelines stipulates that in the agricultural sector special Commission rules for rescue and restructuring aid may continue to be applied to individual beneficiaries at the discretion of the Member State concerned as an alternative to the Guidelines [1].

Conformity of the aid granted to Hamsa with the Community Guidelines on State aid for rescuing and restructuring firms in difficulty

Rescue aid

(106) According to point 3.1 of the Guidelines, rescue aid must:

(a) consist of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates;

(b) be restricted to the amount needed to keep a firm in business (for example, covering wage and salary costs and routine supplies);

(c) be paid only for the time needed (generally not exceeding six months) to devise the necessary and feasible recovery plan;

(d) be warranted on the grounds of serious social difficulties and have no undue adverse effects on the industrial situation in other Member States.

(107) Although the Spanish authorities notified the aid granted between May and December 1995 as rescue aid, it does not meet the above criteria. Thus, the interest rate on these loans, totalling ESP 500 million, was not the applicable market rate required by the Community criteria, but 6 %, while the Spanish reference rate for

[1] The specific guidelines for agriculture applied until 1 January 1998, when a new version of the guidelines entered into force containing the same rules, with amendments.

1995 was 13,2%. The Spanish authorities converted that rate to MIBOR plus 0,5% on 9 April 1996. This change, made a year after the loans were granted, was merely an accounting adjustment. These loans have not been repaid, nor has any interest been paid. Thus, Hamsa had already received other State aid of the same type and for same reason in 1994 and 1995, while the criteria stipulate that such aid may be granted only for the time needed (generally not more than six months) to devise the recovery plan; normally, such aid should be necessary only once. In addition, the guarantees that had already been granted were replaced by others of the same amount, which are still in force.

(108) This aid therefore does not meet the criteria laid down in the Guidelines for rescue aid.

Restructuring aid

(109) In the Guidelines, the Commission notes that restructuring aid raises particular competition concerns as it can shift an unfair share of the burden of structural adjustment and the attendant social and industrial problems onto other producers who are managing without aid and to other Member States. The general principle should therefore be to allow restructuring aid only in circumstances in which it can be demonstrated that its approval is in the Community interest. For the Commission to approve such aid, a restructuring plan must be drawn up which satisfies all five of the following conditions:

(a) restoration of viability within a reasonable timescale;

(b) avoidance of undue distortions of competition;

(c) aid in proportion to the restructuring costs and benefits;

(d) full implementation of the restructuring plan and observance of conditions;

(e) monitoring and annual report.

Restoration of viability within a reasonable timescale

(110) According to point 3.2.2 of the Guidelines, the *sine qua non* of all restructuring plans is that they must restore the long-term viability of the firm within a reasonable timescale. The aid must therefore be linked to a viable restructuring plan submitted in adequate detail to the Commission. The plan must restore the firm to competitiveness within a reasonable period and enable the company to cover all its costs including depreciation and financial charges, and to generate a minimum return on capital such that, after completing its restructuring, the firm will not require further State aid and will be able to compete in the market place on its own merits. Such aid should normally need to be granted only once.

(111) Hamsa began receiving State aid to cope with its financial difficulties in May 1993. It received yet more State aid for the same reason in May 1994. In May 1995, the IFA obtained bare ownership of Hamsa, after which State aid was granted continuously until May 1997. A restructuring plan was not drawn up for Hamsa until December 1995 – that is, two and a half years after the aid was first granted to help it out of its financial difficulties and, according to the Spanish authorities themselves, the plan was incomplete, being based on insufficient and unreliable information, and subject to the outcome of the suspension of payments procedure, which was impossible to predict.

(112) Moreover, the plan referred only to the aid already granted between May and December 1995 and to the loan of ESP 1 739 million granted in 1996. It provided for the firm's other financial needs to be met on the market and for the possible grant of further State aid, of an unspecified amount.

(113) Under the restructuring plan, the firm's profitability was to be restored by substantially increasing the production of all its divisions (see recitals 26 and 27 of this Decision). The Commission considers that it was unrealistic to base the firm's return to viability on an increase in production (without specifying either the reference year or the trend over time) in a sector suffering from structural overcapacity (see recital 119 of this Decision). This assessment was confirmed by the report of 31 December 1996, which provided for the firm's production to be cut back, since sales were lower than forecast (see recital 35 of this Decision). The internal restructuring measures were equally unrealistic because they were based on insufficient and unreliable information.

(114) The Spanish authorities have shown that the firm's management and results were somewhat better in 1996 than in 1995 and that adjustments were made to increase production and to match it to market demand. However, despite these improvements, when the plan was reviewed in June 1997 (situation at 31 December 1996), following five years of State aid (1993 to 1997),

it was recognised that the only alternative to bankruptcy for Hamsa, which had been on the brink of failure since at least 1994, was to capitalise its debts.

(115) In principle, State aids must be assessed at the time they are granted, not in the light of subsequent developments. In any event, before a firm can be restored to viability, its situation must be remedied. It is therefore not possible in this respect to disregard the company's financial responsibilities, which have absorbed its assets, nor to be satisfied with any recent positive cash-flow, in view of the firm's continual losses (see recitals 40 to 43 of this Decision) [1].

(116) The Commission acknowledges that the swine fever epidemic mentioned by the Spanish authorities, which broke out in Spain during the restructuring period, might have made Hamsa's restructuring more difficult and justified amending the restructuring plan. However, this factor cannot justify the specific and continual payment of aid to Hamsa while its competitors, faced with the same difficulties, were managing without such aid.

(117) The Spanish authorities, in their letter dated 8 September 1998, stated on the one hand that the firm was operating well without needing any further financial assistance and that restructuring had been successful, while on the other hand they acknowledged:

(a) that the firm would be going into liquidation;

(b) that the proceeds of the sale of Hamsa's productive and unproductive assets would be used to pay off its liabilities and that any sums remaining would be shared among the shareholders (the IFA owns 80 % of Hamsa's shares);

(c) that the buyer of the productive assets would be required to carry out investments worth ESP 4 000 million.

(118) By letter dated 21 October 1998, the Spanish authorities forwarded a balance sheet and other information to the Commission. These showed that in the first half of 1998 Hamsa had a positive cash flow of ESP 18 million, but still incurred losses amounting to ESP 126 million. Moreover, in view of Hamsa's track record, the amount of its debts in the past and the amount of aid it has received, a slightly positive cash flow during first half of 1998, without any profits or future prospects, cannot be accepted as sufficient proof that the firm has become viable again. Moreover, according to the case law established in the Breda Fucine case (see footnote to recital 115 of this Decision), improvements in the operating margin cannot be invoked irrespective of extraordinary charges to demonstrate that the firm has recovered its viability.

(119) In addition, the purchaser's bid for Hamsa's productive assets (which was not preceded by a tendering procedure and could therefore, if accepted, contain elements of State aid to the purchaser [2]) was restricted to its current liabilities, provided these did not exceed the current assets, and payment for its fixed assets, set at ESP 840 million, was to be staggered over four years. In addition, the bid was subject to the condition that the purchaser would not be liable for other debts and claims against Hamsa. In the Commission's view, the conditions of this bid for Hamsa's productive assets raise even more doubts as to the current viability of the firm. The Commission also considers that the compensation from the public authorities demanded by the buyer might also constitute State aid.

(120) In their letter dated 21 October 1998, Spanish authorities first informed the Commission that Hamsa's operating income had been ESP 13 300 million in 1992, ESP 5 300 million in 1995, ESP 7 100 million in 1996 and ESP 7 400 million in 1997. However, they did not provide figures for 1993 or 1994, nor explain the reasons for the substantial drop in operating income between 1992 and 1995. On the basis of the information available to it, the Commission finds it reasonable to assume that Hamsa's lost market share might already have been taken by its competitors in 1995. It is not explained whether the increase in operating income between 1995 on the one hand and 1996 and 1997 on the other was due to the restructuring measures or a reduction in the firm's prices made possible by the grant of aid. By contrast, the firm's costs varied little between 1995 and 1998.

(121) In conclusion, the Commission considers that the State aid in question was granted not under a plan to restructure the firm, but specifically and continually each time the firm encountered liquidity problems. It can therefore be concluded that Hamsa's restructuring plan could not and did not help the firm to restore its long-term viability within a reasonable time (it was still suffering losses in the first half of 1998), nor to compete using only its own resources without State aid, nor did it set a firm date by which the firm's viability would be restored.

[1] Judgemt of the Court of Justice of 15 September 1998, in Case T-126/96, Breda Fucine, at paragraph 83 (not yet published).

[2] 1993 Report on Competition, point 403, p. 255.

Avoidance of undue distortions of competition

(122) As stated in point 3.2.2(ii) of the Guidelines, measures must be taken to offset as far as possible adverse effects on competitors. The Commission therefore takes the view that, when there is structural excess of production capacity in the Community market served by the recipient of the aid, the restructuring plan must make a contribution, proportionate to the amount of aid received, to the restructuring of the industry by irreversibly reducing or closing capacity.

(123) Some of Hamsa's activities, particularly feedingstuffs and the farming and slaughter of pigs, are carried out in sectors where the Community market has structural overcapacity, as stated in Commission Decision 94/173/EC of 22 March 1994 on the selection criteria to be adopted for investments for improving the processing and marketing conditions for agricultural and forestry products and repealing Decision 90/342/EEC [1], (see in particular the third indent of point 2.1, the first indent of point 2.6, and the second and third indents of point 2.10 in the Annex to that Decision). The Guidelines therefore call for recipients of aid to reduce their production capacity.

(124) The Spanish authorities informed the Commission, by letter dated 19 December 1997, that production capacity had been reduced as a result of closing a slaughterhouse, a cutting plant, one of the firms producing feedingstuffs and the pâté production line.

(125) Nevertheless, the Commission notes that none of these reductions in capacity was provided for in the restructuring plan drawn up in December 1995, which on the contrary planned a substantial increase in slaughtering and the production of meat preparations, cheese and animal feedingstuffs, as well as relaunching pig farming and cured ham production. Moreover, these reductions do not seem to apply to capacity actually used by the firm.

Aid in proportion to the restructuring costs and benefits

(126) In accordance with point 3.2.2(iii) of the abovementioned Guidelines, aid must be in proportion to the costs and benefits of restructuring. The amount and intensity of the aid must be limited to the strict minimum needed to enable restructuring to be undertaken and must be related to the benefits anticipated from the Community's point of view. Therefore, aid beneficiaries will normally be expected to make a significant contribution to the restructuring plan from their own resources or from external commercial financing and aid for financial restructuring should not unduly reduce the firm's financial charges.

(127) In this case, the only party that contributed to the restructuring plan by bringing in new resources was the State. The Molina family, which had owned 100 % of Hamsa's shares, had its shareholding reduced to 20 % as a result of the IFA's capitalisation of Hamsa's debt to it. This operation was decided not by the Molina family but by the IFA, which had bare ownership of 100 % of the shares until 31 December 1997, and the Molina family was not required to provide any resources. Nor did other investors contribute to the restructuring plan. In addition, given Hamsa's financial situation, it would have been unable to obtain external financing without the State's guarantee.

(128) The Spanish authorities argue that the private creditors, including the Molina family, contributed to restructuring by cancelling their debts. This argument cannot be accepted. In the Commission's view, the cancellation of some of a firm's debts as part of the suspension of payments procedure cannot be regarded as a contribution by that firm to its own restructuring. Even if this were the case, the cancellation of debts by private creditors accounts for only a tiny proportion of the aid granted to Hamsa (see recital 65 of this Decision).

(129) Finally contrary to the abovementioned Guidelines, the State aid granted to Hamsa in May 1997 in the form of debt remission and capitalisation appears to have unduly reduced the firm's financial charges in relation to its overall debt (on 31 December 1996, Hamsa's liabilities amounted to ESP 6 814 million; on 29 April 1997, ESP 4 680 million were capitalised and in May 1997 Hamsa's public creditors cancelled debts amount to ESP 3 554 million – see recital 42 of this Decision).

(130) In these circumstances, the Commission cannot consider that the aid granted to Hamsa was in proportion to the costs and benefits of its restructuring.

Full implementation of the restructuring plan and observance of conditions; monitoring and annual report

(131) Lastly, the Guidelines stipulate that the firm must fully implement the restructuring plan that was submitted to and accepted by the Commission and must discharge any other obligations laid down by the Commission Decision. The implementation and proper progress of the restructuring plan is to be monitored by means of detailed annual reports which must be submitted to the Commission.

[1] OJ L 79, 23.3.1994, p. 29.

(132) The Commission did not receive Hamsa's restructuring plan, drawn up in December 1995, until the Spanish authorities forwarded it by letter dated 4 July 1997, after the Article 93(2) procedure had been opened. The Commission was therefore unable to take a decision at the proper time. The report on the situation at 31 December 1996, drawn up in June 1997, consisted mainly of amendments to the restructuring plan of December 1995, and was also sent to the Commission under the procedure. However, the Commission is forced to note that it received these documents after the aid had been paid, so that it was unable to give an opinion on the restructuring plan or to consider the need to impose certain conditions during its implementation. Moreover, not only was the restructuring plan incomplete, covering only some of the aid granted, and not fully implemented, but it was even amended without prior agreement by the Commission, to take account of developments in Hamsa's business. The Commission must therefore conclude that, until June 1997, Hamsa was not being restructured but merely receiving a string of specific aid payments intended solely to keep the firm in business.

Special conditions applicable to restructuring aid in assisted areas

(133) In their comments, the Spanish authorities stress that Hamsa is located in a less-favoured area, so the aid granted to the firm qualifies for exemption under Article 92(3)(a). Accordingly, the aid must be examined in the light of point 2.3.2 of the Guidelines, which provides for special conditions for restructuring aid in assisted regions.

(134) The Guidelines do indeed require the Commission to take the needs of regional development into account when assessing restructuring aid in assisted areas. The fact that an ailing firm is located in such an area does not, however, justify a wholly permissive approach to aid for restructuring. In the medium to long term it does not help a region to support artificially companies which for structural or other reasons are doomed to failure. Furthermore, given the limited Community and national resources available to promote regional development, it is in the regions' own best interests to apply these scarce resources to develop as quickly as possible alternative activities that are viable and durable. Finally, distortions of competition just be minimised even in the case of aid to firms in assisted areas.

(135) In line with these principles, the Guidelines state that the criteria listed in point 3.2.2, referred to above, are also applicable to assisted areas.

(136) Regarding the criterion of restoration of viability, the Guidelines stipulate that, even in the case of the assisted regions, the result of the restructuring operation must be an economically viable business that will contribute to the real development of the region without requiring continual aid. Hence recurring aid will not be considered more favourably than in non-assisted regions. In this specific case, the Commission takes the view that Hamsa has received recurring aid over five years without that aid having guaranteed that the firm's viability will be restored.

(137) Secondly, the Guidelines require restructuring plans to be implemented correctly and adequately monitored. To avoid undue distortions of competition the aid must also be in proportion to the costs and benefits of restructuring. Nevertheless, for the reasons set out above, the Commission does not believe that these criteria are met in the present case.

(138) Thirdly, the Guidelines state that the Commission may be more flexible with regard to reductions in capacity in the case of markets in structural overcapacity. If regional development needs justify it, the Commission will require a smaller capacity reduction in assisted areas than in non-assisted areas and will differentiate between areas eligible for regional aid under Article 92(3)(a) and those eligible under Article 92(3)(c) to take account of the greater severity of the regional problems in the former areas.

(139) By letter dated 19 December 1997, the Spanish authorities informed the Commission that production capacity had been reduced by closing a slaughterhouse (capacity reduction of approximately 15%), one of its two cutting plants (capacity reduction of approximately 15%), its pâté production line and one of the feedingstuffs businesses (capacity reduction of approximately 25%). With regard to Hamsa's activities in the meat sector, particularly pig production, the manufacture of pigmeat-based products and the sale of fresh pigmeat, the Spanish authorities refer in their comments to Commission Decision 94/173/EC (third indent of point 2.10 in the Annex), which permits investments in the slaughter of pigs, cattle, sheep and poultry in Objective 1 regions if there is a shortage of capacity in the region. The Spanish authorities point out that Andalusia indeed has only three slaughterhouses, while Catalonia, with a similar population, has 75.

(140) In this respect, it must be remembered that Hamsa's first restructuring plan did not provide for any capacity reduction, but rather for an increase, which in some cases was very substantial. In therefore seems unlikely that the Commission would have approved the plan as it stood in December 1995. The capacity reductions made subsequently were specific adjustments not carried out as part of a restructuring plan.

(141) In any event, even where the reduction in capacity of some of Hamsa's activities was sufficient, in view of its location in a less-favoured region, the other conditions in the Guidelines have clearly not been met, leading the Commission to conclude that the aid granted to Hamsa does not meet the criteria in the Guidelines for restructuring aid and does not therefore qualify in this connection for the exemptions in Article 92(3)(a) and (c).

Compliance of the aid granted to Hamsa with the special rules applied by the Commission until 1 January 1998 in the agricultural sector for rescue and restructuring

(142) According to the Commission's practice in the agricultural sector until 1 January 1998, State aid for rescuing or restructuring firms in difficulty may be permitted subject to certain conditions:

(a) the aid must be intended to reduce the cost of financing loans contracted in respect of earlier investment;

(b) the cumulated subsidy value of any aid granted when the loans were taken out and of the aid in question may not exceed the rates generally allowed for investments to improve the processing and marketing of agricultural products and investments in primary agricultural production;

(c) the new aid must follow changes in new loan rates in line with the cost of money (the amount payable may not exceed that corresponding to the change in rate) or be for farms presenting guarantees of viability, notably cases where the financial cost of existing borrowings is at danger level, possibly threatening bankruptcy.

(143) In their answer to the Commission's letter dated 29 April 1997 and 10 October 1997, the Spanish authorities furnished no information which would enable the Commission to believe that the aid in question was intended to reduce the costs of financing past investments and thus to meet the abovementioned conditions.

(144) Not until their letter dated 8 September 1998, did the Spanish authorities first state that the aid granted in 1993 and 1994 was intended to reduce the financial costs of past investments. However, they provided no details in this respect and no other information enabling the Commission to check whether the abovementioned criteria were met.

(145) The Commission is therefore forced to conclude that the aids in question do not comply with these specific rules.

VII. **CONCLUSIONS**

(146) The Commission concludes that the Spanish Government granted the aids in question illegally, without prior notification in some cases and without waiting for the Commission to pronounce on compatibility in others.

(147) For the reasons set out above, the aids in question, which fulfil the conditions laid down in Article 92(1) of the Treaty, do not qualify for any of the exceptions laid down in Article 92(2) and (3).

(148) The aids are therefore incompatible with the common market.

(149) Where aid is incompatible with the common market, the Commission must in principle have recourse to the possibility offered by the judgment of the Court of Justice of 12 July 1993 in Case 70/72, Commission v. Germany [1], as confirmed by the judgments of 24 February 1987 in Case 310/85, Deufil v. Commission [2], and 20 September 1990 in Case C-5/89, Commission v. Germany [3], and require the Member State to recover all the aid granted illegally from the recipient.

(150) This measure is necessary in order to restore the *status quo* by removing all the financial benefits which the beneficiaries of the unlawful aid have improperly enjoyed since the date on which the aid was paid.

(151) The aid must therefore be reimbursed in accordance with the procedures and provisions of Spanish law, with

[1] [1973] ECR 813.
[2] [1987] ECR 901.
[3] [1990] ECR I-3437.

interest from the date on which the aid in question was granted. The interest must be calculated on the basis of the commercial rate, with reference to the rate used to the calculation of the subsidy equivalent in the context of regional aids [1].

(152) This Decision will not prejudice the conclusions the Commission may draw, if necessary, for the financing of the common agriculture policy by the European Agricultural Guidance and Guarantee Fund (EAGGF),

HAS ADOPTED THIS DECISION:

Article 1

The following aid, granted by Spain to the company Hijos de Andrés Molina SA, is illegal due to the fact that it was granted before the Commission had decided on its compatibility at the draft stage. Moreover, it is incompatible with the common market within the meaning of Article 92(1) of the Treaty, without fulfilling the conditions for exemption provided for in Article 92(2) and (3), and shall therefore be abolished.

1. State aid in the form of guarantees:

   (a) the guarantee for ESP 375 million granted on 18 June 1993 and called in on 29 September 1996 in an amount of ESP 401 934 206;

   (b) the guarantee for ESP 200 million granted on 28 June 1994 and called in on 29 January 1996 in an amount of ESP 207 578 082;

   (c) the guarantee for ESP 100 million granted on 16 August 1995 and replaced on 19 August 1996 and 11 November 1997 by a guarantee for the same amount;

   (d) the guarantee for ESP 50 million granted on 14 September 1995 and replaced on 19 August 1996 and 11 November 1997;

   (e) the following three guarantees: one for ESP 100 million, granted on 8 October 1996, one for ESP 75 million, granted on 20 August 1996 and one for ESP 21 748 150, granted on 11 November 1997;

   (f) the following two guarantees: one for ESP 450 million, granted on 6 February 1998 and the other for ESP 300 million, granted on 2 May 1997.

2. State aid in the form of loans:

   (a) a loan of ESP 375 million paid on 12 August 1993;

   (b) a loan of ESP 550 million paid on 28 June 1994;

   (c) two loans, one of ESP 350 million and one of ESP 125 million, paid on 24 October 1995;

   (d) a loan of ESP 25 million, paid on 17 October 1996;

   (e) a loan of ESP 1 739 million, paid on 30 December 1995;

   (f) a loan of ESP 850 million, paid on 11 July 1996;

   (g) a loan of ESP 1 100 million, paid on 5 November 1996;

   (h) a loan of ESP 700 million, paid in two parts: ESP 400 million on 2 June 1997 and ESP 300 million on 31 July 1997;

   (i) a loan of ESP 275 951 288, corresponding to the taking over by the Instituto de Fomento de Andalucía, through its public-sector company Sociedad para la Promoción y Reconversión de Andalucía SA, of an ESP 300 million loan made to Hijos de Andrés Molina SA by the financial institute Caixa d'Estalvis i Pensions de Barcelona.

3. State aid in the form of remission of debts by State organisations:

   Cancellation of part of Hamsa's debts by State organisations, approved at the meeting of Hamsa's creditors on 28 May 1997, involving the following amounts:

   — Municipality of Jaén ESP 158 800 000 ,

   — Tax authorities ESP 338 589 000 ,

   — Junta de Andalucía ESP 69 089 000 ,

   — Social security ESP 789 938 000 ,

   — Confederación Hidrográfica del Guadalquivir ESP 5 144 000 .

Article 2

Spain shall, without delay, terminate the loan contracts and revoke the guarantees referred to in Article 1 which are still in force.

[1] Commission communication to the Member States (OJ C 74, 10.3.1998, p. 22).

Article 3

1. Spain shall take the necessary measures to recover the aid referred to in Article 1:

— in the case of the guarantees, the difference between the interest rate granted and the free market rate,

— in the case of the loans, guarantees called in and debts cancelled, 100 % of the amounts concerned.

2. Recovery shall be carried out in accordance with the procedures of national law. The sums to be recovered shall attract interest from the date on which the aid in question was granted. The interest must be calculated on the basis of the commercial rate, with reference to the rate used for the calculation of the subsidy equivalent in the context of regional aids.

Article 4

Spain shall inform the Commission within two months from the date of notification of this Decision of the measures it has taken to comply with this Decision.

Article 5

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 3 February 1999.

For the Commission

Franz FISCHLER

Member of the Commission

COMMISSION DECISION

of 30 April 1999

relating to a proceeding pursuant to Article 85 of the Treaty

(IV/34.250 — Europe Asia Trades Agreement)

(notified under document number C(1999) 983)

(Only the Danish, German, English and French texts are authentic)

(Text with EEA relevance)

(1999/485/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No 4056/86 of 22 December 1986 laying down detailed rules for the application of Articles 85 und 86 of the Treaty to maritime transport [1], as amended by the Act of Accession of Austria, Finland and Sweden, and in particular Articles 3, 11, and 12 thereof,

Having regard to the Commission Decision of 6 April 1994 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission and to present any other comments in accordance with Article 23 of Regulation (EEC) No 4056/86 and with Commission Regulation (EEC) No 4260/88 of 16 December 1988 on the communications, complaints and applications and the hearings provided for in Council Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport [2] as last amended by the Act of Accession of Austria, Finland and Sweden [3],

Having consulted the Advisory Committee on Restrictive Practices and Dominant Positions in the field of maritime transport,

Whereas:

SUMMARY

(1) In this Decision, the Commission considers whether the parties to the Europe Asia Trades Agreement (EATA) have infringed Article 85(1) of the Treaty in relation to an agreement not to use capacity and to exchange information and examines their application for individual exemption.

THE FACTS

I. The application

(2) On 2 September 1992, in accordance with Article 12(1) of Regulation (EEC) No 4056/86, the Commission was notified of an requested to exempt under Article 85(3) of the Treaty, the Europe Asia Trades Agreement (EATA) concerning scheduled maritime transport services for the carriage of containerised cargo from north Europe to the Far East. On 19 September 1997, the Commission was informed that the EATA parties had terminated the agreement with effect from 16 September 1997.

(3) The following shipping lines were party to the EATA:

— CGM Orient SA (CGM),

— Hapag-Lloyd AG (Hapag-Lloyd),

— Kawasaki Kisen Kaisha Ltd (K Line),

— A.P. Møller — Maersk Line (Maersk),

— Malaysian International Shipping Corporation Bhd (MISC),

— Mitsui O.S.K. Lines Ltd (MOL),

— Nedlloyd Lijnen BV (Nedlloyd),

— Neptune Orient Lines Ltd (NOL),

— Nippon Yusen Kabushiki Kaisha (NYK),

— Oriental Overseas Container Line (OOCL),

— P&O Container Line (P&OCL),

— Cho Yang Shipping Co. Ltd (Cho Yang),

— Deutsche Seereederei Rostock GmbH (DSR),

— Evergreen Marine Corp (Taiwan) Ltd (Evergreen),

— Hanjin Shipping Co. Ltd (Hanjin),

— Hyundai Merchant Marine Co. Ltd (Hyundai),

— Senator Linie GmbH (Senator),

— Yangming Marine Transport Corp. (Yangming) ([4]).

(4) A summary of the application was published in the *Official Journal of the European Communities* on 6 April 1993 ([5]) in which the Commission stated that it considered *prima facie* that the agreement fell within the prohibition in Article 85(1) but that it had not yet taken a position as to the applicability of Article 85(3). The Commission informed the former EATA parties on 14 June 1993 that it had serious doubts as to whether any of the four conditions of Article 85(3) were satisfied.

(5) The Commission received complaints about the EATA from a number of third parties including the British Shippers' Council (BSC) the European Shippers' Council (ESC), the French Conseil National des Usagers des Transports (CNUT) and the Japan Shippers' Council (JSC). The former EATA parties have been given an opportunity to comment on these complaints.

II. **The notified agreement**

(i) The parties

(6) The former EATA parties are all shipping lines. A number of them are members of the Far Eastern Freight Conference (FEFC) while the remainder are independent shipping lines operating in the same trades (see recital 66).

(7) Hyundai became a party to the EATA on 12 March 1993. The Commission was informed on 23 July 1993 that the East Asiatic Company Ltd and EACBen Container Line Ltd had left the EATA with effect from 30 June 1993. These two shipping lines no longer operate vessels on the trades in question, although for a while the vessels they had operated were maintained in use on the same trades by Maersk. CGM left the North Europe/Far East trade in 1994 and on so doing ceased to be a party to the EATA.

(ii) Summary of the agreement

(a) General provisions

(8) Article 2 of the EATA provided that the purpose of the agreement was to establish a capacity management programme in order to achieve:

'(a) the optimum use of available capacity on deepsea vessels owned, operated or controlled by the [EATA] parties … and

(b) the improvement of revenue … to a level consistent with a reasonable rate of return on investment for the services provided, and to maintain the viability of such services in the future …'.

(9) According to the recitals to the EATA ([6]), this 'improvement of revenue' was to be brought about by remedying the 'consistently depressed freight rates' referred to in recital (b) to the EATA. Thus, the purpose of the EATA was to bring about an increase in freight rates on services operated by the EATA parties between North Europe and Far East.

(10) One of the ways in which these objectives were to be achieved was by the allocation to each of the parties of a 'maximum allowed capacity', i.e. the maximum amount of capacity that each party was allowed to offer to the market for the carriage of goods (Article 5(a)). These allocations could be made in respect of a particular area, several particular areas or generally (Article 16(e)). They could be made for some or all of the parties (Article 6(e)). The agreement included provisions for the calculation and revision of the allocations.

(11) The 'maximum allowed capacity' of each party was to be calculated according to the eastbound slots available per vessel declared by each party (Article 16(b)). In practise this was done by calculating the total which would be available in the absence of the EATA and reducing it by a certain percentage. This maximum was then divided into four periods of account of three months each.

(12) If a party exceeded its maximum allowed capacity in any period of account, it was potentially liable to pay a 'capacity charge' calculated by reference to the number of TEUs [7] by which it had exceeded its allocation for the period in question (Article 22). Unused portions of a Maximum Allowed Capacity in any period of account could not be carried forward or transferred (Article 18)).

(b) Administrative provisions

(13) The agreement was administered by a General Policy Committee, a Market Review Committee and a Secretariat (Article 5b)).

(14) The General Policy Committee was made up of representatives of each of the parties and determined the size of the allocations of maximum allowed capacities on the basis of recommendations made by the Market Review Committee (Article 6). It also decided the amount of any capacity charges imposed by reason of a line carrying more than its maximum allowed capacity as well as any other measures necessary to give effect to the objectives of the agreement, such as the exchange of information on market conditions and the size of penalty payments for failure to provide information (Article 6).

(15) The Market Review Committee was also made up of representatives of the parties (Article 7). Its function was to consider market conditions and to report to the General Policy Committee. It was supplied by the secretariat with the declarations made by the parties as to their fleet capacity and monthly liftings (i.e. cargo loaded) (Article 14). The agreement provided that the parties were to supply the secretariat with any data, reports or documents necessary to ensure compliance with the agreement (Article 12).

(16) It was the practice of the EATA parties to provide a declaration of the individual capacity of each of their vessels biannually and in advance. The parties also supplied the EATA secretariat every month with the following details:

(i) name of vessel,

(ii) date of Suez Canal entry,

(iii) maximum declared capacity in TEUs,

(iv) total actual filled slots in TEUs,

(v) non-scope cargo [8] in TEUs lifted,

(vi) percentage utilisation,

(vii) a forecast of capacity for each vessel for the following two months,

(viii) estimated monthly totals for the next four months,

(17) The secretariat was accordingly supplied with details of the previous month's actual liftings as well as a forecast for the next six months' liftings. Each of the EATA parties participated in this exchange of information form its inception in 1992 until May 1997: a number of the EATA parties continued to exchange information until July 1997. CGM ceased to provide the relevant information with effect from October 1994.

(18) The secretariat was also given the task of monitoring compliance with the agreement (Article 20). According to the agreement, the Director-General and staff of the FEFC were to serve as secretary and secretariat of the EATA for the duration of the agreement, unless the parties to the EATA otherwise unanimously agreed (Article 30).

(19) The agreement applied to scheduled international maritime transport services for containerised goods between Northern Europe and Asia via the Suez Canal. For the purposes of the notified agreement, the description 'Asia' excluded Pakistan, Sri Lanka, India and Bangladesh and, for certain purposes, the People's Republic of China (Article 3).

(20) Westbound Trades were not directly concerned by the notified arrangements but the EATA parties acknowledged that it was possible that some effect on capacity and freight rates would also be experienced in that direction as a result of the reorganisation of eastbound services reducing the frequency, size or number of calls of vessels [9].

(21) Article 4 of the agreement stated that nothing in the agreement was to have prevented, limited or otherwise precluded the rights of the parties to set their rates independently. This provision should be considered in the light of the comments concerning market structure (recitals 66 to 79).

(22) Any party could withdraw from the agreement by giving less than 90 days' notice (Article 33(d)). However, notwithstanding such withdrawal, parties remained bound to observe their maximum allowed capacities for a period of up to 12 months unless they ceased to own,

operate or maintain vessels as ocean common carriers (Article 18). Failure to comply with the obligation to observe a maximum allowed capacity potentially resulted in the forfeiture of a financial guarantee and other financial penalties (Article 18). New parties were required to receive the unanimous approval of existing parties (Article 33).

(23) Payments in respect of early withdrawal, exceeding maximum allowed capacities or for failure to provide information were to be paid into a fund and distributed equally between the parties at the end of each year (Article 25). Administrative and other expenses incurred in connection with the EATA were to be paid by the parties to the agreement in equal shares (Article 31).

(24) The EATA was said to be of indefinite duration, to be terminated by all the parties to it once the structural problems the parties considered to exist on the northern Europe/Far East trades had been resolved on a lasting basis ([10]).

III. **Implementation of the agreement**

(25) On 26 November 1992, the parties agreed to limit the amount of capacity each of them offered for supply for the period from 1 January 1993 to 31 March 1993 by between 6,25% and 12,25%, calculated on the basis of a sliding scale so that smaller lines (in terms of those with smaller capacities on the routes in question) reduced the amount they offered to the market by smaller proportions than did the bigger lines. This reduction was set at an initial level of 10% of the capacity offered eastbound by the parties to the EATA.

(26) On 12 March 1993, the parties agreed to limit further the amount of capacity each party to the EATA offered for supply on the northern Europe to the Far East eastbound trades by increasing the percentage reductions for the period 1 April 1993 to 30 June 1993 to between 11% and 17%, also calculated by reference to a sliding scale. The EATA parties claimed that this amounted to an aggregate maximum reduction of 15%.

(27) The same aggregate reduction and sliding scale was maintained for the third quarter of 1993. The maximum aggregate reduction was reduced on 5 October 1993 to 5% for the fourth quarter of 1993, still on the basis of the sliding scale, but on 27 October 1993 was further reduced to zero. Full details of these reductions and the sliding scale are given in Annex II. No reduction was imposed between 27 October 1993 and the date of abandonment of the agreement.

(28) In the second quarter of 1993, five of the EATA parties carried more cargo than permitted under the maximum each had been allocated.

IV. **Capacity non-utilisation agreements in liner shipping**

(29) A 'capacity management programme' is an agreement under which the parties agree not to use a proportion of the space on their vessels for the carriage of goods in a particular trade. The proportion set aside is part of the forecast excess of supply over demand.

(30) The parties agree that this space cannot be used for cargo falling within the geographic scope of the agreement ('scope cargo'), although it may be used for cargo originating from elsewhere and transhipped onto the vessels in the programme ('non-scope cargo'). In this Decision, the expression 'non-utilisation' is used to describe agreement not to use space for scope cargo.

(31) There have been three examples of capacity management programmes: the Trans-Atlantic Agreement (TAA), the Trans-Pacific Stabilisation Agreement and the EATA. Each of these agreements has operated on one of the three main world trade lanes and in each case has been made up not only of the conference members in the trade but also the most important non-conference carriers.

(32) The 15 parties to the Trans-Pacific Stabilisation Agreement ([11]) operated a capacity non-utilisation programme from 1989 to 1995, when it was indefinitely supended. During this period those parties operated some 80% of the available capacity on the trades between Asia and the United States. The extent of the capacity agreed to be set aside varied from 6% to 15%. According to Drewry ([12]), in 1994 this was the equivalent to the artificial withdrawal of the eqivalent annual capacity of seven Panamax container vessels of 4 000 TEU each.

(33) When the parties to the Trans-Pacific Stabilisation Agreement applied to the US Federal Maritime Commission in 1996 to restore the capacity non-utilisation programme, the Federal Maritime Commission launched a detailed investigation following which approval was not forthcoming and in March 1997 the application was withdrawn.

(34) The parties to the Trans-Atlantic Agreement implemented their capacity non-utilisation agreement in August 1994 until September 1994. The agreement was for up to 25% of space not to be used for scope cargo but in practice only around 15% of westbound capacity was withdrawn from sale. On 19 October 1994, the Commission adopted Decision 94/980/EC ([13]) prohibiting the Trans-Atlantic Agreement.

(35) On the Europe/Far East Trades, the members of the FEFC had until 1990 a market-sharing agreement, setting the maximum share of the trade that each member of the conference, or each consortium operating within the conference, could carry. There was no agreement not to use certain capacity.

(36) According to the EATA parties, the share of the FEFC on the north Europe/Far East trades had by 1990 fallen to approximately 59% and the market-sharing agreement was terminated for the principal reason that, 'the parties to it no longer had a sufficient critical mass in the NE/FE trades to regulate reserve capacity in a way that would contribute to the stabilisation of the trades' ([14]).

(37) Drewry has estimated ([15]) that the effect of the EATA in 1993 would over a full year have meant the non-utilisation of some 13 500 TEUs of capacity, the equivalent of around 3,33 4 000 TEU vessels. On the basis of a 63-day round voyage time, each vessel could be expected to undertake 5,8 round voyages per annum. Drewry estimates ([16]) the fixed costs of each round trip for a 4 000 TEU vessel on the Europe/Far East trades in 1996 to be the equivalent of some USD 4,1 million. As Table 1 indicates, the total fixed costs over a 12 month period involved in operating the capacity which the EATA parties agreed not to use would have been in the region of USD 80 million.

Table 1

Estimate of annual fixed costs

Number of vessels	Round voyages	Fixed costs per round voyage	Total cost
3,375	5,8	USD 4,1 million	USD 80,26 million

Source: Drewry, *Global container markets.*

V. **The relevant product market**

(38) The relevant product market for the purpose of considering the EATA is that of scheduled maritime transport services for the transport of containerised cargo from north Europe to the Far East. This includes on the one hand ports in Belgium, Denmark, Finland, Northern France, Germany, Iceland, Ireland, the Netherlands, Norway, Sweden and the United Kingdom, and on the other hand ports in Hong Kong, Japan, North Korea, South Korea, Malaysia, the Philippines, Singapore and Taiwan.

(39) The parties consider that there are a number of substitutable ways of transporting goods from Northern Europe to the Far East.

(i) The first is that provided by specialised vessels which can carry some of the large-volume homogeneous products moving within the general cargo sector.

(ii) The second is provided by ships in the bulk of specialised sectors which can also carry a number of containers.

(iii) The third is said to be air and air-sea combinations for good requiring faster shipment.

(iv) The fourth substitute is the possibility of transporting goods by the trans-Siberian Railway.

(v) The fifth possibility is offered by carriers operating westbound out of north Europe which can also serve the Far East either by using rail-land bridges across the United States, or by transshipping at US west coast ports onto Pacific services (i.e. Europe/US east coast/US west coast/Far East).

(vi) Finally, the parties consider that services from the Mediterranean and Black Sea represent a significant source of competition to the operators on the north Europe to Far East trades.

(40) For the reasons set out below, none of these is considered to form part of the same market as the market for scheduled maritime transport services for the transport of containerised cargo from north Europe to the Far East.

(41) In the Tetra Pak Case ([17]), the Court of Justice of the European Communities stated that the stability of demand for a certain product is a relevant criterion for defining a relevant market and that the fact that different products are, to a marginal extent, interchangeable does not preclude the conclusion that these products belong to separate product markets.

(42) The Commission takes the view that, for the vast majority of categories of goods and users of containerised liner shipping, the other forms of maritime transport, including conventional (break-bulk) liner transport, do not offer a reasonable alternative to containerised transport services on the routes falling within the relevant geographic market in this case and that these services constitute one or more markets in their own right.

(43) The effect of marginal competition from other means of transport for certain categories of goods can be limited. This situation arises because liner shipping companies are able to identify shippers of such goods and, because of the differentiated price structure in liner shipping, offer lower prices to such shippers without necessarily affecting prices generally.

(i) Non-scheduled services

(44) Firstly, scheduled maritime transport, or liner, services constitute a separate market from that of tramp services. On the whole the nature of the relationship between shippers on the one hand and shipping lines is quite different depending on whether the latter is providing liner services or tramp services. Liner services are provided on the basis of the operator being a 'common carrier': that is to say, the transport service provider offers to carry all the goods brought to it for carriage. On the other hand tramp services are usually supplied on the basis of *ad hoc* individually negotiated contracts ([18]).

(45) Charters are only viable for containerisable goods ([19]) provided the shipper has a sufficiently large cargo, or is able to combine with other shippers for each trip. Furthermore, chartering and bulk or specialised services will not as a rule give the frequency, regularity or dependability of service required by many shippers, nor can they provide the door-to-door service often required.

(ii) Bulk services

(46) It is clear that many bulk commodities can be containerised and that before the advent of containerisation (in the late 1950s) all goods travelled bulk of some description or another. In the present case, in order to determine the competitive condition in the relevant market, it is only necessary to consider the effect of substitutability from carriage in container to carriage in bulk: there is no lasting substitution from container to bulk in the vast majority of cases.

(47) Almost all cargo can be containerised and, over time, it is likely that the degree of containerisation in most maritime markets involving Member States will be very high. In mature markets, such as the northern Europe/US or the northern Europe/Far East markets, the process of change toward containerisation is more or less complete and few, if any, non-containerised cargoes are left which are capable of being containerised.

(48) Furthermore, once a type of cargo regularly becomes containerised it is unlikely ever to be transported again as non-containerised cargo. The reasons for this are that shippers become accustomed to shipping in smaller but more frequent quantities and become accustomed to the fact that once cargo has been loaded into a container, it is easier to ship onwards from the port of delivery to the ultimate consignee using multimodal transport.

(49) Thus, as the degree of containerisation increases, shippers of non-containerised cargoes turn towards containerised services but once those shippers have become accustomed to shipping in containers they do not revert to non-containerised shipping. Such examples of one-way substitutability are not uncommon ([20]).

(50) Drewry ([21]) makes a cautious estimate that the containerised share of world general cargo trade has risen from 20,7% in 1980, to 35,1% in 1990, to 41,6% in 1994. Drewry forecasts that by the year 2000, this percentage will rise to 53,8%. The transformation from bulk shipping to containerisation reflects not only a change in the nature of the goods being shipped (essentially from raw materials to manufactured commodities), but also the inherent characteristics of containerised liner shipping.

(51) These characteristics include the following. Smaller more frequent shipments, as is typically the case with container shipping, lead to reduced inventory costs. Containerised goods are less likely to suffer from damage and pilferage. Containerised goods are easier to ship multimodally. For these reasons, once a commodity has made the transformation from bulk to container, possibly on a route-by-route basis, the differences in the nature of the service being provided mean that once that transformation period is over, a shipper is highly unlikely to revert to bulk shipping.

(52) In this context, it is not important that certain commodities may still travel by both means: the essential question for determining demand substitutability is whether the choice of mode is made on the basis of the characteristics of the mode. Thus, the fact that some steel products may travel by bulk and others by container does not show that the two modes are substitutable since it does not take into account the diverse nature (and value) of steel products nor the delivery requirements of customers. The same is true for the other products for which the parties claim substitutability between bulk and containers.

(53) Even to the extent that reefer containers (i.e. refrigerated containers) may be substitutable for bulk reefer services ([22]), for the reasons given above this does not mean that bulk reefer services are substitutable for reefer container services. Apart from the advantages offered by liner container services, such as smaller volumes and speed of transfer to other modes of transport, a wider variety of products can travel in reefer containers than can travel as bulk reefer cargoes. Such products include furs and leathers, pharmaceuticals, electronic goods and, because of the steady temperatures and the ability to control ripening, soft fruits.

(54) On this basis, while it is possible that in exceptional circumstances some substitution may occur between break-bulk and container transport, it has not been demonstrated that there is any lasting substitution from container towards bulk for the vast majority of cases.

(55) On the supply side, the parties have argued that break and neo-break carriers could readily convert their vessels so as to enter into the relevant market and for this reason should be regarded as potential competitors.

(56) In principle, any vessel can carry containers. The effect of potential competition from operators of non-fully containerised vessels could only be material if both of the following two conditions were fulfilled. First, it would have to be shown that suppliers of such services could economically compete with the parties on even terms and second that customers regarded carriage on a non-fully containerised vessel as being functionally interchangeable with carriage on a fully containerised vessel.

(57) In considering whether the first of these cumulative tests is fulfilled, it is essential to note that the characteristics and performance of non-fully containerised vessels are significantly different from those of fully containerised vessels.

'It is crystal clear, and almost implicit in the terminology, that cellular containership capacity is more efficient and more productive than non-cellular space when it comes to carrying unitised (i.e. containerised) cargo, and hence of greater significance as far as the supply/demand balance is concerned. Each slot on a cellular vessel will provide more container carrying capacity in any given year than a slot on a non-cellular vessel, since the cellular ship:

— spends less time in port,

— usually possesses a much higher sea-speed,

— operates on regular lines schedules.

While ro-ros may achieve 80% or more of the productivity of a cellular vessel, a semi-containership or a con-bulker will be considerably less efficient on the grounds of both speed and cargo handling time in port. An overall estimate of the relative productivity ratios for cellular and non-cellular capacity might reasonably be 2:1' ([23]).

(58) Apart from the performance characteristics which militate against supply-side conversion, there are a number of technical characteristics. The first of these is the additional expenditure required to carry containers on vessels which were not specifically built as container vessels. Such costs are both one-off in the sense that chains and fittings have to be purchased (according to Dynamar BV, shipping consultants, at a cost of some ECU 150 per slot) and variable in the sense that the cost of labour is higher for stowing containers on non-container vessels than on container vessels. Account need also to be taken of the additional port costs involved in carrying containers on such vessels due to slower towing times and consequentially longer periods spent in port.

(59) The second reason for which the potential capacity of non-fully containerised vessels is less than the parties assert is the fact that the operators of such vessels do not possess the same fleets of containers as do operators of fully containerised vessels. Typically each of the parties has three containers for every vessel slot it operates. Many operators of breakbulk services will own no containers at all. The significance of this is especially important given that 'the global box inventory has seldom, and certainly not for the last 10 years or more

been sufficient to permit all the nominal containership capacity of the non-cellular fleet to be used' ([24]). This situation is compounded by the fact that the operator of non-fully containerised vessels do not generally possess the same landside facilitites as do operators of full-containerised vessels.

(60) So far as the customers are concerned, the Commission does not accept that the vast majority of customers of the parties would regard carriage on a bulk or neo-bulk vessel as being substitutable for carriage on a fully-containerised vessel. Differences so far as customers are concernded are the absence of scheduled weekly sailings and the fact that in many cases non-fully containerised vessels use different port terminals or berths to the ones used by fully containerised vessels with consequential inefficiencies for multimodal transport operations.

(iii) Air transport services

(61) Air transport services (or combined sea-air transport services) are only appropriate for goods which require faster transport times, the high value of which permits higher transport costs to be incurred.

(62) Given that any shipper is concerned to reduce its transport costs to the necessary minimum, it will only incur the additional expense of air transport services if it is necessary for its goods to be delivered faster than would be possible if they were carried by sea and if the value of the goods is sufficiently high to bear the higher transport costs. In such a case it would not be correct to say that sea transport services were substitutable for air transport services. It should be noted that the vast majority of goods carried eastbound from northern Europe to the Far East (the scope of the EATA) are considered by the EATA parties to be of low value.

(iv) Land transport services

(63) The parties point out in the notification that the trans-Siberian Railway is not an efficient substitute form of transport during the present period of economic and political instability in the Commonwealth of Independent States. It is understood that volumes carried on the trans-Siberian Railway have decreased considerably since the collapse of the Soviet Union. In any event, it is understood that a single 4 000 TEU vessel carries the equivalent of some 50 train loads of approximately 2,4 km in length.

(v) Trans-Pacific services

(64) The parties have furnished no evidence that transshipments at US ports or rail land bridges account for material quantities of goods carried from north Europe to the Far East.

(vi) Mediterranean/Black Sea services

(65) The parties have also argued that services from the Mediterranean and Black Sea represent a significant source of competition to the operators on the north Europe to Far East trades. The parties have failed to give a single example of cargo actually switching from one to the other in either the application for exemption or the Reply to the Statement of Objections. Furthermore, Drewry considers that:

'By turning in the Mediterranean, Europe-Far East ships could save at least two weeks on their average nine-week round voyage time (a 22% increase in vessel productivity), but this seems unlikely in anything like the foreseeable future, given the infrastructural limitations of the southern ports and the Eurpean rail system' ([25]).

VI. **Market structure**

(66) In considering the EATA, it is relevant to consider not only the market shares of the parties to the agreement at the relevant time (as to which see recitals 80 and 81) but also the structure of the market. In particular it is significant that many of the EATA parties were members of the FEFC and that all the parties to the EATA, other than Hyundai, were parties to the Far East Trade Tariff Charges and Surcharges Agreement (FETTCSA). Membership of the EATA parties to each of these agreements is set out in Table 2 ([26]).

Table 2

Market Structure – 1993

	EATA	FETTCSA	FEFC
CGM	yes	yes	yes
Cho Yang	yes	yes	no
DSRA Senator	yes	yes	no
Evergreen	yes	yes	no
Hanjin	yes	yes	no
Hapag-Lloyd	yes	yes	yes
Hyundai	yes	no	no
K Line	yes	yes	yes
Maersk	yes	yes	yes
MISC	yes	yes	yes
MOL	yes	yes	yes
Nedlloyd	yes	yes	yes
NOL	yes	yes	yes
NYK	yes	yes	yes
OOCL	yes	yes	yes
P&OCL	yes	yes	yes
Yangming	yes	yes	no

(i) The Far Eastern Freight Conference (FEFC) ([27])

(67) The FEFC is an association of shipping lines which operate liner shipping services on routes between Europe and the Far East. The FEFC does not itself offer any shipping service or enter into contracts with shippers or other customers. It regulates a number of conditions, including tariffs, on the basis of which its member lines offer their services. The FEFC is used by its member lines as a central body for publishing their decisions and communicating with other relevant organisations, including shippers' councils.

(68) In order to come within the terms of the block exemption for liner conferences ([28]), the members of the FEFC are obliged, according to Article 1(3)(b) of Regulation (EEC) No 4056/86, to operate under uniform or common freight rates.

(69) As can be seen from recital 80, the members of the FEFC had a 58% market share in 1991 for traffic between northern Europe and the Far East. In other words, more than 50% of the relevant market was, in principle, moving between northern Europe and the Far East at uniform or common rates decided upon by the shipping lines constituting the majority of the membership of the EATA.

(ii) The Far East Trade Tariff Charges and Surcharges Agreement (FETTSCA)

(70) The FETTCSA was an agreement dated 5 March 1991 between all the major shipping lines on the Europe/Far East trade (other than Hyundai), including 12 members of the FEFC and six non-conference lines operating in the trades. According to the EATA secretary ([29]), the FETTCSA emerged as a result of discussions by various shipping lines concerning the forerunner to the EATA, the European Stabilisation Agreement (ESA).

(71) The FETTCSA envisaged discussions by the parties for purposes of calculating and setting charges and surcharges other than sea freight and inland freight by the following means:

(i) the establishment or application of uniform rules concerning the structure and the conditions governing the application of transport tariffs, and

(ii) the establishment or application of inclusive rates and conditions for the organisation and execution of successive or supplementary maritime transport operations.

(72) The FETTCSA provided for the parties to exchange views and information regarding any matter within the scope of the agreement as well as for the administration of the agreement.

(73) According to data from the European Shippers' Council (ESC) and the Conseil National des Usagers des Transports (CNUT) ([30]) and accepted by the FETTCSA secretariat ([31]), charges additional to ocean freight such as surcharges often amount to some 35% of the total transport cost to shippers' or as much as 60% of the actual freight rate. The Japan Shippers' Council (JSC) has commented that charges and surcharges are much higher than corresponding expenses and therefore constitute part of the lines' overall revenue.

(74) An agreement which allows competitors to discuss the manner in which prices are set and the elements which are to be included in prices is likely to have an effect on freedom to set prices. It amounts to an attempt to fix price levels and not just methods of calculation and causes those prices to be different from what they would be otherwise.

(75) The parties to the FETTCSA terminated that the agreement following the adoption of a Statement of Objections by the Commission in 1994.

iii) Combined effect of the FEFC, FETTCSA and EATA

(76) The express purpose of the EATA was to allow the parties to it to increase their freight rates (see recital 9 of this Decision). Although some members of the FEFC were not party to the EATA, the system of price-fixing practised by the FEFC and the fact that the most important members of the FEFC were parties to the EATA would have ensured that all members of the FEFC operating within the geographical scope of the EATA would have benefited from rate increases whether or not they were party to the EATA.

(77) The combination of the FEFC and the two agreements between the FEFC and independent shipping companies, the EATA and the FETTSCA, is likely to have had a significant effect on price competition between the members of the FEFC (who charge common or uniform rates and do not therefore compete on price) and the non-conference shipping lines. This is because both the EATA and FETTCSA were likely to have caused prices to be raised in a coordinated manner.

(78) Apart from the direct effect the EATA would have had ou the freight rates of the EATA parties, there is also the possibility that the freight rates of independents which were not party to the EATA would also have been increased as a result of the operation of the agreement. This possibility, which would amount to normal and legitimate commercial behaviour on the part of the non-EATA-shipping lines, arises from the fact that those independent lines take into account the FEFC's tariff ([32]) in setting their prices and the FEFC tariff will itself will have been raised as a result of the operation of the EATA.

(79) The EATA and the FETTCSA contained provisions appointing the Director-General and staff of the FEFC as secretary and secretariat of the respective agreements which are identical in all material respects. Their role of administering the three agreements was likely to reinforce the strong links and increase the exchange of information between the conference members and non-conference members.

VII. **Market shares**

(80) According to EATA estimates supplied to the Commission in the application for exemption (and therefore relating to the period before the EATA came into effect), the EATA parties had a market share of some 86% of all eastbound liner traffic from north Europe to the Far East in 1991. This leaves 14% of the market nominally unaffected by the agreement. The figures include an allowance for traffic carried on the trans-Siberian Railwy. For the reasons given in recital 63, the Commission does not consider that the trans-Siberian Railway forms part of the same market but because of the relatively unimportant quantities (approximately 2%) carried in the manner it has not been considered necessary to adjust the figures applied by the EATA so as to exclude the trans-Siberian Railway.

Table 3

Volumes and market shares 1991

Containerised cargo on liner vessels eastbound Northern Europe to Far East

	TEUs	%
EATA	1 447 000	86
Others	235 000	14
Total	1 682 000	100

Source: EATA.
Note: Figure for 'others' includes trans-siberian Railway.

(81) The EATA parties have estimated that the comparable figures to those given for the EATA parties' market share in 1991 in Table 3 were 83,5% in 1993, 80% in 1994 and 78 % in 1995.

VIII. **Freight rates**

(82) The EATA is not a conference agreement (see recital 180) and has no direct mechanism for agreeing on the implementation of freight-rate increases. However, freight-rate increases announced by the Eastbound Management Agreement (EMA-an operating arm of the FEFC which sets FEFC rates for eastbound services) since the implementation of the EATA were USD 100/200 per TEU/FEU in April 1993 and a further USD 75/100 per TEU/FEU from July 1993. In November 1993, after the reduction in the amount of capacity supplied in the market was reduced to zero, it was announced that the EMA would increase rates by a further USD 150/225 per TEU/FEU with effect from 1 January 1994.

(83) According to Drewry ([33]), average eastbound freight rates on the Europe/Far East trades increased as shown in Table 4.

Table 4

Europe/Far East Average Freight rates 1992 to 1995

Year	USD per TEU	% increase/decrease
1992	625	—
1993	725	+ 16,0
1994	825	+ 13,8
1995	925	+ 12,1

(84) On 7 June 1993, the Member Lines of the Asia Westbound Rate Agreement (AWRA – another operating arm of the FEFC covering the westbound trades to Europe and the west Mediterranean) announced that they had agreed to apply a 'rate restoration' of USD 150/300 per TEU/FEU with effect from 1 July 1993. A rate restoration in this context is understood to mean an agreement to reduce the level of discounts across the board, i.e. it is not an increase in the conference tariff rate (which is known as a general rate increase (GRI)) but an attempt to raise actual prices toward the published rate.

(85) According to the EATA secretary, the EATA parties discussed at their meeting in Paris in March 1993 a proposal to extend the EATA to give the parties authority to discuss rates and this proposal did not lead to any decision but some Members considered that were was merit in pursuing the matter further ([34]).

IX. **Capacity utilisation**

(86) Capacity utilisation on the north Europe/Far East eastbound trades is affected by the fact that deadweight

limitations can reduce a ship's carrying capacity by up to 20 % so that 80 % capacity utilisation represents, for practical purposes, full vessels. It is also affected by the fact that seasonal variations mean that demand is considerably greater in the third and particularly in the fourth quarters of an calendar year than in the first and second quaters ([35]).

(87) These factors mean that volumes and revenues would be lower on eastbound trades than on westbound trades even if the degree of capacity utilisation and freight rates was the same in both directions. Moreover, the fact that demand is significantly higher towards the end of a calendar year means that a degree of under-utilisation of capacity is inevitable in the early part of the year if lines wish to have sufficient capacity to meet demand later in the year. The tendency towards lower revenues on eastbound trades is reinforced by the fact that many goods shipped eastbound from north Europe to the Far East are of lower value than goods being carried in the other direction and are generally more sensitive to transport costs.

(88) Another factor which may help to explain apparently low eastbound revenues is the wish of lines to operate 'near-similar capacity' vessels. In other words lines seek to ensure that each vessel in a string of vessels is of a similar size. The consequence of this is that the overall capacity of a string of vessels is governed not just by the regularity and speed of service desired by the line but also by the fact that vessel size will be determined by the highest level of demand anticipated for any vessel in the string. Thus, for example, capacity put in place to meet demand in November will still be in place in January when demand is likely to have slackened.

(89) A further factor affecting capacity utilisation on the eastbound north Europe/Far East trades is the very significant amount of repositioning of containers which takes place. The repositioning of empty containers from one part of the word to another (or from one region to another) results from the imbalance between trade flows so that, for example, more full containers are carried westbound from Japan than eastbound to Japan: the result is that the excess has to be carried back empty. According to figures supplied to the Commission by the EATA parties, some 18 % of all containers carried eastbound by EATA parties in 1992 (including non-scope cargo) were empty. The corresponding figure for 1991 was 24 %.

(90) The Commission understands that at the relevant time, westbound capacity exceeded eastbound capacity by a considerable degree ([36]) and that this was brought about as a result of reorganisation of services to meet the imbalance between eastbound and westbound demand. This was achieved by offering eastbound round-the-world services using smaller and fewer vessels then westbound round-the-world services.

(91) Table 5 sets out capacity utilisation figures averaged across each of the EATA parties and over the four-year period 1989 to 1992.

Table 5

EATA parties' capacity utilisation 1989 to 1992

(in %)

	Excluding empty containers	Including Empty Containers
Eastbound	74,69	94,39
Westbound	82,60	85,84

Source: EATA. The corresponding figures of the individual lines from which Table 5 has been compiled were annexed to the Statement of Objections.

(92) Cumulative figures for the period January/August 1993 showing eastbound capacity utilisation excluding empty containers show that during this period the EATA parties averaged a utilisation level of 80,2 %. When non-scope cargo was taken into account this figure increased to 83,2 %. The capacity utilisation for August 1993 was 86,3 % (excluding empty containers).

(93) One of the economic advisers to the EATA parties has written that:

'As a general observation, however, conversations with ship operators induce the author to believe that round voyage break-even load factor can vary from 55 to 80 % ...' ([37]).

(94) Furthermore, the increase in both eastbound and westbound capacity available in the four years preceding the implementation of the EATA closely matched the

increase in demand. Table 6 takes as its basis the amount of capacity offered and the volume of cargo carried by the EATA parties eastbound and westbound in 1989. In order to make a comparison with subsequent years each base figure has been converted into 100.

Table 6

Increase in capacity measured against increase in demand 1989 to 1992

	Eastbound		Westbound	
	Supply	Demand	Supply	Demand
1989	100	100	100	100
1990	109	109	107	123
1991	125	127	129	139
1992	157	156	165	163

Source: EATA. The corresponding figures for the individual lines from which Table 6 has been compiled were annexed to the Statement of Objections.

(95) Table 6 demonstates that over the four years 1989 to 1992 taken as a whole capacity eastbound increased at the same rate as demand and that capacity westbound has also grown as a similar rate to the growth of demand. Accordingly it may be deduced from Table 6 that the argument of the EATA parties that eastbound capacity had grown in excess of eastbound demand is not substantiated.

(96) The Commission understands that demand on the eastbound leg was well in advance of expectations for the fourth quarter of 1993 and that as a result the capacity non-utilisation programme of the EATA was 'temporarily' suspended (see recital 27), never to be reintroduced. The assertions of the EATA parties as to the structural nature of the alleged overcapacity on eastbound northern Europe to the Far East services (see recital 24) were accordingly unsubstantiated. In any event, the relevance of these assertions is considered further at recital 227.

(97) Moreover, the assertion that the overcapacity at that time was structural in nature is contradicted by the arguments put forward by the parties in the application for individual exemption. To show that any such overcapacity is structural in nature, the parties would have to demonstrate that it could never in its lifetime be efficiently used. However, the EATA parties argued precisely the opposite:

'Even allowing for the present degree of overcapacity … capacity will have to grow substantially over a 10-year period.'

'Taking a 10 year view, the maritime transport industry will have to meet substantial demands for additional capacity, as well as a certain level of replacement, at high new-building prices' ([38]).

(98) In the light of these comments, which the Commission has no reason to doubt, it is considered that the parties assertions that there existed a structural problem of overcapacity on the northern Europe/Far East trades have not been demonstrated to be well-founded.

(99) Finally, according to Drewry, the supply/demand balance on the north Europe/Far East trades looked as follows in the period 1992 to 1997.

Table 7

North Europe/Far East supply/demand balance

1992 to 1995

(million TEU)

Year	Net capacity eastbound	Demand eastbound	Utilisation eastbound (%)	Capacity westbound	Demand westbound	Utilisation westbound (%)
1992	1,52	1,10	72,4	2,02	1,65	81,7
1993	1,53	1,30	85,0	2,36	1,73	73,3
1994	1,92	1,46	76,0	2,57	1,87	72,8
1995	2,15	1,54	71,6	2,85	2,15	75,4
1996	2,42	1,66	68,6	3,21	2,28	71,0
1997	2,62	1,80	68,7	3,49	2,42	69,3

Source: Drewry, Global container markets.

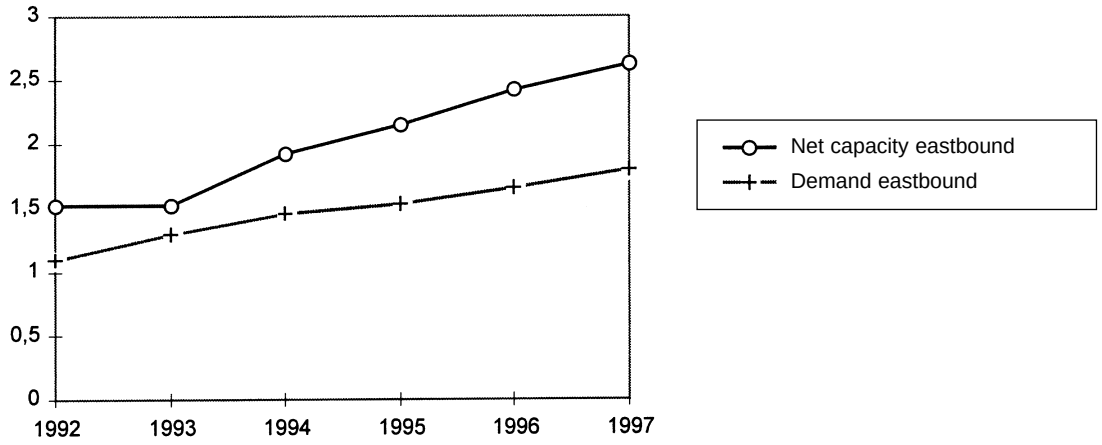
(100) The figures given for demand in Table 7 exclude military traffic and relay/transshipment cargo moved via main trade ports as well as empty containers. They therefore underestimate actual vessel utilisation. The figures given for capacity are calculated after deduction of EATA cap in 1993 and 20 % slot reduction due to deadweight limitations.

(101) Table 7 demonstrates not only continuous eastbound and westbound growth in demand but also demonstrates, as further illustrated in Table 8, that during the period in which the EATA was in operation, the increase in supply easily outstripped demand. Accordingly, in so far as there were any problems of overcapacity, it may be deduced that these would have been caused by the introduction of new capacity and not the existence of overcapacity at the time of implementation of the EATA.

Table 8

North Europe/Far East supply/demand balance

Eastbound 1992 to 1997 (million TEUs)



Source EATA.

(102) Two further conclusions may be drawn. First, there is no obvious reason for the capacity freeze being applied only to eastbound services, that is to say exports from northern Europe. Secondly, there is no reason to believe that the capacity freeze was necessary in 1993 when it was not necessary in 1994 to 1997. Table 9 confirms these conclusions.

Table 9

Capacity utilisation 1993 to 1995

(TEU)

	Eastbound			Westbound		
	1993	1994	1995	1993	1994	1995
Capacity	1 727 330	1 924 900	2 117 100	2 089 720	2 229 140	2 482 270
Empty containers	195 420	137 920	260 110	53 710	71 020	95 850
Available capacity	1 531 910	1 786 980	1 856 990	2 036 010	2 158 120	2 386 420
Demand	1 464 970	1 742 450	1 839 840	1 772 560	1 884 330	2 157 540
Available capacity	1 531 910	1 786 980	1 856 990	2 036 010	2 158 120	2 386 420
Capacity utilisation	96%	98%	99%	87%	87%	90%

Source: EATA.

(103) Table 9 also responds to the argument of the EATA parties that empty containers should not be included in the figures for demand on the grounds that, on the whole, they do not produce revenue. Whatever the merits of this argument, it is indisputably the fact that empty containers reduce the amount of space available on vessels for full containers. Accordingly Table 9 calculates the amount of available capacity by subtracting from the total capacity the number of empty containers carried.

X. **The notion of stability**

(104) A liner shipping conference brings stability to the trades it affects by fixing a uniform tariff which serves as a reference point for the market. Prices set in this way are likely to remain unchanged for a longer period of time than if they are set by individual lines. This reduction in the price fluctuations which would be expected in a normally competitive market may benefit shippers by reducing uncertainly as to future trading conditions ([39]).

(105) The rate stability envisaged by Regulation (EEC) No 4056/86 has the consequential effect of assuring shippers of reliable services. Liner services are by their nature regular in the sense of an evenly spread timetable. Reliable services are those which are of a reasonable quality, such that the shippers goods come to no harm, and are at the same price irrespective of which day and which line is chosen to carry the cargo. Reliability in the supply of transport services is the maintenance over time of a scheduled service, providing shippers with the guarantee of a service suited to their needs.

(106) For these reasons, the customers of the members of liner shipping conferences are considered to obtain a fair share of the benefits arising from the restrictions of competition brought about by liner shipping conferences. Therefore, provided they remain subject to effective competition, agreement between the members of a liner shipping conference as to the rates they charge benefits from group exemption.

(107) However, the EATA parties rely on the thesis that the liner shipping market is so different from all other markets for goods and services that it must be exempt from the normal rules of competition which apply to those other markets. They argue that, 'a competitive equilibrium does not exist in liner shipping' and that 'if a competitive equilibrium does not exist, attempts to attain it via competition policy will be in vain' ([40]).

(108) The EATA parties would like the notion of stability to amount to the assurance that any particular shipping line on any particular trade should be guaranteed sufficient on its capital that its owners should not be tempted to invest that capital elsewhere.

(109) Their main argument is that since the liner shipping industry has considerable fixed but avoidable costs, the existence of reserve capacity gives rise to short-run price competition at levels close to marginal cost, resulting in the withdrawal of capacity as operators either move their vessels to more profitable trades or go bankrupt. In theory ([41]), this could lead to a shortage of capacity which would cause a large increase in prices drawing in

new capacity and operators into the market. Capacity would then increase until an adequate level of reserve capacity was reached (a level necessary for the provision of reliable services) and the cycle would begin again.

(110) These potentially large fluctuations in price and available capacity are a form of market failure: the market is inherently unstable. In order to break out of that cycle, strict price discipline is necessary, preventing lines from offering services at levels which the advocates of this thesis regard as too low (that is to say, 'destructive price competition'). That, in their view, is recognised by Regulation (EEC) No 4056/86, which grants exemption for certain price-fixing activities of liner conferences.

(111) Moreover, simple price-fixing is not sufficient; additional measures such as capacity non-utilisation agreements are necessary in order to limit the volume of goods which each line is allowed to transport, so as to eliminate the temptation for lines to transport additional goods at a price close to marginal cost. Such measures, they say, do not give conferences the power to raise prices as much as they wish since supra-competitive prices would draw hitherto potential competitors into the market.

(112) This analysis is an instance of the arguments made in many competition cases by cartel members seeking to draw a distinction between 'fair' and 'destructive' competition ([42]). In fact, most of the factors relied on in support of the thesis that there is no equilibrium in the liner shipping market are not peculiar to liner shipping. The existence of reserve capacity is common to most capital-intensive industries, where there are large sunk costs but marginal variable costs of production are low. In certain circumstances, there is an incentive to lower prices in order to increase turnover, by means of an increase in volume.

(113) The arguments of those who put forward the thesis of inherent instability are based on two very controversial theories which Pirrong ([43]), Sjostrom and Davies ([44]) in particular have sought to apply to sea transport; the core theory and the theory of contestable markets. The hypotheses necessary for the application of these theoretical models (the presence of fixed but avoidable costs, the impossibility of adjusting capacity in accordance with demand and suicidal conduct of shipowners in setting their own prices) appear unrealistic to most commentators. It is thus hardly surprising that the work of the economists who apply these heterodox theoretical models has not been accepted by most analysts of sea transport ([45]).

(i) The core theory and the theory of contestable markets

(114) According to the core theory ([46]), the maintenance of adequate reserve capacity in order to provide regular and reliable service in spite of demand fluctuations can lead shipowners to forget the *raison d'être* of the reserve capacity (which ought to remain unused unless there is an exceptional increase in demand at constant prices, for example seasonal demand), so that they decide to lower their prices in order to fill their reserve capacity by attracting additional customers. Such a commercial strategy aims at maximising the use of ships.

(115) The decision to lower rates leads other shipowners to enter into a price war which leads to very low price levels, close to or at the short-run marginal cost of transporting an additional container of cargo, since shipowners are not able quickly to adapt capacity to demand. It is in this way that the cycle of excessive swings in prices and service quality described above begins, and this constitutes the inherent instability of the industry.

(116) Without going into the question whether the core theory is anything more than a theory without application, it is clear in any event that the hypotheses which underlie the core theory are not applicable to the liner shipping industry.

(117) First, the concept of reserve capacity corresponds to the problem of the indivisibility of factors of production in regular transport services ([47]). Thus, from the point of view of the individual shipping line, the capacity costs of ships are common costs to all cargo carried and cannot be allocated to individual consignments. They are therefore not included in the calculation of what a particular freight rate should be and the charging floor becomes the direct handling costs. The view that capacity costs cannot be allocated is made more complicated by price discrimination between commodities with the result that one commodity may pay five times as much as another for the same service.

(118) However, as Jansson and Schneerson point out, there is a general problem of part-load transport markets, both for passengers and freight where, if part-loads are relatively small (for example a single container on a

cargo liner), a problem of indivisibility may arise leading to the conclusion that the capacity cost should not be included in the marginal cost. The extent that this ever has been a problem, it is clear that the means to minimise its negative effect on profitability now exist and are well understood by the liner shipping industry. The definition of reasonable prices at the margin is generally achieved by the use of the principles of 'yield management' which are well known in the fixing of air fares. Today, the main shipping lines use these principles of marginal pricing in order to avoid any pollution of their normal rates by sales at the margin ([48]).

(119) The 1991 Drewry report ([49]) pointed out that prices at the level of marginal variable cost would be in the vicinty of USD 20 to 400 per 40-foot container (depending on whether equipment was owned or leased), which is well below any rate recorded at the time. The analysis in the Drewry report shows the absurdity of the idea put forward the proponents of the destructive competition theory that certain occasional rates on marginal shipments (at a level approaching marginal variable cost) will contaminate all rates. Shipping lines, like other businesses, realise the impossibility of making a profit on their operations by offering rates which on average are lower than average total cost.

(120) Secondly, the hypothesis of capacity fluctuation is essential to the application of the core theory. However, it is inconsistent with the existence of large sunk investments on the part of the shipping lines. Investment in, for example, container ships for each service, port and terminal facilities, and the sales and administrative structures necessary to build up a satisfactory customer base cannot be realised withour loss if a line suddenly decides to withdraw from a route. Since withdrawal from a route normally takes place at a time of difficulty, the line must expect to sell its assets at very low second-hand prices.

(121) The collapse of US Line in 1986 is a signal example of sunk costs in ships. It has been estimated that about 40 % to 50 % of the residual value of investments was not recovered in that case ([50]). The investments are so large that lines have no interest in withdrawing from a market as soon as prices start to slide. Consequently, potential competitors must also expect a vigorous reaction from lines already on the market in the event of any change in the competitive structure of the trade. Accordingly, the existence of significant sunk costs limits the risk of hit and run entry predicted by the core theory.

(122) Thirdly, the core theory suggests that the withdrawal of capacity results in a diminution of service quality (frequency and capacity), then a price rise which draws new competitors into the market. This hypothesis reflects the view that the services and capacities operated by lines on the market are rigidly defined, with no flexibility for adaption to demand. This hypothesis corresponds to an incorrect view of the stability of services, according to which the stability of transport means the protection of all existing services and requires protection against all competition, which is considered destructive. Such a hypothesis does not correspond to the circumstances of the main liner routes.

(123) For the above reasons, the Commission does not accept that the core theory is applicable to the study of the liner shipping industry. Moreover, in addition to the fact that the core theory does not provide a satisfactory theoretical framework, it should be observed that the specialists of that theory are not able to propose specific solutions. Dr Pirrong ([51]) states 'Other forms of institutions may also rectify empty core problems. These include monopoly, long-term contracts and vertical integration'.

(124) Accordingly, a commercial strategy based on a differentiation of service quality according to the client and the conclusion of individual service contracts makes it possible to resolve any problem of 'inherent instability' in the industry. Since these commercial strategies are well-known to shipping lines, it must be concluded that the core theory, even if it were applicable, provides no justification for cartels.

(125) Shipowners also reply on the theory of contestable markets in order to argue that the existence of potential competition guarantees efficient services at competitive prices. The threat of the sudden entry of competitors subjects the lines present on the market to certain constraints of efficiency. The applicability of this theory to liner shipping is, however, disputed by many economists ([52]).

(126) In addition to the existence of significant sunk costs which limit profitable entry to the market, it should be

observed that a condition of the applicability of the theory of the contestable market is that there should be no entry or withdrawal, the threat of potential competition being sufficient. According to the contestability theory, it is only if potenial competition does not exert any real competitive pressure that high prices or supply-side inefficiencies may arise and attract new entrants hoping to profit from these inefficiencies.

(127) Jankowski has pointed out that a large number of incidents of entry and exit from the market, most of which are unprofitable and result in failure, suggests a lack of contestability of the market. In his 1986 study ([53]), Dr Davies argued that liner trade between Europe and Canada was contestable precisely because of the number of entries observed; he did not, however, investigate the profitability of these movements. The conclusions of Dr Davies concerning the contestability of the market are therefore questionable.

(128) It should be added that most if not all of the incidents of entry and withdrawal observed by Dr Davies concerned the redeployment of ships by lines present on neighbouring trades. No analysis of these redeployments was done in order to determine whether these were in fact hit-and-run entries.

(129) The concept of mobility and flexibility in the positioning of ships is accepted by most specialists and by shipowners themselves ([54]). The observations of Dr Davies concerning entry to and exit from the Europe-Canada trade also support the idea of flexibility in redeployment of ships rather than any real contestability of the market:

'All the above analyses of entry and exit have been made on the basis of services creation or extinction, not of companies. The movement of vessels by a firm from one trade to another must give rise to the exit and entry of a service — something which in itself will influence the competitive environment in each trade – but it may not alter the number of companies involved in the wider market environment. [Table 4] shows the turnover of companies supplying the liner services on Canadian trades, but again the same problems arise: a company that is new to Canada may not be new to the rest of the world, and an exit from Canada may imply not a death but a movement to a non-Canadian route. Indeed, of the 49 exits listed in Table 4, only six were caused by the complete bankruptcy of the company involved: the remainder were brought about by a service movement or, in the case of the further six, by take-over or merger (Abbott et al. 1984). Similarly, almost all the 60 firms which were new to Canadian trades over the period were not newly established but existing foreign corporations that were redeploying their tonnage, presumably in response to perceived profit opportunities' ([55]).

(130) In his Tarporley lecture, Professor Gilman has also criticised the idea of contestability and the idea of inherent instability on the main world routes in the following terms:

'However, one does not actually need empirical evidence relating to losses in individual cases to criticise the idea of low sunk costs. The basic argument comes down to a question of industry structure as this controls relationships between markets. The mainstream trades consist of three large markets, the Atlantic, the Pacific and the Europe/Far East route. The availability of capacity for entry, and the level of sunk costs related to exit, from any one of these, will clearly depend on conditions on the other two. If the three routes were in anything like equilibrium, the capacity simply would not be available for the instant and total replacement of the incumbents in any other market. As ships began to move out of the other two, rates would go up, the extent depending upon demand elasticities, and the process would quickly come to a stop. So even in the complete absence of barriers to entry and exit, the market would not be contested to the extent of total replacement.

Very large scale entry via newbuildings would also be quite impossible. To replace all of the ships on the Europe Far East route for example would cost in excess of USD 10 billion. And from the decision to build to the full capacity coming on stream would take up to five years on an optimistic view. Ship prices would also escalate, (which would mean that the potential new entrants could not obtain their ships at the price paid by the incumbents) and the attempt to build on this scale would set in train a major disequilibrium in the world shipping industry.

Concentration in global ownership of large containerships also affect to the possibility of entry. The

world fleet is dominated by some 20 very large carriers, many of whom operate on two, or even three, of all mainstream routes, so they basically count as incumbents. The trend over the last two decades has been towards concentration and this expected by many to continue over the next 10 years. New entry into this big league is likely to be quite limited, and the pool of potential new entrants is very small indeed.

Turning to exit, opportunities even for limited redeployment of vessels would depend on market conditions in the sector targeted. If one of the three mainstream routes were over-tonnaged and the other two were strong, there would be opportunities to redeploy some vessels. However, if all routes were suffering the effect of world recession then opportunities would rather be limited. The point here is that, to the extent that markets are affected by a common set of influences, there will be relatively easy exit (for a moderate number of vessels) when market conditions are strong, and much more difficult exit when markets are weak. Thus relative ease of exit is most likely to be available when it is least likely to be of value. Very large scale redeployment would be impossible, and the surplus capacity involved would have to go into lay up.

It is clear from the above analysis that there are a number of implicit assumptions about the structure and performance of a set of related markets, behind the idea of a single market is small relative to size of the industry as whole, the second that the global set of markets is operating profitably, and the third that the ownership structure is diverse enough to provide a pool of potential new entrants. It is only in these circumstances that capacity sufficient to replace that of incumbents could quickly and easily be found and could equally be easily reabsorbed should the incumbents retaliate. For individual liner markets, like the mainstream sectors, which are large relative to global industry size, one cannot very easily envisage a low level of sunk cost except for modest incursions. To come back to current realities, incursions, of moderate scale in a market in which there is no ease of exit can result in ferocious competition, particularly as transport capacity is a perishable commodity.

Physical mobility of assets is directly related to economic mobility in some cases, including that of the transport industries. But it does not guarantee a low level of sunk costs. In other cases output is transportable, and the assets can quite happily stay in one place. A manufacturing company in a single location, but with a diversified strategy which enables it to cover a range of world markets, might well be able to switch its output (and therefore the deployment of much of its fixed capital) between markets, with ease, without moving it an inch'.

(131) Even this analysis of the contestability understates the distinction between the mobility of vessels and the contestability of markets. This is because maritime companies offering multimodal transport services need to make on-shore investments in such areas as management and marketing. Such assets are considerably less mobile than vessels, if at all. In any event the sunk costs of relocating or terminating management and marketing functions can be considerable.

(132) The economic analysis of liner transport is thus a complex area of study. The present discussion leads to the conclusion that arrangements between shipping lines on rates (conferences) or capacity (consortia), or in cartels which are even more restrictive of competition, in particular those which combine rate fixing with capacity management, cannot be analysed solely and simplistically on the basis of the core theory or the contestable market theory.

(ii) Destructive competition

(133) Certain shipowners distinguish between two types of destructive competition: type A, which can exist in industries with certain characteristics, including marginal costs well below average costs, excess or unused capacity, and the presence of sunk costs; and type B, which can exist in a situation where there is no competitive equilibrium, such as that described by the core or contestable market theories.

(134) The foregoing discussion has shown that the conditions required for type B destructive competition are not met, *inter alia* because of the presence of sunk costs and the absence of profitable hit and run entries. As for type A destructive competition, Professor Yarrow (an economic adviser for the EATA parties) accepts that it does not require particular measures as regards the application of the rules of competition, in part because:

'Most economists with a specialism in competition policy, myself included, would not, however, regard such an outcome as itself a sufficient argument for exemption of price agreements from the general provisions of competition law. A central reason for this is that, while firms may suffer protracted accounting losses, customers benefit more than firms suffer: it is economically efficient for prices to be lower than average costs in circumstances of excess capacity'.

(135) Consequently, it is impossible to distinguish that situation of 'destructive competition' from normal competition. Furthermore, the theories of inherent instability disregard certain characteristics which run counter to them. For example, the possibility of redeploying ships on the main world routes as described by Professor Gilman allows supply to adapt itself to considerable fluctuations in demand in order to avoid prolonged overcapacity and find a balance between supply and demand. Dr Reitzes summed up the situation in the 1989 US Federal Trade Commission report as follows:

'Ocean liner markets fail to exhibit the high market-specific sunk costs (as opposed to firm-specific sunk investments) that are a key condition of destructive competition (there is also little evidence in support of the proposition that shipping markets are unsustainable natural monopolies vulnerable to inefficient small-scale entry). None of the empirical studies of this industry has been performed at a sufficient level of sophistication to generate useful insights into this issue. For an illustration of how this might be approached, see Evans and Heckman (1984). Ships are mobile assets that, in some circumstances, may be transferred from less profitable geographic markets in response to fluctuations in demand. The FMC report notes that carriers in certain regional markets can easily alter their port call patterns in response to changing market conditions (FMC-report, p. 165). Furthermore, carriers and shippers can negotiate long-term contracts to minimise the risks associated with uncertain demand and supply conditions (while the theory of the core stresses 'avoidable costs' rather than sunk costs, the difference does not appear important in this case). Because ships are mobile assets, and because long-term contracting is available, ocean carriers have latitude in deciding where and whether to operate their ships. That latitude suggests that carriers will operate their ships on routes least burdened by excess capacity, making destructive competition unlikely'.

(136) The achievement of a balance between supply and demand through the operation of the market ensures that the interests of transport users will be taken into account in the determination of service levels and in maintaining rate stability. If however, cartel agreements make the supply of transport services more rigid, the interests of users, the efficienty of services and the stability of rates are endangered. E. Benathan and A. Walters gave the following conclusion in their first study on cooperation in the liner shipping industry:

'Pooling, as practised in the shipping industry for example, is generally regarded, however, as the most anticompetitive form of cartel organisation. Our findings are consistent with this view in so far as competitive pricing is concerned. Since it is more flexible than quota regimes, revenue pooling should give greater stability to cartels. It allows a fuller and more continuous exploitation of profit opportunities by the cartel as a whole. Hence it may avoid the disruptive crises of the more rigid quota system. If, on the other hand, a cartel is to be permitted (as in the case of shipping cartels in most maritime countries) then pooling does permit a better allocation of traffic within the cartel. It allows the expansion of efficient low-cost firms in the cartel, and promotes the contraction of the inefficient ones. It should, therefore, be less inimical to technical progress in the liner trade than simple quota systems' ([56]).

(137) Consequently, where the adaption of supply of services and rates to demand is prevented by cartel agreements, in particular stabilisation agreements involving a freeze on capacity use and the imposition of artificial rate discipline, the stability and efficiency of services, and thus the interests of users, are endangered. In such circumstances the offer of capacity to the market may be reduced artificially by a partial freeze of capacity use which may lead to large rate increases or at least to the maintaince of an artifical rate level which does not encourage the elimination of less efficient services and any excess capacities (that is to say, capacity in excess of a reasonable reserve which is necessary in order to provide a service which corresponds to users' needs).

(138) In relation to 'stabilisation agreements' including a freeze on the use of part of capacity, the 1991 Drewry report ([57]) made the following remarks:

'Sub-optimal utilisation need not, of itself, be synonymous with low profitability provided that rates are kept as reasonable levels and costs are contained. Indeed the structural inevitability of over-tonnaging in an open, competitive trade will almost certainly produce a "demand gap ratio" of between 15 % and 35 %. Clearly, an acceptable level of profitability is more likely if that gap is nearer 15 % than 35 % but, given some form of trade organisation (whether it be a conference or a stabilisation agreement) to regulate capacity and/or rates, the market can be manipulated at any reasonable level of demand gap ratio'.

(139) The main risk in restrictive cartel agreements is that competition between transporters will be limited to competition on service quality. The lines present on the trade will then be drawn into a race to operate more and more ships of larger and larger capacity (the Averch-Johnson effect). The Problem of monopoly-induced waste is considered by Scherer and Ross ([58]):

'Price-fixing agreements, tacit oligopolistic collusion, and monopoly pricing can also stimulate the wasteful accumulation of excess capacity. There are four main mechanisms.

First, offering ample reserve capacity provides another kind of non-price rivalry advantage, for example, as travellers patronise airlines with the most flights and seats available at the last moment, or as industrial buyers favour suppliers who were able to meet their demands in unusually tight gray markets. Second, when cartel sales quotas are allocated in proportion to capacity, as they were under the US crude oil prorationing system until the early 1970s, investment in excess capacity to get a higher quota is encouraged. Third, excess capacity may be carried to strengthen the credibility of a monopolistic group's entry deterrent. And fourth, monopolistic pricing cushions the survival of capacity in secularly declining industries.

There is reason to believe that the relationship between monopoly power and certain of these propensities is non-linear. Thus, ocean shipping cartels that perfected their monopoly controls through controls over entry, investment, and scheduling were less prone toward costly excess capacity or "overtonnaging" than the losser "open" cartels serving US routes'.

(140) As an illustration of this phenomenon, the 1991 Drewry report ([59]) has described in the following manner the history of trans-Atlantic trade in the 1980s:

'All the conference lines operate on a seven-day schedule in all of their various services, and this frequency is matched by all the leading independents, leaving only some of the smaller operators with lower quality schedules. In 1987 exactly half of the 46 separate services were operated at seven-day intervals, so there has been a major advance in the quality of service generally being provided. This suggests it is becoming increasingly difficult for less frequent services to secure acceptance in the market'.

(141) Such an increase in capacity, which is logically accompanied by a decline in rates, cannot continue without an increase in rates to make up for the increase in product costs. Supply moves further and further away from the point of equilibrium and users pay for this race towards service quality through rates which are higher than they wish. The cycle continues until the point where market forces cannot be resisted. A return to commercial reality on the trade then causes an abrupt adjustment in rates which may cause carriers to leave the market and affect the supply of capacity. The cycle is clearly a source of instability for the market. It is not however, a problem of inherent instability or empty core, but simply the consequence of the disturbance of normal market conditions as a result of the misuse of the market power held by the shipping lines cartel ([60]).

(142) Furthermore, the solutions put forward in Regulation (EEC) 4056/86 to bring about the stability recognised

by that Regulation, that is to say rate stability, are not and were never intended to deal with any problems brought about by liner shipping operators as a result of uneconomic investment decisions.

XI. **Complaints**

(143) The British Shippers' Council (BSC) wrote to the Commission on 20 April 1993 to express its serious concern that the EATA would create the conditions to enable the EATA parties to eliminate all effective competition in the market. The BSC stressed its concern that the impact of the EATA, in combination with the impact of the Trans-Atlantic Agreement, would be to harm European exporters in their two major exporting markets, namely the United States and the Far East.

(144) The BSC also stressed that the objective of the EATA, being to maintain control over prices and capacity arrangements in the market, did not fulfil the conditions of Articel 85(3) of the Treaty since the Agreement was not in the interests of users and did not provide any service or economic benefits to consumers. The BSC urged the Commission to reject the EATA's application for exemption.

(145) The French Conseil National des Usagers des Transports (CNUT) wrote to the Commission on 27 April 1993 to state its view that the EATA did not fulfil the conditions of Article 85(3) for the following reasons:

(a) the purpose of the EATA was not to achieve stability but to restrict competition between the conference members and the independents,

(b) the EATA did not aim to bring about a lasting reduction in capacity and the non-utilisation of capacity meant that shippers would continue to have to meet the costs of all capacity, and

(c) users would not benefit from the EATA but would face rate increases which would harm their ability to export.

(146) The European Shippers' Council (ESC) wrote to the Commission on 28 April 1993 to express its concerns about the EATA. The ESC stated its view that in the case of the EATA, none of the four conditions of Article 85(3) was satisfied. It stressed that the fact that many of the parties to the EATA were members of the FEFC was of major significance. The result of this was that rate increases put into effect by the FEFC would be followed not only by the EATA parties who are not members of the FEFC but also by other parties such as non-vessel operating common carriers.

(147) The Japan Shippers' Council (JSC) wrote to the Commission on 25 May 1993 to express its concern that the EATA would lessen competition at the expense of shippers and consumers. The reason given by the JSC for this view was that a capacity control agreement between parties with an 85 % market share (see recital 80 of this Decision) would lead to excessive price rises. The JSC also expressed concern that a decrease in eastbound capacity would lead to a resulting decrease in westbound capacity. The JSC also stated that since Japanese shippers are still subject to strict loyalty contracts binding them to use conference carriers exclusively ([61]) and are therefore unable to use independent shipping lines, any restrictions on westbound capacity would affect them acutely.

LEGAL ANALYSIS

XII. **Article 85(1)**

(i) Restriction of competition

(148) For the reasons set out below, the Commission considers that the provisions of the EATA relating to capacity non-utilisation and the exchange of information fell within the scope of Article 85(1) of the Treaty.

(149) The agreement relating to the non-utilisation of capacity (as described in recitals 8 to 24 of this Decision) and the exchange of information concluded between the parties to the EATA in respect of their maritime transport activities was an agreement between undertakings within the meaning of Article 85(1) of the Treaty.

(150) The purpose of the EATA was to reduce price competition between the parties to the EATA by artificially limiting the liner shipping capacity made available to shippers wishing to have goods transported from north Europe to the Far East. The EATA parties acknowledge that the effect of the EATA was 'to arrest the rate of decline in average freight revenue' ([62]).

(151) The EATA had as its object or effect the prevention, restriction or distortion of competition because it allowed the limitation or control of production within the meaning of Article 85(1)(b). In particular it allowed the members of the EATA to restrict substantially the competitive capacity of each one of them vis-à-vis the others by limiting the volume that each one offered to the market. Because of the relationship between supply and price, the EATA also had an effect on prices.

(152) The very high market shares of the parties to the EATA (some 86 % in 1991, see recital 80 of this Decision) meant that such prevention, restriction or distortion of competition was likely to have been appreciable. The restrictive effect of the EATA was likely to have been reinforced by the provision for financial sanctions against lines which carried greater volumes of cargo than they were allowed under the term of the EATA (see recitals 12 and 28 of this Decision).

(153) The EATA must also be considered in the light of comments made concerning market structure (see recitals 66 to 79 of this Decision). That is to say, the EATA cannot be considered without also taking into account the restrictions of competition which resulted from the FEFC (the purpose of the FEFC being to maintain or increase tariffs to a level higher than they would otherwise be) and which resulted from the FETTSCA whilst it was in force.

(154) Moreover, every month the EATA secretariat supplied the EATA parties, through the Market Review Committee, which was made up of representatives of the individual lines, with the following information:

(i) maximum declared capacity in TEUs,

(ii) total actual filled slots in TEUs (on a monthly basis),

(iii) non-scope cargo in TEUs lifted,

(iv) percentage utilisation,

(v) forecast of capacity for each vessel for the following two months,

(vi) estimated monthly total for the next four months.

(155) Each of the EATA parties participated in this exchange of information from its inception in 1992 until May 1997: a number of the EATA parties continued to exchange information until July 1997. The information exchanged was not aggregated but clearly stated to which EATA party it related. Thus, every month for five years each EATA party learned exact details of its principal competitors' actual liftings of scope and non-scope cargo, their capacity, their level of capacity utilisation as well as their forecasts of non-scope cargo and capacity. The supply of this information would have ensured compliance with any decision on capacity non-utilisation.

(156) During the course of the administrative procedure in this case, the EATA parties claimed confidentiality vis-à-vis the complainants and other third parties in respect of their individual levels of capacity and capacity utilisation. It is clear that the reason for this was that they did not wish their customers to have access to information which was of a commercially sensitive nature with the potential to have an effect on prices. Information which is commercially sensitive vis-à-vis customers is also likely to be commercially sensitive vis-à-vis competitors. The sensitive nature of the information confirms the anticompetitive context in which the exchange took place.

(ii) Effect on trade between Member States

(157) The EATA parties argued in their application for individual exemption ([63]) that it was 'wholly improbable' that the EATA would have any appreciable effect on trade between the Community and the third countries covered by the relevant trades because of the insignificance of increases in freight rates in comparison with the overall delivered price in the third countries concerned of the goods carried.

(158) The EATA parties also consider that 'it is axiomatic that any effect on trade between Member States, on the one hand, and a third state, on the other, is not an effect on trade between Member States for the purposes of Article 85(1) and must therefore be disregarded for the present purpose' ([64]). They concluded that the EATA consequently fell wholly outside the scope of Article 85(1).

(159) According to the case-law of the Court of Justice, the test of effect on trade between Member States is met whenever it is possible to foresee with a sufficient degree of probability, on the basis of a set of objective factors of law or fact, that the agreement or concerted practice in question may have an influence, direct or indirect, actual or potential, on the pattern of trade in goods or services between Member States ([65]).

(160) It is not necessary to make a finding that inter-State trade is actually being affected at the present time. The condition concerning the effect on trade must be deemed to the fulfilled where it is established that intra-Community trade has actually been affected or that it is potentially affected to a significant degree ([66]).

(161) In considering whether the EATA was capable of affecting trade between Member States, it must be emphasised that the relevant markets which were directly affected relate to the provision of transport and intermediary services and not the export of goods to third countries ([67]).

(162) It is well established that arrangements to share markets or to set prices (including target prices) or allocate quotas between firms from different Member States has an effect on inter-State trade because such agreements, in addition to affecting the structure of competition in the Community, establish a form of private regulation that runs counter to the Treaty's objective of eliminating customs duties, quantitative restrictions on imports and exports and all other measures having equivalent effect ([68]). An effect on inter-State trade may be established when an agreement has the effect of partitioning national markets within the common market ([69]).

(163) The EATA parties make the argument in the Reply to the Statement of Objections (Annex 12 at paragraph 6) that, because Regulation (EEC) No 4056/86 does not apply to inland transport, the services offered by the EATA parties do not concern goods physically passing between Member States. This argument is wrong since it confuses the legal question with the factual question of whether a reduction in competition between undertakings in different countries is likely to affect trade between Member States.

(164) The Commission considers that the EATA was capable of appreciably affecting trade between Member States in the following ways.

(165) The EATA involved shipping lines operating in at least seven Member States and restricted competition between such lines in respect of the services each of them offered and the price charged. The restrictions placed on the use of capacity were restrictions on the service offered and were put in the place for the purpose of reducing price competition.

(166) The elimination or diminution of price and service competition between these companies was likely to reduce significantly the advantages which would accrue to the more efficient of them. This was likely to affect in turn the normal pattern of losses and gains of market share which would have been expected in the absence of the EATA. This restriction of competition between shipowners operating in many Member States consequently influenced and altered trade flows in transport services within the Community, which would have been different in the absence of the EATA.

(167) These changes in the normal pattern of competitive behaviour by which more efficient companies are likely to enjoy increases in market share may also have influenced competition between ports in different Member States, by artificially extending or diminishing their catchment areas ([70]), and the market shares of shipping lines operating out of those ports. In particular, shipping lines operating out of more efficient ports would have been unable to pass on to their customers cost savings resulting from improvements made in port efficiency. The effect that the EATA had on the normal play of competitive forces may also have changed the capacity available at each port and caused deflections of trade between points in Europe and ports in northern Europe from some ports to other ports, thereby being capable of having affected trade between Member States.

(168) The effect on the supply of maritime transport services described in the preceding paragraphs is likely to have had a consequential effect on the supply of services ancillary to the supply of maritime transport services. Such services include the services of freight forwarders, port services, land transport services, and stevedoring services. The effect on these services would principally have been brought about by the alteration in the flow of transport services between Member States.

(169) The Commission thus considers that the EATA affected trade between Member States in relation to the supply of maritime transport services and the supply of services ancillary to the supply of maritime transport services.

(170) By limiting the capacity offered by each party to the EATA in the eastbound direction and by intending to maintain or increase freight rates, the EATA may have reduced (or restrained increases in) the flow of traffic between Europe and the Far East and by doing so may have affected trade between the Member States. This arose in part from the fact that some products exported form northern Europe to the Far East are especially sensitive to increases in freight rates and also in part

from the very high market shares of the EATA parties which reduced the availability of competing transport services.

(171) Where there are goods which would have been exported from a Member State to a third country in the absence of the EATA but which, as a result of increased transport prices, were sold from that Member State into other Member States, the competitive position of intra-Community exporters already selling their goods in those other Member States may have been affected.

(172) Accordingly the restrictions concerning transport services had an indirect effect on trade in goods between Member States. This effect was likely to have been particularly noticeable in those Member States where the EATA parties had an especially high market share.

(173) It has been held that a cartel agreement which fixed the price of a semi-finished product (eau de vie) which was not itself normally exported but which constituted the raw material of another product which was exported throughout the Community did affect trade the finished goods between Member States ([71]). The Commission considers that an agreement such as the EATA which was intended to affect the price of transport services for exported goods may likewise have affected trade in those goods between Member States.

(174) This is in line with the judgment of the Court of Justice in the Commercial Solvents case where it was pointed out that the expression in Article 86 of the Treaty containing the requirement to demonstrate an effect on trade between Member States:

'… is intended to define the sphere of application of Community rules in relation to national laws. It cannot therefore be interpreted as limiting the field of application of the prohibition which it contains to industrial and commercial activities supplying the Member States' ([72]).

(175) The Commission therefore considers that the EATA also had an indirect effect on trade in goods between Member States since it may have had an effect on goods exported from Member States to third countries.

(iii) Conclusion in relation to Article 85(1)

(176) The agreement relating to the non-utilisation of capacity and the exchange of information between the parties to the EATA in respect of their maritime transport activities was an agreement which restricted competition within the meaning of Article 85(1) of the Treaty.

XIII. **Article 85(3)**

(i) Article 3 of Regulation (EEC) 4056/86

(177) Article 3 of Regulation (EEC) No 4056/86 grants exemption from the prohibition in Article 85(1) of the Treaty to the members of a liner conference in respect of the fixing of uniform or common freight rates and any other agreed conditions with respect to the provision of scheduled maritime transport services. It also grants exemption to a limited number of other activities if one or more of these is carried on by the members of a liner conference in addition to fixing prices and conditions of carriage for maritime transport services.

(178) In the Decision on the Trans-Atlantic Agreement ([73]), the Commission explained that the regulation of capacity within the meaning of Article 3(d) of Regulation (EEC) No 4056/86 has always been understood to allow:

'(i) capacity adjustments to facilitate the organisation of conference members' sailings and calls, in order to improve the regularity, reliability and frequency of services to all the ports served, and

(ii) capacity adjustments to take account of seasonal (or short-term) fluctuations in demand …'.

(179) The Commission added that:

'Capacity regulation is exempted by Article 3(d) where it consists of temporary or short-term adjustments in the amount of physical capacity available, such as the withdrawal of a vessel or a reduction in the frequency of a service to meet a seasonal reduction in demand. Article 3(d) does not exempt capacity non-utilisation agreements because their only effect is to raise the level of prices and they do not involve any improvement of the services offered'.

(180) Under the group exemption, conferences are allowed both to operate under a common or uniform tariff and to engage in a number of other specified restrictions of competition including the regulation of the carrying capacity offered by each member of the conference. The EATA did not constitute an agreement or arrangement within the framework of which the parties to the EATA operated under uniform or common rates. The EATA was accordingly not a liner conference within the meaning of Article 1(3)(b) of Regulation (EEC) No 4056/86. The block exemption contained in Article 3 of Regulation (EEC) No 4056/86 was not applicable since it only applies to liner conferences as defined in Article 1(3)(b).

(ii) Conditions for grant of individual exemption

(181) In considering whether the conditions for exemption are fulfilled in respect of any agreement between undertakings, decision by association of undertakings or concerted practice, the Commission must fully take into account the fact that it is one of the fundamental principles of Community law as laid down in the Treaty that the Member States and the Community are to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a of the Treaty.

(182) Notwithstanding the abandonment of the EATA, it is in the Community interest to consider whether that agreement fulfilled the conditions for individual exemption for the following reasons.

(183) First, the parties to the EATA, which have continued to argue that the conditions for exemption are fulfilled, are likely to benefit from the increased legal certainty arising from a formal Commission decision concerning the practices in question, particularly as a large number of them have been the addressees of Commission decisions in the past relating to findings of infringement of Community competition law.

(184) Secondly, Regulation (EEC) No 4056/86 provides that parties do not need to notify an agreement or arrangement for it to be granted exemption by the Commission: other liner shipping companies may therefore benefit from the increased legal certainty arising from a formal Commission decision concerning the practices in question.

(185) Thirdly, national courts and authorities may benefit from a clear statement of the Commission's position in the event that any third party seeks to obtain redress under national law for any harm it has suffered as a result of the practices in question.

(186) Finally, in view of the practice of the Commission of increasing the penalties imposed in the case of recidivist infringement of Community competition law, it is important that a formal decision be adopted in this case for the purposes of future enforcement action.

(187) The Court of First Instance has ruled that: 'it should not be overlooked that whenever an exemption under Article 85(3) of the Treaty is sought, it is incumbent on the applicant undertaking to prove that it satisfies each of the four conditions laid down therein, and to set out in the A/B application form its position on each of those conditions …. It should also be recalled that, owing to the cumulative nature of the conditions required, the Commission is entitled at any time before the definitive adoption of the decision to find that any one of the four conditions is not satisfied' ([74]).

In the light of the Commission's finding that the first condition of Article 85(3) is not fulfilled, it is not strictly necessary to examine whether the other three conditions were fulfilled. However the Commission has undertaken this exercise in the interest of providing greater legal clarity and in order to address the arguments raised by the EATA parties.

(188) Although a high market share does not automatically rule out the possibility of a grant of an individual exemption, the burden of demonstrating that the four conditions of Article 85(3) are satisfied is an important consideration in the case of the EATA given that the EATA parties had a combined market share of some 86 % (see recital 80) in the year immediately preceding the application for exemption.

(189) The parties argued that the EATA was necessary to maintain the structure of the industry on the trades in question. As a result of the acquisition of considerable new capacity in the mid-1980s coupled with subsequent decline in demand, there was said to be a large degree of structural over-capacity ([75]).

(190) It was said that unless the decline in freight rates was reversed, the severe competition resulting from the alleged imbalance between supply and demand would result in failure and a contraction in the industry. Over the medium to long term, world trade would expand to absorb the then current capacity and the large amount of new capacity then on order. However, if the industry contracted at that time to match current demand at current prices, it would have been unable to expand as rapidly as necesssary to meet anticipated demand and there might have been problems of undercapacity with a consequential effect on freight rates.

(191) According to the parties, while the conference system still provided certain benefits to shippers, it could no longer provide the necessary trade and price stability. The EATA provided this trade and price stability and helped to maintain a viable industry which continued to invest, to make a smoother adjustment to the cost profiles that it would face in the mid 1990s and to offer adequate efficient scheduled maritime transport services.

(192) The parties argued that the EATA did not directly control rates and would cause no permanent reduction in capacity which would also reduce westbound capacity and affect FDW (fixed day, weekly) and RTW

(round-the-world) services. It would restrict eastbound capacity in a way which would not simply lead to a transfer of market share to independent shipping lines.

(193) The parties claimed that since the arrangements did not include pricing, or operations and service quality, they would not eliminate competition, in spite of the fact that they covered a substantial part of the trade.

(a) Improvement of production or distribution or promotion of technical or economic progress

(194) Concerning the first condition of Article 85(3), the EATA parties have argued that:

'A healthy industry would need to respond (to the needs of the second half of the 1990s) with an active investment programme, meeting the needs and anticipated needs for more capacity with new orders, and allowing for an acceleration in the rate of scrapping in order to accommodate new technological requirements. An impoverised industry would become much more risk-adverse and inclined to make do with existing capital stock' ([76]).

(195) The EATA parties argued in the application that by countering the effects of overcapacity and low rates of return, the EATA would enable them to continue to invest in new capacity, new containers and technological advances such as EDI (electronic data interchange). In particular, it was said that the successful operation of the EATA would enable the parties to order new tonnage of the largest and most efficient variety ([77]).

(196) In the reply to the Statement of Objections, the parties altered their argument to one based on stability and the notion of destructive price competition, arguing that destructive price competition needed to be prevented in order to allow the parties to make a sufficient return on capital to contemplate making further investments on the north Europe/Far East trades.

(197) The reasons for which the Commission does not accept the parties' arguments as to stability and destructive price competition are set out in recitals 104 to 142. So far as investments are concerned, it is true for all industries, and not just shipping, that the money available for investment is always potentially increased where prices and revenues are artificially increases by price-fixing arrangement. The fact that companies are making profits does not necessarily lead to investment and certainly not to any particular kind of investment ([78]).

(198) Instead of attempting to resolve any substantive problems of overcapacity, whether structural or temporary, the EATA allowed shipowners to maintain their capacity on the northern Europe/Far East trades at a level higher than was necessary to meet demand. The parties produced no evidence that the EATA would help to ensure that in the long-term the level of capacity would be better adjusted to meet the level of demand.

(199) Furthermore, the temporary freezing of capacity does not encourage the removal of older capacities on a real and lasting basis but principally brings about an increase in freight rates by temporarily reducing the supply of capacity to the market. The Commission considers that such an approach could not address the long-term structural problems of the industry which the parties alleged to exist in the application for exemption.

(200) It is also possible that rather than encouraging the introduction of new technology, the restrictions on competition resulting from the EATA stifled such introduction by reducing the competitive advantages which would otherwise accrue. This situation arises from the fact that the diminution or elimination of price competition which was the purpose of the EATA was likely to have prevented shipping lines from passing on cost savings resulting from new technologies to their customers. Equally the fact that more efficient lines were less likely to benefit from their efficiencies and were less likely to increase market share as a result means that efficient lines were less likely to invest in new technologies.

(201) Finally, there is no evidence that the services operated by the EATA parties during the period in which the EATA was in operation were in any way impoved by the agreements not to use part of the parties' capacity and to exchange information.

(202) Furthermore, the parties have argued that the sole purpose of the agreement to exchange information was to enable them to put into effect the capacity non-utilisation agreement and have put forward no reasons why this agreement could have contributed on its own to improving technical or economic progress or to improving production or distribution of maritime transport services. Since the capacity non-utilisation agreement did not have this effect, it may be inferred that neither did the agreement to exchange information.

(203) For all of these reasons, the Commission considers that the capacity non-utilisation agreement and the exchange of information between the EATA parties did not contribute to improving technical or economic progress or to improving production or distribution of maritime transport services.

(b) The question whether consumers receive a fair share of the resulting benefits

(204) The EATA parties stated that:

'… capacity management agreements such as the EATA would provide support to the existing structure since they would tend to have an upward effect on rates which currently do not provide an adequate return on capital' ([79]).

(205) The parties considered that any increase in rates which came about as a result of the operation of the EATA would benefit shippers because it would allow the carriers involved to make a smoother adjustment to future cost profiles, to continue with new investments and to provide an adequate efficient scheduled maritime transport service.

(206) At paragraph 4.3.3 of their application for individual exemption, the EATA parties claimed that:

'… any increase in ocean freight rates resulting from the EATA will be insignificant in comparison with the overall delivered price, in the third countries concerned, of the goods carried'.

(207) In the reply to the Statement of Objections, the parties again focused on what they consider to be stability and argued that the benefit shippers derive from stability is sufficient for the second condition of Article 85(3) to be fulfilled.

(208) As discussed at recitals 8 and 9, the purpose of the capacity management programme was to alter the alleged imbalance between supply and demand in the eastbound leg of the trades in question so as to allow the EATA parties to increase, collectively and individually, their freight rates. This is a benefit to shipowners and not to shippers.

(209) In the short term, the purpose of the EATA was to raise prices and freight rates, as is demonstrated by the increases announced with effect from 1 April 1993, 1 July 1993 and 1 January 1994 (see recitals 82 to 85). These increases were directly contrary to the interests of shippers, who were obliged to reflect them in their selling prices or their margings without benefiting from any advantage in terms of frequency, regularity or reliability of service.

(210) The EATA prevented the use of part of existing capacity for certain cargoes (i.e. those falling within the geographic scope of the EATA) but did not eliminate it. This action did not reduce transport costs and made clients carry the burden of unutilised capacity.

(211) The proportion of fixed operating costs (capital, labour, energy and insurance) to variable costs is very high; this is especially true of capital costs which are, according to the EATA parties, a particularly significant element of overall costs. The capacity management programme withdrew capacity from the market which over a full year would have been the equivalent of almost three and a half 4 000 TEU vessels sailing empty. As described at recital 37, the fixed costs of operating this amount of capacity would have been very significant.

(212) The direct effect of an artificial reduction in capacity utilisation (as opposed to a permanent reduction in capacity) is to share fixed operating costs amongst a smaller number of containers. The EATA had no effect in reducing fixed operating costs. A reduction in capacity could benefit shippers if the cost of transport

was reduced, i.e. if capacity was really withdrawn from the northern Europe/Far East trade by the progressive withdrawal of certain vessels or certain operator currently present.

(213) The Commission has received complaints about and objections to the EATA from bodies representing a significant number of consumers of maritime transport services. It has received no indications from shippers that they consider the EATA to have been of benefit to them. There is no evidence that conditions on the north Europe/Far East trades prior to the implementation of the EATA were such that shippers were in danger of not having access to the reliable services which Regulation (EEC) No 4056/86 recognises to be a benefit to them.

(214) An agreement such as the EATA and in particular the capacity non-utilisation agreement and exchange of information, the purpose of which was an increase in freight rates with no corresponding increase in service quality, cannot be regarded as allowing consumers a reasonable share of the benefit. Accordingly, the Commission considers that the EATA did not allow a fair share of benefits which it brought about to be passed to consumers.

(c) Indispensability of restrictions of competition

(215) The parties argued in the application for exemption that the EATA was the loosest and least restrictive cooperative arrangement that could be made to deal with the prevailing conditions of overcapacity and low rates. It was also claimed that the combination of overcapacity and depressed freight rates leading to uneconomic rates of return constituted a 'threat to the future financial viability and stability of scheduled liner services from northern Europe to Asia' ([80]).

(216) At paragraph 6.1.10 of their application for exemption, the EATA parties argued that only the EATA could provide the stability envisaged in Regulation (EEC) No 4056/86. This appears to have been because the market power of the FEFC was said to be no longer sufficient to regulate the use of capacity through the conference structure. Consequently restrictions on use by the members of the conference alone would have resulted in a loss of market share to non-conference members. The EATA parties also argued ([81]) that the EATA was considerable less restrictive of competiton than traditional liner conferences.

(217) The EATA parties have also argued that if a conference which fixes prices and regulates capacity fulfils the conditions of Article 85(3)of the Treaty, it follows that an agreement such as the EATA which only regulates capacity must necessarily fulfil the conditions for exemption.

(218) The Commission considers that the EATA must be considered in the context of the market in which it operated in cosidering the question in indispensability. To this end, the Commission regards as significant the facts that the majority of the parties to the EATA were members of the FEFC and that all but one of them were parties to the FETTSCA because of the cumulative effect of the restrictions of competition arising under the three agreements.

(219) As explained at 66 to 79, the likely effect of the EATA was determined to a very considerable extent by the structure of the market in which it operates. The combination of the two types of restrictive agreement, restrictions on supply arising under the EATA and restrictions on price arising under the FEFC, is likely to have had an effect that is highly restrictive of competition.

(220) The assertion that the EATA was less restrictive than a traditional liner conference is untrue in the context in which the EATA was operating: this conclusion could only be reached if the combined effect of the EATA, FEFC and FETTSCA was ignored.

(221) In any event, it should be noted that the Commission does not accept that an agreement between conference and non-conference shipping lines in a particular trade is necessarily less restrictive of competition than a conference agreement. This arises from the fact that a more flexible kind of arrangement than a conference agreement may be intended to extend the market power of conference members by making it possible for shipping lines which do not wish to operate under common of uniform rates to become party ([82]).

(222) The group extension for liner conference agreements contained in Article 3 of Regulation (EEC) No 4056/86 is granted on the basis that conferences are subject to

real or potential effective competition. The stability envisaged by the Regulation therefore be capable of existing under conditions where there is effective competition. Consequently, the Commission does not accept that the existence of competition precludes that kind of stability. Indeed, if that kind of stability could only exist where there was an absence of effective competition, then the group exemption for liner conference agreements could not fulfil the conditions of Article 85(3) of the Treaty.

(223) The stability envisaged by Regulation (EEC) No 4056/86 assures shippers of reliable services. Reliable services are those which are regular, in the sense of an evenly spread timetable, of a reasonsable quality, such that the shippers' goods come to no harm, and at the same price irrespective of which day and which line is chosen to carry the cargo. A conference also brings stability to the trades it affects by fixing a uniform tariff which serves as a reference point for the market.

(224) In the Commission's notice in the Irish Club Rules case ([83]), it is stated that during discussions with the representatives of the parties to the agreement in question, the Commission informed those representatives that: 'the Irish Club Rules could not be exempted on the basis that they had a stabilising effect, which was aknowledged as a sufficient condition by Regulation (EEC) No 4056/86 only for liner conferences; an agreement of this type could not produce the stabilising effect referred to in the eighth recital to Regulation (EEC) No 4056/86 and which results principally from cooperation between shipping companies on freight rates leading to the adoption of a common tariff (a feature absent in the case at issue)'.

(225) The Commission considers that scheduled and reliable maritime transport services would have continued to be provided with or without the existence of the EATA.

(226) So far as the argument that almost the entire trade had to be cartelised in order to avoid a loss of market share from the conference members to non-conference lines, it must be emphasised that consumer choice plays a fundamental role in ensuring that markets operate efficently. To the extent that the EATA was intended to deprive shippers of the choice between the members of the conference and an independent carrier, it must be concluded that its object was to prevent the efficient division of market share between conference members and non-conference lines that would have been more likely to result from the free play of supply and demand than from the EATA. Even if this was indispensable as regard the purposes of the EATA, it would certainly not have been in the interests of consumers nor have fulfilled the other conditions of Article 85(3).

(227) In any event, the EATA parties have not demonstrated that at all relevant times overcapacity actually existed on the trades covered by the EATA. If the problems which the EATA parties alleged existed did not actually exist, then the restrictions of competition that the EATA entailed could not be indispensable to meet those unproven problems.

(228) Even if overcapacity existed (see recitals 86 to 93) and was causing shipowners considerable losses as alleged, it has not been proved that the quality of service was seriously threatened.

(229) Capacity agreements between conference and non-conference members which limit the supply of a service cannot be considered indispensable to achieve the objective of stability within the meaning of Regulation (EEC) No 4056/86 when such agreements operate in combination with direct price-fixing agreements as is the case with the EATA.

(230) Accordingly, the Commission considers that the restrictions of competition arising from the capacity non-utilisation agreement and the exchange of information did not fulfill the third condition of Article 85(3).

(d) Elimination of competition for a substantial part of the services in question

(231) The parties claimed that since the EATA did not include pricing, or operations and service quality, they would not eliminate competition, in spite of the fact that they covered a substantial part of the trade.

(232) This assertion fails to recognise that the non-utilisation of capacity under the EATA was intended to have an effect on prices by reducing the supply of transport services to the market. This must be viewed, once again, in combination with the price restrictions under the FEFC and in the light of the very high market shares of the parties to the EATA.

(233) It is clear from Regulation (EEC) No 4056/86 that external competition to conferences is an essential factor so far as the granting of the group exemption is concerned. An agreement such as the EATA which enables the members of a conference to extend their market power by engaging in anticompetitive behaviour in common with shipping lines which are not members of the conference is, in general, intended to eliminate competition for a substantial part of the services provided in the market in question.

(234) In the present case, although is likely to have been the intention of the EATA parties, the fact that the capacity non-utilisation programme was only put into effect for a relatively short period of time and the fact that the first three conditions of Article 85(3) of the Treaty are not, in any event, fulfilled, leads to the conclusion that it is not necessary for the Commission to adopt a formal position as to the fourth condition of Article 85(3).

(235) Finally, the EATA parties argue that:

'Since it is clear that a liner conference comprising all the members of EATA would qualify for the block exemption under Regulation (EEC) No 4056/86, the EATA parties can only conclude that an agreement with less extensive cooperation between the parties would also satisfy the fourth condition of Article 85(3)' ([84]).

(236) The Commission does not accept this argument, which contains at least two flaws. First, it is tantamount to arguing that the absence of a market share limit in the group exemption for liner conferences effectively disapplies the fourth condition of Article 85(3) of the Treaty: this is not a reasonable interpretation of the Regulation. Secondly, it ignores Article 7 of Regulation (EEC) No 4056/86 which expressly places an obligation on the Commission to withdraw the benefit of the group exemption in circumstances where effective competition is absent.

(iii) Conclusion as to the applicability of Article 85(3)

(237) Examined in its full economic context, and, in particular, in the light of the other restrictions of competition in which the EATA parties were engaging, the Commission finds that the EATA did not meet the conditions for exemption set out in Article 85(3) of the Treaty.

XIV. **Conclusions**

(238) The EATA fell within the scope of the prohibition contained in Article 85(1) of the Treaty of agreements between undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. It did not satisfy the conditions of Article 85(3).

(239) The duration of the infringemnt was from September 1992 to May 1997. CGM ceased to participate in the infringement with effect from October 1994,

HAS ADOPTED THIS DECISION:

Article 1

The agreement between the following former members of the Europe Asia Trades Agreement (EATA) relating to the non-utilisation of capacity and the exchange of information constituted an infringement of Article 85(1) of the Treaty:

— CGM SA,

— Hapag-Lloyd Container Linie GmbH,

— Kawasaki Kisen Kaisha Ltd,

— A.P. Møller — Maersk Line,

— Malaysian International Shipping Corporation Bhd,

— Mitsui O.S.K. Lines Ltd,

— Neptune Orient Lines Ltd,

— Nippon Yusen Kaisha,

— Oriental Overseas Container Line,

— P&O Nedlloyd Container Line Limited,

— Cho Yang Shipping Co. Ltd,

— DSR-Senator Linie GmbH,

— Evergreen Marine Corp. (Taiwan) Ltd,

— Hanjin Shipping Co. Ltd,

— Hyundai Merchant Marine Co. Ltd,

— Yangming Marine Transport Corp.

Article 2

The application for a declaration that Article 85(1) of the Treaty is inapplicable to the EATA is refused.

Article 3

Each of the undertakings referred to in Article 1 is hereby required to abstain from any similar agreement or practice in the future which has the object or is capable of having a similar effect to the infringement referred to in Article 1.

Article 4

This Decision is addressed to the undertakings listed in Annex I.

Done at Brussels, 30 April 1999.

For the Commission

Karel VAN MIERT

Member of the Commission

Notes

(1) OJ L 378, 31.12.1986, p. 4.

(2) OJ L 376, 31.12.1988, p. 1.

(3) Regulation since repealed and replaced by Commission Regulation (EC) No 2842/98 (OJ L 354, 30.12.1998, p. 18) and Commission Regulation (EC) No 2843/98 (OJ L 354, 30.12.1998, p. 22).

(4) CGM SA is the legal successor to CGM Orient SA. DSR-Senator Linie GmbH is the legal successor to Deutsche Seereederei Rostock GmbH and Senator Linie GmbH. In 1996, CGM was purchased by Compagnie Maritime d'Affretement. In 1997, Nedlloyd Lijnen BV and P&O Containers Limited merged to form P&ONedlloyd, Hapag Lloyd AG transferred its containerised liner shipping activities to Hapag Lloyd Container Linie GmbH and Hanjin acquired control of DSR/Senator.

(5) OJ C 97, 6.4.1993, p. 2.

(6) 'WHEREAS:

(a) The Parties operate scheduled international maritime transport services between North Europe and Asia;

(b) the economic and trading environment in the Eastbound North Europe to Asian Trades has resulted in a combination of overcapacity and consistently depressed freight rates;

(c) the economic imbalances described in recital (b) above have led to consistently uneconomic rates of return on investment for the parties …

(d) the said economic imbalances and their consequences as described in recitals (b) and (c) above are continuing to deteriorate, leading to a threat to the future financial viability and stability of scheduled liner services from North Europe to Asia;

(e) …'.

(7) TEU/FEU is the industry standard abbreviation for ('20-foot equivalent unit/40-foot equivalent unit') and refers to the size of the containers.

(8) Non-scope Cargo is cargo lifted from ports outside the geographical scope of the EATA.

(9) See paragraph 4.2.7 of the application for exemption. See also the comments of the Japan Shipper's Council at recital 147 of this Decision.

(10) See application for exemption at paragraph 1.5.

(11) Members: APL, Evergreen, Hanjin, Hapag-Lloyd, Hyundai, Maersk, Mitsui OSK, Nedlloyd, NOL, NYK, OOCL, P&OCL, Sea-land, Yangming.

(12) Drewry, *Global container markets*, London 1996, p. 72.

(13) OJ L 376, 31.12.1994, p. 1.

(14) See reply to the Statement of Objections at paragraph 2.51.

(15) Drewry, *Global container markets*, p. 73.

(16) Drewry, *Global container markets*, p. 162.

(17) Case C-333/94 P, *Tetra Pak International v. Commission* [1996] ECR I-5951, at paragraphs 13, 14 and 15.

(18) See the definition of 'tramp vessel services' in Article 1(3)(a) of Regulation (EEC) No 4056/86, which emphasises the freely negotiated nature of tramp service freight rates

(19) It should be noted that containers generally measure 20 feet of 40 feet by 8 feet on the outside and that vessel slots are sized to match. Accordingly cargoes which are larger in width or length than these dimensions use up slots in an inefficient manner.

(20) Such oneway substitutability is not restricted to shipping: for example, although soft drinks are not a substitute for bottled waters, it is not necessarily the case that bottled waters are not a substitute for soft drinks – see Commission Decision 92/553/EEC in Case No IV/M.190 — Nestlé/Perrier (OJ L 356, 5.12.1992, p. 1).

(21) Drewry *Global container markets*, pp. 38 to 48.

(22) According to Mats Jansson, President of Unicool and Cool Carriers, 'The reefer container capacity deployed is still limited and the negative impact so far on the demand for specialised reefers is small' (*Fairplay*, 3 July 1997).

([23]) Drewry, *Global container markets*, pp. 69 and 71.

([24]) Drewry, *Global container markets*, p. 70.

([25]) Drewry, *Global container markets*, p. 76.

([26]) EACBen was a party to all three agreements. DSR/Senator and Yangming became members of the FEFC in 1996. Hyundai became member of the FEFC in 1998.

([27]) The FEFC includes the Europe/Japan and Japan/Europe Freight Conferences, Hong Kong/Europe Freight Conference, Philippines/Europe Conference and Sabah, Brunei and Sarawak Freight Conference.

([28]) Article 3 of Regulation (EEC) No 4056/86

([29]) See letter from the EATA secretary to the Commission dated 19 October 1993.

([30]) See letter from CNUT to the Commission dated 27 September 1991.

([31]) See letter from the FETTCSA secretariat to the Commission dated 19 October 1993.

([32]) 'It is generally accepted that the FEFC tariff, in the Europe to Asia trades acts as an industry reference point, and independents compete aggressively against the FEFC by offering rates, which are set at a discount from the FEFC tariff'. Per FEFC reply to the statement of objections in Case IV/33.218 – DSVK/FEFC, 31 March 1993 at p. 23. That case led to Commission Decision 94/985/EC (OJ L 378, 31.12.1994, p. 17).

([33]) Drewry, *Global container markets*, p. 110.

([34]) See letter from the FETTSCA secretariat to the Commission dated 19 October 1993 referred to in note 31.

([35]) Drewry, *Container market profitability to 1997*, London, December 1992, p. 87.

([36]) According to figures supplied to the '*The American shipper*' by NYK and published in the August 1993 edition, westbound capacity (2,42 million TEU) at that time exceeded eastbound capacity (1,75 million TEU) by some 38 %.

([37]) 'An analysis of cost and supply conditions in the liner shipping industry', J. E. Davies, *The Journal of Industrial Economics*, June 1983, at p. 425.

([38]) See application for individual exemption at paragraphs 2.5.46 and 2.5.47.

([39]) See the Commission's proposal for a Council Regulation laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport (OJ C 282, 5.11.1981, p. 4) and the accompanying memorandum. COM (81) 423 final.

([40]) See reply to the Statement of Objections at paragraph 1.6.

([41]) No examples have ever been put forward by the EATA parties of shortages of capacity arising from the withdrawal of vessels from the trade.

([42]) See for example the judgement in Case T-29/92 *SPO* v. *Commission* [1995] ECR II-289, at paragraph 294, where the Court of First Instance of the European Communities considered that no distinction could be made between normal and destructive competition. The appeal was rejected as manifestly inadmissible by Order of the Court of Justice in Case C-137/95 P [1996] ECR I-1611.

([43]) Dr Pirrong, Core theory and liner shipping markets, *Journal of law and economics*, 1992, footnote on p. 11.

([44]) *Competition, contestability and the liner shipping industry*, 1986, p. 310.

([45]) See for example, Jankowski in 'The development of liner shipping conferences', *International Journal of transport economics*, October 1989; Jansson and Schneerson in their book *Liner shipping economics*, 1987; the report of the US Federal Trade Commission, 'An analysis of the maritime industry and the effects of the 1984 Shipping Act'; November 1984, the analysis of the US Department of Justice, 'Analysis of the impact of the Shipping Act of 1984', March 1990; the lecture given by Professor S. Gilman at Tarporley in February 1994.

([46]) Proponents of the theory of the empty core argue that a competitive equilibrium is only sustainable if there is no coalition of consumers and producers (actual or potential) that can be made better off by deviating from the proposed equilibrium and forming its own agreement. According to the theory, any outcome where firms have excess capacity, or wehre the market would not clear unless firms operate at output levels that exceed their minimum average costs, could potentially produce incentives for opportunistic behaviour by a coalition consisting of an existing firm, or a potential entrant, and a group of consumers. This opportunistic behaviour arises as firms try to eliminate excess capacity, or as potential entrants lure customers away from existing firms that offer prices in excess of average cost. In such circumstances, firms will exit the industry rather than engage in price competition that, for any significant period of time, leads to prices that are below the level consistent with the recovery of all costs. Thus, the market is constantly unstable as firms continually enter and leave the market in response to existing price conditions.

([47]) See for example Jansson and Schneerson, see footnote 45, at Chapter 10.2: 'Ccommon costs and indivisibility'.

([48]) See the article 'Sea-Land's computer wars' in *Containerisation international*, August 1995, and the article 'Market share isn't everything' in *American shipper*, July 1995; see also Drewry 'Strategy and Profitability' in *Global Container Shipping*, London 1991, p. 104-106. For example, the article in American shipper states in relation to Atlantic Container Line: 'the company developed a contribution model which works off equipment flows. The model serves as a cargo-acceptance guideline. As a result sales staff are much more aware these days of the overall value of a business prospect'. See also 'The liner industry: structural changes and future outlook', *Industrial Bank of Japan Quarterly Survey* (1995 IV) p. 43: ' There has been a fundamental shift from the profit management system by ship or route to management by cargo unit. The profit for each cargo unit yields the net contribution of each container per voyage. The introduction of unit management has resulted in one container having the same meaning that one ship had in the past'.

([49]) See footnote 48, at pp. 105-6.

([50]) See in particular the Gilman lecture cited in footnote 45.

([51]) See footnote 45.

([52]) See for example Jankowski, 'Notes and comments: competition, contestability and the liner shipping industry', *Journal of transport economists and policy*, May 1989, or Jankowski, 'The Development of Liner Shipping Conferences', cited in footnote 45 and the Gilman lecture cited in footnote 45.

([53]) See footnote 44.

([54]) See *inter alia*, the US Federal Trade Commission report, cited in footnote 45, at p. 20; Jansson and Schneerson, cited in footnote 45, at Chapter 10.2; and the article 'Sea-Land's computer wars', cited in footnote 48.

([55]) See footnote 44.

([56]) 'Revenue pooling and cartel', p. 173. See also *'The economics of ocean freight rates'*, Bennathan and Walters, 1969, Praeger.

([57]) See footnote 48, at p. 69.

([58]) Scherer und Ross, *Industrial market structure and economic performance*, 1990, Houghtlin Mifflin, at p. 674.

([59]) See footnote 48, at p. 120.

([60]) See also Jansson and Schneerson, cited in footnote 44, at Chapter 10.2 and Annex A.

([61]) Such arrangements are subject to the obligations on shipping lines contained in Article 5(2) of Regulation (EEC) No 4056/86.

([62]) See the reply to the Statement of Objections at paragraph 2.102.

([63]) See application for individual exemption at paragraph 4.3.3.

([64]) See application for individual exemption at paragraph 4.3.4.

([65]) Joined Cases 56 and 58/64 *Consten and Grundig* [1966] ECR 322, at p. 341.

([66]) Case C-41/90 *Höfner and Elser v. Macrotron* [1991] ECR I-1979, paragraphs 32 and 33, and Case T-65/89, *BPB Industries and British Gypsum* v. *Commission* [1993] ECR II-389, at paragraph 134.

([67]) Joined Cases T-24/93, T-25/93, T-26/93 and T-28/93, *Compagnie maritime belge transports and Others v. Commission* [1996] ECR II-1201, at paragraph 205.

([68]) Commission Decision 86/398/EEC in Case IV/31.149-Polypropylene (OJ L 230, 18.8. 1986, p. 1), at paragraph 30.

([69]) Commission Decision 92/262/EEC in Case IV/32.450 – French-West African shipowners' committees, (OJ L 134, 18.5.1992, p. 1) at paragraph 43.

([70]) See the sixth recital of Regulation (EEC) No 4056/86. See also the *Compagne maritime belge transports* case cited in footnote 67, at paragraph 202.

([71]) Case 136/86 *BNIC* v. *Aubert* [1987] ECR 4789, paragraph 18. Similarly, the Court ruled under Article 92 in Joined Case 67, 68 and 70/85 *Van der Kooy* v. *Commission* (Dutch natural gas prices 1) [1988] ECR 219, at paragraph 59, that subsidisation of the price of natural gas to Dutch glasshouse crop producers by 5,5% affected trade between Member States because of the importance of energy costs (25 to 30% of the selling price) and of the market share (65%) and the exports (91%) of the firm receiving the State aid.

([72]) Joined Cases 6/73 and 7/73 *Istituto Chemioterapico Italiana and Commercial Solvents* v. *Commission*, [1974] ECR 223, at p. 252. The EATA parties have argued in the reply to the statement of objections (Annex 12 at paragraph 13) that jurisprudence of the Court of Justice under Article 86 is not relevant to the present proceedings under Article 85. In the Commission's view, the test of an effect on trade between Member States is identical for the purposes of Article 85 and Article 86. Furthermore, it is clear from the two paragraphs following the one quoted above that the principles being discussed by the Court in *Commercial Solvents* are applicable to Article 85 as well as to Article 86:

'32. The prohibitions of Articles 85 and 86 must be interpreted and applied in the light of Article 3(f) of the Treaty, which provides that the activities of the Community shall include the institution of a system ensuring that competition in the common market is not distorted, and Article 2 of the Treaty, which gives the Community the task of promoting "Throughout the Community harmonious development of economic activities". By prohibiting the abuse of a dominant position within the market in so far as it may affect trade between Member States, Article 86 therefore covers abuse which may directly prejudice consumers as well as abuse which indirectly prejudices them by impairing the effective competitive structure as envisaged by Article 3(f) of the Treaty.

33. The Community authorities must therefore consider all the consequences of the conduct complained of for the competitive structure in the common market without distinguishing between production intended for sale within the Market and intended for export. When an undertaking in a dominant position within the common market abuses its position in such a way that competition in the common market is likely to be elimated, it does not matter whether the conduct relates to the latter's exports or its trade within the common market, once it has been established that this elimination will have repercussions on the competitive structure within the common market'.

([73]) Trans-Atlantic Agreement, Commission Decision 94/980/EC of 19 October 1994 (OJ L 376, 31.12.1994, p. 1 at recitals 365 and 366).

([74]) Case T-66/89 *Publishers Association* v. *Commission* [1992] ECR II-1995, paragraph 69.

([75]) The EATA parties have, somewhat confusingly, described the alleged overcapacity as both structural and cyclical.

([76]) See application for individual exemption at paragraph 6.1.22.

([77]) See application for individual exemption at paragraph 6.1.28.

([78]) See the *Interim report of the multimodal group* at paragraph 65, published in March 1996 by the Office for Official Publications of the European Communities (ISBN 92-827-6964-X).

([79]) See application for individual exemption at paragraph 2.5.43.

([80]) See footnote 4.

([81]) See reply to the Statement of Objections at paragraph 6.3.4.

([82]) See the Decision on the Trans-Atlantic Agreement, cited in footnote 13, at recital 345, et seq.

([83]) Notice pursuant to Article 23(3) of Council Regulation (EEC) No 4056/86 concerning Case No IV/33.677 Irish Club Rules, (OJ C 263, 29.9.1993, p. 6 at point).

([84]) See the reply to the Statement of Objections at paragraph 3.77.

ANNEX I

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ANNEX II

EATA capacity limits 1993

	January-March		April-September		October-December	
	(%)	(TEUs)	(%)	(TEUs)	(%)	(TEUs)
CGM	6,25	546	11,0	909	1,0	87
Cho Yang	6,25	574	11,0	931	1,0	86
DSR-Senator	7,25	904	12,0	1 562	2,0	277
EACBen	11,25	3 472	15,0	4 478	6,0	1 821
Evergreen	0	0	15,0	4 406	6,0	1 814
Hanjin	12,25	4 343	17,0	6 651	6,0	2 017
Hapag-Lloyd	10,25	3 065	16,0	5 110	6,0	2 009
Hyundai					4,0	868
K Line	9,25	1 918	14,0	3 110	4,0	862
Maersk	12,25	4 241	17,0	6 089	6,0	1 965
MISC	6,25	556	11,0	919	1,0	79
MOL	8,25	1 391	13,0	2 299	3,0	536
Nedlloyd	8,25	1 504	13,0	2 191	3,0	474
NOL	9,25	1 914	14,0	3 076	4,0	868
NYK	9,25	1 942	14,0	3 342	4,0	986
OOCL	9,25	2 227	15,0	3 798	5,0	1 287
P&OCL	12,25	4 506	17,0	6 277	8,0	3 302
Yangming	9,25	2 177	14,0	3 207	4,0	845
TOTAL		35 281		58 355		20 183

Sliding scale — 1993

	January-March	April-September	October-December
0 TEU to 10 000 TEU	6,25%	11,0%	1,0%
10 000 TEU to 15 000 TEU	7,25%	12,0%	2,0%
15 000 TEU to 20 000 TEU	8,25%	13,0%	3,0%
20 000 TEU to 25 000 TEU	9,25%	14,0%	4,0%
25 000 TEU to 30 000 TEU	10,25%	15,0%	5,0%
30 000 TEU to 35 000 TEU	11,25%	16,0%	6,0%
35 000 TEU to 40 000 TEU	12,25%	17,0%	7,0%
40 000 TEU to 45 000 TEU			8,0%
45 000 TEU to 50 000 TEU			9,0%
50 000 TEU to 55 000 TEU			10,0%
55 000 TEU to 60 000 TEU			11,0%
60 000 TEU to 65 000 TEU			12,0%

Note: The reduction in capacity for the fourth quarter of 1993 was reduced to 0% on 27 October 1993.