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II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 26 June 1997

declaring a concentration to be incompatible with the common market

(Case No IV/M.890 — Blokker/Toys 'R' Us)

(notified under document number C(1997) 1884)

(Only the English text is authentic)

(Text with EEA relevance)

(98/663/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area and in particular Article 57(2)(a) thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings⁽¹⁾, as amended by the Act of Accession of Austria, Finland and Sweden, and in particular Article 8(3) and (4) and Article 22 thereof,

Having regard to the Commission Decision of 21 February 1997 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,

Having regard to the opinion of the Advisory Committee on Concentrations⁽²⁾,

Whereas:

- (1) The procedure under consideration concerns a request received by the Commission on 23 January 1997 from the Dutch Government pursuant to Article 22 of Regulation (EEC) No 4064/89 ('the Merger Regulation') to examine the acquisition of the Dutch operations of Toys 'R' Us by Blokker. The agreement (which contains implementation agreements) underlying the operation was signed by the parties in the form of an exchange of letters on 24 December 1996. By letter of 13 January 1997 the transaction was notified to the Dutch authorities.
- (2) On 21 February 1997 the Commission adopted a decision under Article 6(1)(c) in conjunction with Article 22 of the Merger Regulation finding that the request was admissible in accordance with Article 22, that the request had been made within the one-month period provided for in

⁽¹⁾ OJ L 395, 30.12.1989, p. 1; corrected version, OJ L 257, 21.9.1990, p. 13.

⁽²⁾ OJ C 363, 25.11.1998.

Article 22(4) and that the concentration raised serious doubts as to its compatibility with the common market.

I. THE PARTIES

- (3) Blokker Holding BV ('Blokker') is a major retail operator in the Netherlands. Its principal activities are retail trade in household articles, toys and other products. Blokker operates several retail chains either as owner of shops or through franchising agreements. Blokker currently operates 147 wholly owned toy shops under the 'Bart Smit' trade mark and 196 toy shops under the 'Intertoys' trade mark, of which [...] (*) are franchised to individual operators. Blokker also sells a broad assortment of toys in its household articles stores, in particular in the outlets under the 'Blokker', 'Marskramer' and 'Familux' trade marks (431 shops of which [...] are franchised). The total turnover of Blokker in 1995 was ECU [...] million.
- (4) Blokker is also active in other Member States. It operates about 160 Blokker household stores in Belgium, Luxembourg, Germany and France, 15 Bart Smit stores in Belgium and 2 Intertoys stores in Germany.
- (5) Toys 'R' Us Inc. (US) is one of the world's biggest toy retailers and is active in most Member States of the European Community. The worldwide turnover of Toys 'R' Us Inc. (US) in 1996 was ECU 7 523 million. Toys 'R' Us (Netherlands) BV is a wholly owned subsidiary of Toys 'R' Us Inc. (US) and achieved in 1996 a total turnover of ECU 27,5 million. The undertakings are hereinafter jointly referred to as 'Toys 'R' Us'.

II. THE OPERATION

- (6) The operation as set out in the agreement of 24 December 1996, referred to as the 'Letter Agreement' has been implemented through a set of agreements: the 'Master Sub-lease Agreement', 'Asset Purchase Agreement', 'Franchise Agreement' and the 'Marketing Subsidy Agreement'. Of the

nine stores operated by Toys 'R' Us, Blokker takes over the six stores in Alkmaar, Utrecht, Breda, Beek and Muiden and Rotterdam-De Boog. The three stores in Arnhem, Rotterdam-Zuidplein and Eindhoven are operated by Blokker under a temporary operating agreement. The latter will be closed once another tenant has been found for the premises or an agreement has been reached with the respective landlords. The transaction was concluded on 3 February 1997. That is also the date on which Blokker started to operate the Toys 'R' Us stores.

- (7) Speelhoorn BV, a wholly owned subsidiary of Blokker, sub-leases from Toys 'R' Us the premises for the five shops in Alkmaar, Utrecht, Breda, Beek and Rotterdam-De Boog which are currently leased by Toys 'R' Us (Netherlands) BV. Speelhoorn leases the shop in Muiden from Toys 'R' Us which is owned by Toys 'R' Us Inc. (US). The respective lease terms will end between the years [...] and [...], the respective sub-leases, or in the case of Muiden the lease, are valid as long as the franchise agreement is in effect. The floor capacity per store will be reduced from 3 000-4 000 m² to approximately [...], the remaining space will also be sub-leased per square metre by Toys 'R' Us if possible. The amount of rent Blokker pays to Toys 'R' Us is less than the amount Toys 'R' Us is paying to its respective landlords.
- (8) Blokker purchases from Toys 'R' Us (Netherlands) BV the assets and inventory of all nine stores except for the cash register and the computer system. Blokker pays Toys 'R' Us NLG [...] for the inventory and an amount of NLG [...] for so-called assets (fixtures and furniture). Blokker also takes over the employment contracts of the personnel of all stores [...].
- (9) The Franchise Agreement provides that Blokker has the exclusive right to use the trade mark and the Toys 'R' Us system in the Netherlands. Toys 'R' Us has developed requirements for type, quality and category mix of the items to be carried. Blokker has the right to add other product categories which are usually not sold in Toys 'R' Us stores and is free to determine the individual products in each category and the respective prices. The term of the franchise is 12 years, the franchisee has the right to renew the agreement for terms of 10 years provided the franchisee has not committed material breaches of the agreement. The franchise fee is [...] of net sales, the franchisee has to pay a service fee of [...] on merchandise procured in connection with coordinated purchases [...].

(*) This version of the Decision has been edited to ensure that confidential information is not disclosed.

- (10) The Franchise Agreement gives Blokker the right to purchase toys through the Toys 'R' Us central buying operation. According to the Agreement, this merchandise can be offered for sale by the franchisee or in any 'franchised store'.

- (11) [...].

III. CONCENTRATION

- (12) The parties argue that this operation is not a concentration within the meaning of the Merger Regulation. They state that the Franchise Agreement is the nucleus of the transaction and that the other agreements are merely ancillary agreements facilitating the execution of the Franchise Agreement. They further that Blokker does not obtain control within the meaning of the Merger Regulation and that Blokker does not gain any more security of tenure than a franchisee in any typical franchise agreement. They also argue that a franchise agreement needs to be assessed under Article 85 of the EC Treaty and Commission Regulation (EEC) No 4087/88, the Franchise Block Exemption Regulation⁽³⁾, and cannot therefore be an element of a concentration.

- (13) According to Article 3(1)(b) of the Merger Regulation, a concentration arises when one undertaking acquires direct or indirect control of the whole or parts of another undertaking. Article 3(3) defines the element of control as constituted by rights, contracts or any other means which confer the possibility of exercising decisive influence on an undertaking, in particular by ownership or the right to use all or part of the assets of an undertaking. Control for the purposes of the Merger Regulation means the possibility of exercising decisive influence on an undertaking. Therefore, acquisition of control is not limited to cases where a legal entity is taken over but can also happen through the acquisition of assets. In this situation the assets in question must constitute a business to which a market turnover can be clearly attributed⁽⁴⁾.

- (14) The mere fact that a franchise agreement is a part of the operation cannot exclude the whole operation from the application of the Merger Regulation. The decisive question is whether the

whole set of agreements concluded between Toys 'R' Us and Blokker will give Blokker control of the Toys 'R' Us business which remains on the Dutch market. The three shops which are to be closed and are only temporarily in operation are not part of the concentration, since Blokker does not acquire control on a lasting basis.

- (15) In this operation Blokker takes over all the assets (leases, fixtures and inventory, personnel, use of brand name) which make up the business of Toys 'R' Us in the Netherlands. To this business, a turnover can clearly be attributed. The operation leads to a lasting change in the structure of the undertakings concerned since the agreements underlying the operation are of a long-lasting nature. Toys 'R' Us has repeatedly stated that it has definitely decided to leave the Dutch market and that it will not choose any other buyer for its business. The fact that Blokker operates the stores as a franchisee is not a factor militating against the exercise of control by Blokker. The particular Franchise Agreement does not confer upon Toys 'R' Us rights which could lead to the assessment that Toys 'R' Us retains control of the business. It is the franchisee who selects the products within the given categories and who determines the prices at which they will be sold. Blokker has confirmed in its letter of 7 February 1997 that its particular agreement with Toys 'R' Us allows it to add other product categories which are usually not sold in Toys 'R' Us stores, such as garden furniture or Christmas items. Blokker has also stated that it wants to create a new shopping formula which differs essentially from the existing Toys 'R' Us concept. This confirms that Blokker not only gains control over the day-to-day operations but that Blokker determines the concept of the shops. Therefore, Toys 'R' Us will no longer determine the course of the business but cedes its influence to Blokker.

- (16) Therefore, Blokker acquires control of parts of an undertaking within the meaning of Article 3(1) and the operation constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

IV. COMMUNITY DIMENSION

- (17) The combined worldwide turnover of the parties does not exceed ECU 5 000 million. The worldwide turnover of Blokker is ECU [...] million. The turnover of Toys 'R' Us (Netherlands) BV that can be attributed to the shops taken over by Blokker is estimated by Toys

⁽³⁾ OJ L 359, 28.12.1988, p. 46.

⁽⁴⁾ Commission notice on the notion of a concentration under Council Regulation (EEC) No 4064/89, paragraph 11 (OJ C 385, 31.12.1994, p. 5).

'R' Us at ECU [...] million. It follows that the concentration has no Community dimension within the meaning of Article 1 of the Merger Regulation.

V. EFFECT ON TRADE BETWEEN MEMBER STATES

- (18) Article 22(3) of the Merger Regulation requires that the concentration affects trade between Member States. A [...] proportion of the toys [...] sold by the Blokker group and in general on the Dutch market is imported into the Netherlands from other Member States. In addition, before the operation the majority of the products sold by Toys 'R' Us were provided from their German organisation. Following the operation, that is no longer the case. Blokker obtains its products from a variety of sources, including direct imports from manufacturers in the Far East and from Dutch importers or sales offices.
- (19) In addition, the acquisition of the Toys 'R' Us stores by Blokker can increase barriers to entry for new entrants to the Dutch market for toys, including entrants from other Member States.
- (20) Thus, the change in structure of the Dutch specialised toy retail market as set out below will have an appreciable influence, directly or indirectly, actually or potentially, on the pattern of trade between Member States⁽⁵⁾.

VI. COMPATIBILITY WITH THE COMMON MARKET

A. Toy retailing in the Netherlands

Market information on retail of toys

- (21) The range of products generally sold in toy retail outlets includes principally the following product categories: baby and toddlers' toys, puppets, cuddly toys, play animals, construction toys, board games, puzzles, assembly kits, outdoor play items, look and listen toys and hobby articles (the so-called classic toys) and electronic toys such as computer games and video games. The

abovementioned categorisation of toys usually sold in retail outlets is used in the available market studies⁽⁶⁾ and is generally accepted in the toy industry, and is confirmed by the Commission investigation with retailers and suppliers of toys.

- (22) There are only two publicly available studies providing information on the total value of sales of toys in the Netherlands. These are published by the EIM/Centre for Retail Research⁽⁷⁾, and the GfK Interact⁽⁸⁾ respectively. Both studies give estimates of the total retail sales of toys in the Netherlands and estimates of the importance of the various retail channels through which toys are sold to the final consumer. Both studies indicate a decline in the value of total sales of toys in recent years. According to the GfK study the number of toys sold in the Netherlands shows a slight increase over the last three years but the average price per toy item has decreased which leads to a decrease in total value.
- (23) A specific feature of toy retailing is its highly seasonal character. About 50 % of the yearly sales are realised in the period between 1 October and 31 December. A characteristic feature of the Dutch market in this respect is the Saint Nicholas period which starts in November and has its high point on the evening of 5 December. Thus the annual peak in sales occurs earlier in the Netherlands than in neighbouring countries. A specific feature of the Dutch market is also that the amount of money spent on toys per child in the Netherlands is approximately 20 % lower than the average in Western Europe.

Total value of sales

- (24) The EIM/Centre for Retail Research has estimated the total value of toy sales in the Netherlands at NLG 870 million (ECU 410 million) in 1996. According to the EIM definition, this figure covers classic and other toys, electronic and computer games, but does not cover CD-ROMs and children's videos. The EIM bases its findings on the production statistics of the Dutch Centraal Bureau voor de Statistiek together with its own estimations.
- (25) The GfK market study estimates the total sales value of toys in the Netherlands at around NLG 734 million (ECU 343 million) in 1996. The GfK

⁽⁵⁾ Judgment of the Court of Justice of the European Communities in Case 56/65 *Société Technique Minière v. Maschinenbau Ulm* [1966] ECR, p. 235.

⁽⁶⁾ These studies will be discussed below (paragraphs 24 to 25).

⁽⁷⁾ EIM/Centrum voor Retail Research, Brancheschets Speelgoeddetailhandel, 1996 and 1997.

⁽⁸⁾ GfK Interact Consumer Panel 1996.

study covers all categories of toys, including electronic and video games, but does not cover children's videos and CD-ROMs. This market study is based on a consumer panel of 5 000 people, questioned regularly about their expenditure on toys. The study covers only purchases with a value of more than NLG 10 (ECU 4,7) by persons older than 12 years. Two major suppliers (Lego and Mattel) have stated that the Gfk figures cover only about 75-80 % of the total sales. Based on this assumption the total sales value can be estimated at NLG 980 million (ECU 457 million) in 1996.

- (26) The Commission received one market study from Lego which stated that the size of the total sales amount to NLG 1 053 million. This market study does not cover children's videos and CD-ROMs.

B. Relevant product market

- (27) The parties concerned in the operation are active in the retail of a broad assortment of toys in specialised toy shops or shops with a specialised toy department. In the Netherlands toys are sold for the most part by specialised toy shops which carry a broad assortment of toy products throughout the whole year. In addition, toys are also sold through other retail channels such as certain drugstores, petrol stations, supermarkets, electronic or computer shops, a cash and carry wholesaler and mail order companies.
- (28) It is the view of the Commission that the relevant market is the market for retail outlets which sell a broad assortment of toys the final consumer throughout the year. In the Netherlands these outlets include specialised toy shops and shops with a specialised toy department such as department stores and household articles stores. These outlets are referred to as specialised toy outlets. By contrast, the parties argue that the relevant market should be defined more broadly including all the distribution channels through which toys are sold to the final consumer.
- (29) The parties submit that the exclusion of other outlets is arbitrary. Furthermore, the parties argue that all sales of products such as CDs, audio appliances, computers, children's videotapes and sports articles should also be included in the definition of the relevant market, since these products are sold in specialised toy shops as well as in other outlets. The parties also refer to a

study prepared by Lego. According to this study the relevant market should be defined according to products and services requested by children for their leisure time. This approach is referred to as the concept of the children's wish-list. The parties state that the appropriate criterion for the market definition should be the children's entertainment character of a product. The parties cite as examples the facts that sports shoes, CD-ROMs or computer games or hi-fi equipment are perceived by children as perfect substitutes for 'traditional' toys.

- (30) The concept of defining the relevant market according to the children's wish-list is not accepted by the Commission. In so far as services are included it would already go beyond retailing. Under the Merger Regulation, a relevant product market comprises those products or services which are substitutable by the consumer by reason of their characteristics, their price and their intended use. Even if the market definition were restricted to the retail of products with an entertainment character, that would include the retail of products for which competition takes place on other markets. The relevant market in a retail context cannot be defined by all possible options of consumer spending.
- (31) The specialised toy outlets can be distinguished from other retail channels because they carry throughout the whole year a broad assortment of toy products specifically aimed at children. These specialised outlets enable consumers to make a choice from a broad assortment. Toys 'R' Us stated at the hearing that specialised toy retailers carry a range of toy products selected with the aim of attracting as many consumers to the store as possible. A broad assortment normally includes products from the following categories: baby and toddlers' toys, puppets, cuddly toys, play animals, construction toys, board games, puzzles, assembly kits, outdoor play items, look and listen toys and hobby articles (the so-called classic toys) and electronic toys such as computer games and video games. The abovementioned categorisation of toys is used in the available market studies and is generally accepted in the toy industry, and is confirmed by the Commission's investigation with retailers and suppliers of toys.
- (32) Specialised toy retail outlets have the distinctive feature that they all publish special toy catalogues for the Saint Nicholas sales period, which in the Netherlands is the annual peak in sales. Other catalogues such as the catalogue published by the drugstore Kruidvat, are not toy catalogues since they use toys only as an eye-catcher and toy products make up only a small percentage of the overall number of products advertised.

- (33) The composition of the assortment of toy products may vary between the different specialised toy retail outlets as some put more emphasis on certain categories or select other products within the categories. Furthermore due to the dynamics of the market and the introduction of new toys, the relative weight of product categories themselves can change over time. For example products such as electronic games and video games have entered the range as a mainstream product category in recent years. In this respect the most recent development is CD-ROMs for children which are now being introduced in certain toy shops.
- (34) A specific feature of toy retailing in the Netherlands is that the majority of sales of toys (at least 80 %) is concentrated in specialised outlets. Outlets such as computer shops and electronics shops normally carry only video games and computer games which is only one category out of the assortment of specialised toy retail outlets. Other distribution channels such as supermarkets and drugstores only carry a limited number of products as part of another range of consumer goods. Those supermarkets which carry toys have a small selection of usually small items below a certain price level. Similarly drugstores offer a limited selection usually from one to three branded suppliers. Even the drugstore chain Kruidvat which has the highest turnover among the drugstores only carries up to 100 items of the three brands Lego, Fisher Price and Barbie on a permanent basis. All other items are only sold on a temporary basis. This is considerably less than the toy department of the Blokker household shops which carry up to [...] toy items. Some petrol stations, in particular Shell, carry a very limited number of branded products (for instance Lego), often on a temporary basis. The products are usually packaged specifically for the outlet in question and differ slightly from the products available in the specialised toy outlets.
- (35) Moreover, in these other distribution channels, toys are often used as a means to attract consumer traffic for the sale of other products or as impulse purchases. By contrast, consumers go to specialised toy outlets with the expectation of having a choice from a broad assortment of toys or finding the item or product category there. Although the sales of a small selection of branded products in non-toy outlets may have some influence on prices of similar products in specialised toy retail outlets, they cannot be regarded as fully-fledged competitors with these outlets. This view has been confirmed by other toy retailers.
- (36) The parties argue that the hypermarket Maxis and the cash and carry wholesaler Makro should be included in the relevant market. Maxis carries a broad assortment comparable with a Blokker store and is considered to be part of the relevant market. Makro as such, is a wholesaler which is in principle not open to the general public. Sales of mail order companies are negligible.
- (37) The assortment of products in specialised toy retail outlets may include products such as books, sports articles, watches and in some outlets even computers, which are more commonly found in other outlets. Competition for these items largely takes place on neighbouring retail markets. The fact that a small number of these items may be sold in specialised toy retail outlets does not affect this conclusion. For this reason it is not appropriate to include all these products in the assessment of competition between specialised toy retail outlets. In any event, this does not make a substantive difference to the assessment of the case⁽⁹⁾. Children's videotapes are sold in a variety of outlets including specialised toy retail outlets. Since the question whether these have to be considered as a toy is not decisive for the case, the product category can be left open.

C. The relevant geographic market

- (38) In earlier decisions concerning retail operations, the Commission has generally taken the view that retail markets can be defined as national under certain circumstances⁽¹⁰⁾. Although the catchment area of a retail outlet, which can be based on the distance a consumer is willing to travel to reach it, is of a local or regional scale, the catchment area does not necessarily determine the geographic market. In a situation where several retail chains operate networks of stores on a national scale, the important parameters of competition are determined on a national scale. Therefore, from the viewpoint of the catchment area, what may be a local or regional market has to be aggregated to a national market in these circumstances.

⁽⁹⁾ Since the proportion of these products in Blokker's turnover seems to be higher than that of its competitors, the inclusion of these products would only increase Blokker's market share among the specialised toy retailers.

⁽¹⁰⁾ Commission Decision 97/277/EC in Case IV/M.784 — Kesko-Tuko (OJ L 110, 26.4.1997, p. 53, paragraph 21).

- (39) The specialised toy retail market in the Netherlands is characterised by chains which operate on a country-wide basis. Both Blokker and Toys 'R' Us operate their retail outlets according to a national, and in the case of Toys 'R' Us, even international, store concept. In these concepts important parameters of competition are determined at the central level of the chain.
- (40) Pricing decisions for toys sold in stores belonging to the Blokker group are determined at the central level of each chain. Even the Blokker and Intertoys shops, which are operated under franchise agreements, are bound by the prices determined at the central level. Franchisees of Blokker and Intertoys are obliged to inform the management of the chain about local competition but it is the central management which decides whether or not to react to local competition. Although the members of Otto Simon are not bound by the centrally recommended prices, most of them follow those prices.
- (41) Advertising by retailers is mainly carried out on a national scale as catalogues and flyers have the same appearance and are distributed throughout the country. Furthermore, the product ranges of the chains, especially the retail outlets belonging to the Blokker group, are determined at the central level of the chains.
- (42) Although the chains operated by Blokker are active in other Member States (Bart Smit and Blokker in Belgium, Intertoys in Germany) and the Toys 'R' Us formula is operated in large parts of Europe, the geographic market cannot be defined on a basis wider than a national market. Consumer preferences and habits differ from one Member State to another. The catalogues of retailers are published and distributed only on a national scale. The poor performance of Toys 'R' Us in the Netherlands which introduced on the Dutch market the German Toys 'R' Us concept and the product range selected for the German market is a good example to show that the Dutch specialised toy retail market is national.

D. Effects of the concentration

- (i) Structure of supply in the relevant market

The Blokker group

- (43) The Blokker group operates two chains of specialised toy shops: 'Bart Smit' and 'Intertoys'.

The 147 Bart Smit shops are all owned by Blokker. The Intertoys chain comprises 196 shops, of which [...] are operated through franchise agreements and [...] are wholly owned.

- (44) Blokker also sells an assortment of toys in its chains for household articles: 'Blokker', 'Marskramer' and 'Familux'. In total, toys are sold in 288 Blokker shops. Of these shops [...] are owned by Blokker while [...] are operated through franchise agreements. Under the Marskramer and Familux formulas, Blokker operates 143, shops of which [...] are operated through franchise and [...] owned.
- (45) The position of Blokker in toy retailing is for a large part the result of acquisitions. In 1985 the Blokker group acquired Bart Smit. In 1994 the Blokker group acquired Intertoys, Marskramer and Familux in which it earlier had a minority interest.

Toys 'R' Us

- (46) Toys 'R' Us entered the Dutch market in 1993, introducing a new concept of toy retailing: that of so-called megastores in out-of-town locations. Toys 'R' Us operated nine megastores in the Netherlands in 1996. Because of their extensive floor size the stores can carry the largest possible range of toy products. The product range of Toys 'R' Us also contains other products including bicycles, nappies and baby food.

The Otto Simon group

- (47) Otto Simon BV⁽¹¹⁾ is a wholly owned subsidiary of Otto Simon Beheer BV which belongs to the German Vedes group. The members of the Otto Simon system are all independent retailers. Otto Simon offers its members joint purchasing, accepts the *del credere* risk and provides marketing and other support services.
- (48) Otto Simon operates four different formulas of specialised toy shops. 'De Speelboom' is a specialised toy shop carrying a broad product range (100 shops). 'Wigwam' is a 'shop in a shop' concept which is mainly operated in combination with other outlets such as household shops, book shops, drugstores and carries a smaller range of

⁽¹¹⁾ Otto Simon BV was formerly operating under the name Toypartners BV.

toys (241 shops). 'Techno Hobby' is a chain specialising in model trains, radio-controlled toys, miniature cars and model construction sets (45 shops)⁽¹²⁾. From 1 May 1997 Otto Simon took over the operation of the five specialised toy shops of 'Early Learning Centre' through a master franchise agreement. These shops carry a broad range of toys with educational value for children aged between 0 and 8 years.

In Den Olifant

- (49) In Den Olifant is a franchise chain of small specialised toy shops. It operates seven stores in the Netherlands.

Department stores and hypermarkets

- (50) In the Netherlands there are three important chains of department stores which have specialised toy departments: Vroom & Dreesmann (63 stores, of which 46 sell toys), which is owned by Vendex International, and De Bijenkorf (6 stores) and Hema (236 stores), which are both owned by Koninklijke Bijenkorf Beheer (KBB). The only hypermarket in the Netherlands is Maxis, which operates 5 stores.

Other independent specialised toy outlets

- (51) There are also a number of small independent specialised toy shops and independent household articles shops. Their operations are not substantial and they are declining. In addition, there are a number of smaller independent department stores which sell toys.

⁽¹²⁾ Techno Hobby does not carry a broad assortment as defined above. The question whether it should be part of the relevant market can be left open since it would make a substantive difference to the assessment. For the purpose of this case, it is incorporated in the market share of Otto Simon.

(ii) Market shares in the relevant market

- (52) As described above, the Commission has defined the relevant product market as the retail of toys through specialised toy retail outlets.
- (53) In order to determine the market shares of the parties active in the relevant market the Commission has sent questionnaires to suppliers/ and retailers regarding the size of the total market, the relative importance of various distribution channels and the actual turnover figures of parties active in the relevant market. In this way the Commission has determined the market shares of all main players in the market⁽¹³⁾. The combined market share of the remaining independent specialised toy shops, the independent household articles stores and independent department stores is estimated at 10 % of sales in the relevant market since it would be nearly impossible to obtain turnover figures for these outlets. (This figure is based on the Gfk market study.)
- (54) Based on the aggregation of actual turnover figures of the parties active in the relevant market and the estimation of the combined market share of the independent operators, the sales value in the relevant market is estimated at around NLG 785 million (ECU 366 million) in 1996.
- (55) The market shares of the parties in the relevant market, calculated on the basis of their actual turnover figures, are set out in the table. These figures have not changed substantially over the last three years.

⁽¹³⁾ For the purpose of calculating market shares, other products such as books, sports articles, watches and children's videotapes are not taken into account. Since not all Blokker's competitors sell CD-ROMs in their toy department (department stores), CD-ROMs are not taken into account in calculating Blokker's market share. For these reasons, the Commission has based the calculation of Blokker's market share on a turnover figure of which 20 % has been deducted as indicated by Blokker.

Market shares in the relevant market in 1996

Bart Smit	[...]	[20-30 %]
Intertoys	[...]	[20-30 %]
Marskramer/Familux	[...]	[<5 %]
Blokker	[...]	[5-15 %]
Total Blokker group	[...]	[55-65 %]
Toys 'R' Us	[...]	[3-10 %]
Blokker + Toys 'R' Us	[...]	[...]
Otto Simon	[...]	[10-20 %]
Vroom & Dreesmann	[...]	[3-10 %]
Bijenkorf	[<5 %]	
Hema	[<5 %]	
In den Olifant	[<5 %]	
Other (including Maxis)	[10 %]	Combined market share (estimate)
Total relevant market	100 %	

(56) In the calculation of Blokker's market share, all chains are taken together. According to Blokker, the Bart Smit, Intertoys and Blokker chains all have their own commercial policies with regard to purchasing, determination of product ranges and retail prices. [...]. However, this cannot lead to the conclusion that Blokker, Bart Smit and Intertoys are independent undertakings. What is decisive is that the chains all operate within the control over the competitive behaviour of all three chains. [...].

(57) Moreover, although Blokker argues that there is no coordination on purchasing between the chains, it appears from the Commission's investigation that a degree of coordination between the three chains with respect to purchasing conditions does exist. A number of suppliers have stated that, although the Blokker chains make their purchases separately, the prices and conditions fixed are the same. In addition, a number of suppliers have stated that they operate a bonus system in which bonuses are based on the aggregated purchasing volume of the Blokker chains taken together. Furthermore, the Blokker Group does make certain purchases as a group, as is confirmed by Blokker itself.

(58) [...].

(iii) Position of Blokker prior to the operation

Market share

(59) On the basis of the Commission's investigation, prior to the operation the Blokker group held a market share of around [55-65 %] on the specialised toy retail market. This high market share in itself creates a presumption of dominance⁽¹⁴⁾, especially when compared to the fragmented structure of the rest of the market. The nearest competitor, Otto Simon, is more than three times smaller than Blokker with [10-20 %]. Vroom and Dreesmann has between [<3 %] and [<10 %] and Toys 'R' Us is in a similar position, while all the other market players have market shares significantly below 5 %.

Formula diversity

(60) Prior to the operation, Blokker already operated three different formulas of specialised toy retail

⁽¹⁴⁾ Commission Decision 97/277/EC in Case IV/M.784—Kesko/Tuko (OJ L 110, 26.4.1997, p. 53, paragraph 106).

outlets all of which were located in city-centre shopping streets and urban shopping centres. Bart Smit is more often found in larger and medium-sized supply areas while Intertoys is more often found in smaller cities and communities. The average size of the stores does not exceed [...] m².

- (61) Both Bart Smit and Intertoys offer a large but not complete product range. This is due to the high lease costs of retail space in the city centre and in shopping centres resulting in relatively small stores. Both chains focus on the articles which are most popular at the time. The toy departments of the Blokker stores carry a smaller product range than the Bart Smit and Intertoys stores (for example, Blokker stores do not sell video games or PC software). The product assortment of the Bart Smit, Intertoys and Blokker formulas differ to a certain extent, as confirmed by Blokker and the Commission's investigation of the catalogues of the chains. Nevertheless, the chains together carry an extensive range of toy products.
- (62) The fact that Blokker operates three distinct formulas, particularly with varying product assortments, is a competitive advantage. The difference in product range reduces the overall transparency of prices *vis-à-vis* competitors and consumers. Moreover, it enables Blokker either to initiate or react to product or price changes on the level of the chain rather than the group as a whole which increases its flexibility *vis-à-vis* its competitors on the market.

Scale economies in unbranded and own-branded products

- (63) On the Dutch toy retail market, the proportion of unbranded and own-branded products directly purchased from the Far East is higher than in neighbouring countries. According to several competitors the Blokker chains have a reputation for carrying a large proportion of unbranded and own-branded products. Blokker itself states that its direct purchases in the Far East include branded products.
- (64) The higher proportion of unbranded and own-branded products on the Dutch market is explained by the parties by the relatively high costs of retailing due to expensive high street locations. As a result of this, parties state, retailers tend to compensate the lower margins on branded products, of which prices are usually harmonised by suppliers at a European level, with higher margins on unbranded and own-branded products.

- (65) The fact that Blokker carries a large proportion of unbranded, own-branded and directly purchased branded products in combination with its high market share enables it to realise economies of scale in purchasing which cannot be achieved by its competitors. These economies of scale confer upon Blokker a significant competitive advantage. Furthermore the high volume of unbranded and own-branded products also enables Blokker to behave more independently on the market in relation to pricing strategies, since it is not subject to direct price comparisons by competitors and customers in the same way as with branded products.

- (66) The parties argue that the prices of unbranded products are determined by prices of similar competing branded products and as a result of this, Blokker is restricted in its pricing strategies on unbranded products. Although unbranded and own-branded products will generally not be sold at prices higher than those of competing products, this still leaves Blokker considerable scope for independent pricing behaviour.

Gatekeeper function of Blokker

- (67) With regard to the position of Blokker, some suppliers have confirmed that, as a result of its high market share, Blokker has a 'gatekeeper' function as concerns access to the toy retail market. To introduce a new toy product on the market a supplier needs to have access to the important distribution channels in order to realise the necessary critical sales volume to recover its investments in radio and television commercials. One of the largest suppliers stated that it would need access to and the support of a minimum of two of the current three Blokker formulas for a successful strategic new product launch with media support, in order to recover the cost of introduction of the new product on the market. Furthermore, two other large suppliers stated that they would not consider introducing a new product on the Dutch market without it being in the Blokker outlets. It follows from the above that Blokker can influence the range of products introduced on the Dutch market. This was also stated by a number of competitors who complained that they were unable to make purchasing decisions on product lines independently of Blokker.

The parties' argument on prices

- (68) The parties argue that prices are low in the Netherlands and that the Dutch consumers are

very price conscious and they state that is an indication that Blokker does not hold a dominant position. The Commission acknowledges that the average value per toy item sold on the Dutch market may be lower than in neighbouring markets. However, as the parties themselves state that 'pricing levels of branded products are usually harmonised at the European level', the supposed low average price per toy item therefore mainly concerns unbranded or own-branded products, which make up a large proportion of toy sales in the Netherlands and for which price comparison parameters do not exist or are not available. Furthermore, one of the largest suppliers mentioned as an additional explanation the Dutch habit of giving many small presents at Saint Nicolas instead of one big present.

(iv) The position of competitors

Otto Simon

(69) As stated above, the aggregate market share of the three Otto Simon formulas is less than one third of that of the Blokker group. In addition, the structure of the Otto Simon group is relatively loose. Since the shops may differ in appearance, the members of the Speelboom formula do not necessarily give the impression of belonging to a chain. The central organisation of Otto Simon operates a common purchasing system, advises on product ranges and offers certain support services. However, members are free to determine their product range. Although this flexibility might be an advantage in so far as it enables members to adopt individual marketing strategies, the loose organisation in combination with the relatively small market share limits the possibility for Otto Simon as a group to carry out a sustained competitive strategy against the Blokker Group.

(70) According to Otto Simon, between 1992 and 1997 more than 30 Otto Simon members have left one of the Otto Simon formulas to join the Intertoys formula of the Blokker group. Blokker has pointed out that the acquisition of Intertoys was made in 1994 and not in 1992. However, in 1992 Blokker had a significant minority stake in Intertoys. How Blokker views the strength of competition from the Otto Simon group is illustrated by the remark from Mr Blokker, Chairman of the Board of Blokker, in an interview published in the business magazine *Quote* in December 1994 in which he states: 'For some time we have been busy converting a number of these shops (Otto Simon members) to the right belief' and 'If they don't opt for Intertoys, they face the risk of getting one of our shops next door'. It should be noted in this context that Blokker does not sell toys in all its household articles shops. It therefore has flexibility

to open toy departments in its stores where and when it considers appropriate.

Toys 'R' Us

(71) Toys 'R' Us entered the Dutch market in 1993 and operated nine stores in the Netherlands in 1996. [...].

(72) The Toys 'R' Us concept is based on a merchandise and logistics system which ensures that the broad product range is always in stock. This concept needs a certain critical mass of sales in order to be economically viable. According to Toys 'R' Us, the critical mass of sales and number of stores needed to achieve an acceptable return could not be achieved in the smaller European markets (such as the Netherlands). Therefore the strategy of Toys 'R' Us operating in these smaller markets was to expand into them from neighbouring bigger markets using the existing infrastructure in these bigger markets.

(73) The Toys 'R' Us operations were managed and supplied through the German Toys 'R' Us subsidiary. However, in copying the German Toys 'R' Us concept in the Netherlands without changing the product range, Toys 'R' Us underestimated the significant differences in preferences between Dutch and German consumers, which had an adverse effect on sales in the Netherlands.

(74) In addition, it is common knowledge that in its first year of operations Toys 'R' Us was not fully aware of the specificity of the Dutch Saint Nicholas Day, the peak of toy sales in the Netherlands. Store appearances emphasised Christmas instead of Saint Nicholas.

(75) [...].

(76) It can be seen, therefore, that Toys 'R' Us suffered from structural weaknesses and made marketing errors which severely limited its ability to compete strongly on the Dutch market. These weaknesses are recognised by Blokker, the market in general and Toys 'R' Us itself. In the light of the above, Toys 'R' Us did not develop into a significant competitive force on the Dutch market.

Department stores and other specialised outlets

(77) The departments stores have a combined market share of between 5 % and 10 %. Although they

are all part of major retail operators, their market shares in the relevant market are nevertheless small. According to one department store, toys are considered to be a necessary component of the overall product range offered by such a store. Nevertheless, with such a small market share their ability to compete is limited.

- (78) All other operators in the relevant market have market shares considerably lower than 5 %. Most of them can be characterised as specialised niche players which lack the possibility or the intention to compete against the retailers which carry broader ranges.

Competitive pressure from other outlets

- (79) The Commission acknowledges that to some extent the specialised toy retail outlets do face competition from other outlets selling toys, in particular in the toy season. As stated above, toys are sold for the most part through specialised toy retail outlets. In reaction to the request from the Dutch Government, which estimates the importance of other outlets at 5 % of total sales, Blokker estimates this percentage at a maximum of 20 % of total sales.

- (80) As regards the so-called classic toy products, certain other retail outlets have had some success with the sale of individual classic toy products. These retail outlets do not sell a broad assortment of toys but offer only individual items or a limited number of products from between one and three suppliers. These products are used to attract consumer traffic by offering a particularly attractive price or are intended to be bought as impulse purchases. For example, Shell has sold a considerable number of Lego products in its petrol stations. The drugstore chain Kruidvat currently sells Lego products, Barbie dolls and Fisher Price articles on a permanent basis and certain non-branded items as action sales. These sales can have a competitive effect on the same or similar products offered by specialised toy retail outlets. However, their effect on the overall position of the specialised toy retail outlets is limited. Moreover, to the extent that these sales are of a temporary nature, their competitive effect will also be limited in time. Therefore, this competition from drugstores, supermarkets and petrol stations is not regarded as sufficient to counteract the market power of Blokker in the relevant market.

- (81) Electronic and videogames are more widely available through other retail channels such as computer shops, electronics shops and record shops. The sale of these items through other outlets can affect prices of these items in the specialised toy retail outlets of Blokker. However

the competitive effect of these sales only concerns one category of the broad assortment of the specialised toy retail outlets, which makes up at most 10 % of total turnover of these outlets. Furthermore, the Bart Smit and Intertoys retail outlets of Blokker are still the most important vendors of these products.

Conclusion

- (82) On the basis of the foregoing, it is the Commission's view that prior to the concentration Blokker already had a dominant position on the market for specialised toy retail outlets.

(v) Position of Blokker after the operation

Market share

- (83) The market share of the Toys 'R' Us operation at the nine stores in the Netherlands is estimated at [3-10 %]. According to Toys 'R' Us, the six shops which Blokker has taken over account for [...] % of its total turnover, which leads to a market share of at least [...] %.

- (84) [...].

- (85) The combination of Blokker with the Toys 'R' Us operation in the Netherlands will lead to a combined market share of at least [60-70 %].

- (86) The calculated increase in market share of the Blokker group does not include the increase in market share gained from three shops which will be closed. It can be expected that a significant part of the market share of those three stores will be obtained either by the existing chains of Blokker or by the remaining Toys 'R' Us stores. Therefore the actual combined market share after the operation will be higher.

- (87) The parties argue that the increase in market share is insignificant and cannot be considered to strengthen a dominant position. They state further that 'irrespective of whether the transaction is approved, the accretion of market share will be insufficient to effect any meaningful change in the competitive structure of the market'.

- (88) In the view of the Commission, the combination of the increase in market share with a number of factors which together demonstrate that the potential of the acquired business is much greater than is reflected in its actual market share, further strengthens the dominant position of Blokker.

*Strategic value and complementarity of
Toys 'R' Us to Blokker*

(89) Through the acquisition of the six Toys 'R' Us stores, Blokker adds a fourth formula to its three existing toy formulas. This fourth formula is distinct from the three formulas already under control of the Blokker group with respect to location, size and product ranges.

(90) [...].

(91) The Toys 'R' Us formula consists of megastores with substantial floor space located outside the city centres and urban shopping centres which are easily accessible by car. Toys 'R' Us sells toys in a supermarket-like environment which is aimed at efficient shopping without services such as gift wrapping. Because of their extensive floor space, Toys 'R' Us stores can offer a very large product range (according to Toys 'R' Us, 'the widest possible choice') which also includes therefore the widest range of branded toys and also the more bulky toy products. The Toys 'R' Us formula applies not only to toys but also to other child-related products such as nappies, baby food and baby furniture. These other products can be used as a means to attract consumers and increase the frequency of consumer visits to the store. Another distinctive feature of Toys 'R' Us is that a part of the warehousing is done in the stores themselves. Therefore Toys 'R' Us claims that it can guarantee that its products are always in stock.

(92) Since the Toys 'R' Us megastores are all located at peripheral and suburban locations, the acquisition gives Blokker relatively easy access to the market segment of large-scale suburban retailing, which is considered to be of great importance for the future of retailing. This assessment is made by the majority of suppliers. As a result of this Blokker has an important first mover advantage. Although the Dutch Governmental policy on large-scale retailing has been relaxed recently, large-scale suburban retailing of products like toys is still restricted to only 13 urban agglomeration centres ('stedelijke knooppunten'). To date Toys 'R' Us is the only specialised toy retailer operating in this market segment.

(93) The franchising agreement permits Blokker to purchase toys through the central buying operation for sale by the franchisee or in any franchised store. This provides Blokker with an additional advantage which could be even more valuable to the extent that it could also apply

beyond the Toys 'R' Us stores and directly to other Blokker chains. Although the parties claim that Blokker is not entitled to use the central buying operation for outlets other than Toys 'R' Us outlets, this interpretation is not supported by the wording of the Franchise Agreement. The parties further claim that joint purchasing is only of limited importance, representing about [...] of the Toys 'R' Us stores sales. However, this argument does not negate the potential value of joint purchasing.

(94) Moreover, by acquiring control over the Toys 'R' Us formula, Blokker can seek to ensure the greatest complementarity between the four formulas with respect to product ranges and prices. [...]. Although Blokker may have to keep up the Toys 'R' Us image of attractive prices to attract consumers out of the city centres, it can seek to prevent actual competition between the Toys 'R' Us stores and the Bart Smit and Intertoys stores by for example using selective low-price strategies on products which are only sold at Toys 'R' Us stores or using complementary product-range strategies. The fact that Blokker carries a large proportion of unbranded goods further increases its possibility to carry out such a strategy. In this respect it may be noted that the Franchise Agreement gives Blokker considerable freedom within the product categories given by Toys 'R' Us.

The potential of Toys 'R' Us in the Blokker Group

(95) Although the Dutch Toys 'R' Us operation had relatively little market success and is in a difficult financial position, the formula and the stores still have a considerable market potential, particularly in the hands of Blokker, which has the necessary knowledge of the Dutch market. Toys 'R' Us is a very strong brand name. According to Toys 'R' Us, it has a reputation of having the broadest product ranges at attractive prices. In a situation where a local partner acts as a franchisee of the Toys 'R' Us stores, the stores will still be linked to the network of stores of one of the world's largest toy retailers and can profit from any services provided by the network as well as its brand.

(96) The fact that Toys 'R' Us is now operated by what is by far the leading player in the market brings a number of significant advantages for Toys 'R' Us. More specifically, Blokker will bring in its extensive knowledge of the specific preferences and habits of consumers in the national market. It

is entitled to select the products and is likely to do so in a way that better suits the preferences of the Dutch consumers. Blokker will not face the same structural weaknesses as Toys 'R' Us and is unlikely to make the same marketing errors. [. . .]. In addition, all the advantages of economies of scale, including discounts, will apply. Furthermore, Toys 'R' Us can benefit from the advantages of being linked to a major Dutch retailer such as access to advertising, personnel management and support services (for example cleaning and security).

"R" Us puts a formula in the market which is necessary for a healthy and balanced toy market in the Netherlands. A takeover of Toys "R" Us has become necessary at this moment to secure the continuity of this undertaking in the Netherlands. The fact that this formula is picked up by a professional party in the Dutch toy market is very favourable for the Dutch consumer. The possible takeover of the Toys "R" Us activities by Blokker will not influence the competitive situation significantly further'.

(97) From the above it can be concluded that it is likely that Toys 'R' Us controlled by a local partner with the required knowledge of the national market will perform significantly better than it has done to date and will show substantial growth in market share and potential expansion in the number of stores. [. . .].

(101) In a meeting with the Commission services, ORNES confirmed its support for the operation, particularly on the premise that otherwise Toys 'R' Us would exit the market. At this meeting, it also confirmed the potential success of Toys 'R' Us in the hands of Blokker.

(98) This argument is also borne out by the statement of Toys 'R' Us which cites the success of its partnerships with local distributors in other Member States. The poor performance of Toys 'R' Us in smaller markets was not only limited to the Dutch market. Similar situations have occurred in Sweden and Denmark. The Toys 'R' Us operations in Sweden and Denmark were started up in 1994 and were originally managed and supplied from the United Kingdom. The operations in Denmark (one store) and Sweden (three stores) did not achieve the financial returns required by Toys 'R' Us in 1994 and 1995. In 1996 the operations were transferred to local retailers operating under a franchise agreement. After the new franchise operators introduced a market-specific merchandise assortment, sales per store went up significantly in both Sweden and Denmark. In Denmark the number of stores increased from one to nine in the year 1996.

(102) It must be said at the outset that the interests of suppliers and consumers in a retail market are not necessarily the same. The consumer's interest is not generally served by the concentration of supply in the hands of a single player. In addition, it is noted that the Dutch Toys 'R' Us stores were previously not supplied by the Dutch sales offices but through the German Toys 'R' Us operation. In this respect, therefore, the Dutch sales offices will gain in sales from the operation, a fact which has been expressly recognised by many individual suppliers.

(vii) The ability of competitors to react

(vi) Comments of suppliers

(99) In the course of its investigation the Commission contacted a number of suppliers to Blokker as well as ORNES, the organisation in which Dutch subsidiaries of international branded toy manufacturers and Dutch suppliers of branded toys are represented.

(103) As explained above, the operation will further increase the substantial lead of Blokker over its competitors. These will be even less able to compete with Blokker, in particular as one of the potentially strong competitors is now in the hands of Blokker. In addition, Blokker will be able to minimise any negative effects of the increase in market share by Toys 'R' Us on its other operations by adapting its product range and pricing strategy.

(100) On an individual basis, suppliers tended to be neutral or indifferent to the operation while acknowledging the already strong position of Blokker. Some, however, were more critical of the operation while others recognised advantages and disadvantages arising from the operation. ORNES has stated: 'ORNES is of the opinion that Toys

(104) Since products stocked in Toys 'R' Us stores by the German sales organisation prior to the operation will now be purchased by Blokker, this will increase the latter's control over the products supplied on the Dutch market, especially branded products. This can only further weaken the negotiating position of competitors *vis-à-vis* suppliers by comparison with the position of Blokker.

(viii) Barriers to entry and potential competition

strengthening of a dominant position on the market for specialised toy retail outlets by Blokker.

Barriers to entry

- (105) There are no regulatory barriers to entering the market of specialised toy retailing except that planning restrictions may apply to large-scale outlets. In recent years, three toy retail formulas have entered the Dutch market, Toys 'R' Us, the Early Learning Centre and In Den Olifant. However, the market share of the latter two is minimal. Moreover, Toys 'R' Us and the Early Learning Centre, which have been managed from outside the Netherlands, have since been taken over by Dutch operators. This underlines the difficulties for new entrants from outside the Netherlands to penetrate successfully the Dutch market. Moreover, the dominant position of Blokker is in itself a barrier to entry. In addition, market entry has not necessarily been encouraged by a generally declining value of the toy retail market in recent years.

Potential entry into the relevant market

- (106) The reactions from Dutch retailers approached by the Commission indicate that there is little likelihood that other Dutch retailers will enter the market for specialised toy retailing in the foreseeable future. There is nothing to indicate that those retailers which already carry a small selection of toys intend to become specialised toy retail outlets in the near future.
- (107) Argos, a major catalogue retailer in the UK, is planning to enter the Dutch market in 1998 and will start operations with five stores. The concept of Argos is based on the publication of a catalogue which features a wide range of predominantly branded products which the consumer can collect and pay for at an Argos store. Argos will carry among its products a specialised assortment of toys. Argos will start operations on a relatively small scale. It is unlikely to compete at a significant level in the short to medium term. There are no indications that other retailers from neighbouring countries will enter the market.

(ix) Conclusion

- (108) For the reasons set out above, the view of the Commission is that the operation leads to the

VII. FAILING COMPANY DEFENCE

- (109) Toys 'R' Us has argued that its Dutch operations are not financially viable without the support of a local partner and has put forward the 'failing company defence'. It has stated that Toys 'R' Us will close its operation in the Netherlands if the transaction is not permitted. In its initial reaction Toys 'R' Us said that the market share of Toys 'R' Us would inevitably go to Blokker; later it said that Blokker will pick up most of the Toys 'R' Us share. It is also claimed that there is no alternative solution which is less anti-competitive.
- (110) The Commission has decided in earlier cases⁽¹⁵⁾ that a merger is generally not regarded as leading to a deterioration in the competitive structure if it is clear that the acquired undertaking would in the near future be forced out of the market, the acquiring undertaking would take over the market share of the acquired undertaking if the latter were forced out of the market, and that there is no less anti-competitive alternative purchaser in the market. The burden of proof in this respect is on the parties themselves.
- (111) The 'failing company' doctrine as developed in these cases and confirmed by Advocate-General Tesouro⁽¹⁶⁾ is based on the lack of causality between the concentration and the creation or strengthening of a dominant position. This means that it is the disappearance of the failing company, which is unavoidable whether or not the concentration takes place, and not the concentration itself, which creates or strengthens the dominant position.
- (112) This lack of causality between the operation and its effects on the market has not been established in this case. It has not been established that the whole of the market share of Toys 'R' Us would

⁽¹⁵⁾ Commission Decision 94/449/EC in Case IV/M.308 — Kali & Salz Mdk Treuhand (OJ L 186, 21.7.1994, p. 38, paragraph 71); Commission Decision 97/610/EC in Case IV/M.774 Saint-Gobain/Wacker-Chemie/NOM (OJ L 247, 10.9.1997, p. 1, paragraph 247).

⁽¹⁶⁾ Opinion of Advocate-General Tesouro of 6 February 1997 in Joined Cases C-68/94 and C-30/95 France v. Commission [1998] ECR I, p. 1375, paragraph 49 *et seq.*

go to Blokker. Furthermore, it is not only the gain in market share but also the potential of Toys 'R' Us as part of the Blokker group which leads to the deterioration of the competitive situation. Therefore, it cannot be said that it is the disappearance of the Toys 'R' Us operations which would lead to the same results as the merger, the deterioration of the competitive situation.

- (113) Furthermore, Toys 'R' Us has not shown that there was no less anti-competitive purchaser. The claim of Toys 'R' Us that only the Blokker group met its requirement of having sufficient knowledge of the Dutch toy retail market and the necessary infrastructure is not in itself an argument that there were no other potential buyers. On the contrary, it rather supports the assessment that Toys 'R' Us selected the strongest player on the market. In its description of other potential buyers, Toys 'R' Us said that it rejected those parties which had no specific knowledge of the market conditions in the Benelux or operators which were potential competitors in other Member States.

VIII. OVERALL CONCLUSION

- (114) For the above reasons the Commission concludes that the acquisition by Blokker of the Dutch operations of Toys 'R' Us strengthens a dominant position on the market for specialised toy retail outlets in the Netherlands, as a result of which effective competition is significantly impeded in the Netherlands.

IX. APPLICATION OF ARTICLE 8(4) OF THE MERGER REGULATION

- (115) Article 8(4) states that, where a concentration has already been implemented, the Commission may, in a decision pursuant to Article 8(3), require the undertakings or assets brought together to be separated or any other action that may be appropriate to restore conditions of effective competition.
- (116) The Commission takes note of a supplementary agreement [...]. In the statement of objections the Commission referred to that supplementary agreement and stated that conditions of effective competition could be restored by ordering Blokker to terminate all agreements which implement the Letter Agreement of 24 December 1996.

- (117) On 4 June 1997 Blokker and Toys 'R' Us submitted to the Commission undertakings by which they sought to resolve the competition concerns raised in this case. The parties requested the Commission, in the light of those undertakings, to grant a clearance decision under Article 8(2) of the Merger Regulation. Subsequently those measures were clarified and supplemented in a certain number of respects.

- (118) It is noted that Blokker has been operating the Toys 'R' Us business since 3 February 1997. As such, therefore, the concentration has been fully implemented since that date. [...].

- (119) For the reason the Commission considers it appropriate to maintain the decision under Article 8(3) of the Merger Regulation and considers the parties' proposals as a means of divestiture to be seen in the light of Article 8(4), rather than under Article 8(2), of the Merger Regulation.

- (120) In summary the undertakings submitted by Blokker and Toys 'R' Us include the following.

- (121) Blokker undertakes to transfer to its wholly owned subsidiary Speelhoorn BV (Speelhoorn): (i) all of Blokker's rights and obligations pursuant to the Franchise Agreement; (ii) all of Blokker's rights and obligations pursuant to the Marketing Subsidy Agreement; and (iii) all the assets acquired by Blokker pursuant to the Asset Purchase Agreement.

- (122) Blokker undertakes as soon as practical after the notification of this decision, to begin negotiations with interested third parties with a view to transferring at least 60 % of the share capital of Speelhoorn to a viable and independent undertaking not connected with either Blokker or Toys 'R' Us, which is capable of maintaining the Dutch Toys 'R' Us on the market and fulfilling the social commitment made by Blokker. The choice of such an independent third party will be subject to the Commission's reasonable approval.

- (123) Blokker undertakes not to retain a minority shareholding in Speelhoorn that exceeds 20 %. Blokker undertakes to transfer to Toys 'R' Us a minority shareholding corresponding to its own shareholding. Blokker and Toys 'R' Us will both be entitled to a maximum of one seat on the board of Speelhoorn which will comprise five members. Furthermore, Blokker and Toys 'R' Us will not be granted any special rights beyond those typically provided to minority shareholders.

Blokker undertakes that it will not interfere with Speelhoorn's freedom to determine independently its commercial policy.

- (124) Prior to the completion of the transfer of a majority shareholding in Speelhoorn to a third party, Blokker will ensure that Speelhoorn and the Dutch Toys 'R' Us stores are managed as distinct and saleable undertakings with their own management accounts. During this period, Blokker will ensure the continued viability and market value of those stores and will provide sufficient financial resources to this end in the ordinary course of business.
- (125) [...].
- (126) [...].
- (127) [...].
- (128) The parties have subsequently clarified and supplemented these measures as follows. The third party will be an independent undertaking unconnected to the Blokker group, which is able to maintain and develop the Toys 'R' Us business as an active competitive force on the market. Blokker will end its presence on the management board of Speelhoorn after [...] years following the transfer of a majority shareholding to a third party. [...]. Blokker will provide to the Commission on a monthly basis written reports concerning the relevant developments in its or the banker's negotiations with third parties concerning the transfer of a majority shareholding in Speelhoorn.

Assessment and measures pursuant to Article 8(4) of the Merger Regulation

- (129) In the Commission's view, the total package of measures agreed by the parties will restore conditions of effective competition on the market. As such, therefore, the package of measures can be accepted as an alternative order for divestiture under Article 8(4) as compared with an order to undo the deal immediately, as set out in the statement of objections.
- (130) The Commission acknowledges that the transfer of up to 80 % of the share capital of Speelhoorn (up to 20 % to Toys 'R' Us and the remainder to an independent third party) provides the opportunity for an independent undertaking to acquire a substantial interest in the Toys 'R' Us business and, should that undertaking wish to do so, to acquire the whole share capital of Speelhoorn immediately or after a certain period

of time. In the Commission's view, an essential element to restore effective competition is that the purchaser of a majority share must be an independent undertaking unconnected to the Blokker group which is able to maintain and develop the Toys 'R' Us business as an active competitive force on the market.

- (131) In addition, the Commission must be put in a position to evaluate whether a chosen purchaser satisfies the abovementioned requirements. Therefore, it is necessary for Blokker to obtain the approval of the Commission before entering into a binding agreement with such a third party. In a request for approval, evidence that the third party satisfies the abovementioned requirements must be produced in order to put the Commission in a position to assess the choice of third party. If the Commission does not either formally indicate its disagreement with the choice of the third party or require further evidence that the third party satisfies the abovementioned requirements, within two weeks after submission of the request, the transfer of the share capital to a third party should be free to proceed.
- (132) The Commission further acknowledges that, in the light of the specific circumstances of the case, in particular the poor performance of the Toys 'R' Us business in the Netherlands since its establishment in 1993, there may be difficulties in attracting a third party to purchase the whole of the Toys 'R' Us business. For this reason, the Commission considers that the continued presence of Blokker in the form of a 20 % minority shareholding in combination with the active presence of Blokker on the management board of Speelhoorn can, at least for a certain period of time, serve both to demonstrate the confidence of Blokker in the future viability of the company and to guarantee the development of the company into a viable business within this period. However, in the light of the specific circumstances of this case, the Commission considers that Blokker's representation on the board should not only be reduced but, after a certain period of time, in this case [...] years after the transfer of the shareholding to the third party, eliminated completely.
- (133) In reaching this conclusion, the Commission takes into account the following specific circumstances of the case. The management board of a small retail company such as Speelhoorn will by its nature be composed of a small number of representatives which are closely involved in the commercial policy of the company. Although Blokker undertakes not to interfere with Speelhoorn's freedom to determine independently its commercial policy, the presence of Blokker on the board will still give it access to information on

the commercial decisions which it could use for its own competitive strategy and also in relation to the competitive strategy of the Toys 'R' Us business operated by Speelhoorn. This possibility is to be evaluated especially in the light of the fact that, for a certain period of time, Blokker will have been operating the Toys 'R' Us business on its own and that, even after the implementation of the divestiture asset set out in the proposals, Blokker has a dominant position on the market. Therefore the Commission considers it necessary in order to ensure that effective competition is restored on the market, that Blokker's active presence on the management board should be eliminated once the viability of the company is established. This can be achieved by ordering Blokker to end its presence on the management board [...] years after the transfer of a majority shareholding in Speelhoorn to a third party.

- (134) The active presence of Blokker in Speelhoorn can also be ended by giving the third party the opportunity, should it wish to do so, to purchase the share capital of Speelhoorn held by Blokker. [...].
- (135) The Commission considers it necessary and appropriate that Blokker should provide to the Commission on a monthly basis written reports concerning the relevant developments in its or the banker's negotiations with third parties concerning the transfer of a majority shareholding in Speelhoorn.
- (136) The Commission underlines that the parties are free, at any stage during the period set out above, to terminate the agreements provided for in the Letter Agreement of 24 December 1996 with the aim of transferring all rights, obligations and assets acquired by Blokker back to Toys 'R' Us. In addition, Blokker is not obliged to terminate any employment agreements,

Speelhoorn BV: (i) all of Blokker's rights and obligations pursuant to the Franchise Agreement dated 3 February 1997, between Blokker and Toys 'R' Us, (ii) all of Blokker's rights and obligations pursuant to the Marketing Subsidy Agreement of 3 February 1997 between Blokker and Toys 'R' Us; and (iii) all the assets acquired by Blokker pursuant to the Asset Purchase Agreement of 3 February 1997 between Blokker and Toys 'R' Us. This transfer must be implemented as soon as practical after the notification to Blokker of this Decision and in any event no later than the date on which Blokker enters into a binding letter of intent with a third party on the sale of a majority shareholding in Speelhoorn BV;

- (b) to divest itself of at least 80 % of the total share capital of Speelhoorn BV in the following way. Up to 20 % of the total share capital of Speelhoorn BV shall be transferred to Toys 'R' Us. At least 60 % of the total share capital of Speelhoorn BV shall be transferred to a third party. The third party shall be given the possibility to purchase the total share capital of Speelhoorn BV or at least the 80 % held by Blokker. The third party must be an independent undertaking unconnected to the Blokker group and must be able to maintain and develop Speelhoorn BV as a viable and active competitive force in the market for specialised toy retailing. Blokker may hold one seat on the management board of Speelhoorn BV on condition that the third party has at least three seats and Toys 'R' Us has one seat. Blokker may hold the seat no longer than for a period of [...] years, following the transfer of a majority shareholding to a third party [...];
- (c) to appoint a banker with recognised experience in the sale of undertakings to act on its behalf to sell a majority shareholding in Speelhoorn BV, if it has not entered into a binding letter of intent on the sale of a majority shareholding in Speelhoorn BV by [...];

HAS ADOPTED THIS DECISION:

Article 1

The concentration by which Blokker Holding BV acquires the Dutch operations of Toys 'R' Us Inc. is declared incompatible with the common market and with the functioning of the EEA Agreement.

Article 2

Blokker is ordered:

- (a) to transfer the following assets, rights and obligations to its wholly owned subsidiary

- (d) to provide to the Commission written reports on a monthly basis concerning the relevant developments in its or the banker's negotiations with third parties concerning the transfer of a majority shareholding in Speelhoorn BV;
- (e) to obtain the approval of the Commission before entering into a binding letter of intent with such a third party. In a request for approval, evidence that the third party satisfies the requirements set out in (b) must be produced in order to put the Commission in a position to assess the choice of a third party. If the Commission does not either formally indicate its disagreement with the choice of the third party or require further evidence that the third party satisfies the requirements set out in (b) within two weeks after submission of the request,

the transfer of the share capital to a third party shall be free to proceed.

Article 3

In the event that Blokker fails to enter into a binding letter of intent with a third party before [...] in the manner set out in Article 2, Blokker is ordered to transfer all rights, obligations and assets acquired pursuant to the Letter Agreement of 24 December 1996 to Toys 'R' Us [...]. Blokker is not obliged to terminate any employment agreements.

Article 4

This Decision is addressed to:

Blokker Holding BV
Van der Madeweg 13
The Netherlands 1099 BS Amsterdam

Done at Brussels, 26 June 1997.

For the Commission

Karel VAN MIERT

Member of the Commission

COMMISSION DECISION

of 16 December 1997

on State aid granted by the *Land* of Thuringia to Thüringer Motorenwerke GmbH

(notified under document number C(1997) 4341)

(Only the German text is authentic)

(Text with EEA relevance)

(98/664/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 regard to the Agreement establishing the European Economic Area, and in particular Article 62(1)(a) thereof,

Having given the other Member States and other parties concerned notice to submit their comments, in accordance with Article 93(2) of the EC Treaty,

Whereas:

I

State aid for Thüringer Motorenwerke GmbH (hereinafter referred to as 'TMW') was notified by Germany to the Commission by letter dated 8 August 1996, received on 12 August 1996. The notification concerned rescue aid provided under a scheme known as the Consolidation Fund of the *Land* of Thuringia (*Konsolidierungsfonds des Landes Thüringen*), authorised by the Commission on 20 December 1995⁽¹⁾.

Several loans totalling DEM 4,8 million had been made to the company under the scheme in 1995 and 1996 without awaiting the Commission's decision. The case was therefore registered as non-notified aid under the reference NN 99/96.

TMW's main business is the production of engines for motor vehicles.

By letter dated 8 November 1996, the German authorities informed the Commission that *Gesamtvollstreckungsverfahren* proceedings (insolvency proceedings prior to a takeover or the winding-up of the company) had been initiated on 30 September 1996.

The Commission informed Germany, by letter dated 23 January 1997, that it was initiating Article 93(2) proceedings in respect of the whole of the rescue aid

measures in the form of subsidised loans (with a nominal value of DEM 4,8 million), on the following grounds:

- doubts as to the compatibility of the loans with the common market, in view of the period they covered, which was more than six months,
- doubts as to the compatibility with the common market, of the loans granted in 1996, since the principle that the aid should be a one-off operation did not seem to have been complied with; also, doubts as to the nature of the aid and whether the respite obtained through the granting of the loans had actually been used to draw up a coherent restructuring plan aimed at restoring the company's long-term viability,
- doubts whether various commitments entered into when the company IFA Motorenwerke Nordhausen GmbH was privatised by the Treuhandanstalt ('THA') had been adhered to in the business plans presented.

The letter also stated that the business prospects described by Germany took no account whatever of TMW's insolvency.

By a notice published in the *Official Journal of the European Communities*⁽²⁾, the Commission gave the other Member States and interested parties the opportunity to submit any comments on the measures in question within one month of its publication.

II

Having requested on 24 February 1997 a one-month extension of the period initially set for presenting their comments, a request which the Commission granted, the German authorities submitted their comments by letter dated 1 April 1997. Since in the Commission's view the answers provided were not complete, it asked additional questions on 7 May 1997 and 6 August 1997. Germany then provided additional information by letters dated 26 June 1997, 10 October 1997 and 6 November 1997.

⁽¹⁾ OJ C 215, 25.7.1996, p. 6.

⁽²⁾ OJ C 104, 3.4.1997, p. 6.

- (a) Germany pointed out that the three loans granted in July 1995 (DEM 2 million), February 1996 (DEM 0,8 million) and April 1996 (DEM 2 million) by the public-law Thüringer Aufbaubank ('TAB') are subject to Commission approval and that, in the event of a negative decision, they would have to be recovered.

III

No comments from third parties were received by the Commission.

- (b) In addition, Germany noted that the first loan had been granted when ZMW belonged to Antriebstechnik Weimar-Amberg GmbH ('AWA'). Following the insolvency of AWA, the failure of what the German authorities described as the 'first restructuring' of TMW and the intervention of the company Rebag, which envisaged injecting DEM 2 million in new capital, it became apparent that the first loan was not sufficient to carry out successfully a new restructuring plan. A commercial bank had then stated that it was prepared to grant a DEM 6 million loan if it obtained a guarantee from the *Land* of Thuringia. The guarantee was not given, however, because, according to the information provided by the German authorities on 6 November 1997, the regional authorities had doubts as to the effectiveness of the restructuring plan, the stability of the company's management team and the balance-sheet situation, which was deteriorating. In the intervening period intended to allow the conditions to be re-established for the granting of the loan by the private bank, the TAB granted a third loan to safeguard TMW's liquidity. This arrangement, described by Germany as the 'second restructuring plan' also proved to be a failure. Following the insolvency of TMW, repayment of the loans was requested by the TAB, which instituted legal proceedings to recover its claims.

IV

- (c) Germany maintains its view that the loans granted to TMW were in the nature of 'restructuring' aid.
- (d) The information communicated by Germany shows the following picture:

(in DEM million)

	1993	1994	1995	30 June 1996
Workforce	115	85	87	87
Turnover	11	15	6	7
Profit or loss	-3,3	-7,9	-6,9	-2,2

The net position at 30 June 1996 showed debt of DEM 16,1 million. Production was halted as from September 1996.

- (e) By letter dated 10 October 1997, Germany informed the Commission that TMW no longer existed as a commercial undertaking.

- (a) The *Land* of Thuringia granted three successive loans to TMW through the intermediary of the TAB. It seems certain that, in view of its financial situation, TMW could not have obtained any loan to maintain its solvency and creditworthiness from a commercial bank. The preferential terms on which the loans were granted to TMW distort or threaten to distort competition. Furthermore, the market in engines for motor vehicles, on which TMW operates, involves significant intra-Community trade. There is therefore evidence of State aid within the meaning of Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

- (b) The Consolidation Fund of the *Land* of Thuringia authorised by the Commission on 20 December 1995⁽³⁾, under which the loans were granted, provides rescue and restructuring aid within the meaning of the Community Guidelines on State aid for rescuing and restructuring firms in difficulty 'the Guidelines'⁽⁴⁾. It requires individual notification where aid is granted in sensitive sectors, including the motor vehicle industry. Furthermore, the first loan, amounting to DEM 2 million, was granted in July 1995, before the Commission had approved the scheme. The German authorities should therefore have notified this first loan to the Commission as *ad hoc* aid, which they failed to do.

In its letter of 6 February 1996, the Commission noted that Germany had agreed to notify individually all cases in which rescue or restructuring aid was repeatedly granted to one and the same firm and in which the amount of restructuring aid previously granted exceeded ECU 1 million (some DEM 1,9 million). Since it considers all the aid to be restructuring aid, Germany should therefore have notified individually the second and third loans; this was not done.

The Commission concludes from the above that the three loans were notifiable under Article 93(3) of the

⁽³⁾ See footnote 1.

⁽⁴⁾ OJ C 368, 23.12.1994, p. 12.

EC Treaty. Since, moreover, the German authorities did not comply with the suspensory effect of Article 93(3) by granting the three loans before the Commission had taken a final decision, the aid provided through each of the loans is illegal in its form.

- (c) The aid element contained in such loans depends on the financial situation of the company. If its financial situation is not too unfavourable, the aid consists of the difference between the rate which the firm would obtain from a commercial bank, on the basis of the risk which it represents, and the rate on the loan granted through State assistance. However, if the company is in too precarious a financial situation, no commercial bank would grant a loan. The Commission's practice is then to consider that the aid element corresponds to the whole of the loan. On the basis of the information communicated by the German authorities, such as TMW's balance-sheet situation in 1995 and 1996, and the very unfavourable trend of turnover, the Commission considers that, in 1995 and 1996, TMW was in such a serious financial situation as to make it unable to obtain any loan whatsoever without State assistance. Consequently, the Commission considers that the amount of aid is the total amount of the loans, i.e. DEM 4,8 million.
- (d) Article 92(1) of the EC Treaty lays down the principle that aid corresponding to the circumstances which it envisages is incompatible with the common market. However, Article 92(2) of the EC Treaty sets out a number of exemptions from this principle. Given the nature and purpose of the aid, Article 92(2)(a) and (b) are not applicable here. Nor has Germany argued or shown that the aid was intended to compensate for the economic disadvantages caused by the division of Germany. The exemption provided for in Article 92(2)(c) is therefore also not applicable in this instance.

Article 92(3) sets out the types of aid which may be considered to be compatible with the common market. Compatibility with the EC Treaty must be assessed in the context of the Community as a whole and not in a purely national context. In order to safeguard the proper functioning of the common market and in view of the principles set out in Article 3(g) of the EC Treaty, the derogation criteria provided for in Article 92(3) must be interpreted strictly. As regards the derogation provided for in Article 92(3)(b) of the Treaty, the relevant aid is clearly not intended to promote the execution of an important project of common European interest or to remedy a serious disturbance in the German economy.

In order to be able to ascertain the compatibility of the aid with the common market under one of the derogations provided for in Article 93(3)(a) or (c) of the EC Treaty, the Commission must examine, respectively, whether the aid promotes the long-term development of the relevant region or whether the conditions laid down in the Community Framework on State aid to the motor vehicle industry⁽⁵⁾ and the Community Guidelines on State aid for rescuing and restructuring firms in difficulty are complied with.

V

Germany claims that what is involved is three successive grants of restructuring aid. The Commission cannot agree with this view.

- (a) The documents submitted by Germany show that the purpose of the three loans is to secure TMW's solvency in the short term by making available financial resources for the payment of salaries and outstanding debts. Furthermore, even if the limited resources which Rebag would have made available to TMW are included, the loans cannot at the same time secure the firm's short-term solvency and finance a hypothetical restructuring programme. The information provided by Germany following the initiation of Article 93(2) proceedings does nothing to rebut the Commission's view. By their nature and their objective, the three loans are therefore rescue aid.
- (b) Even if it had accepted Germany's mistaken description of the aid as restructuring aid, the Commission never received from Germany any information on any restructuring plan, within the meaning of the Guidelines, in respect of the granting of the first loan. In the absence of any such plan, the Commission is unable to regard such alleged restructuring aid as being compatible with the Treaty.
- (c) The German authorities did not present any information that would have removed the doubts expressed by the Commission in initiating proceedings regarding the existence of a coherent restructuring plan for restoring TMW's long-term viability in connection with the second and third loans. In addition, the Commission considers that the plan for reorientating the firm's activities, described briefly in the notification and amplified,

⁽⁵⁾ OJ C 284, 28.10.1995, p. 3.

albeit insufficiently, in the replies to the Commission's additional questions in 1996 and following the initiation of Article 93(2) proceedings, was not capable of restoring the firm's long-term viability. The DEM 6 million bank loan referred to in various letters from Germany was ultimately not granted, by the private commercial bank because, according to the letter of 6 November 1997, the *Land* guarantee was not given in view of doubts as to the real chances of implementing the reorganisation plan presented by the firm. Consequently, it is apparent that both the regional authorities, which refused to give an additional guarantee to the tune of DEM 6 million, and the commercial bank, which refused to grant the loan without a guarantee from a public body, took the view that the 'restructuring' would not allow TMW to restore its long-term viability. Another conclusion which the Commission draws from examination of the sequence in which events occurred is that the third loan was granted at a time when the German authorities already had doubts as to the quality of the restructuring plan and the company's viability.

The essential requirement that a plan for restoring the long-term viability of the firm must be drawn up and implemented has thus not been met as regards either the second or the third amounts of 'restructuring' aid. The Commission therefore concludes that the last two loans are also incompatible with the Treaty.

- (d) In addition, the period over which the loans were granted (nine months) and the breakdown of the total volume of aid into three separate agreements, with different amounts (DEM 2 million, DEM 0,8 million and DEM 2 million), show clearly that three successive grants of aid were involved, not to be confused with the payment by instalments which was provided for in the various loan agreements.

The Guidelines stipulate that, like rescue aid, aid for restructuring should normally need to be granted only once. The Guidelines also state that recurrent injections of aid in an assisted area will not be viewed any more leniently than in non-assisted areas.

- (e) Consequently, even if it had accepted the German authorities' unjustified description of the aid as restructuring aid, the Commission would have had to conclude that the three loans were incompatible with the Treaty.
- (f) The Commission also notes that TMW's bankruptcy and the winding-up of its business confirm that it was impossible to restore the firm's long-term

viability on the basis of the restructuring plan communicated by the German authorities.

VI

After careful scrutiny of the documents transmitted by the German authorities, the Commission considers that what is in fact at issue is three successive grants of rescue aid, as evidenced by the nature and purpose of the loans. Their compatibility with the Treaty should therefore be examined on that basis.

- (a) The Commission notes that the period covered by the first loan (from July 1995 to February 1996, when the second loan was granted) amounts to a little over six months. This repayable loan clearly constitutes liquidity help. As may be seen from the contract with the TAB, the loan is restricted to the amount needed to keep the firm in business, and in particular to the covering of its social security costs and routine operations. Furthermore, the loan is warranted on the grounds of the risk of the imminent cessation of payments by the firm and hence the unemployment of its workforce. Because of the level of business of the firm as illustrated, for example, by its turnover in 1995 and 1996, the scale of the rescue aid is not such as to have any undue adverse effects on the industrial situation in other Member States.

The first rescue aid, namely the first loan, thus complies with the conditions set out in the Guidelines. Consequently, the Commission concludes that, although illegal, this aid is compatible with the Treaty, since it qualifies for the exemption provided for in Article 92(3)(c) of the EC Treaty.

- (b) The Guidelines stipulate that rescue aid should be a one-off operation and that a series of rescues (in this case, the loan renewals) that merely maintain the status quo, postponing the inevitable and in the mean time transferring the attendant industrial and social problems to other, more efficient producers and other Member States is clearly unacceptable. Rescue aid should therefore be a one-off holding operation mounted over a limited period during which the company's future can be assessed.

The period during which the aid enabled TMW to remain in business was from July 1995 until the beginning of *Gesamtvollstreckungsverfahren*

insolvency proceedings, at the end of September 1996, giving a total of 15 months, whereas the Guidelines stipulate that such aid may be granted only for a period generally not exceeding six months. Furthermore, the Commission considers that no real restructuring plan under which the firm's long-term viability could be restored was drawn up during the additional period in which the firm was kept in business thanks to the second and third loans. Lastly, the German authorities do not cite any external factors which the firm could not have foreseen in order to justify the granting of the last two loans.

In conclusion, the aid granted illegally through the second and third loans does not qualify for the exemption provided for in Article 92(3)(a) of the EC Treaty, since the aid covered by that provision must help to promote the long-term development of the region, which is not the case in this instance, given the fact that the aid is intended only to cover the firm's operating costs and its losses without bringing about any structural improvement. The Commission would add that the derogations whereby certain operating aid in the assisted areas may be authorised under Article 92(3)(a) of the EC Treaty are not applicable in this case, notably because such operating aid may not be granted in breach of the specific rules covering aid granted to firms in difficulty, and because the aid must be intended to promote lasting and balanced development of economic activity, which is clearly not the case here. Lastly, the aid does not qualify for the exemption provided for in Article 92(3)(c) of the Treaty, since it does not comply with the principles set out in the Guidelines.

VII

The Guidelines state that the Commission will take account of the special features of small and medium-sized enterprises. Applying these specific criteria to TMW does not lead to any change in the assessment of the aid.

Since the aid provided under the second and third loans is illegal and incompatible with the Treaty, it must be recovered by the German authorities. Repayment must be made in accordance with the procedures and provisions of German law, together with interest running from the date on which the aid was granted, at an interest rate equal to the percentage value on such date of the reference rate used to calculate the net grant equivalent of regional aid in Germany,

HAS ADOPTED THIS DECISION:

Article 1

The aid granted to Thüringer Motorenwerke GmbH under the first loan of July 1995 amounting to DEM 2 million is illegal, but is compatible with the common market since it qualifies for the exemption provided for in Article 92(3)(c) of the EC Treaty.

Article 2

The aid granted to Thüringer Motorenwerke GmbH under the second loan of February 1996 amounting to DEM 0,8 million and the third loan of April 1996 amounting to DEM 2 million is not eligible for the exemptions provided for in Article 92(3) and is therefore incompatible with the common market.

Article 3

Germany shall recover the aid provided referred to in Article 2. Repayment shall be made in accordance with the procedures and provisions of German law, together with interest as from the date on which the aid was granted, at an interest rate equal to the percentage value on such date of the reference rate used to calculate the net grant equivalent of regional aid in Germany.

Article 4

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

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 16 December 1997.

For the Commission

Karel VAN MIERT

Member of the Commission

COMMISSION DECISION

of 25 February 1998

concerning aid awarded by Germany to HIBEG and by HIBEG via Krupp GmbH to Bremer Vulkan AG, facilitating the sale of Krupp Atlas Elektronik GmbH from Krupp GmbH to Bremer Vulkan AG

(notified under document number C(1998) 582)

(Only the German text is authentic)

(Text with EEA relevance)

(98/665/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 in accordance with Article 93 to interested parties to submit their comments and having regard to those comments,

Whereas:

I

By letter dated 17 December 1991 Germany notified a guarantee given by the Freie Hansestadt Bremen/*Land* Bremen. The Commission, by letter dated 20 January 1992, requested supplementary information from Germany. Germany's answer of 4 March 1992 was received on 9 March 1992. On 6 May 1992 the Commission decided to open the procedure provided for in Article 93(2) of the EC Treaty. This was communicated to Germany by letter of 20 May 1992 which was published in the *Official Journal of the European Communities* ⁽¹⁾.

On 6 April 1993 the Commission took a negative decision, Decision 93/412/EEC ⁽²⁾, by which it declared as incompatible with the common market aid awarded to the Hanseatische Industrie-Beteiligungen GmbH (HIBEG) and by HIBEG via Krupp GmbH (hereinafter 'Krupp') to Bremer Vulkan AG (hereinafter 'BV'), facilitating the sale of Krupp Atlas Elektronik GmbH (hereinafter 'KAE') from Krupp to BV.

By its judgment of 24 October 1996 in Joined Cases C-329/93, C-62/95 and C-63/95 (Germany and Others v. Commission ⁽³⁾), the Court of Justice of the European

Communities annulled Decision 93/412/EEC, ruling that it was insufficiently reasoned on four points, namely on the value of the new BV shares, the application of Council Directive 90/684/EEC of 21 December 1990 on aid to shipbuilding ⁽⁴⁾, as last amended by Directive 94/73/EC ⁽⁵⁾ (seventh Directive on aid to shipbuilding) distortion of competition and the effect on intra-Community trade and the alleged aid in favour of HIBEG.

In light of the Court's ruling, the Commission is obliged to take a new final Decision in order to close the procedure.

II

The notification concerns a guarantee given by the Freie Hansestadt Bremen/*Land* Bremen to support the buying of KAE by BV from Krupp. Germany described a complex plan involving various transactions which, in combination, effect the sale of KAE to BV.

In order to further diversify out of shipbuilding BV bought a 74,9 % share in KAE from Krupp. The price of DEM 350 million was not paid in cash but with newly issued shares in BV. The following transactions took place or were agreed on:

- 17 October 1991: the general meeting of shareholders of BV decides on an increase in the share capital,
- 21 November 1991: the Freie Hansestadt Bremen/*Land* Bremen gives a guarantee of DEM 126 million plus credit costs and interest to HIBEG, a public company owned by the *Land* Bremen,

⁽¹⁾ OJ C 171, 7.7.1992, p. 3.

⁽²⁾ OJ L 185, 28.7.1993, p. 43.

⁽³⁾ [1996] ECR I-5151.

⁽⁴⁾ OJ L 380, 31.12.1990, p. 27.

⁽⁵⁾ OJ L 351, 31.12.1994, p. 10.

- 26 November 1991: a share-swap between Krupp and BV whereby BV gives 2,8 million new BV shares (total value according to BV, DEM 350 million, i.e. DEM 125 per share) to Krupp in order to acquire a 74,9% holding in KAE,
- 26 November 1991: Krupp and HIBEG together found a Gesellschaft bürgerlichen Rechts (GbR),
- 31 December 1991: Krupp and HIBEG bring both their agreed holdings into the GbR. Krupp contributes the 2,8 million BV shares and HIBEG contributes DEM 350 million in cash, financed by a bank credit partly covered by the *Land's* guarantee mentioned above,
- 31 December 1991: on the basis of the agreement establishing the GbR, the GbR gives a DEM 350 million advance to Krupp. HIBEG gets the irrevocable entitlement to sell the BV shares to a third person at a minimum price of DEM 125 per share. Every share sold reduces the holding of the two partners in the GbR, by effecting both a reduction of the balance owed on the advance to Krupp and a repayment of the credit brought in by HIBEG,
- 28 February 1994 (at the earliest) or 31 December 1994 (at the latest): the GbR is dissolved. The remaining BV shares are transferred to HIBEG while Krupp holds the balance of the advance. HIBEG has the option, agreed upon with the banks that gave it the credit, of repaying (part) of the credit by selling the BV shares to those banks for DEM 80 per share at the end of the credit term.

This means that BV acquires from Krupp a 74,9% share in KAE in exchange for 2,8 million BV shares. Within the framework of the GbR, Krupp exchanges those shares with HIBEG and Krupp receives DEM 350 million. At the time of the transaction, BV shares were quoted on the stock market at a value of around DEM 80 per share, i.e. the total of the 2,8 million shares was DEM 224 million. The *Land Bremen/Freie Hansestadt Bremen* supports HIBEG with a guarantee of DEM 126 million, the difference between the agreed purchase price of the share of KAE and the prevailing value of the shares, thereby allowing the sale of KAE to BV to take place.

Germany in its letter of 4 March 1992 states that the guarantee, with the exception of some modifications, does fulfil the requirements of the *Bürgschaftsrichtlinien des Landes Bremen*, approved by the Commission by letter of 28 October 1991 (N 512/91). The main amendment that the letter mentions is that instead of an 'Ausfallbürgschaft' (deficiency guarantee), a 'selbstschuldnerische Bürgschaft' (absolute guarantee) is used, the difference being that in the latter case the creditor can

turn direct to the guarantor and does not have to go first to the debtor should the debtor be unable to pay.

III

In its assessment before commencing the procedure pursuant to Article 93(2), the Commission considered three questions: (1) whether aid is involved; (2) if so, how much aid is involved; and (3) who is receiving the supposed aid.

Its position on the first question was affirmative. The average share price for BV shares in November to December 1991, when the most important transactions took place, was around DEM 80 per share. This price already reflected the lowering effect which a new share issue normally has, since as early as 17 October 1991 the general meeting of shareholders of BV had decided on the new issue. The issue price of new shares usually has to be below the market price of the shares in order to avoid failure of the issue. Accordingly, the Commission concluded that DEM 80 per share was the maximum share price that could have been asked in an open issue. This view seemed confirmed by the banks' willingness to accept the unsold shares by the end of the credit term at DEM 80 per share.

It is obvious that with the market price of DEM 80 per BV share, as determined by the Commission, BV could not have bought KAE. The 2,8 million shares are worth DEM 224 million and not DEM 350 million (the price for 74,9% of KAE). HIBEG, wholly owned by the *Land Bremen* and therefore to be regarded as a public company, could only offer DEM 350 million in exchange for the new BV shares because the *Land Bremen* offered a guarantee for the difference of DEM 126 million. This DEM 126 million represents exactly the difference between DEM 350 million (the total credit) and DEM 224 million (the value of the shares on the basis of a market price of DEM 80 per share). The Commission therefore could not accept the implication that HIBEG's involvement was normal commercial practice because, as Germany argues, the quoted price of BV shares averaged DEM 130,8 per share in 1990, even reaching DEM 170,5 per share on 1 June 1990, and fell at the end of 1991 as a consequence of the general down-turn in the stock market caused by the Gulf War.

The Commission answered the second question as to how much aid was involved by looking at the same facts. On the basis of a market price of DEM 80 per share, the new BV shares were worth DEM 224 million. The difference as against the agreed purchase price for KAE of DEM 350 million, i.e. DEM 126 million, cannot be accounted for by commercial motives as explained above. Therefore the total value of this difference, being equal to the guarantee, has to be regarded as aid.

At the time of the opening of the procedure, an answer to the third question as to the recipient of the aid could not be given. It depends on the assessment of what is the real commercial market price for KAE. If it is held that 74,9 % of KAE is worth only DEM 224 million then all the aid may be attributed to Krupp. If it is held, however, that the price of DEM 350 million for 74,9 % of KAE is a justifiable market price, then all the aid goes via HIBEG to BV to make it possible for BV to acquire 74,9 % of KAE. If the real market value of 74,9 % of KAE is between those two values, the aid is to be apportioned between BV and Krupp accordingly.

As to Germany's reference to the *Bürgschaftsrichtlinien des Landes Bremen* (see II), the Commission could not accept that the guarantee fulfilled the requirements of the approved guarantee scheme. Not only is the form of the guarantee ('selbstschuldnerisch' instead of 'Ausfallbürgschaft') not in conformity with the approved scheme, but also the Commission could not agree, on the basis of the facts, that there is a normal relationship between the proceeds of the investment in GbR and the funds needed to service the loan, as required in the guarantee scheme.

Moreover, the guarantee scheme requires that securities be given as a collateral and that a premium of 0,5 % of the guarantee on delivery and 0,5 % annually be paid, yet neither requirement, on the basis of the available information, seemed to be met. Therefore, conformity with the approved guarantee scheme did not seem to be in evidence and, on the basis of Commission letters SG(89) D/4328 and SG(89) D/12772, Germany should have notified the guarantee before granting it, to enable the Commission to investigate it pursuant to Articles 92 and 93 of the EC Treaty.

Against this background the Commission decided to initiate the Article 93(2) procedure in order to allow the Commission to examine the guarantee given by the Freie Hansestadt Bremen/*Land Bremen* on DEM 126 million plus credit costs and interest of the bank credit of HIBEG and HIBEG's transactions with Krupp in the GbR and assess the overall compatibility with the common market.

IV

After publication of notice of the opening of the procedure, the following other parties concerned submitted their comments:

- Bremer Vulkan AG, Bremen,
- and
- Fried. Krupp AG, Essen.

BV claimed to have received no aid and referred to the point of view of the German Government. Fried. Krupp AG was also of the opinion that it had received no aid, as

the value of 74,9 % of KAE was at least DEM 350 million. It pointed out that this value was also acknowledged by BV in its letter inviting its shareholders to the meeting to approve the issue of new BV shares and that the value was also the subject of scrutiny by two independent consultancy/accountancy companies.

The comments received from the parties concerned were transmitted by the Commission to Germany by letter dated 16 September 1992 to give the German Government the opportunity to reply.

V

Germany reacted on the opening of the procedure by letter dated 1 July 1992. By letter dated 15 October 1992 it reacted to the comments of the other parties. By letter IV.E.5 D/09810 dated 23 November 1992 the Commission requested additional information, to which Germany replied by letter dated 8 January 1993. The contents of the letter can be summarised as follows.

1. The German Government does not agree that the value of the BV shares was or is DEM 80 per share, although this was the traded price at the end of 1991 on the stock market. According to the German Government, the share price on the stock market does not reflect the situation of the individual company but is the expression of general national and international economic developments. The issued price was not to be based on the actual share price on the stock market but on past and future developments and expectations. The German authorities assess the value of the BV shares at DEM 125 each at least, for the following reasons:
 - (a) the banks value the shares at DEM 125 per share or more. This is reflected in the fact that the banks give a credit on 50 to 60 % of the value of shares offered as security. It is only for the credit above that 50 to 60 % that the banks needed extra security, given by the *Land Bremen* in the form of the guarantee.

The very fact that the banks are prepared to buy the shares in BV for DEM 80 per share at the end of the credit period indicates, on the basis of this same 50 to 60 % rule, that the banks estimated the value of BV shares to be at least DEM 125 per share.

In answer to the Commission's request for submission of bank analyses or reports pointing to such an evaluation, the German authorities answered that they could not supply such documents as it had no access to them;

- (b) the share price of BV averaged DEM 130,8 per share in 1990 and even reached DEM 170,5 on

1 June 1990. The price fell later, as a consequence of the Gulf War and the down-turn in the economy, something that could not be foreseen at the time of the deal;

- (c) synergy effects would result from integrating KAE in BV;
- (d) a big block of shares (2,8 million shares is around 20 % of all BV shares) is more attractive to an investor than individual shares;
- (e) the annual balance sheet of GbR, as approved by two independent accountants and tax advisers, testifies to the value of DEM 350 million for the 2,8 million BV shares;
- (f) the decisive date for the valuation of the shares was 12 July 1991, the date of the signature of a memorandum of understanding. That memorandum, which was not to take effect until it had been approved by the parties' supervisory organs, provided for an increase in BV's capital by 2,8 million new shares, to which Krupp would subscribe. In consideration of the acquisition of those shares, Krupp was to transfer to BV its 74,9 % holding in KAE. The two parties to the agreement valued their contributions at DEM 350 million each, which means that the new BV shares were valued at DEM 125 each.

2. On the question as to the value of 74,9 % of KAE, Germany referred to extensive assessments made by two independent accountancy companies at the request of Krupp and BV at the time of the transaction between the two last mentioned. Those two accountancy firms assessed the value of the holding in KAE at DEM 350 million.
3. As to whether the guarantee fulfils the requirements of the *Bürgschaftsrichtlinien des Landes Bremen*, Germany gave the following answer. The *Bürgschaftsrichtlinie* requires that guarantees be in principle ('grundsätzlich') 'Ausfall' guarantees. This means that 'selbstschuldnerisch' guarantees are possible under the *Bürgschaftsrichtlinie*. As HIBEG is State-owned, an 'Ausfall' guarantee, with its possible insolvency procedures, is inappropriate from an economic point of view.

As regards the question whether the proceeds of the investment will, under normal conditions, be sufficient to service the loan, Germany answered that this depended on the valuation of the BV shares and referred in that respect to its arguments mentioned above (see 1).

As regards the securities and premiums required under the *Bürgschaftsrichtlinien*, Germany answered that they were not necessary as HIBEG is State-

owned. The premiums would only result in an internal transfer ('Umbuchung'). As regards the notification before the granting of the guarantee, Germany commented that the notification had been made on 17 December 1991 and that the guarantee had only come into effect when the credit agreement became operative (end of December).

4. The Commission requested in its letters of 20 January, 20 May and 23 November 1992 information regarding ownership of BV (private and public). Germany gave as an answer that HIBEG owned, at the time of the deal, 0,08 % of the shares of BV and that the *Land Bremen* has no further participation.

VI

The first question to be answered in this final assessment of the facts is whether there is aid involved. The Commission's answer, in line with its reasoning at the opening of the procedure (see III), is affirmative. The average share price for BV shares in November to December 1991, when the most important transactions took place, was around DEM 80 per share (DEM 84,94 in November and DEM 75,43 in December). According to the Commission, the share price on the stock market does reflect the situation of the individual company, in the context of general national and international trends. A central idea in the financial literature is that capital markets are efficient. This means that shareholders value a company by its future profit streams and the share price of a company whose shares are regularly traded on the stock market (as in the case of BV) reflects the present value of future profit streams and dividends. Indeed the capital market is generally considered, with the currency markets, to be the most efficient market because of its high transparency, rapid response to new information and high number of knowledgeable players. Thus the stock market price represents a genuine market evaluation of the share value as it reflects supply and demand equilibrium in a fully public, transparent environment. The issue price of new shares usually has to be below the market price of the shares in order to avoid a failure of the issue. (This situation should not be confused with that of a takeover bid where it is common for the bidding company to offer a premium on the current share price). This implies that, given the stock market price of around DEM 80, the issue price would have needed to be below DEM 80 per share. The Commission therefore concludes that DEM 80 per share is the maximum share price that could have been asked in an open and commercial issue.

The reasons given by the German Government to value the shares of BV considerably higher at DEM 125 per share (see V) cannot be accepted. The transaction at a value of DEM 125 per share could take place only because of the granting of the guarantee covering the difference between DEM 125 and DEM 80 per share.

Germany was unable to supply analyses or reports of the banks to support such a high valuation. The fact that the share price averaged DEM 130,8 in 1990 does not take account of the fact that the share price was consistently lower than DEM 100 since as early as 1981, with the exception of the periods from the end of 1985 until 1986 and from early 1989 until the end of 1990.

The Commission does not accept that the decisive date for the valuation of the shares was 12 July 1991, the date of signature of the Memorandum of Understanding between BV and KAE. That was not a binding document. What counts is the date on which binding agreements are signed. The value at the time of the binding transaction incorporates all market expectations about future profits. Therefore the price of the shares at the time of the transactions is the relevant real (market) value. The value of the shares in the past is simply not relevant.

Nor does the Commission accept that the valuation of DEM 125 per share could have been justified by any inside information available to the parties that the market did not have, for example with respect to the likely synergy effects. First, it is inconceivable that those effects could have covered the gap between DEM 80 and DEM 125. Secondly, there are market and industry analysts and large investors which normally have the same knowledge or are very quick in acquiring this knowledge which is then transmitted to the market. In the event that there had been any such inside information about synergy effects in this particular case, it must be assumed that HIBEG, in order to sell the shares at DEM 125, would have made this inside information public and widely known. A rapid positive market reaction had to be expected in the case of any significant synergy or other positive effects. However, the contrary was true.

A posteriori the actual development of the BV share price contradicts the arguments advanced by Germany since the stock market price for BV shares fluctuated in 1992, 1993 and 1994 at a much lower level than DEM 125. From September to the end of December 1991 the stock market quotation for BV shares constantly declined (DEM 73,50 on 30 December 1991). In 1992 the price of the shares fluctuated below DEM 98 and fell by 30 December 1992 to DEM 68. In 1993 the price did not rise above DEM 100,80 (20 October) and in 1994 reached a maximum of DEM 106,50 on 5 January. HIBEG has stated that by the end of February 1994 it sold all its BV shares at an average of DEM 97,18 each. BV eventually went into liquidation in early 1996.

As regards Germany's argument that a big block of shares is more attractive to an investor than single shares,

it is difficult to accept that this could give a plausible explanation of the difference between DEM 80 and DEM 125 per share. It should also be borne in mind that a new share issue runs the risk of having the effect of lowering the share price. Moreover, it is quite evident in this case that Krupp had no intention of selling KAE for the 2,8 million shares. It wanted cash and for this reason the *Land* Bremen was called upon. Through its investment arm HIBEG, the *Land*/City of Bremen was prepared to buy the 2,8 million shares for DEM 350 million and take the risk of selling the shares to repay the DEM 350 million credit that HIBEG obtained.

As regards the approval of the balance sheet of GbR by two accountants/tax advisers the following should be noted: in general when an opening balance sheet is established, accountants have to apply the principle of prudent valuation (*Vorsichtsprinzip*) which means that they have to value any asset at the lowest possible level. If there is any market value, established for example by a stock exchange, that value is to be referred to. But if, as is the case with the BV shares, there is a recent established price which differs from the stock market price, accountants are allowed to take that price into account for their valuation. Accordingly, the accountants only referred to the price of DEM 350 million recently paid for the 2,8 million BV share package, which was established by Krupp and Bremer Vulkan in collaboration with the Bremen Senate through HIBEG and the bank consortium, so that one cannot talk in terms of an independent valuation of the accountants. The valuation only mirrored the valuation of the parties involved.

It is obvious that at the market price for the new shares at the time of the main transactions of DEM 80, as determined by the Commission, BV could not have bought KAE. HIBEG could only act in the interest of BV and pursue the arrangements with Krupp in the GbR as described above (see II), as the risk was covered with the guarantee on DEM 126 million plus credit costs and interest. This DEM 126 million represents exactly the difference between DEM 350 million (the total credit and price of 74,9 % of KAE) and DEM 224 million (the value of the 2,8 million BV shares at DEM 80 per share). The Commission cannot accept the implication that HIBEG's involvement is normal commercial practice. As in previous cases, HIBEG was intervening as the instrument of the *Land* Bremen in support of a company — BV — whose owners, despite many inquiries, remain unknown to the Commission. On a previous occasion, HIBEG took upon itself to guarantee the issue in 1987 of BV shares to finance the shipbuilding activities of BV. The guarantee to purchase the new shares not sold at issue was considered not to be a normal guarantee but to constitute aid for the full amount of the difference between the guaranteed price and a stock market based real value of the shares. That assessment by the Commission was not contested by Germany, nor was its approval of the aid under the prevailing aid ceiling of Council Directive

87/167/EEC of 26 January 1987 on aid to shipbuilding⁽⁶⁾ (sixth Directive on aid to shipbuilding) by letter of 16 October 1990.

The foregoing also answers the question as to how much aid is involved. As when the procedure commenced, this can be calculated as the full amount covered by the guarantee. On the basis of a market price of DEM 80 per BV share, the 2,8 million BV shares are worth DEM 224 million. The difference with the price for KAE of DEM 350 million, i.e. DEM 126 million, cannot be accounted for by commercial motives. The total of this difference, being equal to the total guarantee, has to be viewed as aid. HIBEG could pay DEM 350 million for the BV shares, which were worth no more than DEM 224 million only with the cover of the guarantee.

On the question of the recipient of the aid, Germany's answer concerning the value of the 74,9% holding in KAE confirms the hypothesis that the DEM 350 million value, established in negotiations between two equal partners on the market, reflects the real market value of the 74,9% stake. The Commission considers that to be confirmed by Germany's explanation that the value of 74,9% of KAE was set at DEM 350 million by two independent accountancy firms (see V).

This means that the final recipient of the aid is BV. The total of the transactions and the aid involved made it possible for BV to acquire 74,9% of KAE worth DEM 350 million not for cash but in exchange for 2,8 million BV shares worth DEM 224 million. Under the arrangement chosen, the aid was given by HIBEG, subject to the conclusion of the transaction between BV and Krupp, in the form of a cash payment. In this regard it is important to note that Germany in its different letters described the whole arrangement as seeking to achieve the diversification of BV through the buying of KAE. Although it was Krupp that received the cash payment direct from HIBEG within the agreements concerning the GbR, it is BV which effectively improves its financial position through the cash contribution by HIBEG and the related State guarantee and which is therefore the final aid recipient.

Germany's unwillingness or inability to supply full information on the ownership of BV makes it impossible for the Commission to discover why it is necessary in the present case for HIBEG (0,08% shareholder) and the *Land Bremen*, rather than the company's own shareholders, to supply finance.

As to whether the guarantee fulfils the requirements of the *Bürgschaftsrichtlinien des Landes Bremen/Freie*

Hansestadt Bremen, Germany's answer cannot be accepted by the Commission. It is disputable whether the text of the *Bürgschaftsrichtlinien*, as notified to the Commission by letter dated 31 July 1991, allows 'selbstschuldnerische Bürgschaften' instead of 'Ausfallbürgschaften'. Article 2.1 of the *Bürgschaftsrichtlinie* provides: 'Die Bürgschaften werden grundsätzlich gegenüber Kreditinstituten im Sinne von § 1 des Gesetzes über das Kreditwesen als Ausfallbürgschaften übernommen'. As regards the securities and premiums required under the *Richtlinie*, it is clear that, as these were not required from HIBEG, this constitutes a deviation from the approved *Richtlinien*. The fact that no securities and premiums were required from HIBEG in itself constitutes aid. The costs of the guarantee should have weighed on the transaction between Krupp and HIBEG. Consequently, the guarantee should have been notified in accordance with the Commission's letters SG(89) D/4328 of 5 April 1989 and SG(89) D/12772 of 12 October 1989 before it was granted, and not, as Germany did, before it became 'operational'.

The Commission has also considered whether the notified aid should be assessed under the provisions of the seventh Directive on aid to shipbuilding. As can be seen from BV's annual report for 1991, the total share of shipbuilding in BV's overall results for 1991 was 42,4%. It is therefore arguable whether BV could be said to have been active principally in shipbuilding. Moreover, the fact that BV had shipyards does not mean that aid to BV has necessarily to be examined under the seventh Directive on aid to shipbuilding. This depends on which of BV's activities is being aided. Only if the aid had been awarded in favour of shipbuilding activities could it be argued that the seventh Directive on aid to shipbuilding applied. In this particular case, the BV activity being aided was marine and defence electronics. Similarly, the fact that KAE was operating in the fields of marine and defence electronics did not make it a shipbuilding company within the meaning of Article 1 of the seventh Directive on aid to shipbuilding ('shipbuilding is building of metal hulled sea-going vessels'). Thus the Commission concludes that the acquisition of KAE by BV does not come within the scope of the seventh Directive on aid to shipbuilding.

VII

Germany failed to notify those aid measures in advance pursuant to Article 93(3) of the EC Treaty. Germany notified the aid only after the guarantee had been given and after Krupp and BV had sold or bought 74,9% of KAE and after HIBEG and Krupp had founded GbR.

Since Germany did not notify the aid before granting it, as it should have done pursuant to Article 93(3) of the EC Treaty, the Commission was unable to make known its view on the measures before they were implemented. The aid was thus illegal under Community law from the date on which it was granted.

⁽⁶⁾ OJ L 69, 12.3.1987, p. 55.

VIII

At the time of the transactions in question (KAE was later merged with the BV subsidiary STN, which in turn was taken over by a consortium led by Rheinmetall), KAE's main activities were in the fields of marine and defence electronics (echo-sounding techniques, signal- and data-processing). There is competition in the Community between producers in these fields and there is trade between the Member States in the products involved.

According to the 1991 yearly report of (K)AE (the name of KAE was changed to AE after the acquisition by BV), KAE itself achieved part of its turnover within the Community. Of its DEM 689 million turnover for 1991, DEM 45 million was derived from business with other Member States. For 1990 those figures were respectively DEM 578 million and DEM 30 million. KAE had a workforce of 3 242 in 1990 and its profits in the period from 1986 to 1990 ranged from DEM 11 million to DEM 20,2 million.

Within the marine and defence electronics sector, KAE operates in a number of specialised markets for which there is evidence to show that intra-Community trade exists. Such information is summarised in the following table:

Imports from other Member States 1991

Different products categories

(ECU million)

Country	8531 ⁽¹⁾	8526 ⁽²⁾	9014 ⁽³⁾
France	114	36	130
Belgium/Luxembourg	49	21	11
Netherlands	51	20	63
Germany	48	70	55
Italy	36	20	64
United Kingdom	72	11	190
Ireland	16	3	3
Denmark	14	11	18
Greece	12	7	0,5
Portugal	18	3	5
Spain	41	7	11

⁽¹⁾ 8531: electric sound or visual signalling apparatus.

⁽²⁾ 8526: radar apparatus, radio navigational aid apparatus and radio remote control apparatus.

⁽³⁾ 9014: direction finding compasses, other navigational instruments and appliances.

In its invitation to the general meeting of BV on 17 October 1991, the Board made clear its hope that through the acquisition of KAE the long-term international competitiveness of its marine electronics subsidiary STN would be enhanced. The BV Board also referred to the expected rapid realisation of synergy effects through the fusion of KAE and STN. The very aim of the acquisition of the 74,9 % stake in KAE was clearly to improve the competitive position of BV in the marine and defence electronics sector. Moreover, the aid enabled BV to strengthen its position in that sector without having to bear the full costs. Following the acquisition of KAE, the share of the BV Group's total turnover accounted for by electronics and systems design was forecast to increase to 55 to 60 %. The sector was characterised by strong competition. According to the data available at the time of the acquisition, there were more than 40 companies in the defence electronics sector alone with a turnover in excess of ECU 30 million.

Consequently, the aid which Germany granted to BV and HIBEG affects trade between Member States and distorts competition between marine and defence electronics manufactures within the meaning of Article 92(1) of the EC Treaty.

IX

Article 92(1) of the EC Treaty lays down the principle that aid having the characteristics specified therein is incompatible with the common market. The derogations from that principle set out in Article 92(2) of the EC Treaty do not apply to the case in point, given the nature and objectives of the aid. The aid in this case does not have a social character, does not serve to make good the damage caused by natural disasters nor is it aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

As regards the exception pursuant to Article 92(3)(a), the aid was not designed to promote the economic development of an area where the standard of living is abnormally low or where there is serious underemployment. Nor has Germany attempted to justify the aid on such grounds.

As far the derogation pursuant to Article 92(3)(b) is concerned, the aid was clearly not intended to promote a project of common European interest or to remedy a serious disturbance in the German economy. Nor has Germany attempted to justify the aid on such grounds.

As regards the derogation pursuant to Article 92(3)(c) of the Treaty for aid to facilitate the development of certain economic activities or of certain economic areas,

where such aid does not adversely affect trading conditions to an extent contrary to the common interest, the Commission has examined the aid on its sectoral and regional aspects. In both respects, it is important to note that the aid given to BV is investment aid to help BV buy an already existing company (KAE) and not to create new production facilities or employment. It is also important to refer to Part VIII, in which it is clearly shown that there is competition between the Member States in the products involved. As regards the sectoral aspect, it is the sector which receives investment that is of importance. This case concerns the electronics sector in which KAE operates.

As there is no Community sectoral justification for this aid, it has to be regarded as adversely affecting trading conditions to an extent contrary to the common interest. The aid would give BV, in operating KAE, an unjustified advantage over KAE's competitors on the market, which did not and will not receive such aid. Germany has not, indeed, attempted to justify the aid on such grounds. As regards the regional aspect, Bremen is an area eligible for assistance on the national level ('Gemeinschaftsaufgabe: Verbesserung der regionalen Wirtschaftsstruktur') and Community level ('Objective 2 area'). However, the aid in this case was not, as is required, granted as part of an approved regional scheme but was given as an *ad hoc* investment aid. In addition, the buying of an existing company or part of an existing company cannot be viewed as an investment eligible for aid under the previously mentioned 'Gemeinschaftsaufgabe', as no employment is thereby created and as Germany has not supplied any evidence or indication that KAE would have had to close had it not been sold to BV. Consequently, the aid cannot be justified on the basis of regional grounds pursuant to Article 92(3)(c) of the EC Treaty. Furthermore, Germany did not notify the aid as regional aid nor attempt to justify it on regional grounds.

X

In conclusion, the aid granted by the Freie Hansestadt Bremen/*Land* Bremen to BV via HIBEG is not compatible with the common market, since it was granted illegally in breach of Article 93(3) of the EC Treaty and furthermore does not meet any of the conditions provided for in Article 92(2) and (3) of the Treaty.

The aid must be revoked and any aid granted must be repaid in accordance with the judgment of the Court

of Justice in Case C-301/87 France v. Commission ('Boussac' case)⁽⁷⁾,

HAS ADOPTED THIS DECISION:

Article 1

Aid in favour of Bremer Vulkan AG totalling DEM 126 million, granted within the context of the acquisition of 74,9 % of the capital of Krupp Atlas Elektronik GmbH through Hanseatische Industrie-Beteiligungen GmbH, is unlawful, since it was granted in breach of the procedural rules laid down in Article 93(3) of the EC Treaty. Furthermore, the aid is also incompatible with the common market pursuant to Article 92(1) of the Treaty, since it does not meet any of the conditions for exemption provided for in Article 92(2) and (3) of the Treaty.

Article 2

1. Germany shall ensure that the aid of DEM 126 million to Bremer Vulkan AG referred to in Article 1 is fully recovered and paid to Hanseatische Industrie-Beteiligungen GmbH within two months of the notification of this Decision.
2. Germany shall recover the amount of aid referred to in Article 1, in accordance with the procedures and provisions of national law, in particular those relating to interest on arrears payable on State claims, with interest running from the date on which the unlawful aid was granted.
3. Germany shall inform the Commission, within two months of the notification of this Decision, of the measures taken to comply with it.

Article 3

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 25 February 1998.

For the Commission

Karel VAN MIERT

Member of the Commission

⁽⁷⁾ [1990] ECR I-307, paragraph 22.

COMMISSION DECISION

of 6 May 1998

declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement

(Case No IV/M.970 — TKS/ITW Signode/Titan)

(notified under document number C(1998) 1257)

(Only the English text is authentic)

(Text with EEA relevance)

(98/666/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area, and in particular Article 57(2)(a) thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings⁽¹⁾, as last amended by Regulation (EC) No 1310/97⁽²⁾, and in particular Article 8(2) thereof,

Having regard to the Commission Decision of 22 December 1997 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,

Having regard to the opinion of the Advisory Committee on Concentrations⁽³⁾,

Whereas:

- (1) On 20 November 1997, the Commission received a notification under Article 4 of Council Regulation (EEC) No 4064/89 (hereinafter 'the Merger Regulation') of a proposed operation by which the German undertakings Thyssen Krupp Stahl GmbH ('TKS') and ITW Signode Holding GmbH ('ITW Signode') were to acquire joint control of the German company Titan Umreifungstechnik GmbH ('Titan').
- (2) After examination of the notification the Commission has concluded that the notified operation constitutes a concentration falling within the scope of the Merger Regulation. On

22 December 1997, the Commission decided to initiate proceedings pursuant to Article 6(1)(c) of the Merger Regulation after finding that the notified concentration raises serious doubts as to its compatibility with the common market.

I. THE PARTIES

- (3) TKS is a joint venture company into which Thyssen Stahl AG and the Krupp-Hoesch Stahl AG have merged their activities in the production and distribution of quality steel flat products⁽⁴⁾. The business areas which are merged into TKS achieved a total worldwide turnover of approximately ECU 2 880 million in 1996, of which ECU [...] million were achieved within the Community and ECU [...] million were achieved in the EFTA States.
- (4) ITW Signode is a fully-owned holding company of the US undertaking Illinois Tool Works, Inc. ('ITW') and the sole owner of the Signode System GmbH. The business activity of Signode System GmbH essentially consists in the production and distribution of strapping band made of steel and plastic as well as seals for their closure. The ITW group achieved a total worldwide turnover of ECU 3 935 million in 1996, of which approximately ECU [...] million were achieved within the Community and ECU [...] million were achieved in the EFTA States.
- (5) Titan is currently a fully-owned subsidiary of the Krupp-Hoesch group and possesses two production facilities in Germany, one production facility for steel strapping, balelocks and seals located in Hagen-Kabel and one operating branch located in Schwelm for the design, manufacture and marketing

⁽¹⁾ OJ L 395, 30.12.1989, p. 1; corrected version: OJ L 257, 21.9.1990, p. 13.

⁽²⁾ OJ L 180, 9.7.1997, p. 1.

⁽³⁾ OJ C 363, 25.11.1998.

⁽⁴⁾ The creation of this jointly controlled company was the subject of proceedings under the Merger Regulation and Article 66 of the ECSC Treaty. See Commission Decision in Case IV/M.925 — Krupp Hoesch/Thyssen, (OJ C 285, 20.9.1997, p. 14) and Case IV/ECSC.1243 respectively.

⁽⁵⁾ This version of the Decision has been edited to ensure that confidential information is not disclosed.

of strapping equipment⁽⁶⁾. However, only the production facilities in Hagen-Kabel are subject to the concentration (see point 7). Titan achieved a total worldwide turnover of ECU 55,5 million in 1996. The Hagen-Kabel production facilities which will be retained by the future joint venture achieved a total worldwide turnover of ECU [...] million, of which approximately ECU [...] million were achieved within the Community and ECU [...] million were achieved in the EFTA States.

II. THE OPERATION

- (6) The Krupp-Hoesch group in October 1996 decided to sell Titan in order to withdraw from the packaging business. ITW Signode and TKS intend to acquire all of the shares of Titan and thus to form a joint venture. ITW Signode will hold 65 % of Titan's share capital whereas TKS will hold 35 %. In addition, ITW Signode will contribute its German steel and plastic strapping production lines, operated by the Signode System GmbH in Dinslaken, to the joint venture (see Chart A in the Annex).
- (7) On 18 November 1997, Titan entered into a sales and transfer contract by which, simultaneously with the acquisition of its shares by ITW Signode and TKS, it would sell its strapping machinery and equipment operation located in Schwelm as well as the related industrial property rights, the Titan trade marks and its domestic and foreign distribution organisation to a subsidiary of the medium-sized German undertaking P. W. Lenzen GmbH & Co. KG ('Lenzen'). The entry into force of this sales contract is conditional upon the implementation of the acquisition of joint control of Titan by ITW Signode and TKS.

III. THE CONCENTRATION

Joint control

- (8) The managing directors ('Geschäftsführer') of the proposed joint venture will be appointed on a proposal from ITW Signode, by unanimous consent of the shareholders' assembly ('Gesellschafterversammlung'). If the shareholders' assembly establishes a board of administrators ('Verwaltungsrat') in order to supervise the board of directors and to determine the business policy of the joint venture, ITW Signode will appoint two out of the three

members of the board of administrators, which will take its decisions by simple majority.

- (9) However, certain strategic commercial decisions require the unanimous consent of the shareholders' assembly, especially the appointment of the managing directors, the approval of the annual financial and business plans including investments and their modification as well as the approval of the extension of the board of directors' powers. These veto rights are related to strategic commercial and financial decisions on the future joint venture's business policy and surpass the usual rights protecting the financial rights of minority shareholders⁽⁷⁾. Thus, TKS has rights within the meaning of Article 3(3) of the Merger Regulation which confer the possibility of exercising decisive influence on the strategic behaviour of the joint venture. Therefore, the proposed joint venture will be jointly controlled by ITW Signode and TKS.

Autonomous full function entity on a lasting basis

- (10) The proposed joint venture brings about a lasting change in the structure of the undertakings concerned. The joint venture agreement is of indefinite duration and includes call and put options which, if exercised, would allow or force ITW Signode to acquire all the shares that TKS will have in the joint venture. These options cannot be exercised before 30 November 2002. Even if the options were exercised at the earliest possible date, the joint venture would exist for at least five years. This period is considered to be sufficiently long to bring about a lasting change in the structure of the undertakings concerned⁽⁸⁾.
- (11) Furthermore, the notified joint venture constitutes an autonomous economic entity, as it will operate on the strapping markets, performing all the functions normally carried out by undertakings operating on these markets. The joint venture will continue to carry out its activities with its own management and with access to sufficient resources, including finance, staff and assets. In the future the joint venture's production will be undertaken at its facilities in Hagen-Kabel and in Dinslaken, while the distribution will be carried out primarily by the joint venture itself and, additionally, by independent distributors and the distribution subsidiary of the ITW group.

⁽⁷⁾ See Commission Decision in Case IV/M.897 — Stinnes/Haniel Reederei (OJ C 289, 24.9.1997, p. 3, at paragraphs 7-17).

⁽⁸⁾ Commission notice on the distinction between concentrative and cooperative joint ventures under Council Regulation (EEC) No 4064/89 (OJ C 385, 31.12.1994, p. 1, at paragraph 16). See further Commission Decision in Case IV/M.823 — John Deere Capital Corp./Lombard North Central plc, (OJ C 359, 28.11.1996, p. 11, at paragraph 9).

⁽⁶⁾ The manufacture of strapping machines was outsourced to independent assemblers at the end of 1993.

- (12) The Thyssen and Krupp-Hoesch groups will be major customers of the future joint venture for steel strapping. However, even if both groups were to purchase, at market conditions, all their requirements for steel strapping from the joint venture, the parents would account for only between 25 % and 30 % of Titan's current worldwide sales. In addition, there is a [...] year supply agreement which will oblige the joint venture to purchase cold-rolled pre-material from a joint venture company in which the Krupp-Hoesch group currently has a controlling interest. These purchases will represent less than 40 % of the total raw materials requirements of the future joint venture. TKS also supplies substantial quantities of hot-rolled coil (about [...] tonnes p.a.) to the operation that ITW Signode is contributing to the joint venture. However, as there is no supply contract between ITW Signode and TKS for this tonnage the joint venture will be free to buy from any supplier. Therefore, the joint venture will be sufficiently independent of its parents in relation to the supply of raw materials to ensure its independence. Finally, value added to the pre-material accounts for between 15% and 30 % of total production costs, further indicating that the joint venture will operate an autonomous business.

Absence of coordination of competitive behaviour

- (13) As TKS and the Thyssen and Krupp-Hoesch groups do not retain any activities in the production and distribution of strapping band and strapping equipment, the future joint venture will not bring about a coordination of the competitive behaviour of independent undertakings.

Conclusion

- (14) For the above reasons the joint venture arising from the notified operation constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

IV. COMMUNITY DIMENSION

- (15) The combined aggregate worldwide turnover of all the undertakings concerned exceeds ECU 5 000 million. Two of the undertakings concerned, ITW Signode and TKS, have a Community-wide turnover in excess of ECU 250 million, but they do not achieve more than two thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension according to Article 1(2) of the Merger Regulation. It does not qualify for cooperation with the EFTA Surveillance Authority pursuant to Article 2 of Protocol 24 to the EEA Agreement.

V. COMPATIBILITY WITH THE COMMON MARKET

- (16) The proposed joint venture, after the acquisition of the strapping business of Signode System GmbH, will be active in the production, marketing and distribution of steel and plastic strapping band, balelocks and seals. As far as balelocks are concerned no competition concerns arise from the proposed concentration, because balelocks are sold exclusively to customers outside the EEA. Seals are used to join the ends of the strap and maintain its tension. Their sales are therefore directly related to the sale of the strapping with which they will be used, and do not require separate examination. However, as ITW Signode has important activities in the neighbouring markets for strapping equipment, in particular in the markets for sealing heads for strapping machines, these activities must also be taken into consideration when assessing the effects of the proposed concentration.

A. RELEVANT PRODUCT MARKETS

A.1. The market for strapping band

1. Introduction into the strapping market

- (17) Steel and non-metallic strapping is used to secure, to close, to unitise or to strengthen packages or to reduce package volumes; it is applied under tension by hand tools or automatic machines. Basically, there are four different types of strapping for industrial packaging applications: high-strength steel strapping, regular duty steel strapping, polyester plastic strapping and polypropylene plastic strapping.
- (18) Steel strapping is produced from cold-rolled steel strip and is further processed to meet the requirements of its intended applications. For use in heavy duty applications steel strapping is manufactured from steel strip with a high proportion of manganese which undergoes special heat treatment. The majority of steel strapping however, is used in regular duty applications which do not call for special requirements as to tensile strength or break strength.
- (19) Plastic strapping is produced in extrusion lines either from polypropylene or polyester resins. Polyester strapping (hereinafter 'PET strapping') provides for high-strength applications and is

characterised by a high impact resistance, whereas polypropylene strapping (hereinafter 'PP strapping') offers the highest elasticity. Plastic strapping, on account of its resistance to corrosion, its superior elongation, improved safety features (being less dangerous when the strapping is removed from the load) and lower weight provides benefits which cannot be achieved by steel strapping.

fracture. The tensile strength corresponds to the maximum stress that can be sustained by a structure in tension. The elongation is the relative change in length caused by tensional stress. Finally, the impact resistance designates the energy (stress impact) which can be imposed from the initial tension up to a pre-selected portion of the minimum break strength.

(20) The parties suggest that while, in the past, it may have been appropriate to define a separate product market for steel strapping, owing to economic and technological developments, such market definition may no longer be upheld. In their view, therefore, the relevant product market in this case includes at least both steel and plastic strapping, and may include packaging films (stretch and shrink films).

(21) However, the results of the Commission's market investigation show that packaging films do not form part of the same relevant product market as steel strapping. Stretch or shrink films are widely considered by customers to be complementary products which serve as protection for the packaged goods from damage, contamination or the weather rather than being direct substitutes for strapping. Even the parties in their notification said that the vast majority of packaging films are used for other reasons than those associated with strapping⁽⁹⁾. Furthermore, according to the results of the parties' customer survey, only one out of 168 end-users who were considering changing the strapping material they use indicated that he would replace strapping band by packaging film. Packaging films, therefore, do not form part of a market for strapping band, regardless of whether or not it covers only steel strapping or includes certain types of plastic strapping.

2. Comparison of steel and plastic strapping

Physical and mechanical product characteristics

(22) Strapping products can be distinguished by the type of material and certain physical and mechanical properties, in particular their minimum break strength, their tensile strength, their elongation and their impact resistance. The minimum break strength designates the force (load) that can be applied to the strapping material without inducing

(23) Steel strapping has a tensile strength of between 700 newton (hereinafter 'N') per mm² (regular duty) and 1 250 N/mm² (high-tensile strength), whereas the tensile strength of PET strapping ranges between 330 and 600 N/mm² and the tensile strength of PP strapping ranges between 280 and 380 N/mm². Depending on its size and thickness, regular-duty steel strapping has a minimum break strength of between 3 and 14 kg newton (hereinafter 'kN'), whereas the break strength of heavy duty steel strapping ranges between 12 and 28 kN, in special qualities up to 55 kN at maximum. In contrast, while PET strapping has a minimum break strength of between 2 and 10 kN at maximum, PP strapping has a relatively low break strength of between 0,5 and 6 kN.

(24) Furthermore, steel strapping, PET strapping and PP strapping show significant differences in the reduction of the initial applied tension over time ('relaxation effect'). According to the Richtlinienarbeit Nr. 3968 of the Verband Deutscher Ingenieure (VDI) (Association of German Engineers), while the tension of steel strapping is still the same after six days after it has been applied, the tension of PET strapping is reduced by about 20 % and the tension of PP strapping by up to 80 %⁽¹⁰⁾. Therefore, if the same impact resistance is required, in particular PP strapping must be applied to the packaged goods with a much higher initial tension. This would often require pneumatically or electrically powered tools instead of simple manually operated tools. In addition, whereas PET straps recover up to 95 % of their initial elastic strain after a stress impact has occurred, PP straps regain only 75 %⁽¹¹⁾.

(25) In certain applications heat resistance is a precondition for strapping to be used. Whereas steel strapping resists temperatures of up to 600-750°C, plastic strapping may weaken considerably at elevated temperatures. According to Euronorm CEN T261, PET strapping is permitted for temperatures of up to 90°C, but the material will soften and

⁽⁹⁾ According to the parties, of the total estimated EEA turnover of ECU 808 million, some 15 % of the stretch film and 20 % of the shrink film is used in applications which are directly competitive with strapping.

⁽¹⁰⁾ See Richtlinienarbeit VDI Nr. 3968, paragraph 3.2 'Kunststoff-Verpackungsbänder'. The expert studies presented by the parties do not deal with physical properties such as creep effect and stress relaxation over time.

⁽¹¹⁾ Titan Umreifungstechnik GmbH: Technische Spezifikationen — Kunststoffverpackungsband.

increase its elongation characteristics even at lower temperatures. By contrast, PP strapping is recommended for applications the temperature of which does not exceed 35°C. In certain applications in the steel industry, i.e. strapping of hot steel coils, the temperature of the product is a determinant factor. However, such applications account only for between 3 % and 10 % of total steel strapping consumption in Western Europe.

- (26) From the comparison of physical and mechanical product characteristics it appears that while PET strapping provides characteristics comparable to those of steel strapping, in particular regular duty steel strapping, PP is a less satisfactory substitute for steel strapping particularly in heavy applications where the strapping is intended to last for a longer time and rigidity and low elongation is decisive, or in applications at higher temperatures. Differences in the physical characteristics of products and their intended uses can provide important information as to the definition of the relevant product market⁽¹²⁾ but are not themselves sufficient to exclude the possibility that customers and end-users view those products as being effective alternatives⁽¹³⁾. Therefore it is necessary to evaluate to what extent these differences would prevent a significant number of steel strapping customers from switching to plastic strapping, in particular PP strapping, if the relative price for steel strapping were to increase permanently by a small amount.

Areas of usage and categories of consumers

- (27) According to the results of the Commission's investigation, steel strapping accounted for approximately 55 % in value terms of total strapping consumption in Western Europe in 1997, PET strapping for 11,5 % and PP strapping for 34 %. In Western Europe, more than 75 % of total steel strapping consumption is used in basic steel and non-ferrous production (steel coils, metal sheet, billets, ingots and slabs) and metal working industry (flat products, pipes and tubes, profiles), building materials industry (bricks and blocks), agriculture and forestry (lumber, wood panels), textile and staple fibre industry, in the automobile and components industry, and in the transport and ocean shipping sector.

- (28) Steel strapping accounts for approximately 97 % of total strapping consumption (by value) in the steel and non-ferrous metal production, 92-95 % in the steel working sector, 90 % in the ocean shipping and transport sector, 77-80 % in the staple fibre industry, 69-75 % in the brick and block sector, 58-65 % in the other building materials industries and 56-70 % in the automobile industry. In contrast, PP strapping is predominantly used in the newspapers and printing industry (90-93 %), in the food and beverages industry (60-65 %), and in the cardboard and corrugated products industry (45-46 %). PP strapping currently is not used to a significant extent in the steel production and steel working industries and in the staple fibre industry, while in the building materials industry, PP strapping accounts for less than 15 % of total strapping consumption. In most cases where steel and PP strapping are used in the same consumer industry, the strapping materials are used for different applications⁽¹⁴⁾.

Evidence of substitution in the recent past

- (29) The notifying parties take the view that today in nearly every field of application, steel strapping could be replaced by plastic strapping. Plastic strapping first replaced steel in relatively simple and undemanding applications where the high strength of steel was not required. In the last decade, however, because of the development of high-tensile PET strapping and the improvement of packaging technology, plastic materials have increasingly been used and have made their way into all applications.
- (30) This view appears to be supported by the contrasting development of consumption of steel and plastic strapping in recent years. According to the parties, in value terms total consumption of steel strapping in Western Europe diminished by ECU 38,6 million (11,7 %) between 1987 and 1997. Total consumption of plastic strapping increased by ECU 128,6 million (73,8 %) in the same period. As a result, the share of steel strapping in total strapping consumption diminished from approximately 65 % to 49 % (by value) between

⁽¹²⁾ See Commission Decision 93/9/EEC in Case IV/M.214 — Du Pont/ICI (OJ L 7, 13.1.1993, p. 13, paragraphs 21-22); Commission Decision 97/610/EC in Case IV/M.774 — Saint-Gobain/Wacker-Chemie/NOM (OJ L 247, 10.9.1997, p. 1, paragraph 83).

⁽¹³⁾ See Commission notice on the definition of relevant market for the purposes of Community competition law (OJ C 372, 9.12.1997, p. 5, paragraph 36).

⁽¹⁴⁾ The [...] tin-plate works in [...] only use small quantities of PET strapping for internal handling between processes. Such applications encompass one circumferential strap on coils of tin-plate and two vertical straps on palletised tin-plate bulks. External despatch packaging still requires steel strapping; the polyester strap is removed prior to this final packaging.

1987 and 1997. The Commission acknowledges that total sales of plastic strapping have increased strongly in recent years and that in particular PET strapping has made considerable inroads into applications in which previously steel strapping had been used (see point 37).

Absolute price differences

- (31) It is difficult to make a direct comparison of prices for the various types of strapping as there are a large number of variables which need to be taken into consideration. For a given application it may be possible to replace strapping of one type with another type of the same dimensions, though this is unlikely. Similarly, when using different materials different configurations may be the best solution, for example four PP straps might be replaced by three PET straps of different dimensions. However some indicative comparisons may be made. According to the results of the Commission investigation, the price of steel strapping was between ECU 60 and ECU 400 per 1 000 metres, whereas plastic strapping cost between ECU 15 and ECU 90 per 1 000 metres depending on dimensions. Richtlinienarbeit Nr. 3968 of the Verband Deutscher Ingenieure (VDI) states that when comparing strapping of the same dimensions, PET strapping is 20 % and PP strapping 40 % cheaper than steel⁽¹⁵⁾. Finally, the notifying parties gave examples of differences in the costs of the different strapping materials for applications for which steel, PET and PP were suitable. For these applications, PET was on average 7 % cheaper and PP over 50 % cheaper than steel.

Long-term development of prices

- (32) The parties have presented a chart which has been prepared on the basis of the official statistics of the British Tensional Strapping Association which shows the comparative development of British market prices for steel, PET and PP strapping from 1987 to 1996. This chart shows clearly a parallel development of prices of steel and PET strapping, whereas the prices of PP strapping seem to have developed more independently of the prices for their potential substitutes.

Switching costs and lead times

- (33) Costs associated with switching from steel strapping to plastic alternatives encompass the capital

investment for new strapping equipment as well as the expenses resulting from operator training and the reorganisation of the strapping processes at the end-users' production sites. Strapping tools usually are designed to be used with either steel or plastic strapping with the result that changing the type of strapping would require the replacement of the complete tool. Strapping machines, on the other hand, can in many cases be operated with either material, as the so-called sealing head can be replaced separately. Switching costs appear to be moderate and generally seem not to be a significant factor. For example, the costs of hand tools range from about ECU 80 for a simple manual seal combination tool through to about ECU 2 000 for a modern electrically operated portable tool and can reach up to ECU 5 000 if an electronically controlled tool is used. Steel sealing heads cost between ECU 15 000 and ECU 25 000 and plastic sealing heads vary between ECU 4 000 and ECU 5 000.

Views of customers

- (34) The views of end-users and of customers and competitors of the undertakings concerned are of particular importance for the delineation of the relevant product market. In the present case, to verify the views of the parties, the Commission first undertook a small-scale inquiry among 48 customers of the parties to the concentration for strapping band. Altogether, the purchases of those customers represent approximately 14 % of total consumption in Western Europe.
- (35) Almost all of those customers stated in their replies to the Commission that they could not without any significant problems replace steel strapping in all of their strapping applications. When asked for their reasons, most end-users referred to the superior tensile strength and very high break strength of steel strapping, its temperature resistance compared to plastic, its resistance to sharp edges (abrasion resistance), its exceptional rigidity and low elongation, and its better recycling characteristics. Major customers in the steel producing industry have stated that in 60-70 % or even more of their current strapping applications they can only use steel strapping because of product temperature and the break strength and abrasion resistance required. Companies active in the concrete block, limestone, and brick industries which currently use both types of strapping band have stated in their responses to the Commission's inquiry that they could not replace either material in all of their applications but consider steel and plastic strapping to be complementary rather than substitute products. Customers in the limestone industry have stated

⁽¹⁵⁾ See Richtlinienarbeit VDI Nr. 3968, table 'Bandeigenschaften im Vergleich (Allgemeine Übersicht)'.

that they cannot replace steel strapping by plastic alternatives in 90-100 % of their current package strapping applications.

(36) However, the parties to the concentration have forwarded to the Commission the results of an inquiry among 518 consumers of strapping band, according to which companies which currently use steel strapping already use 'plastic' alternatives to a significant extent and would consider switching from steel to 'plastic' substitutes. To verify these results, the Commission undertook a second inquiry to which 191 strapping customers replied, covering the major steel strapping consuming industries; further, the survey is widely drawn across Western Europe.

(37) Of the total of 69 companies which have changed their strapping materials in the past three years, 39 (20,4 % of the total sample) have switched from steel to PET strapping but only 20 (10,5 %) have switched from steel to PP strapping. This switching pattern is not the same in all industries using strapping, but switching from steel to PP strapping is considerably lower in the timber and forestry and in the staple fibre and textile industries (none of the contacted companies in these sectors switched from steel to PP strapping) as well as in the metals and steel working industries (only 8,6 % have switched from steel to PP strapping). In contrast, in the building materials industry 15,3 % of the consumers in this sector have switched from steel to PP strapping and in the automobile industry 16,7 % of the consumers in this sector.

(38) A total of 59 companies (30,9 % of the total sample) told the Commission that they were currently considering changing their strapping materials. Of this total, 49 (25,7 %) companies were considering switching from steel to PET strapping but only 17 (8,9 %) customers were considering switching from steel to PP strapping. The pattern of future switching is not the same for all sectors. In the timber, staple fibre and automobile sectors none of the companies who responded to the Commission's inquiry is considering a switch from steel to PP strapping. In the building materials industry 2,6 % of those responding are considering switching from steel to PP strapping. In the metals and steel working industries 11,6 % of the customers are considering switching from steel to PP strapping.

(39) In addition, it has to be taken into consideration that a considerable proportion of the switching customers do not use steel strapping and plastic alternatives in similar applications (similar pack

goods, similar pack weight). In the metals industries only 32,1 % of the customers noted that they would use plastic strapping in similar applications for which they use steel strapping. However, most of these customers (61,1 %) use PET strapping whereas only 38,9 % (12,5 % of the total, excluding those who currently use only plastic strapping) use PP strapping as a direct substitute for steel strapping. Similarly, in the building industries, only 14,8 % of the customers use plastic strapping in similar applications to steel strapping and all of them use only PET strapping as a substitute for steel strapping. In the timber and fibre industries, only 10,5 % use PP strapping in applications for which they currently also use steel strapping.

3. Conclusion on the strapping market

(40) Based on the above the Commission has come to the conclusion that PET strapping clearly is an immediate and satisfactory substitute for steel strapping in most of the applications in which consumers currently use steel strapping. PET strapping therefore forms part of the same relevant product market as steel strapping. In particular the findings of the Commission's survey among suppliers and end-users of strapping support the view that PET plastic strapping in almost all strapping applications is considered an effective substitute for steel strapping except for applications where heat resistance is required. Those applications, however, account for only 3-10 % of total steel strapping consumption in Western Europe and price discrimination between different groups of individual customers, according to whether they use steel strapping in hot applications or not, generally seems not to be feasible.

(41) As to whether PP plastic strapping forms part of the same relevant product market as steel strapping, the Commission has doubts due to the differences in the product's physical and mechanical characteristics, absolute prices and the development of prices in the recent past. Furthermore, results of the Commission survey among end-users in various industries seem to indicate that if consumers consider switching from steel to PP strapping, in most cases factors other than relative prices are of decisive importance. However, the Commission is aware of a significant number of customers who have switched from steel to PP strapping in the past three years or currently are considering such a switch. In a number of consumer industries these customers account for more than 10 % of the total number of end-users whose views were obtained. This proportion can be considered sufficient to prevent producers of steel

strapping from raising prices permanently by a small but significant amount, particularly as the Commission's investigations did not show that steel strapping producers could price discriminate between the various end-user applications. In view of this conflicting evidence the Commission has not been able to prove beyond doubt that PP strapping does not form part of the same relevant product market as steel strapping. Therefore, in this case a wider product market for steel strapping including PET and PP plastic strapping had to be considered.

A.2. Sealing heads for strapping band are a relevant product market

(42) Sealing heads are the most sophisticated and complex device at the heart of the automated strapping machines and engineered strapping systems which apply tension to the strapping band and make the joint. Hand-operated tools do not have a sealing head; rather the strapping band is manually fed into the tool and jointed together. Sealing heads can be distinguished from the machine body because they are regularly sold individually to independent machine assemblers who do not manufacture sealing heads themselves or produce only a limited number of heads or a narrow range⁽¹⁶⁾. In 1995-97, sales of single sealing heads to independent assemblers and competitors accounted for between 15 % and 25 % of the total number of sealing heads produced by the ITW group and for between 80 % and 90 % of Titan's production of sealing heads.

(43) From the demand side point of view, sealing heads for steel strapping applications cannot be replaced by sealing heads for plastic strapping applications nor vice versa, because of specific characteristics of each type of strapping and the different way in which they are joined — either through stamping the steel band or through applying heat to the plastic band. However, the basic technical characteristics of sealing heads and the engineering know-how required for their production are generally comparable. Furthermore, most of the producers of sealing heads manufacture both types of sealing heads although in differing ratios. For these reasons, from a supply side point of view, the Commission has come to the conclusion that both types of sealing heads belong to the same relevant product market.

⁽¹⁶⁾ Main customers for single sealing heads for strapping machines are Itipack (Italy), AmCa Machinery Inc. (USA), Sorsa (Spain) and Samuel Strapping Systems (Canada).

B. RELEVANT GEOGRAPHIC MARKETS

B.1. The market for steel and plastic strapping

1. *The relevant market is wider than national*

(44) The relevant geographic market for strapping goes beyond the geographic boundaries of the individual Member States of the Community and EFTA, given that strapping is offered cross-border in all of those States. Both, ITW Signode and Titan, supply customers in all Member States of the Community. Furthermore, with the exception of specific situations in Sweden, Finland and Norway, no major differences in the parties' market shares exist between the major Community countries and EFTA States⁽¹⁷⁾.

(45) Strapping band is subject to several internationally accepted norms and standard specifications or to established selection guides and packaging and loading requirements⁽¹⁸⁾. The notifying parties, therefore, take the view that within the Community and the EFTA States there are no relevant differences as regards the nature and characteristics of the products concerned.

2. *The relevant market is not wider than the EEA and Switzerland*

Proximity to end-users and consumer preferences for Western European suppliers

(46) Strapping band is ordered by the end-users according to their actual consumption, in several instalments over the year. Since any interruption in the delivery of strapping band will have a severely damaging effect on the production process of end-users, customers rank the supplier's reliability and security of delivery among the most important criteria by which they choose their suppliers. For these reasons, based on the results of the market

⁽¹⁷⁾ The significantly higher market shares of ITW Signode, of up to 70 %, in the Scandinavian countries, reflects the acquisition of Burseryds by ITW in 1995 and the continued transitional sales to the independent re-seller Cyklop, the former owner of Burseryds.

⁽¹⁸⁾ For example, Draft European Standard CEN TC261/SC3/WG3 (January 1998) and corresponding norms 'Packaging — Specification for tensional steel strapping' and 'Packaging — Specification for non-metallic tensional strapping'.

inquiry of the Commission, customers do not seem to consider suppliers established outside the EEA and Switzerland to be readily available alternatives to their present suppliers. None of the end-users who have responded to the Commission's questionnaires have imported any strapping band from suppliers outside Western Europe.

Transport costs

- (47) According to the parties, costs for transportation from the US to Europe would amount to approximately 5-10 % of the final prices for steel strapping, the exact proportion depending on the value of the product and the means of transportation. Transport costs for plastic strapping would amount to less than 5 %. Furthermore, from information provided by ITW Signode it appears that total freight and insurance expenses, in general, exceed 10 % of customer steel strapping prices for long-distance or overseas transport. Although the transport and insurance costs appear modest it should be remembered that strapping is a low-value product for which the value added to the raw materials is 15-30 %. In this context, supplies will be sensitive to transport costs.

Import duties and other non-tariff barriers to trade

- (48) The duty on imports into the Community from member countries of the WTO (conventional duty rates), applicable since 1 January 1998, are 3,2 % for steel strapping, 10,1 % for PP strapping and 10,4 % for PET strapping. The duties on imports from other countries (autonomous duty rates) are 10 %, 23 % and 20 % respectively. At least the duty rates on plastic strapping are quite significant in view of the modest value added to these products and make it rather unlikely that imports would increase considerably in response to a small but significant increase of relative prices in Western Europe.

Trade flows and imports

- (49) Official figures on trade flows of strapping band are not available because the tariff and statistical nomenclature of the European Community does not provide for a separate customs code for strapping band⁽¹⁹⁾. However, according to the parties, about

20 000 tonnes of steel strapping and about 2 000 tonnes of plastic strapping were imported into the EEA in 1996, accounting for approximately 6 % and 3 % in total EEA sales respectively. Together these imports are believed to account for approximately 5 % of the total strapping market. Because of their limited volume, imports of strapping band have not had a significant impact on the conditions of competition in Western Europe, in particular on the price-setting of the major suppliers in this area.

3. Conclusion

- (50) On the basis of the above findings, the Commission has come to the conclusion that the relevant geographic market for steel and plastic strapping is limited to the EEA area and Switzerland (hereinafter 'Western Europe') because the conditions of competition in this area are sufficiently homogeneous and can be distinguished from neighbouring areas and because, taken together, the transport costs and duty payable place imports at a significant disadvantage to producers based in the EEA.

B.2. The market for sealing heads for strapping machines

- (51) The geographical scope of the markets for sealing heads is worldwide. There are no significant barriers to imports into the Community and as sealing heads are a relatively high value-added product, transport costs do not affect the scope of activity of suppliers and the purchase decisions of their customers. Furthermore, both ITW Signode and Titan sell sealing heads to customers all over the world. In 1995-97, Titan achieved between 50 % and 80 % of its total sales of single sealing heads outside the EEA.

C. ASSESSMENT

- (52) This assessment is carried out on the basis of the parties' statement in the notification that, in accordance with their sale and purchase contract, at the same time as they acquire joint control of Titan that company will sell its strapping machinery and equipment operation to an independent company, Lenzen (see point 7). According to the parties, on the basis of the turnover attained in 1996, their future joint venture company is expected to reach a total turnover in the EEA of approximately ECU [...] million assuming full retention of current volumes. Of this turnover approximately ECU [...] million would stem from the current Titan company

⁽¹⁹⁾ The parties have identified customs tariff classification numbers which, in their view, would cover the trade flows of the products under consideration: steel strapping — 72124098; PP strapping — 39202079; PET strapping — 39206290. These customs codes, however, do not represent strapping band only.

and ECU [...] million from the production facilities to be transferred from ITW Signode.

Intended purpose of the notified operation

- (53) The proposed concentration results from the Krupp-Hoesch group's intention to withdraw from the production and distribution of strapping and strapping equipment. Krupp-Hoesch initially intended to split the business activities of Titan, its subsidiary in this field, between ITW Signode which would take over all the company's activities outside Germany, and the German undertaking Lenzen which would take over the German part of the business. This operation, which was notified under German competition law, was abandoned in April 1997 after the Bundeskartellamt had expressed serious competition concerns in a warning letter.
- (54) The operation under consideration is structured differently, with ITW Signode acquiring joint control of Titan's strapping band business only (see point 7). From the perspective of ITW Signode the proposed joint venture is a reflection of the current changes on the German and European steel and strapping markets. Within the context of the joint venture, ITW Signode will complete its production plants in Germany by the addition of the existing production lines of Titan which are partially complementary to its production lines in Dinslaken.

C.1. The major suppliers of strapping band in Western Europe

- (55) ITW group is the world's largest supplier of strapping and related equipment and is active in Western Europe through its subsidiaries Burseryds Bruk AB (Sweden), Signode Systems GmbH (Germany) and Orgapack Holding AG (Switzerland) with subsidiaries in France, Scotland and the USA. Burseryds and Orgapack were acquired by ITW in 1995 and 1996 respectively. ITW also is active in the neighbouring markets for wrapping products and considers itself to be a worldwide leader in offering customers a single source for stretch wrapping machinery and stretch film⁽²⁰⁾. ITW group achieved a total worldwide turnover of ECU 3 935 million in 1996.
- (56) Titan has two production facilities in Germany, one for steel strapping and seals located in Hagen-Kabel
- and one located in Schwelm for the design and manufacture of strapping equipment⁽²¹⁾. However, only the production facilities in Hagen-Kabel are subject to the concentration, because the Schwelm business unit will be divested to the Lenzen group. Titan has licensed both the ITW group and Lenzen for the use of a patent related to a method of securing balelocks.
- (57) The most important supplier of steel strapping besides the parties to the concentration is the family-owned company M. J. Maillis SA ('Maillis'), which operates three production lines for steel strapping in Greece. Since 1996, the company has also operated a production line for PP and PET plastic strapping. In 1997 it installed a new heat-treatment line which enables it to produce high-strength steel strapping and a production line for stretch film. As Maillis does not have a distribution organisation of its own outside Greece, most of its strapping sales are made through independent distributors. Maillis achieved a total worldwide turnover of about ECU 35 million in 1996.
- (58) Cyklop International is a major supplier of plastic strapping and also manufactures strapping equipment. At present, Cyklop's biggest suppliers of steel strapping are ITW Signode and Titan. Cyklop is also the exclusive distributor in Sweden and Finland for sealing heads and steel strapping machines manufactured by Orgapack, a company belonging to the ITW group, and also sells Orgapack tools on a non-exclusive basis in other Member States. In addition, Cyklop and ITW recently have formed a joint venture company, CS Packaging Corporation, to act as a base for serving potential markets in the Far East. The Cyklop group achieved a total worldwide turnover of about ECU 150 million in 1996.
- (59) Brevetti Signode Labea SpA is a producer of both steel and plastic strapping and of strapping equipment using manufacturing technology licensed by ITW. The ITW group does not have a share holding in Brevetti, but has granted Brevetti the exclusive right to supply the Italian market. Brevetti achieved a total worldwide turnover of about ECU 30 million in 1996.
- (60) Samuel Strapping Systems Company, part of Samuel Manu-Tech Inc. of Canada, is a leading supplier of steel and plastic strapping and strapping equipment in North America. In Western Europe, Samuel is active in the steel and plastic strapping markets

⁽²⁰⁾ See ITW's Annual Report 1996, p. 19.

⁽²¹⁾ The manufacture of strapping machines was outsourced to independent assemblers at the end of 1993.

through its UK subsidiaries Acme Gerrard Ltd and Pakseal Industries Ltd. The Samuel group achieved a total worldwide turnover of about ECU 304 million in 1996.

- (61) Lenzen, a family-owned German undertaking, produces steel strapping and designs strapping machines. It has achieved a global turnover of about ECU 21 million in 1996. The undertakings Brockhaus and Theis are family-owned, medium-sized companies which operate cold-rolling mills in Germany. Etiam/Sollac belong to the French steel producer Usinor SA.

C.2. The market for steel and plastic strapping

1. *The present market position of the parties*

Size of the market

- (62) The Commission knows of no statistics, whether official or unofficial (compiled by trade associations etc.), relating to the size of the strapping market. Furthermore, the sales figures of major strapping producers are not readily comparable, since some suppliers do not have a sales organisation of their own but make use of independent distributors and resellers. Hence, the Commission has had to make various calculations in order to establish its own estimate of the market size, based on the sales figures of all major producers in Western Europe. In particular, the Commission has eliminated the double counting of sales resulting from deliveries between competitors and has not taken into consideration the sales of independent distributors

and resellers, as they purchase their materials almost exclusively from Western European producers. The Commission has estimated the sales generated by smaller producers and has also taken into consideration the size of imports estimated by the notifying parties (see point 49). As a result, the Commission estimates that total sales of steel and plastic strapping band in Western Europe amounted to approximately ECU 489,4 million in 1997, the margins of independent distributors and resellers⁽²²⁾. Of that total approximately ECU 267,4 million were sales of steel strapping, ECU 56,3 million were sales of PET strapping and approximately ECU 165,7 million were sales of PP strapping.

Market shares

- (63) Total strapping sales of ITW Signode in 1997 amounted to about ECU [...] million, of which ECU [...] million (74,2 %) were steel strapping, ECU [...] million (8,2 %) PET strapping and ECU [...] million (15,6 %) from PP strapping. Those sales represent a market share of approximately [30-35 %] of the total market for steel and plastic strapping in Western Europe. Titan achieved a total turnover of about ECU [...] million (only steel strapping) representing a market share of approximately [5-10 %]. The next largest suppliers of strapping in Western Europe can be seen from Table 1 below. None of them have market shares exceeding 10 % and most have market shares below 5 %.

⁽²²⁾ According to the notifying parties, total strapping consumption in Western Europe amounted to ECU 593,2 million in 1997. Of this total, steel strapping sales accounted for ECU 290,3 million and plastic strapping sales accounted for ECU 302,9 million. On this basis the parties' market share would be [30-35 %].

(64)

Table 1

**Leading producers of steel and plastic strapping in Western Europe — Shares in total sales
(in value terms)**

(%)

Suppliers	Steel strapping	PET strapping	PP strapping	Total steel and plastic strapping	
	1997	1997	1997	1996	1997
ITW Signode	[...]	[...]	[...]	[...]	[...]
Titan (Hagen)	[...]	0	0	[...]	[...]
Total parties	[50-60]	[20-25]	[15-20]	[35-45]	[35-45]
Strapex (CH)	0	< 10	10-20	< 10	< 10
Samuel/ACME Gerrard (UK)	< 10	< 3	< 5	< 5	< 10
Cyklop (D)	0	20-30	< 10	< 10	< 10
Maillis (GR)	< 10	< 3	< 3	< 5	< 5
Brevetti (I)	< 5	0	< 5	< 5	< 5
Teufelberger (D)	0	0	< 10	< 5	< 5
Lenzen (D)	< 5	0	0	< 5	< 5
Sekisui Jushi (NL)	0	0	< 10	< 5	< 5
Kaltwalzwerk Brockhaus (D)	< 5	0	0	< 5	< 5
Theis-Gruppe (D)	< 5	0	0	< 5	< 5
Jäger (D)	0	0	< 10	< 5	< 5
Etilam/Sollac (F)	< 5	0	0	< 5	< 5
Sander (D)	0	< 5	< 5	< 5	< 5
PP Payne (UK)	0	< 5	< 5	< 5	< 5
Plastic Extruders (UK)	0	< 5	< 5	< 5	< 5

Source: Market inquiry of the Commission (only producers with a total market share above 1 %).

Remarks: The figures are based on the total sales of the companies after the elimination of double counting resulting from deliveries between competitors. The Cyklop group does not produce steel strapping itself but is active in this market as a distributor only; its sales in this segment therefore have not been shown in the above table. The market shares were calculated on the basis of an estimated market size (see point 62).

Capacities and production

- (65) The notifying parties have estimated, total capacities for steel strapping in Western Europe at between 410 000 and 450 000 tonnes a year during the last three years. This has been confirmed by the Commission's market inquiry, the results of which gave a total steel strapping capacity of approximately 437 300 tonnes in 1997. Of this total, the parties' production lines together accounted for about [45-55 %]. The biggest competitor, Maillis, recently increased its steel strapping capacity from 60 000 tonnes to 80 000 tonnes a year or about 18 % of total capacity. Overall capacity utilisation in Western Europe was approximately 84 % in 1997. In view of an anticipated stagnant demand for steel strapping in the next two to four years there does not appear to be any significant spare capacity which could effectively constrain the parties' behaviour after the concentration.
- (66) Total capacity for plastic strapping amounted to approximately 100 000 tonnes in 1996. Of this total, ITW Signode's production lines together account for 15-20 %. As a result of the recent expansion of plastic strapping capacity by competitors, the parties' current share of capacity is likely to be below 15 %. The biggest plastic competitors, Strapex and Cyklop, together account for between 20 % and 30 % of total plastic strapping production capacity. Total production capacity for PET strapping amounted to approximately 20-25 000 tonnes, the utilisation of which averaged between 60 % and 70 %. Maillis has recently started PET and PP plastic strapping production and Brevetti has concrete plans to invest in new PET strapping lines.

*2. The market position of the parties concerned after the concentration**Market shares*

- (67) As a result of the proposed concentration, on the basis of the Commission's estimates for the market size, ITW Signode and the proposed joint venture would achieve a combined market share, by value in 1997, of about [35-45 %] at the maximum in the total market for steel and plastic strapping. However, ITW Signode expects to lose between [...] % and [...] % of Titan's current steel strapping sales as the result of the transfer of Titan's sales organisation and trade marks to Lenzen. This expected loss appears far too high, given the fact that Titan has no established sales organisation outside Germany. The Commission

expects that the Lenzen group will manage to enter into supply contracts with some former customers of Titan in Germany. In view of the special circumstances in the present case, the sales that the future joint venture will lose to Lenzen are expected to amount to [...] % of Titan's current sales. Therefore, taking into consideration this loss of market shares, the combined market share would probably be [less than 40 %]. The parties to the concentration would have a combined market share which is about 5-6 times higher than the market share of their next largest competitor. In addition, the notifying parties after the concentration would be the largest supplier of strapping worldwide.

- (68) Although the parties will have a high market share there are a large number of other suppliers, in particular in the plastic strapping segment. In view of the fact that the overall market for strapping is growing at about 3 % a year and the steel segment is in relative decline (see point 30), the market share of the merging parties is expected to decline over time as their presence in the plastic strapping segment is relatively weaker. Furthermore, since there are continuing improvements in materials and technology, particularly for plastic strapping and equipment, the smaller competitors are likely to be able to further develop their businesses. Several competitors have been installing additional capacity in recent years, in particular Maillis, Lenzen, Teufelberger Strapex, Sander and Plastic Extruders. Even in the steel strapping area where the long-term trend in consumption is downwards at least two competing producers are installing additional capacity.
- (69) At present, none of ITW's competitors is capable of providing customers with a comparably comprehensive product range of steel and plastic strapping as the notifying parties. However, the Samuels/Acme group and Maillis both have recently entered the plastic strapping market; Samuel group took over the plastic strapping business of Interlake Corp which is mainly focused on the US market and Maillis started plastic strapping production at the end of 1996. Both companies have emphasised that they would actively seek to increase their market shares in plastic strapping, in particular in PET strapping in the coming years.
- (70) ITW Signode is one of the leading suppliers of strapping equipment and has a unique product range of strapping tools and machines both for steel and for plastic strapping. Its major competitors in the strapping equipment markets, however, are the plastic strapping producers Cyklop and Strapex and the engineering firms Fromm and Mosca. These companies are widely considered capable of providing strapping users with a sufficient selection of strapping equipment and have the necessary

know-how and technical experience to establish themselves as a reliable alternative to ITW Signode in the equipment markets. Since the Commission's inquiry has shown that customers in their strapping equipment can fairly easily use strapping materials from different producers, the strong position in the markets for strapping equipment cannot be considered a significant advantage for the sale of strapping consumables.

Potential competition

(71) Entry into the steel strapping segment of the relevant product market appears to be difficult, at least for newcomers who do not have access to steel processing technology. Furthermore, as demand for steel strapping is likely to decrease in the long term, any newcomer would have to take sales volumes from the present suppliers. According to the parties, there have been no new entrants into the steel strapping business in the last five years. According to the information available to the Commission at present, effective potential competition, whether in the form of establishing new production facilities in Western Europe or through increased imports into this market segment is unlikely in the foreseeable future.

(72) By contrast, as far as the segment for plastic strapping is concerned, the barriers to market entry appear to be comparatively modest. According to the parties, total investment cost for a new high-strength PET line is estimated to cost about ECU 1,1 million (not including the costs for installation, for land and buildings) and a combined PP/PET line would not cost very much more. The strong increase in demand for plastic strapping, in particular PP strapping, would make investments in new extrusion lines reasonable and offer opportunities for a profitable entry plan. This has already been proven by the recent investments made by Maillis. In addition it has to be taken into consideration that capital cost necessary for the conversion of specialised PP strapping lines into combined PP/PET extrusion lines appears to be below even the abovementioned figures. Therefore, the first to invest in new PET production lines are the current producers of PP strapping.

Current customers

(73) Strong market positions of suppliers can also be counterbalanced by powerful purchasers who, because of the volume of their requirements and their size and resources, can prevent a producer with a strong market position from exploiting it.

This is particularly so in this case, where the products are largely homogeneous and where a substantial proportion of sales are made through distributors. Distributors serve a wide variety of customers and make it more difficult for suppliers such as ITW Signode/Titan to discriminate between different groups of customers.

(74) The major consumers of strapping materials are concentrated in industrial sectors such as steel and metals industries, glass manufacture, construction materials, paper production, printing and synthetic fibres, which are characterised by large sophisticated buyers who can negotiate from positions of comparative strength and who have the resources and experience to find alternative suppliers. At present, because strapping is not usually a significant cost, purchase decisions may be made at a comparatively low level in an organisation. However, should there be any important price increase, these customers would bring their size and experience to bear on the suppliers. Customers in the steel industry have additional advantages. They supply the raw material for the production of steel strapping and so have a detailed knowledge of the most important cost component of the strapping manufacturers. In addition they also, in their own businesses slit, heat-treat and coat steel strip. These are the other important operations carried out by steel strapping producers.

Conclusion

(75) The above results of the Commission's market investigation show that the proposed operation would not lead to the creation or strengthening of a dominant position on a relevant product market for steel and plastic strapping.

C.3. The market for sealing heads for strapping machines

(76) The notified concentration will not lead to any addition of market shares in the market for sealing heads for strapping machines. The current business activities of Titan immediately after the completion of the concentration will be divested to the independent German company Lenzen. Lenzen's position in a combined market for both steel and plastic heads would be stronger than its position in a market for steel heads alone and therefore it will be a serious competitor to the parties. The creation or strengthening of a dominant position on the part of ITW Signode in the market for sealing heads as a

result of the concentration can therefore be ruled out.

GmbH and Thyssen Krupp Stahl GmbH is declared compatible with the common market and the functioning of the EEA Agreement.

VI. FINAL CONCLUSION

(77) On the basis of the results of the investigation as outlined above, the Commission has come to the conclusion that on the relevant product market for steel and plastic strapping as well as on the relevant product market for sealing heads, the proposed concentration would not lead to the creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded within the common market or the EEA,

Article 2

This Decision is addressed to:

1. Thyssen Krupp Stahl GmbH
Kaiser-Wilhelm-Straße 100
D-47166 Duisburg;
2. ITW Signode Holding GmbH
Magnusstraße 18
D-46535 Dinslaken.

HAS ADOPTED THIS DECISION:

Done at Brussels, 6 May 1998.

Article 1

The notified acquisition of joint control of Titan Umreifungstechnik GmbH by ITW Signode Holding

For the Commission

Karel VAN MIERT

Member of the Commission

COMMISSION DECISION

of 6 May 1998

concerning the extension of eligibility for regional aid for the acquisition costs of intangible property for large firms provided for in the 25th outline plan for the joint Federal Government/*Länder* programme for improving regional economic structures

(notified under document number C(1998) 1942)

(Only the German text is authentic)

(Text with EEA relevance)

(98/667/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given notice to the other Member States and the parties concerned to submit their comments, in accordance with Article 93(2) of the Treaty establishing the European Community,

Whereas:

I

By letter dated 25 March 1996, Germany, acting pursuant to Article 92(3) of the EC Treaty notified the Commission of the 25th outline plan for the joint Federal Government/*Länder* programme for improving regional economic structures ('the 25th outline plan'). By letter dated 12 August 1996, the Commission notified Germany of its decision to initiate the procedure pursuant to Article 93(2) of the EC Treaty concerning the 25th outline plan which, *inter alia*, extended eligibility for regional aid for the acquisition costs of intangible property for large firms.

The present procedure concerns the provisions detailed below.

The joint programme for improving regional economic structures, which is jointly financed and administered by the Federal Government and the *Länder*, forms the main regional aid scheme in Germany. It provides for assistance and guarantees for investment and infrastructure projects for economic activities in assisted areas that are eligible for regional aid pursuant to Article 92(3)(a) and (c) of the EC Treaty. The budgetary funds for each aid period are fixed, and any alterations in

the terms for aid made, on the basis of annually-adopted outline plans.

The preceding plan, the 24th outline plan, authorised by the Commission (N 531/95)⁽¹⁾ specifies that, in addition to acquisition costs, manufacturing costs and leasing costs of tangible property, the acquisition costs of intangible property which can be included in an enterprise's assets (for example, patents, licences, investment or application planning) are eligible for aid provided that the intangible property:

- is acquired from a third party or from an enterprise which has no business, legal or personal links with the aid recipient,

and

- has remained for at least three years after the termination of the investment project in the ownership of the aid recipient, unless it is replaced by assets of equal or higher value; moreover, during that period the assisted property may not be leased or granted as security other than in the context of corporate restructuring recognised for tax purposes or the creation of a partnership under paragraph 15 of the Income Tax Law while remaining within the business of the aid recipient and/or a related enterprise,

and

- does not account for more than 25 % of the total investment project.

Under the 25th outline plan, Germany intends to remove the third of those conditions, that is the limit on eligibility for aid for intangible property where it accounts for more than 25 % of the cost of the overall investment project.

In its decision to initiate the procedure, the Commission expressed doubts whether the projected aid for large firms was compatible with the common market on the following grounds:

⁽¹⁾ OJ C 291, 4.10.1996, p. 4.

- the amendment envisaged has the effect of broadening the basis of the scheme and, applying the same aid intensity, would have the effect of increasing the permissible volume of aid above that permitted on the uniform basis of assessment laid down in the common method of assessing aid adopted by the first resolution of 20 October 1971 of the representatives of the Governments of the Member States, meeting within the Council, on general systems of regional aid⁽²⁾,
- under the rules applicable when the decision to initiate the procedure was adopted, the acquisition costs of intangible property other than research and development projects were eligible for aid only in the case of small and medium-sized enterprises pursuant to the Community guidelines for State aid for small and medium-sized enterprises⁽³⁾,
- in view of the mobility of intangible investments within the common market and in particular within firms belonging to the same enterprise, effective control of misuse of such aid can scarcely be conceived in so far as, even if aid were granted solely in areas eligible for regional aid, it might in reality benefit firms outside those areas.

In addition, the Commission made the following points:

- in the course of the procedure for drawing up the guidelines on national regional aid⁽⁴⁾ and at the multilateral meetings on this matter, several delegations emphasised that the expenditure on intangible property by large firms should also be eligible for aid,
- the Green Paper on innovation⁽⁵⁾ stresses the need to stimulate innovation,
- in the framework for State aid for research and development⁽⁶⁾, the Commission confirmed the need to stimulate investment in intangible property, notably in assisted areas.

Regarding the eligibility of expenditure on intangible property by large firms in the new *Länder* (areas specified in Article 92(3)(a) of the EC Treaty), the Commission made the following points:

- in the areas specified in Article 92(3)(a) of the EC Treaty, under the Commission communication of 1988 on the method for the application of

Article 92(3)(a) and (c) to regional aid⁽⁷⁾, large firms may be granted, in addition to aid for investment in plant and machinery, operating aid, whose distorting effects undoubtedly exceed those of aid for intangible property up to the ceiling for regional aid,

- in the areas specified in Article 92(3)(a) of the EC Treaty there is often no appropriate local R&D activity, as is in fact the case in the new *Länder*. It is crucial to the success of the development strategy for the new *Länder* that firms there should develop competitive products and processes. In view of their liquidity difficulties, therefore, it may be fully justified to take into account their expenditure on the acquisition of intangible property.

The decision to initiate the procedure was notified to Germany and at the same time it was asked for its comments on that decision. Following the publication of the decision in the *Official Journal of the European Communities*⁽⁸⁾, other Member States and interested parties were given the opportunity to submit observations.

II

By letter of 20 September 1996, Germany gave its comments on the decision, which are summarised below.

Germany points out that the Green Paper on innovation stresses the need to assist innovation and intangible investments and the abovementioned Community framework for State aid for research and development also emphasises the need to provide aid for intangible investments.

Regarding the Commission's expressed concern over the risk of misuse of aid because of the mobility of intangible property, Germany's view is that the basic conditions for the grant of aid for intangible investment can be considered an effective means of preventing misuse. It points out that the acquisition costs of intangible property only qualify for assistance if the investor has not acquired it from an associated enterprise, or one having business, legal or personal links to the investor. It considers that those exclusionary conditions ensure that, for example, a parent company set up outside the assisted area cannot benefit from the assistance for the acquisition costs of intangible property by having it remitted indirectly to it. Germany therefore concludes that the programme precludes remitting the aid under an agreement to that effect or an agreement conferring control of the aided company on another company. Moreover, the conditions excluding aid also exclude

⁽²⁾ OJ C 111, 4.11.1971, p. 1.

⁽³⁾ OJ C 213, 23.7.1996, p. 4.

⁽⁴⁾ OJ C 74, 10.3.1998, p. 9.

⁽⁵⁾ COM(95) 688 final.

⁽⁶⁾ OJ C 45, 17.2.1996, p. 5.

⁽⁷⁾ OJ C 212, 12.8.1988, p. 2.

⁽⁸⁾ OJ C 35, 4.2.1997, p. 6.

assistance in cases where the links between the businesses are purely personal. Germany therefore concludes that assistance for the acquisition of intangible property by large firms will only be granted if there are no links, formal or otherwise, between the applicant enterprise set up in the assisted area and other enterprises from which the applicant enterprise acquires the property, whether the latter are set up inside or outside that area.

Regarding the Council resolution of 20 October 1971⁽⁹⁾ specifying the common method of assessing aid, Germany's position is that the standard base should reflect the pattern of investments which are typical of the Member State in question. The programme has been in operation for over 25 years and, in the view of the German authorities, it is necessary to adapt it to take account of the increasing significance of intangible property since it should be fully included in that base, and in the case of large firms too.

Lastly, Germany employs current data to bring out the increasing significance of intangible property in investment aid. The data indicate that investment projects for intangible property are more effective in creating jobs than 'classic' investments. In addition, if large firms were no longer excluded, it would be possible to assist investment projects with a particularly high level of innovation.

III

The other Member States and other interested parties have not presented any comments in this procedure.

However, in the process of drafting the new guidelines on national regional aid a number of Member States expressed their views on the eligibility for aid of the acquisition costs of intangible property for large firms. In the course of the multilateral meetings held on 15 May 1996 and 23 May 1997 to discuss the draft guidelines, a number of other delegations gave their opinion, in the German delegation's presence, on the eligibility of intangible property for aid.

In fact a majority of the Member States' delegations advocated that intangible assets should be eligible for aid, to some extent at least. On the other hand, at the multilateral meeting of 23 May 1997 one delegation raised the issue of the mobility of immaterial property

and the resultant risk of misuse; another delegation considered that a limit on eligibility for aid of 25 % of the total investment concerned in the standard base was over-restrictive.

Lastly, Germany, in its written observations of 16 June 1997 on the draft guidelines on national regional aid, made no substantive observations on the eligibility of intangible property for aid, but only referred to the procedure involved.

It should be noted that the guidelines were adopted with regard to national regional aid on 16 December 1997⁽¹⁰⁾. They lay down that eligible expenditure may include certain categories of intangible investment (transfer of technology through the acquisition of patents, operating or patented know-how licences and unpatented know-how) provided that the limit of 25 % of the standard base is not exceeded in the case of large firms. Further, the intangible property must be used exclusively in the establishment receiving that aid, regarded as amortisable assets, purchased from third parties under market conditions, included in the assets of the firm and remain in the establishment receiving the regional aid for at least five years. Pursuant to point 6.1 of the guidelines, the Commission has proposed to all Member States as appropriate measures under Article 93(1) of the EC Treaty that all regional aid schemes in operation on 1 January 2000 be altered to ensure that they are compatible with the guidelines on that date.

IV

The investment aid and guarantees including those for intangible property granted under the joint Federal Government/*Länder* programme for improving regional economic structures constitute aid for the purposes of Article 92(1) of the EC Treaty. They are made available through State means to specific enterprises or industries and are liable to affect trade between Member States and thereby to distort competition.

In accordance with the common method of assessing aid indicated in the resolution of 20 October 1971, the Commission, in dealing with regional aid, adopts a standard basis for aid consisting of investment expenditure on land, buildings and plant weighted for each Member State. Under point 5(d) of the Annex to that resolution, in Germany's case this amounts to 65 % for plant and machinery, 30 % for buildings and 5 % for land. If aid is granted for additional expenditure, in this

⁽⁹⁾ See footnote 2.

⁽¹⁰⁾ See footnote 4.

case intangible property, under the 1971 common method a fresh calculation must be made of the base in the scheme in relation to the standard base.

The base for the costs eligible for aid specified in the 24th outline plan previously authorised by the Commission, already include, together with plant and buildings (but excluding land) the acquisition costs of intangible property provided that they do not account for more than 25 % of the total investment. The aid granted under the 24th outline plan is thus founded on a base other than the standard base. No provision is made for a fresh calculation of the base for expenses eligible for aid under the outline plan for the joint Federal Government/*Länder* programme. It follows that the volume of aid permissible under the 24th outline plan can exceed that permitted through the application of the standard base since the basis of calculation can be extended beyond 25 %, which is only partially compensated by the exclusion of land from the base for the programme.

This decision is not concerned with the compatibility with the common market of the 24th outline plan. Since the Commission has adopted the new guidelines on national regional aid and the proposal for the appropriate measures for their implementation and since, under the guidelines, the acquisition costs of certain intangible property qualify for aid provided that they do not exceed 25 % of the standard base in the case of large firms, appropriate measures pursuant to Article 93(1) to adapt the 24th outline plan for the future to the rules on State aid should not be proposed at the present stage.

The present aid project under the 25th outline plan abolishes the exclusionary threshold for aid for the acquisition costs of intangible property for large firms. The question consequently arises whether allowing without restriction, subject to certain conditions, the acquisition costs of intangible property included in the assets of the firm to be included in the base for regional aid in the case of large firms in national development areas under Article 92(3)(a) and (c) of the EC Treaty can be considered to be compatible with the common market.

The derogation in Article 92(2) of the EC Treaty is not applicable since the aid in question is not aid having a social character (under indent (a)), aid to make good the damage caused by natural disasters or exceptional occurrences (under indent (b)), or aid granted in order to compensate for the economic disadvantages caused by the division of Germany (under indent (c)).

There is also no reason to apply the derogations in Article 92(3)(b) and (d) because the aid is not 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, nor is it aid to promote culture and heritage conservation.

Lastly, the derogation in Article 92(3)(c), which concerns aid for the development of certain economic activities or of certain economic areas, is not applicable. As has been pointed out, the present procedure concerns only the eligibility of aid for the acquisition costs of intangible property for large firms since the Community guidelines on State aid for small and medium-sized enterprises make provision, on certain conditions, for the unrestricted inclusion of the acquisition costs of intangible property in the base for aid for SMEs. Moreover, the present aid project makes no provision for aid for the acquisition of intangible property in connection with the implementation of a research and development project. For this reason the provisions on the eligibility of intangible property for aid contained in the Community framework for State aid for research and development do not apply to the present case.

However, it is necessary to verify whether the aid project can be considered to be compatible with the common market under the derogations concerning particular areas envisaged in Article 92(3)(a) and (c). Since the 25th outline plan was notified before the entry into force of the new 1997 guidelines on national regional aid, the compatibility of the project must be assessed, pursuant to point 6.1 of those guidelines, on the basis of the rules applicable at the time of notification.

As Germany pointed out in its comments, the significance of innovation for ensuring that European enterprises can stand up to globalised competition is emphasised in the 1994 Commission White Paper, 'Growth, Competitiveness, Employment'⁽¹¹⁾ and in the 1995 Green Paper on innovation. To strengthen the innovatory capacities of European businesses, particular importance is attached, in addition to the completion of the internal market, economic and monetary union and an operational competition policy, to research, further training and dissemination of research. It is observed in that connection, *inter alia*, that there is less investment in research and technological development in the Member States of the Union than in other industrialised States such as the United States of America or Japan. It is also indicated that the cost of registering a patent in the Community is six times what it is in the United States of America. Germany expressly pointed out the particular

⁽¹¹⁾ COM(93) 700 final.

significance of investment in innovation in the economically less developed areas of the Community, where SMEs in particular encounter difficulties in obtaining financing for innovatory measures.

Regarding the use of public funds to attain these objectives, it is indicated in the White Paper that 'investment in training, research, the promotion of innovation and, generally speaking, the non-physical components of value-added must be treated at least as favourably as traditional forms of investment. The aim should be to promote the emergence of new generations of products that make optimum use of all the technologies available on the world market, and to encourage the dynamic incorporation of innovation into processes, products and organisation. An essential precondition is that there should be an increase in research activities by Community firms and greater selectivity in government assistance'⁽¹²⁾.

Regarding the provisions on State aid, the Green Paper on innovation focuses on the revision of the Community framework for State aid for research and development.

Lastly, a recent publication⁽¹³⁾ indicates that expenditure on intangible investments as very broadly defined covers expenditure on research and development, acquisition of technology, public-relations work, training and software and that enterprises' expenditure on such property has increased at both macroeconomic and microeconomic levels.

The foregoing points show that enabling the acquisition costs of intangible property to be included in the assets of a firm forms only one of the proposed measures to promote innovation by enterprises; other measures include legislative and administrative measures to establish an environment favourable to innovation or measures to promote training, research and development and investment in intangible property which cannot be included in the assets of the firm.

Regarding State aid, the Commission has already taken the following steps to support businesses' ability to innovate:

- the Community framework for State aid for research and development published in 1996 lays down that research and development projects, in the case of large firms and outside national assisted areas as well,

have greater eligibility for aid up to the limits fixed in the WTO rules on aid and includes among eligible R&D costs 'research, technical knowledge and patents, etc. bought from outside sources',

- regarding SMEs, the 1996 Community guidelines on State aid for small and medium-sized enterprises lay down that aid for intangible investment inside and outside national assisted areas and expenditure on consultancy services, training and dissemination of knowledge qualify for aid,
- the 1997 guidelines on national regional aid lay down that expenditure on certain categories of intangible assets can be eligible for aid, on certain conditions, provided that it does not exceed 25 % of the standard base in the case of large firms,
- in the draft Community guidelines for State aid for training, last considered by the Member States at the multilateral meeting on 10 March 1998, there are greater possibilities for granting aid for training measures, also in the case of large firms.

This shows that the Commission has already adopted considerable measures on State aid with a view to attaining its objective of promoting the innovatory capacities of large firms. In particular, as Germany indicated in its comments, the Commission has, by adopting the new guidelines on national regional aid, adjusted the base for costs eligible for regional aid to the increasing significance of intangible investment in enterprises' investments.

Unlimited eligibility for regional aid for the acquisition costs of intangible property, where those costs exceed the levels in the abovementioned rules, cannot be considered to be compatible with the common market on the basis of the derogations for specific areas contained in Article 92(3)(a) and (c) for the reasons set out below.

First, unlimited eligibility for regional aid for the acquisition costs of intangible property would considerably extend the standard base for calculating the basis for granting investment aid. This would produce a considerable increase in the permissible volume of aid on the basis of the same aid intensity. The result would be an increased risk of distortion of competition through State aid.

Moreover, this extension of the base would reduce comparability of aid between Member States and thus

⁽¹²⁾ Point 2(3)(b).

⁽¹³⁾ Intangible investments, impact on competition and scale effects', *The Single Market Review*, Volume 2 of subseries V, European Commission, 1998.

reduce transparency in this area since the definition of intangible property which qualifying firms could include in their assets would differ in the various Member States and would depend on different accounting rules⁽¹⁴⁾.

Furthermore, extending the base in the case of large firms removes the relative advantage conferred under Community law through State aid for SMEs under the Community guidelines on State aid for small and medium-sized enterprises. Those guidelines are intended to level out the handicaps limiting SMEs' access to the financing necessary to acquire new technology. This does not apply in the case of large firms, which are usually better able to carry through research programmes than SMEs and develop their own intangible property.

Regarding the risk of misuse of aid because of the mobility of intangible property, the points set out below should be made concerning Germany's arguments on this issue. The legal condition referred to by Germany that a person investing in intangible property must not acquire it from a related enterprise cannot preclude a situation where property for which aid was received in implementation of an investment project in an assisted area is transferred to another area, for example one which is ineligible for regional aid; the provision referred to by Germany can prevent the transfer of property for which aid has been granted where intangible property is acquired from a related enterprise and the assignment of the related rights to that enterprise.

On the contrary, under this provision, where intangible property is acquired from a third party not related to the enterprise in receipt of aid and set up in an assisted area, it is impossible to preclude the transfer of the property for which aid has been granted to an area ineligible for aid and the assignment of the rights in the property at a lower price than would have been the case without State aid to a (related) enterprise in an area ineligible for aid.

The fixing of a ceiling for eligibility for aid for intangible property in relation to the total cost of the tangible investments enables the intangible investments to be connected to the tangible investments so that the added value in respect of which aid was granted can be more securely linked to the assisted region. For example, the fixing of that ceiling prevents a business from setting

up an enterprise in an assisted area with the sole aim of acquiring intangible property and subsequently transferring it to other enterprises, including enterprises outside assisted areas.

The abovementioned condition under the outline plan for the joint Federal Government/*Länder* programme for granting aid whereby (tangible and intangible) property must remain for at least three years after the implementation of the investment project in the ownership of the enterprise in receipt of aid unless it is replaced by property of equivalent or higher value, cannot by itself prevent the risk of misuse. This provision, in so far as compliance can somehow be verified, ensures that the intangible property will be used for this period in the enterprise in receipt of regional aid; on the other hand, it does not prevent the rights linked to the property being used in other enterprises, including those set up outside assisted areas.

In order to minimise the risk of misuse of regional aid for large firms while at the same time permitting certain acquisition costs of intangible property to be included in the base for costs eligible for aid, it is essential to link aid for intangible investments to the use of those investments for tangible assets, for example plant and equipment and buildings, if the derogations in Article 92(3)(a) and (c) of the EC Treaty are to be applied.

Regarding the existing unrestricted eligibility for aid of these costs in the case of SMEs, it should be borne in mind that SMEs, by reason of their typical handicaps, must buy in intangible property instead of developing new technology through their own research and development more often than is the case with large firms. In adopting the Community guidelines on State aid for small and medium-sized enterprises, the Commission consequently took the view that the advantage of the objective of promoting innovation for SMEs outweighed the disadvantage of the increased risk of misuse. In any event, the risk of distortion of competition through any misuse of aid remains limited in view of the size of SMEs.

Lastly, it is necessary to verify whether, by reason of the lack of innovation on the part of businesses in particularly disadvantaged regions like the new German *Länder*, the unrestricted inclusion of the acquisition costs of intangible property in the base for aid in assisted regions can be considered to be compatible with the common market under Article 92(3)(a).

⁽¹⁴⁾ See footnote 13.

Moreover, in such areas the Commission makes provision for preferential aid, permitting increased intensity in the case of aid for initial investment and, on certain conditions, permitting operating aid to be cumulated with aid for initial investment; in addition, State aid for research and development can be granted with increased intensity. It consequently appears inappropriate to provide a base for costs eligible for aid other than that for cases of aid outside assisted areas pursuant to Article 92(3)(a). The arguments cited above concerning the extension of the base and the consequent risk of distortion of competition, the lack of comparability between the concepts of the intangible investments which can be included in the balance sheet of the recipient enterprise, compensation for handicaps suffered by SMEs in relation to large firms and the risk of misuse of regional aid for intangible investments cannot be disregarded in the case of aid granted in those regions.

On these grounds, the Commission considers the proposal contained in the 25th outline plan for the joint Federal Government/*Länder* programme for improving regional economic structures to repeal the provisions rendering large firms ineligible for aid for intangible property to be incompatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The repeal envisaged by Germany in the 25th outline plan for the joint Federal Government/*Länder*

programme for improving regional economic structures ('the 25th outline plan') of the provisions rendering large firms ineligible for aid for intangible property is incompatible with the common market in so far as it concerns firms that do not meet the definition of small and medium-sized enterprises.

Article 2

Germany is not entitled to apply the 25th outline plan in the form envisaged.

Article 3

Germany shall inform the Commission, within two months of being notified of this decision, of the measures taken to comply therewith.

Article 4

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 6 May 1998.

For the Commission

Karel VAN MIERT

Member of the Commission

COMMISSION DECISION

of 1 July 1998

on State aid granted by the Republic of Austria and the *Land* of Upper Austria to Actual Maschinenbau AG

(notified under document number C(1998) 1943)

(Only the German text is authentic)

(Text with EEA relevance)

(98/668/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given the parties concerned the opportunity to submit their comments in accordance with the abovementioned Article 93,

Whereas:

By letter dated 12 August 1996 the Austrian authorities informed the Commission that they intended to grant restructuring aid to Actual Maschinenbau AG, a machine tool manufacturer. On the basis of Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises⁽¹⁾, Actual Maschinenbau is to be considered a large firm. Its registered office is in Ansfelden, which is not in an assisted area. It is active in the manufacture of machine tools.

On 25 October 1996 the Austrian authorities notified the Commission of a proposal to grant the firm R&D aid as well.

By letter dated 17 December 1996 Austria withdrew both notifications and informed the Commission that the Republic of Austria and the *Land* of Upper Austria wished to grant rescue aid in the form of a rescue loan worth ATS 15 million (ECU 1,1 million), over six months and at an interest rate of 6,8 %. The legal bases for the aid were Section 35a of the *Arbeitsmarktförderungsgesetz* (Labour Market Promotion Act) and the *Allgemeine Förderrichtlinien* (General Development Guidelines) of the *Land* of Upper Austria.

On 5 February 1997 the Commission decided not to raise any objections to the planned rescue aid. The Austrian authorities were informed of this by letter dated 25 February 1997, reference SG(97) D/1422.

By letter dated 18 July 1997 the Austrian authorities notified an extension of the rescue aid until 31 October 1997, indicating that, before a final restructuring plan could be drawn up, a number of important decisions had to be taken concerning, among other things, a transfer of shares in the firm's Hungarian subsidiary and a composition arrangement with the present owners. Settlement of both matters was said to be crucial to the firm remaining in business.

On 16 September 1997 the Commission decided to initiate proceedings pursuant to Article 93(2) of the EC Treaty in respect of the extension of the rescue aid until the end of October of that year, this being tantamount to a second rescue aid measure. It took the view that the extension of the rescue loan might merely maintain the *status quo* and transfer the problems associated with structural change to other, more efficient firms. It was doubtful, therefore, whether an extension of the rescue aid could be considered compatible with the common market.

The Austrian authorities were informed of this by letter dated 2 October 1997, reference SG(97) D/8079. They submitted their comments by letter dated 10 November 1997, in which they acknowledged that the new rescue aid had been granted before the Commission had stated its position on the matter. They declared that they had taken preliminary steps to recover outstanding debts. The Commission observed in a letter dated 21 November 1997 that repayment of the loan had clearly not yet been ordered and that it assumed that the Austrian authorities would inform it in due course once this was done, furnishing supporting evidence. The Austrian authorities confirmed by fax on 10 June 1998 that the same terms applied to the extended rescue loan as to the authorised loan, adding, however, that so far the firm had neither paid any interest nor repaid the loan.

A Commission notice concerning the decision to initiate proceedings and inviting other interested parties to submit comments was published in the *Official Journal of the European Communities*⁽²⁾. No comments were received.

⁽¹⁾ OJ L 107, 30.4.1996, p. 4.

⁽²⁾ OJ C 390, 23.12.1997, p. 11.

By letter dated 23 February 1998 the Austrian authorities informed the Commission that they wished to grant Actual Maschinenbau restructuring aid. They sent additional information in a further letter dated 10 March 1998. The Republic of Austria intended to grant under Section 35a of the *Arbeitsmarktförderungsgesetz* an ATS 20 million (ECU 1,4 million) loan over eight years, with a two-year repayment holiday, repayable in 12 half-yearly instalments and bearing an interest rate of 3,5 %, the gross grant equivalent of which within the meaning of the Commission notice on the *de minimis* rule for State aid⁽³⁾ came to ATS 3,7 million (ECU 268 000). On the basis of its *Allgemeine Förderrichtlinien*, the Land of Upper Austria intended to provide a grant amounting to ATS 10 million (ECU 725 000) for R&D work which the Austrian authorities deemed essential to the firm returning to profit. The total cost of the planned R&D work came to ATS 83 million, of which ATS 51,9 million had already been spent in 1996 and 1997 and of which only ATS 31,1 million remained to be spent in 1998.

In a letter dated 7 April 1998 the Commission put a number of questions to the Austrian authorities, expressing doubt as to whether the restructuring plan met the conditions of the Community guidelines on State aid for rescuing and restructuring firms in difficulty⁽⁴⁾. In its opinion, it was not apparent from the forecasts that the firm would, as the Austrian authorities maintained, be completely restructured by 1999. It doubted in particular whether the firm's capital base could be considered adequate in the long term. Moreover, the forthcoming operating results were expected to be low, and the assumptions underlying the forecasts were not set out in the restructuring plan. The Commission pointed out in particular that, in the absence of further explanation, the projected increase in turnover was implausible. With regard to the R&D work, it stated that it could not be concluded from the information available that the costs qualified for assistance under the Community framework for State aid for research and development⁽⁵⁾. In any case, only future costs were eligible. Finally, it took the view that there was not enough evidence to support the Austrian authorities' assertion that a new investor willing to inject sufficient capital into the firm would take the firm over.

By letter dated 5 May 1998 the Austrian authorities informed the Commission that the takeover negotiations between the present owners and the investor had failed. They now shared the Commission's doubts about the compatibility of the notified restructuring aid with the common market and were accordingly withdrawing the notification of the restructuring aid for Actual Maschinenbau AG.

The Commission has already explained in its decision to initiate proceedings in this case that the extension of the rescue aid constitutes State aid within the meaning of Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

Under those provisions, aid having the features set out therein is incompatible with the common market.

Article 92(2) and (3) of the EC Treaty and Article 61(2) and (3) of the EEA Agreement list the cases in which aid may, by way of exception, be declared compatible with the common market.

The exception pursuant to Article 92(2) of the EC Treaty and Article 61(2) of the EEA Agreement is not applicable here. The aid is neither aid having a social character granted to individual consumers nor aid to make good the damage caused by natural disasters or exceptional occurrences, nor aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

The exception pursuant to Article 92(3)(a) of the EC Treaty and Article 61(3)(a) of the EEA Agreement is likewise not applicable here inasmuch as the aid is not intended to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment.

As regards the exception pursuant to Article 92(3)(b) of the EC Treaty and Article 61(3)(b) of the EEA Agreement, the Commission has ascertained that the aid is intended neither to promote the execution of an important project of common European interest nor to remedy a serious disturbance in the economy of a Member State.

The regional component of the exception pursuant to Article 92(3)(c) of the EC Treaty and Article 61(3)(c) of the EEA Agreement is not applicable inasmuch as the firm's registered office is located outside an assisted area. Indeed, the Austrian authorities have not relied on any of the abovementioned exceptions to justify the aid.

As regards part of Article 92(3)(c) of the EC Treaty and of Article 61(3)(c) of the EEA Agreement dealing with aid to facilitate the development of certain economic activities or of certain economic areas, the Commission would refer to the Community guidelines on State aid for

⁽³⁾ OJ C 68, 6.3.1996, p. 9.

⁽⁴⁾ OJ C 368, 23.12.1994, p. 12.

⁽⁵⁾ OJ C 45, 17.2.1996, p. 5.

rescuing and restructuring firms in difficulty, according to which Article 92(3)(c) of the EC Treaty may form the basis for exempting rescue aid if the aid contributes to the development of economic activities without adversely affecting trading conditions to an extent contrary to the common interest.

According to the abovementioned guidelines, a rescue loan may be granted only for the time needed (generally not exceeding six months) to devise the recovery plan. As was already indicated in the decision to initiate proceedings, an extension of the rescue aid would infringe this general rule. The Commission authorised the rescue aid for a period of six months. The rescue loan was disbursed as follows: ATS 8 million on 27 January 1997 and ATS 7 million on 13 February 1997. It ought therefore to have been paid back by the end of July 1997.

The Commission can depart from the general six-month rule only in well-founded, exceptional cases. When they notified the extension of the rescue aid, the Austrian authorities did not, however, present it as being necessary owing to unforeseeable, extraneous circumstances. They sought instead to justify it by the need to examine questions to do with the transfer of shares in the Hungarian subsidiary and the composition arrangement with the present owners. These two interrelated aspects ostensibly formed part of the efforts to find a new investor with a view to providing the firm with an adequate capital base and improving its strategic position. These factors were therefore crucial to the firm remaining in business and a precondition for devising a viable restructuring plan that would restore the firm to profitability within a reasonable period.

It must be borne in mind, however, that these questions should have been resolved, not just recently, but before the aid application was submitted at the end of 1996. The Austrian authorities pleaded, in the course of proceedings pursuant to Article 93(3) of the EC Treaty, no exceptional circumstances such as might have warranted extending the rescue aid. Nor did they prove that the firm would be capable in the foreseeable future of taking the necessary decisions which they considered crucial to the firm remaining in business. What is more, they notified the granting of restructuring aid by letter dated 23 February 1998, only to withdraw the notification by letter dated 5 May 1998 on the ground that they shared the Commission's doubts about the aid's compatibility with the common market.

There was at the time of initiation of proceedings by the Commission, and there is now, insufficient evidence to support the contention that exceptional circumstances justify an extension of the rescue loan or that such an

extension will ultimately enable the firm to devise a suitable restructuring plan.

The Commission must also take the situation in the relevant market into consideration. The firm is active in the following four sectors: machine tools for the production of plastic windows, machine tools for the manufacture of plastic sections, extrusion of sections and plastic injection mouldings.

The relevant machine tool market, being highly export-oriented, is subject to strong international competition. Manufacturers, who are mostly either SMEs or fairly large firms, are concentrated mainly in Central Europe. According to the Austrian authorities, Actual Maschinenbau's leading competitors are Greiner GmbH, TOP and Technoplast in Austria, IDE in Italy and Schwarz in Germany.

Demand for the abovementioned machine tools is strongly influenced by developments in the building industry and in urban renewal and by the share of the overall window market accounted for by plastic windows. The market in plastic windows grew from 1980 onwards above all because of its increasing share of the overall market and because of the building boom. Since the second half of 1995, the window market has been affected by the recession in the building industry. The Central European market seems to be saturated and there is probably already a degree of overcapacity.

As a result of the rescue loan, Actual Maschinenbau AG is in receipt of funds totalling ATS 15 million which it would not normally have received, and hence has gained an unjustified financial advantage over its unaided competitors. The problems associated with the structural change may thus be transferred to other, more efficient operators, and this may adversely affect this branch of industry in other Member States.

Since no exception is applicable in this case, the extended rescue aid must be regarded as aid which adversely affects trading conditions to an extent contrary to the common interest.

In the Commission's opinion the extended rescue loan is accordingly incompatible with the common market.

The rescue aid authorised by the Commission on 5 February 1997 expired at the end of July 1997. The Austrian authorities notified in their letter of 18 July 1997 an extension of the rescue aid by a further three months until the end of October 1997. They

implemented this measure at the end of July 1997 when the authorised rescue loan expired — that is to say, before the Commission had stated its position. The implementation was therefore unlawful. Moreover, the aid was granted, not only until October 1997, but until the present time. The aid is incompatible with the common market.

The Commission must therefore take the measures necessary to restore the *statuts quo ante*, which, according to the judgment of the Court of Justice of the European Communities in Case C-142/87, *Belgium v. Commission (Tubemeuse case)*⁽⁶⁾, presupposes that the undue financial advantage enjoyed by Actual Maschinenbau AG after the expiry of the authorised rescue loan must be eliminated. According to the judgment of the Court of Justice in Case 301/87, *France v. Commission (Boussac case)*⁽⁷⁾, the rescue loan must be repaid in accordance with the procedures and provisions of Austrian law, with interest, at a percentage rate corresponding to the reference rate used to calculate the net grant equivalent of regional aid in Austria, payable from the date on which the aid was granted until the date on which it is actually repaid,

HAS ADOPTED THIS DECISION:

Article 1

The extended rescue loan of ATS 15 million granted by Austria to Actual Maschinenbau AG is unlawful inasmuch as it was made available at the end of July 1997 before the Commission had stated its position. The aid is, moreover, incompatible with the common market because none of the criteria pursuant to Article 92(2) and

(3) of the EC Treaty or Article 61(2) and (3) of the EEA Agreement are satisfied.

Article 2

Austria is hereby required to ensure that the rescue loan referred to in Article 1 is repaid. The loan shall be repaid in accordance with the procedures and provisions of Austrian law, with interest, at a percentage rate corresponding to the reference rate used to calculate the net grant equivalent of regional aid in Austria, payable from the date on which the aid was granted until the date on which it is actually repaid.

Article 3

Austria shall inform the Commission within two months of the date of notification of this Decision of the measures taken to comply therewith.

Article 4

This Decision is addressed to the Republic of Austria.

Done at Brussels, 1 July 1998.

For the Commission

Karel VAN MIERT

Member of the Commission

⁽⁶⁾ [1990] ECR I-959, at paragraph 66.

⁽⁷⁾ [1990] ECR I-307, at paragraph 22.