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Contents

I Acts whose publication is obligatory

.....

II Acts whose publication is not obligatory

Commission

2006/945/EC:

- ★ **Commission Decision of 21 September 2005 on the implementation of aid scheme N192/1997 by Italy — Autonomous Province of Bolzano** (notified under document number C(2005) 2723) ⁽¹⁾ 1

2006/946/EC:

- ★ **Commission Decision of 6 September 2005 on State aid Portugal — Extension of the three-year delivery limit for two chemical tankers built by Estaleiros Navais de Viana do Castelo, S.A.** (notified under document number C(2005) 3268) ⁽¹⁾ 16

2006/947/EC:

- ★ **Commission Decision of 7 December 2005 on the State aid implemented by Belgium for ABX Logistics (No C 53/2003 (ex NN 62/2003))** (notified under document number C(2005) 4447) ⁽¹⁾ 21

2006/948/EC:

- ★ **Commission Decision of 4 July 2006 on State aid which Italy is planning to implement for Cantieri Navali Termoli S.p.A (No C 48/2004 (ex 595/2003))** (notified under document number C(2006) 2972) ⁽¹⁾ 53

2006/949/EC:

- ★ **Commission Decision of 19 July 2006 concerning a measure taken by the Netherlands with regard to VAOP** (notified under document number C(2006) 3224) ⁽¹⁾ 61

2006/950/EC:

- ★ **Commission Decision of 26 September 2006 on aid measure No C 49/2005 (ex N 233/2005) for Chemobudowa Kraków S.A.** (notified under document number C(2006) 4214) ⁽¹⁾ 67

⁽¹⁾ Text with EEA relevance

(Continued overleaf)

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EN

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

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

★ Commission Decision of 12 October 2006 the United Kingdom's application of the tax on non-domestic property to telecommunications infrastructure in the United Kingdom (No C 4/2005 (ex NN 57/2004, ex CP 26/2004) (<i>notified under document number C(2006) 4378</i>) ⁽¹⁾	70
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⁽¹⁾ Text with EEA relevance

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 21 September 2005

on the implementation of aid scheme N192/1997 by Italy — Autonomous Province of Bolzano

(notified under document number C(2005) 2723)

(Only the Italian text is authentic)

(Text with EEA relevance)

(2006/945/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having regard to decision C(2003) 517 final by which the Commission decided to initiate the procedure provided for in Article 88(2) of the Treaty in respect of aid C18/2003 (ex NN01/2003) ⁽¹⁾,

Having called on interested parties to submit their comments pursuant to those provisions,

Whereas:

2002 and A/36773 of 18 September 2002. The text of the new implementing criteria for Law No 4/97, which were adopted by Resolutions of the Provincial Executive Nos 4732 of 11 December 2000 and 4607 of 17 December 2001, was attached to the second letter.

(3) By letter SG(2003)D/228597 of 21 February 2003, the Commission notified the Italian authorities of its decision to initiate the procedure laid down in Article 88(2) of the Treaty in respect of this aid.

(4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽²⁾. The Commission invited interested parties to submit their comments on this aid.

(5) The Commission received no comments from interested parties.

I. PROCEDURE

(1) By letter registered as received on 11 February 2002 (CAB (02)A/410), a complaint was lodged in respect of two provincial laws of the Autonomous Province of Bolzano, Law No 4 of 13 February 1997, Chapters II and III, and Law No 9 of 15 April 1991.

(2) Additional information was requested by letters D/50813 of 25 February 2002 and D/53149 of 18 June 2002. The Italian authorities replied by letters A/32982 of 22 April

(6) Two meetings between the Italian authorities and the Commission departments took place in Brussels on 9 April and 5 August 2003.

(7) Several draft replies accompanied by the text of new implementation criteria for the scheme were sent informally to the Commission. They were followed by exchanges of emails. On 22 October 2003 and 27 February 2004 Italy was invited to submit its own comments formally.

⁽¹⁾ OJ C 120, 22.5.2003, p. 2.

⁽²⁾ See footnote 1.

(8) Italy sent its comments by letter No 8000 of 22 June 2004, registered as received on 25 June 2004 under the number A/34747.

to restrict the application of this scheme to SMEs and to comply with all the conditions laid down by Community law on state aid.

(9) After a meeting held on 3 March 2005, the Commission requested, by letter D/52114 of 18 March 2005, additional information and undertakings from the Italian authorities, which were given in letter A/34426 of 2 June 2005.

(12) However, new criteria for granting the aid provided for by Provincial Law No 4/97 in the craft, distributive, tourism and service sectors were adopted by the Provincial Executive in Resolution (*deliberazione*) No 4607 of 17 December 2001. The resolution was not notified in advance to the Commission.

II. DETAILED DESCRIPTION OF THE AID FOLLOWING THE APPLICATION OF RESOLUTION 4607/ 2001

(10) According to the complainant, investment aid in the form of grants or subsidised loans with a maximum intensity of 40 % were granted under the above laws to enterprises in the Province of Bolzano, even though the province is not eligible for the exemptions provided for in Article 87(3)(a) and (c) of the Treaty.

(13) The basic aid intensities of 13 % and 6 % decided by the province for investment aid for small and medium-sized enterprises respectively in the craft, tourism and distributive sectors (wholesale and retail) are systematically exceeded as a result of a number of increases.

(11) The two laws of the Province of Bolzano referred to in the complaint had been approved by the Commission:

(14) These increases entail:

(a) Provincial Law No 4 of 13 February 1997 was registered as aid N192/97 and authorised by letter SG (97) D/10781 of 19 December 1997 ⁽³⁾. This law provides for various forms of aid, in particular aid for business investment (Chapter II); aid for ecological-environmental investment (Chapter III); aid for the promotion of consultancy and training services (Chapter V); aid for job creation (Chapter VI); and aid for internationalisation (Chapter VIII).

(a) an intensity of 40 % for microenterprises (for a maximum investment of EUR 2 million over three years);

(b) an intensity of 25 % for small enterprises (maximum investment of EUR 3,5 million over three years for the craft sector and EUR 2 million, again over three years, for the tourism and distributive sectors),

(c) an intensity of 22,5 % (20 % in the distributive sector) for medium-sized enterprises (the maximum investment permissible in the craft sector is EUR 4 million over three years and is EUR 3 million in other sectors).

On the basis of the above decision approving aid scheme No 192/97, any aid to large enterprises that exceeds the *de minimis* threshold must be notified individually. The Italian authorities undertook not to exceed the thresholds of 15 % and 7,5 % for investment aid to small and medium-sized enterprises respectively since the province of Bolzano is not eligible for the exemption provided for in Article 87 (3)(a) and (c) of the Treaty. However the Commission approved an aid intensity of 40 % for microenterprises not engaged in activities where there was intra-Community trade;

All these increases in respect of the basic intensity are granted, according to the Italian authorities, under the *de minimis* rule.

(b) Law No 9 of 15 April 1991, which was approved under the reference NN95/95 by letter SG(96) D/4842 of 22 May 1996 ⁽⁴⁾, establishes an economic incentive fund. The measure in question establishes only the form of the aid (loans on favourable terms) and otherwise refers to other aid measures to be introduced by subsequent measures; these were laid down in Law 4/97. The Italian authorities undertook

(15) Craft microenterprises, of whatever size and regardless of the activity they exercise, can receive an aid intensity of 40 %. In particular, struggling microenterprises employing no more than two people and engaged in activities mentioned in the resolution referred to above may enjoy this intensity even in absence of the conditions required for other enterprises.

(16) Even large enterprises in the tourism sector are eligible for investment aid under the above resolution, at a basic intensity of 6 %, apparently without any requirement for prior individual notification.

There are also increases in aid intensity of up to 22,5 % for large enterprises on the basis of the *de minimis* criterion. The maximum investment eligible for aid is EUR 3 million over three years.

⁽³⁾ Brief notice in OJ C 47, 12.2.1998, p. 4.

⁽⁴⁾ Brief notice in OJ C 188/1996, p. 1-2.

- (17) The resolution in question also provides for three forms of aid for the protection of the environment:

Aid of an intensity of 25 % is available for SMEs of any sector and for large enterprises in the tourism sector to enable them to adjust to new mandatory standards.

Aid of an intensity of 40 % is available for measures that go beyond mandatory standards.

Aid, again with an intensity of 40 %, is available for environmental audit projects.

Under the *de minimis* rule provision is made for increasing the maximum intensities up to 30 %, 40 % and 75 % respectively for the three aid headings of the measure. The maximum eligible investment, in particular in the case of aid to promote compliance with new mandatory Community standards, ranges from EUR 1 million to EUR 4 million, depending on the size of the enterprise.

- (18) Under Resolution 4607/2001 the following became eligible for employment aid: the costs of legal and tax advisory services, those incurred in setting up new enterprises or transferring enterprises, and the cost of 'tutoring' new enterprises in the first two years after their setting-up.

Also admissible are the costs of research on existing trademarks and patents and the costs of registering trademarks. Provision is made for an aid intensity of 50 %. Large tourism enterprises may also, in principle, receive such aid.

- (19) Aid for internationalisation includes aid to cover the expenses of SMEs participating in fairs and exhibitions (with an intensity of 25 % in the EU and 40 % outside); aid for studies, research and consultancy services (up to 50 % intensity); and aid for other initiatives in and outside the EU, apparently in the form of business advertising on websites (50 %).

Also admissible are the costs of guaranteeing export credits and insuring exchange-rate risks, with a maximum intensity of 50 % accorded to SMEs. There is also provision for aid to large enterprises for export credits for trade with any country outside the EU of up to 50 %, under the *de minimis* rule.

- (20) There is aid for training and consultancy services at the rate of 50 % of eligible costs. There is an increase of 30 points, under the *de minimis* rule, for the first four days of consultancy services provided directly or indirectly by a chamber of commerce or business innovation centre (BIC). Large enterprises in the tourism sector are also covered by

this aid; there is also provision in this scheme for an aid intensity of 35 % for creating web pages. Only aid intensities of over 35 % for training and 50 % for consultancy services are accorded under the *de minimis* rule, where appropriate.

- (21) There is also provision for aid intensity of 80 % for joint projects under Community programmes, including LEADER and INTERREG (but individual contributions to specific enterprises are excluded).

III. GROUNDS FOR INITIATING THE PROCEDURE

- (22) The Commission approved aid schemes N192/97 and NN69/95, which have their legal basis in Provincial Laws Nos 4/97 and 9/91 respectively (see recital 11(a) and (b)).
- (23) Examination of Resolution 4607/2001 showed that the new criteria adopted for granting aid in the craft, distributive, tourism and services sectors under Law 4/97 (also in the form of loans on favourable terms under Law 9/91) did not appear to comply with the Commission decisions that approved the schemes, and did not seem consistent with the relevant new rules guidelines and regulations for reasons that are set out below.

Investment aid for large enterprises

- (24) At the start of this procedure the Italian authorities stated in letter A/32982 that both medium-sized and large enterprises in the distributive and tourism sectors could receive aid under Resolution 4607/2001 in the form of loans at preferential rates for eligible investments of between EUR 1 million to EUR 3 million.
- (25) The tables in Resolution 4607/2001 show that large enterprises in the tourism sector may be granted a basic intensity of 6 %, possibly rising to 22 % (increase accorded under the *de minimis* rule), while large enterprises in the distributive sector may enjoy aid intensities of between 6 % and 20 %.

Only in the case of the distributive sector does the resolution specify that 'unless notification is made to the Commission "in applicable cases", aid for large enterprises may be granted only if *de minimis*'. But no limit seems to be set for large enterprises in the tourism sector.

- (26) Under Article 87(3)(a) and (c) of the Treaty large enterprises outside assisted areas should not receive investment aid. The province of Bolzano was not eligible for regional aid at the time schemes N192/97 and NN69/95 were approved, nor is it now.

Here it should be emphasised that the Commission decision on scheme N192/97 explicitly excluded large enterprises from aid other than *de minimis* aid.

(27) Aid granted in the form of loans on favourable terms under Law 9/91 is also covered by scheme NN69/95 governing the form of the aid. The Commission approved this scheme on condition that only SMEs benefited, and following the undertaking given by the Italian authorities to comply with all the rules concerning SMEs in force at the time and to notify the provincial administration of these rules in a circular setting out implementation criteria for the scheme to ensure its correct application.

(28) In spite of this, Resolution 4607/2001, which lays down the implementation criteria for scheme N192/97 (and of scheme NN69/95 in cases where aid is granted in the form of soft loans under Law 9/91), also accords investment aid to large enterprises.

(29) Accordingly, the Commission took the view that Resolution 4607/2001 constituted a misuse of aid schemes N192/97 and NN69/95 within the meaning of Article 16 of Council Regulation (EC) No 659/99⁽⁵⁾ and doubted whether investment aid granted to large enterprises on the basis of this resolution other than *de minimis* cases could be exempted from the prohibition laid down in Article 87(1) of the Treaty.

Investment aid for SMEs

(30) When the Commission appraised the dossier for scheme NN65/95 the Italian authorities undertook to comply with all the conditions laid down in Community legislation on state aid for SMEs. On notifying aid scheme N192/97 they also undertook not to grant them operating aid.

(31) It should also be emphasised that the eligible investments referred to in Resolution 4607/2001 do not correspond to the definition of initial investment in Regulation (EC) No 70/2001⁽⁶⁾, in that mere replacement investment does not appear to be excluded.

(32) Moreover, the fact that the aid recipients are only SMEs that have their registered office on the territory of the province of Bolzano appears to be an infringement of the principle of freedom of establishment of enterprises inside the European Union.

(33) Finally, the principle of the necessity of aid is not adhered to, as aid applications must as a rule be submitted within six months of the start-up of work or from the date of the first invoice for the work.

(34) The Commission doubted therefore whether the aid in question was compatible.

Aid to microenterprises deemed exempt from the prohibition of Article 87(1) of the Treaty

(35) The Italian authorities have argued that the aid intensity of 40 % was confined to struggling craft microenterprises with no more than two employees engaged in a strictly defined list of activities⁽⁷⁾ — which list was given in the letter A/36773 of 18 September 2002 — and to some microenterprises in the distributive sector.

(36) Analysis of Resolution 4607/2001 shows that the craft microenterprises referred to above can enjoy this intensity even when they do not satisfy the conditions for such an increase in intensity that apply to other microenterprises; it also shows that this intensity is extended to all craft microenterprises, regardless of their size and economic situation. Since the level of admissible investment is EUR 2 million over three years (EUR 1 million in the case of microenterprises with up to two employees), it would seem that the level of aid could reach EUR 800 000 (EUR 400 000 for microenterprises with up to two employees).

(37) Moreover, the definition of a microenterprise that is not considered to be involved in intra-Community trade, and is consequently eligible for the aid intensity of 40 % given in Resolution 4607/2001⁽⁸⁾, seems to focus on the activity being carried out by individual beneficiaries of aid not involving the establishment of economic relations with enterprises of other Member States, rather than — as would be correct — on the lack of intra-Community trade in the sector of activity of the enterprises concerned.

(38) In view of this, and considering that microenterprises are SMEs within the meaning of Recommendation 96/280/EC⁽⁹⁾ and so are not outside the application of Article 87(1) of the Treaty, the Commission expressed doubts as to whether all the aid granted to them under the measure in question could escape the definition of state aid.

⁽⁵⁾ Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now 88) of the EC Treaty (OJ L 83, 27.3.1999, p. 1).

⁽⁶⁾ Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OL L 10, 13.1.2001, p. 33).

⁽⁷⁾ This list is given in the footnote on page 3 of Table A in Annex 1 'Craft sector' to Resolution 4607/2001.

⁽⁸⁾ See point 3.1 of Annex 1 'Craft sector' to Resolution 4607/2001.

⁽⁹⁾ Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises (OJ L 107, 30.4.1996, p. 4).

Aid for environmental protection

- (39) The Commission approved the environmental protection aid provided for in Provincial Law 4/97 ⁽¹⁰⁾ on the basis of the previous state aid rules on environmental protection that have now been replaced by new guidelines published on 3 February 2001 (OJ C 37, p. 3).

When the new guidelines came into force, it was proposed to the Member States that they adopt appropriate measures. Having agreed to do this, Italy was obliged to implement them. In assessing the measure in question, therefore, the Commission has referred to the new rules on state aid for environmental protection.

- (40) On the basis of point 28 of the Community guidelines on state aid for environmental protection ('the guidelines') ⁽¹¹⁾, investment aid to help SMEs meet new standards may be authorised up to a maximum of 15 % of gross eligible costs for a period of three years from the adoption of new mandatory Community standards.

- (41) The Commission took the view that the aid intensity of 25 % to help SMEs adjust to the new Community standards provided for in Law 4/97 and confirmed by Resolution 4607/2001 was not consistent with the guidelines, and that the aid to help large enterprises adhere to the new mandatory environmental standards could not be exempted.

- (42) According to point 29 of the guidelines, investment aid to enable firms to improve on Community standards may be authorised up to a basic 30 % of the investment made in the absence of mandatory Community standards.

- (43) The Commission therefore considered that the 40 % intensity for investment aid to enable firms to improve on Community standards, mainly intended for large tourism enterprises, was not compliant with point 29 of the guidelines.

- (44) Finally, under point 41 of the guidelines aid may be granted to advisory/consultancy services to help SMEs with environmental protection in accordance with Regulation (EC) No 70/2001 ⁽¹²⁾.

- (45) However, under Regulation (EC) No 70/2001 aid to environmental audit projects as provided for in the resolution may be granted only to SMEs and must satisfy the conditions of Article 5(a) of that Regulation.

- (46) In the case of aid for environmental investments provided for in the first two environmental provisions of the measure, which are referred to in recitals 41 and 43, the Commission also expressed doubts in relation to points 36 and 37 of the guidelines concerning investments to be taken into account and methods of calculating eligible costs.

Employment aid

- (47) The Commission had approved employment aid for SMEs of a maximum intensity of 25 % of the wage bill under scheme N192/97.

- (48) However, the aid provided for under this heading by Resolution 4607/2001 does not create or maintain jobs, the Commission considered that it could not be defined as employment aid, though some of forms of this aid (for consultancy services) might be exempted if they satisfied the conditions of Article 5 of Regulation (EC) No 70/2001 and the recipients were exclusively SMEs.

- (49) The Commission took the view that the aid for trademark and patent searches and for registering trademarks and business products provided for in the specific measure for employment aid could not enjoy any exemption for large enterprises, as it did not appear to be linked to any research and development activity.

Aid for internationalisation

- (50) In opening the procedure the Commission noted that the aid for participation in fairs and exhibitions may be considered compatible under Article 5(b) of Regulation 70/2001 if the expenses to which the maximum aid intensity of 50 % are applied consist in the hiring, setting-up and running of the stand. Such an exemption applies only to a firm's first participation in a given fair or exhibition.

⁽¹⁰⁾ OJ C 72, 10.3.1994, p. 3.

⁽¹¹⁾ OJ C 37, 3.2.2001, p. 3.

⁽¹²⁾ Commission Regulation No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OJ L 10, 13.1.2001, p. 33).

The consultancy services provided by external consultants should not be permanent or regular nor be linked to the firm's normal running costs, such as advertising.

Finally, aid for export-related activities ⁽¹³⁾ is not covered by Regulation 70/2001, Regulation 69/2001 ⁽¹⁴⁾ or the Commission notice on *de minimis* aid of 1996 ⁽¹⁵⁾.

for checking the threshold or other conditions laid down in the *de minimis* Regulation ⁽¹⁶⁾ or the old 1996 notice on the subject ⁽¹⁷⁾.

(51) So, in the Commission's view, the aid for internationalisation provided for in Resolution 4607/2001, other than participation to fairs and exhibitions that meets the conditions of Article 5 of Regulation 70/200, could not be considered compatible, even if it was granted only to SMEs.

(52) Moreover, the Commission found that export credits, in particular those for large enterprises, which had been explicitly excluded when Law 4/97 was notified, were not entitled to any exemption, even under Regulation 69/2001.

Aid provided under Community programmes

(53) Such aid, which was not provided in scheme N192/97, was not considered state aid in Resolution 4607/2001.

(54) However, the Commission had doubts as to whether enterprises do not derive a competitive advantage from involvement in joint projects under the Community programmes Leader and Interreg, which are accorded an intensity of 80 %.

Consultancy services

(55) The definition of consultancy service needs to be clarified. On the basis of the current definition the Commission thinks that no aid to large enterprises for consultancy services can be exempted other than in cases where the consultancy is an eligible cost of a training-aid project within the meaning of Article 4(7)(e) of Commission Regulation No 68/2001 of 12 January 2001 on training aid.

Application of the *de minimis* rule

(56) According to the Italian authorities, in the case of investment aid, any increase in the basic aid intensity rates of 13 % and 6 % for small and medium-sized enterprises respectively was granted under the *de minimis* rule.

(57) Neither Law 4/1997 nor the text of Resolution 4607/2002 adopted on 17 December 2001, i.e. after the entry into force of Regulation 69/2001, make reference to procedures

(58) In view of the amount of eligible investment (EUR 3,5 million and EUR 4 million over three years for small and medium-sized enterprises respectively) and the maximum intensity provided for in Resolution 4607/2001 (25 % and 22,5 %, of which 12 and 16,5 percentage points under the *de minimis* rule for small and medium-sized enterprises respectively), the Commission doubted whether the EUR 100 000 threshold over three years laid down in the *de minimis* Regulation was adhered to.

(59) In a broader perspective the Commission had doubts about Resolution 4607/2001's provision for very extensive use of the *de minimis* rule with the aim of systematically exceeding maximum permissible intensities for SMEs and the granting of a maximum aid intensity of 22,5 % to large enterprises outside assisted areas, also given the high level of eligible investment.

IV. COMMENTS FROM INTERESTED THIRD PARTIES

(60) No comment has been submitted by either interested third parties or the complainant, who was notified by letter D/51908 of 24 March 2003 of the opening of the procedure and the possibility of supplementing the comments made in the original complaint in response to the letter.

V. COMMENTS FROM ITALY

(61) Following two meetings between representatives of the Province of Bolzano and DG COMP, Italy's comments were set out in letter A/34747 of 25 June 2004.

In this letter the Italian authorities made the following points.

V.1. Investment aid for large enterprises

(62) Resolution 4607/2001 did not explicitly exclude large tourism enterprises, as it did enterprises in the distributive sector, because of a clerical error.

(63) However, no large enterprise in the tourism sector had received aid either under scheme N192/1997 (Provincial Law 4/97) or scheme NN69/1995 (Provincial Law 9/91). In

⁽¹³⁾ I.e. aid directly related to the quantity of exports, the setting-up and operation of a distribution network, and other export-related routine expenditure.

⁽¹⁴⁾ Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid (OJ L 10, 13.1.2001, p. 30).

⁽¹⁵⁾ OJ C 68, 6.3.1996, p. 9.

⁽¹⁶⁾ See footnote 14.

⁽¹⁷⁾ Commission notice on the *de minimis* rule for State aid (OJ C 68, 6.3.1996, p. 9).

the distributive sector large enterprises were already excluded from aid other than *de minimis* aid under Resolution 4607/01.

opened this case. Moreover, enterprises that possess only an operating unit in the Province of Bolzano can now benefit from the scheme in question.

(64) The Italian authorities undertook to exclude large enterprises more explicitly from aid in the form of loans on favourable terms under scheme NN69/95, even though none had received any such aid other than *de minimis*.

V.2.3. *The necessity of aid principle*

(71) This principle was already applied in accordance with the second indent of Article 7 of Regulation 70/2001 in that the conditions for granting aid were so objective that the Province had no possibility of using discretionary powers.

(65) Subsequently, in answer to a specific question from the Commission, it was explained in a letter of 2 June 2005 that no aid had been granted to large enterprises in any sector, and also that enterprises whose main activity was in the transport sector were excluded from aid.

(72) However, the Italian authorities have undertaken to require that the request be introduced before the start of work on the project for which the aid is granted.

(66) Furthermore, the draft new implementation criteria explicitly excluded all large enterprises from aid other than *de minimis* aid, in accordance with Regulation 69/2001.

V.2.4. *Aid for microenterprises*

(73) Henceforth, the only provision for any increase of more than 15 % in the intensity of investment aid for microenterprises in general is under the *de minimis* rule

V.2. **Aid for SMEs**

V.2.1. *Failure to exclude replacement investment from eligible costs*

(67) Although not explicitly excluded from the implementation criteria, the Italian authorities said no aid had been granted for replacement investment.

(74) Aid of an intensity of 40 % not falling within the scope of Article 87(1) of the Treaty and not even classed *de minimis*, is now reserved exclusively for some local activities, notably small-scale traditional trades threatened with extinction and small distributive businesses, which are listed exhaustively in the new criteria.

(68) Specifically, what was eligible for aid was investment in tangible assets complying with the definition in Article 2(c) of Regulation 70/2001, namely the creation of a new establishment and investment in diversification or modernisation that involved a fundamental change in the product or production process of an existing establishment. Relatively high minimum investment thresholds had been set in relation to the average size of the enterprises concerned.

(75) In any case, a survey carried out by the Italian authorities revealed that no aid exceeding both the 15 % intensity and the *de minimis* threshold had been granted so far.

(69) The new criteria explicitly excluded both replacement investment and maintenance costs, and the description of eligible investments was fully in compliance with Regulation 70/2001.

V.2.5. *Aid for environmental protection*

(76) The only aid intensities authorised are those of 15 % for transitional investment aid granted to SMEs to help them adapt to new Community rules and 30 % for aid for improving on Community standards or for investment carried out in the absence of mandatory Community standards.

V.2.2. *Freedom of establishment*

(70) The condition laid down in the old criteria that in order to have access to aid firms should have a registered office in the Province of Bolzano was not rigorously applied even in the past. In support of this argument a list was supplied of 16 recipients of investment aid under the scheme whose registered office was outside the Province of Bolzano (and in one case even outside Italy). In many cases (six of the 16) the aid dated back to 1998, i.e. well before the Commission

(77) Aid for environmental audits is currently confined to SMEs, by Article 5(a) of Regulation 70/2001, while large enterprises are eligible only for *de minimis* aid. The provision of Article 12(4) of Law 4/97 making large enterprises eligible would be repealed as soon as possible; in the meantime the Italian authorities have pledged not to grant it anymore.

(78) Finally, the Italian authorities undertook to comply with the conditions set out in points 36 and 37 of the guidelines concerning investments to be taken into account and methods of calculating eligible costs.

- (79) Only one request — in the craft sector — had been received on the basis of the existing criteria for the scheme in question; the aid amounted to EUR 14 719,02, which was over the authorised intensity of EUR 7 359,51. So this amount was classed as *de minimis*.

V.2.6. Contributions classed as 'employment aid'

- (80) According to the Italian authorities such aid is linked to the start-up phase of new enterprises (the first 24 months after their establishment) and, even though it takes the form of support for consultancy services and research into and/or registration of trademarks and business products, is designed to create jobs and is therefore compatible. In any case it has not been granted to any large enterprise.

- (81) However, in compliance with Chapter V of Law 4/97, the only provision now is in the form of loans on favourable terms as laid down in Chapter VI of the same law for the purpose of increasing the availability of funds on the basis, and within the limits, of the *de minimis* criterion.

V.2.7. Aid for internationalisation

- (82) Up to now only negligible amounts of such aid have been granted. Some SMEs had been accorded an aid intensity of 25 % for participation in fairs and exhibitions, plus an intensity of up to 50 % without verification whether it was their first participation in a given event; only two aid grants in the form of a contribution (50 %) to the insurance cost of export credits — for EUR 3 500 and LIT 7 million — have been accorded for countries outside the EU.
- (83) The new implementation criteria provide for aid of an intensity of 50 % only to SMEs for the cost of consultancy services supplied by external consultants and the cost of their first participation in a fair or exhibition inside or outside the Community.
- (84) Aid for the insurance of export credits is authorised only for the premium to cover risks which are not insurable on the market and which arise out of dealings with non-Community countries, excluding a number of OECD countries where such risks are marketable ('marketable countries' currently being Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland and the United States).

V.2.8. Aid provided for under Community programmes

- (85) Aid intensity of 80 %, previously offered to some joint projects carried out under the Community programmes LEADER and INTERREG, in which enterprises also take part, is not granted anymore.

V.2.9. Application of the *de minimis* rule

- (86) According to the Italian authorities, the *de minimis* rule is adhered to. First, the relevant departments of the Bolzano provincial authorities are interconnected thanks to an intranet system. Moreover, before applicants can obtain any aid under such a scheme they must submit a declaration concerning any other such aid received over the relevant three-year period.
- (87) Another system for automatically controlling all aid, not just that granted by the Province, is being set up; this system in turn will be connected to the national network currently being established.

VI. ASSESSMENT OF THE MEASURES

VI.1. Assessment of the nature of the aid measures in question

- (88) A measure may be considered aid within the meaning of Article 87(1) of the Treaty only if it satisfies all four of the following conditions: its being granted through state resources, selectivity, likelihood of distorting competition, and effect on trade.
- (89) In this case the first condition is satisfied as the measure is financed from the budget of the Autonomous Province of Bolzano — i.e. with public resources; the second because only enterprises operating in the Province of Bolzano receive the aid; the third because the financial situation of the recipients is improved; and the fourth because the firms concerned may in fact engage in international trade, since they are in a border region that is also very active in tourism. Therefore the measures in question are liable to affect trade between Member States, subject to the assessment of the measures resulting from the application of new criteria in favour of specific microenterprises, which is dealt with in recital 116.

- (90) Furthermore, the measures which are the subject of this procedure were deemed state aid within the meaning of Article 87(1) of the Treaty when the Commission examined the dossiers for state aid measures N192/97 and NN69/95.

VI.2. Legality of the measures

- (91) Since the measures were not notified to the Commission in advance in accordance with Article 88(3) of the Treaty they are illegal on the grounds of lack of notification. Since they are implementation criteria for scheme N192/97 (and, indirectly, for NN69/95), they constitute misuse of these schemes.

VI.3. **Compatibility of the aid measures taken under Resolution 4607/2001**

VI.3.1. *Investment aid for large enterprises*

- (92) Given that the Province of Bolzano was not eligible for regional aid throughout all the period in which the measures in question were in force, no exemption can be granted for investment aid to large enterprises in the province.
- (93) The Commission's decision on case N192/97 had already explicitly excluded large enterprises from any aid under the scheme other than *de minimis*.
- (94) Aid granted in the form of loans on favourable terms under Law 9/91 also comes under scheme NN69/95. The Commission approved that scheme on condition that only SMEs were eligible and following the undertaking given by the Italian authorities to comply with all the rules on SMEs and to communicate these rules to the provincial administration to ensure that the scheme was implemented correctly.
- (95) But the implementation criteria set out in Resolution 4607/2001 for scheme N192/97 (and for NN69/95 where aid is accorded in the form of soft loans under Law 9/91) are incompatible with the common market since they provide for investment aid for large enterprises as well.
- (96) The Commission notes that, according to the information supplied by the Italian authorities, no large enterprise has in fact received such aid.

VI.3.2. *Investment aid for SMEs*

- (97) First, the Commission confirms that any aid granted for replacement investment must be considered incompatible, while noting that the Italian authorities have informed it that no aid for this type of investment has been granted under the scheme in question.
- (98) Investment aid that exceeds the threshold of 15 % for small enterprises and 7,5 % for medium-sized enterprises is also incompatible.

VI.3.3. *Microenterprises*

- (99) The Commission confirms that, on the basis of both Recommendation 96/280/EC⁽¹⁸⁾ and the new definition in force since 1 January 2005⁽¹⁹⁾, microenterprises as a

⁽¹⁸⁾ Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises (OJ L 107, 30.4.1996, p. 4).

⁽¹⁹⁾ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 136).

category of SME are not excluded as such from the application of Article 87(1) of the Treaty. It follows that investment aid granted for such enterprises, where it exceeds an intensity of 15 % and cannot be considered *de minimis*, must be deemed incompatible with the common market.

- (100) The Commission takes note of the information supplied by the Italian authorities that no aid granted to microenterprises has exceeded both the 15 % intensity and the *de minimis* threshold.

VI.3.4. *Environmental aid*

- (101) The Commission finds that the aid intensities of 25 % and 40 % for the first two types of aid under this specific measure (namely adjustment to new mandatory standards and improving on Community standards), plus the eligibility of large enterprises to receive aid for environmental audit projects, are incompatible with the common market.
- (102) On this point the Commission notes that on the basis of information supplied by Italy only one grant of aid (of an amount much lower than the *de minimis* level) has exceeded the permissible thresholds, and that application of the legal basis for the third type of aid (aid for environmental audits) has been suspended and will be repealed as soon as possible.

VI.3.5. *Contributions described as 'employment aid'*

- (103) The Commission confirms that the aid provided for under this heading in Resolution 4607/2001 does not correspond in any way to the aid authorised by the Commission decision on scheme N192/97. Furthermore, since it neither creates nor saves jobs, but it is accorded for consultancy services and activities related to trademarks and patents, it cannot be considered employment aid.
- (104) However, since most of the eligible costs under this specific measure are deemed to be made up of consultancy/advisory activities for newly-set up SMEs and for the registration of trademarks and business products that may be eligible under Articles 5 and 5c of Regulation 70/2001, such aid is incompatible only where the conditions laid down in Regulations Nos 70/2001 and 364/2004 are not met⁽²⁰⁾.
- (105) Such aid is incompatible, however, if large enterprises are also recipients.

⁽²⁰⁾ Commission Regulation (EC) No 364/2004 of 25 February 2004 amending Regulation (EC) No 70/2001 as regards the extension of its scope to include aid for research and development (OJ L 63, 28.2.2004, p. 22).

VI.3.6. Aid for internationalisation

(106) The Commission takes note of the fact that only a few aid grants of negligible amounts have been made on the basis of the implementation criteria that constituted the grounds for initiating the procedure. Furthermore, the intensity granted for participation in fairs and exhibitions is 25 %, instead of 50 % as was authorised, although it is true that there has been no verification as to whether it was the first participation in a given event. There have been five cases in total, with aid grants ranging from EUR 1 250 to EUR 8 875. There have been only two cases of aid for insuring export credits with an aid intensity of 50 %; the aid grants of EUR 3 500 and LIT 7 million (which is likewise about EUR 3 500) were restricted to the cost of the insurance premium and to countries outside the EU. These grants are compatible only on condition that they satisfy conditions of the Commission communication on short-term export-credit insurance ⁽²¹⁾.

(107) However, any aid for consultancy services for large enterprises and for export-related activities (even that for SMEs) is incompatible with the common market. Also incompatible is aid to enterprises of whatever size for consultancy services that constitute a permanent or regular activity and aid related to an enterprise's normal running costs, such as advertising.

VI.3.7. Aid under Community programmes

(108) The Commission remarks that such aid, of an intensity of 80 % as provided for in Resolution 4607/2001, was not authorised by the Commission decision on measure N192/97. Given the very high intensity, plus the fact that there seems to be no eligible objective, such aid is incompatible where Article 87(1) is applicable, in particular if persons engaged in economic activities may also benefit by participating in joint projects subsidised under the measure in question.

(109) However, the Commission notes that the sums granted under this heading to the individual projects in question are, according to the information supplied by the Italian authorities, very small, and well below the *de minimis* threshold. Hence there was no impact on intra-Community trade. These measures may therefore be considered as not constituting state aid within the meaning of Article 87 of the Treaty, provided that the Italian authorities supply the Commission with proof that all the criteria for the application of Regulation 69/2001 have been adhered to. Finally, the Commission takes note of the fact that aid to joint projects under the LEADER and INTERREG programmes in which enterprises also participate is no longer provided for in the new criteria for implementation of the scheme in question.

VI.3.8. Aid for consultancy services

(110) The Commission reiterates its opinion that no aid may be granted for consultancy/advisory services to large enterprises, except within the framework of a training project within the meaning of Article 7(7)(a) of Regulation (EC) No 68/2001 ⁽²²⁾. Aid is therefore incompatible outside this framework.

VI.3.9. Application of the *de minimis* rule

(111) The Commission takes note of the assurances given by the Italian authorities that all the conditions set out in the relevant *de minimis* provisions, currently those of Regulation (EC) No 69/2001 ⁽²³⁾, are rigorously adhered to, principally thanks to the ASTAT control system.

VI.4. Compatibility of the measures in the light of the new criteria notified by letter A/34/747 of 25 June 2004, amended and supplemented by letter A/34426 of 2 June 2005.

(112) The Commission remarks that, regarding investment aid, the new implementation criteria explicitly exclude large enterprises, other than in *de minimis* cases.

(113) In the case of investment aid for SMEs, the definition of eligible investment in the new criteria satisfies the conditions laid down in Regulation 70/2001 ⁽²⁴⁾, and replacement investment and maintenance costs are explicitly excluded.

(114) The Commission also notes that now there is formal provision for the principle of the freedom of establishment, whereas previously it was merely *de facto*, as is shown by the list notified in the course of procedure (see recital 70); it is now sufficient to have an operating unit on the territory of the Province of Bolzano to have access to the aid in question.

(115) Finally, the principle of the necessity of aid is complied with since there is now a requirement to submit an application before starting to implement the project for which aid is given

(116) Article 87(1) of the Treaty does not apply to micro-enterprises where these are merely enterprises engaged in local activities and so not in a position to affect intra-Community trade in view of their characteristics, size and location, and also because enterprises of other Member States have no interest in accessing their markets. In this case such enterprises are quite specific activities employing no more than two people in the craft sector (typically traditional trades threatened with extinction such as knife

⁽²¹⁾ OJ C 281, 17.9.1997, p. 4, as amended by communication 2001/C 217/02 (OJ C 217, 2.8.2001, p. 2).

⁽²²⁾ OJ L 10, 13.1.2001, p. 20.

⁽²³⁾ See footnote 14.

⁽²⁴⁾ See footnote 14.

grinders, coopers, carders and spinners of wool, chandlers or candle dippers, basket makers, farriers and so on) and in distributive trades (in particular, the retail sale of products in daily use, above all food products, in localities with no more than a thousand inhabitants, not in commercial centres, and in any case outside areas more developed for tourism); both the craft and distributive activities are exhaustively listed in the new implementation criteria for the scheme.

(117) Turning to environmental protection aid, the Commission finds that the transitional aid of an intensity of 15 %, confined to SMEs to help them adjust to new mandatory standards over a period of three years from their adoption, is consistent with point 28 of the Community guidelines on state aid for environmental protection ('the guidelines') ⁽²⁵⁾.

(118) Furthermore, aid of an intensity of up to 30 % to encourage enterprises of whatever size to improve on mandatory Community standards or to make investments designed to protect the environment in the absence of mandatory Community standards now satisfy the conditions of point 29 of the guidelines.

(119) Aid for advisory/consultancy activities confined to SMEs are consistent with Article 5(a) of Regulation (EC) No 70/2001 ⁽²⁶⁾, and are therefore compatible with the common market.

(120) However, this Decision does not prejudice the compatibility of Resolution 4007 of 4 November 2002, thanks to which, it is claimed, all forms of environmental aid offered by the Province of Bolzano have been adapted to the new Commission guidelines, since this resolution is not the subject of this procedure.

(121) On the issue of the supposed employment aid, the Commission notes that such aid is confined to the grant of loans to constitute liquid assets within the limits of Regulation 69/2001 on *de minimis* aid ⁽²⁷⁾.

(122) As to the aid for internationalisation, the Commission notes that the new implementation criteria notified to it provide only for aid of an intensity up to 50 % for the costs of consultancy services supplied by external consultants and for the costs incurred in a first participation in a given fair or exhibition, and that the aid is confined to SMEs. This complies with Article 5 of Regulation 70/2001 ⁽²⁸⁾.

(123) The Commission also notes that the only premiums now eligible are those for insuring credits for risks which are not insurable on the market and which arise out of dealings with non-Community countries, excluding OECD countries where such risks are marketable (these 'marketable countries' are currently Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland and the United States). This is in accordance with the communication on short-term export-credit insurance ⁽²⁹⁾.

VII. FINAL COMMENTS

(124) The Commission deplores the fact that the implementation criteria for Provincial Law No 4/97, adopted by Resolution 4607 of 17 December 2001, were enacted by Italy (Autonomous Province of Bolzano) without prior notification to the Commission, in violation of Article 88(3) of the Treaty, and so are illegal. This was a misuse of aid scheme N192/97 (and also, indirectly, of scheme NN69/95) within the meaning of Article 16 of Regulation 659/99 ⁽³⁰⁾.

(125) For that reason the Commission decided to initiate this formal procedure to investigate the aid in question.

(126) However, during the procedure the Italian authorities explained that in most cases the provisions of Resolution 4607/2001 that were liable to be found incompatible and illegal in the light of the Commission's investigation have not been applied, or have been applied in only a very small number of cases and for insignificant amounts well below the *de minimis* threshold even in the case of SMEs.

(127) On this subject much information has been supplied, in particular regarding the number and amount of aid grants in relation to the more controversial aspects of the specific aid measures covered by the scheme. According to this information, no large enterprise has received investment aid under the scheme in question. This type of aid has in fact been reserved for SMEs, as stipulated in the Commission decision approving schemes N192/97 and NN69/95.

(128) The Italian authorities have also actively cooperated by suspending the application of a number of measures that will be repealed as soon as possible (in particular, aid for consultancy services for large enterprises) and proposing to amend the implementation criteria for the aid which is the subject of this procedure.

⁽²⁵⁾ OJ C 37, 3.2.2001, p. 3.

⁽²⁶⁾ Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to state aid to small and medium-sized enterprises (OJ L 10, 13.1.2001, p. 33).

⁽²⁷⁾ See footnote 14.

⁽²⁸⁾ See footnote 26.

⁽²⁹⁾ Communication of the Commission to Member States amending the communication pursuant to Article 93(1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance (OJ C 217, 2.8.2001, p. 2).

⁽³⁰⁾ See footnote 5.

(129) Finally, the Commission takes note of the undertakings and assurances given by Italy concerning compliance with the *de minimis* conditions and threshold, the Commission having expressed doubts about the extensive use of *de minimis* aid when initiating the procedure.

(130) As long as aid was not granted to excluded sectors or export-related activities, and no aid was subordinated to the preferential use of domestic rather than imported products, the *de minimis* rule could be applied to the aid in question in accordance with Regulation 69/2001, provided that the aid did not exceed the EUR 100 000 threshold for any one enterprise over the relevant three-year period. Therefore such aid does not come under article 87(1) of the Treaty.

(131) The Commission also remarks that a decision on an aid scheme does not exclude the possibility that individual measures may not constitute state aid (if the aid grant complies, for example, with the *de minimis* rule, as explained above), or may be considered, in whole or in part, compatible with the common market because of their specific characteristics (notably on the basis of an exemption regulation).

(132) Even though, in the light of recitals 124 to 131 and the considerations set out in Part VI.3 concerning the compatibility of the measures taken under Resolution 4607/2001, no recovery, or only a partial recovery, of aid may possibly be necessary in this specific case, it is the established practice of the Commission to require the recovery of aid that has been declared illegal and incompatible under Article 88 of the Treaty. This practice is confirmed in Article 14 of Regulation No 659/99 ⁽³¹⁾.

(133) The Commission will therefore require Italy to take all necessary measures to recover incompatible aid from beneficiaries of the scheme, other than in individual cases that satisfy the conditions for declaring the aid compatible with the relevant rules. Within two months of notification of this Decision, Italy must order aid recipients to repay the aid, with interest.

(134) As laid down in Article 14(2) of Regulation 659/99, the aid to be recovered is to include interest calculated in accordance with Chapter V of Commission Regulation (EC) No 794/2004 ⁽³²⁾. Interest is to be payable from the date the unlawful aid was at the disposal of the beneficiary until the date of its recovery.

(135) The Commission requests Italy to send back the attached form concerning progress in the recovery procedure, to draw up a list of recipients subject to the recovery order and to indicate clearly what specific steps have been taken to ensure an immediate and effective recovery of the aid. An exhaustive list of all the aid measures cited in this Decision must be sent within two months of the date of notification of this Decision; for each measure there should be a breakdown of the amount granted, the amount compatible as a result of one of the cited exemptions, and the amount to be recovered.

(136) The Commission also requests Italy to send within two months of the date of notification of this Decision documents that prove that procedures to recover illegal and incompatible aid from the recipients have been initiated (for example, circulars, repayment orders, and the like),

(137) Lastly, the new implementation criteria, notified by letter A/34747 of 25 June 2004 and amended and supplemented by letter A/34426 of 2 June 2005, satisfy the conditions for compatibility with the common market, as is set out on a case-by-case basis in Part VI.4 (recitals 112 to 123),

HAS ADOPTED THIS DECISION:

Article 1

The implementation criteria for Provincial Law No 4/97, adopted by Resolution No 4607 of 17 December 2001, are illegal because of the failure to notify the Commission in accordance with Article 88(3) of the Treaty. This means that the implementation of aid scheme N192/1997 was unlawful, as was, indirectly, that of scheme NN69/1995.

Article 2

The following aid measures provided for in Resolution 4607/2001 are incompatible with the common market:

- a) all investment aid for large enterprises;
- b) aid for SMEs that was granted for replacement investment and the portion of any investment aid grant which is over the 15 % gross aid-intensity threshold in the case of small enterprises and the 7,5 % threshold in the case of medium-sized enterprises;
- c) investment aid for microenterprises, other than that provided for in Article 3, which is in excess of a gross aid intensity of 15 %;

⁽³¹⁾ See footnote 5.

⁽³²⁾ Commission Regulation (EC) of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 (now 88) of the EC Treaty (OJ L 140, 30.4.2004, p. 1).

d) following the entry into force of the new Community guidelines on state aid for environmental protection ⁽³³⁾ and the acceptance by the Member State ⁽³⁴⁾ of the proposal for appropriate measures to adapt the schemes previously approved in accordance with point 77 of the guidelines referred to above, namely from 1 January 2002:

i. the portion of environmental protection investment aid to help adjustment to new mandatory Community standards that have recently entered into force which is over the 15 % gross aid-intensity threshold in the case of SMEs, and without exception where the recipients are large enterprises.

ii. investment aid for environmental protection for the purpose of improving on mandatory Community standards, or in the absence of such standards, for the portion in excess of the gross aid intensity of 30 % in the case of large enterprises (40 % for SMEs);

iii. all aid for environment-related consultancy/advisory activities for large enterprises;

e) aid to enterprises for internationalisation, except aid that is confined to SMEs for an enterprise's first participation in a fair or exhibition, and aid that satisfies the criteria set out in the Commission communication on short-term export-credit insurance ⁽³⁵⁾;

f) contributions described as 'employment aid' (consisting in fact of aid for consultancy/advisory services and for the cost of registering trademarks) received by large enterprises;

g) all aid for consultancy services received by large enterprises;

h) aid of an intensity of 80 % granted for joint projects under Community programmes, the recipients of which include enterprises.

Article 3

The measures provided for in the new implementation criteria for scheme N192/97, notified by letter A/34747 of 25 June 2004, amended and supplemented by letter A/34426 of 2 June 2005 for microenterprises employing no more than two persons engaged in specific craft activities corresponding to typical

traditional trades threatened with extinction and to local activities in the distributive sector, exhaustively listed in the implementation criteria referred to above, do not constitute aid within the meaning of Article 87(1) of the Treaty.

Article 4

Measures other than those referred to in Article 3 that are provided for in the new implementation criteria for scheme N192/97, notified by letter A/34747 of 25 June 2004, amended and supplemented by letter A/34426 of 2 June 2005, are compatible with the common market.

Article 5

1. Italy shall take all necessary measures to recover from the recipients any illegal and incompatible aid referred to in Article 2.

2. Italy shall suspend all payments of incompatible aid from the date of notification of this Decision.

3. Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective enforcement of this Decision.

4. The aid to be recovered shall include interest charged from the date on which it was at the disposal of the recipients until the date of its recovery.

5. Interest shall be calculated on the basis of Chapter V of Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty.

6. Within two months of the date of notification of this Decision, Italy shall order all the recipients of the aid referred to in Article 2 to repay the aid unlawfully granted with interest calculated as described above.

Article 6

Within two months of the date of notification of this Decision, Italy shall inform the Commission of the measures taken to comply with it by completing the questionnaire annexed hereto.

⁽³³⁾ Community guidelines on state aid for environmental protection (OJ C 37, 3.2.2001, p. 3).

⁽³⁴⁾ By letter No 4592 of 5 April 2001, registered as received on 6 April 2001 (A/32899).

⁽³⁵⁾ OJ C 281, 17.9.1997, p. 4, as amended by communication 2001/C 217/02 (OJ C 217, 2.8.2001, p. 2).

In particular, Italy shall, by the same deadline, send a complete list of all the aid measures referred to in this Decision, giving for each measure a breakdown of the amount granted, the amount compatible as a result of one of the cited exemptions, and the amount to be recovered.

Finally, again by the same deadline, Italy shall send all the documents demonstrating that it has initiated the procedures for recovering the unlawful aid from the recipients.

Article 7

This Decision is addressed to the Italian Republic.

Done at Brussels, 21 September 2005.

For the Commission

Neelie KROES

Member of the Commission

ANNEX

Information regarding the implementation of Commission Decision C(2005) 2723**1. Total number of recipients and total amount of aid to be recovered**

1.1. Please explain in detail how the amount of aid to be recovered from individual recipients will be calculated?

- The capital
- The interest

1.2. What is the total amount of unlawful aid granted under this scheme that is to be recovered (gross aid equivalents; prices of ...)?

1.3. What is the total number of recipients from which unlawful aid granted under this scheme is to be recovered?

2. Measures planned and already taken to recover the aid

2.1. Please describe in detail what measures are planned and what measures have already been taken to effect an immediate and effective recovery of the aid. Please also indicate where relevant the legal basis for the measures taken/planned.

2.2. By what date will the recovery of the aid be completed?

3. Information by individual recipient

3.1. Please provide details for each recipient from whom unlawful aid granted under the scheme is to be recovered in the table below:

Identify of recipient	Amount of unlawful aid granted (*) Currency:	Amounts reimbursed (**) Currency:

(*) Amount of aid put at the disposal of the recipient (in gross aid equivalents).

(**) Gross amounts reimbursed (including interest).

COMMISSION DECISION

of 6 September 2005

on State aid

Portugal — Extension of the three-year delivery limit for two chemical tankers built by Estaleiros Navais de Viana do Castelo, S.A.

(notified under document number C(2005) 3268)

(Only the Portuguese version is authentic)

(Text with EEA relevance)

(2006/946/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having regard to Council Regulation (EC) No 1540/98 establishing new rules on aid to shipbuilding⁽¹⁾ (hereafter the 'Shipbuilding Regulation') and in particular Article 3.2 thereof,

Having called on interested parties to submit their comments pursuant to those provision(s)⁽²⁾ and having regard to their comments,

Whereas:

I. PROCEDURE

- (1) By letter dated 21 January 2004, registered in the Commission on 29 January 2004, Portugal notified the Commission of its request to extend the three year delivery limit for two chemical tankers built by Estaleiros Navais de Viana do Castelo. It provided the Commission with further information by letters dated 1 April 2004 (registered 2 April 2004), 11 June 2004 (registered 15 June 2004) and 24 August 2004 (registered 31 August 2004).
- (2) By letter dated 20 October 2004, the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.
- (3) By letter dated 23 November 2004 (registered 1 December 2004), the Portuguese authorities presented their comments in the context of the above-mentioned procedure.

- (4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽³⁾. The Commission called on interested parties to submit their comments.

- (5) The Commission received comments from interested parties. It forwarded them to Portugal, which was given the opportunity to react; its comments were received by letter dated 3 March 2005 (registered 7 March 2005). A meeting between the Commission services and the Portuguese authorities was held on 22 April 2005. By letter dated 23 May 2005 (registered 27 May 2005) Portugal submitted further comments.

II. DETAILED DESCRIPTION OF THE AID

- (6) The notified measure consists of the award of contract-related operating aid to Estaleiros Navais de Viana do Castelo S.A., in relation to the construction of two product/chemical tankers designated C 224 and C 225. The aid amounts to 2 675 275 Euro per vessel.
- (7) Portugal notified the measure under the Shipbuilding Regulation ⁽⁴⁾. Article 3 of this Regulation allows operating aid to be granted for ships contracted until 31 December 2000 and delivered within a maximum limit of three years from the signing of the contract. No contract related operating aid can therefore be granted for ships delivered after the three year limit, unless an extension of this deadline is authorized by the Commission pursuant to Article 3 (2) subparagraph 2 of Regulation No 1540/98.
- (8) Portugal requested an extension of the three-year delivery deadline for the two product chemical tankers built by Estaleiros Navais de Viana do Castelo, S.A. Portugal claimed that this request is justified by the technical complexity of the project associated with unforeseeable events as explained below.

⁽¹⁾ OJ L 202, of 18.7.1998, p. 1.

⁽²⁾ OJ C 308, of 14.12.2004, p. 6.

⁽³⁾ Cf. footnote 2 above

⁽⁴⁾ Cf. footnote 1 above

- (9) Portugal stated, in this context, that the shipbuilding contracts for both vessels were signed on 22 December 2000 between Estaleiros Navais de Viana do Castelo, S.A. and Alpha Navigation Ltd (the 'original contracts'). On 14 May 2001, Alpha Navigation transferred its position as a buyer to a company based in Finland, ABB Credit OY, via 'assignment agreements' that were signed by the three parties involved: Alpha Navigation, ABB Credit OY and Estaleiros Navais de Viana do Castelo S.A. The new owner requested new specifications, namely the upgrading of the vessels to 'Class I-A Super' for navigation in the ice and to that effect signed with Estaleiros Navais de Viana do Castelo, S.A., also on 14 May 2001, 'Amended and Restated contracts' for the vessels.
- (10) According to Portugal, the new specifications requested by the new ship owner had implications on several features and materials of the vessels and required the yard to use new techniques, which in turn delayed production. Portugal highlighted, in particular, the following main difficulties in relation to the project:
- Adaptation of the initial projects to class IA Super related to the conditions for navigation in the ice.
 - Application of a new standard, ISO 8501-3, concerning the grade of preparation of the steel surface before painting. This standard was still in the process of adoption when the contracts were signed ⁽⁵⁾. Portugal claims it required a training period for the workers of the yard.
 - Application of a special paint, called 'Marineline', which requires a longer application cycle than traditional paint.
 - Additional changes requested by the ship owner at several instances during production.
 - Supply of steel plates with serious default that had to be corrected.
- (11) In Portugal's view, the difficulties relating in particular to the implementation of the new standard and the supply of steel plates with default were unforeseeable circumstances.
- (12) Under the terms agreed with ABB Credit OY, the yard had foreseen to deliver vessel C 224 on 30 October 2003 and vessel C 225, on 15 November 2003, i.e. within the three-year delivery deadline. However, due to the above factors,

the ships were effectively delivered on 29 October 2004 and 4 February 2005, respectively ⁽⁶⁾.

Grounds for initiating the procedure

- (13) The Commission initiated the procedure for the following main reasons:
- (14) The Commission had doubts, at the outset, whether the amended and restated contracts signed with ABB Credit OY on 21 May 2001, could be considered the same as the original contracts signed with Alpha Navigation. The amended and restated contracts signed with ABB Credit OY changed several characteristics of the vessels, the type of paint used on the cargo tanks, the identity of the buyer and the vessels' prices. It was therefore questionable whether the object of these contracts was still the same as that in the original ones and whether the contracts signed with ABB Credit OY could qualify for aid.
- (15) Also, regarding Portugal's claim that the extended deadline was justified by the technical complexity of the project, the Commission had doubts that the type of product/chemical tankers built by Estaleiros Navais de Viana do Castelo, S.A. could qualify for an extended deadline on these grounds. The Commission tends to interpret the argument on technical complexity in a restrictive and objective way ⁽⁷⁾ and the evidence supplied by Portugal was insufficient to reach a conclusion.
- (16) The Commission further doubted whether the elements raised by Portugal could qualify as 'exceptional circumstances, unforeseeable and external to the shipyard', within the meaning of Article 3(2) of the Shipbuilding Regulation. The Commission noted, in this respect, that most of the difficulties encountered by the shipyard resulted from the changes requested by the new owner and in so far as the shipyard had accepted these changes it was questionable that they could qualify as 'external and unforeseeable'.

III. COMMENTS FROM INTERESTED PARTIES

- (17) The Community of European Shipyards' Association (CESA) commented that in the shipbuilding business, the assignment of a construction contract from one buyer to another may happen with certain frequency and that a shipyard faced with this situation has limited leverage for refusing the assignment. In particular in Europe, shipyards frequently adapt to changing requirements of the buyers. However, in the view of CESA, this would not imply that

⁽⁵⁾ Standard ISO 8501-3 only came into effect on 22 December 2001

⁽⁶⁾ Portugal initially notified an extension request up to July 2004 for vessel C 224 and November 2004, for vessel C 225 and later extended this request up to the actual delivery dates of October 2004 and February 2005.

⁽⁷⁾ See case N 731/01 where the Commission considered that a liquefied gas tanker is a particularly complex ship, (OJ C 238, 3.10.2002, p. 1).

the changed contracts are new contracts given that the product type — product/chemical tanker — and range of the overall capacity or weight of the vessels remained the same.

- (18) One party requested the Commission to verify the correct classification of the ships (product/chemical tankers, as opposed to pure chemical tankers as initially indicated in the decision to initiate the procedure).

IV. COMMENTS FROM PORTUGAL

- (19) Portugal noted that the shipyard had programmed to complete the vessels within the three-year limit imposed by the Shipbuilding Regulation. At the time the assignment of the contracts to ABB was concluded, the shipyard's order book was virtually full, which left the yard with little flexibility for eventually advancing production of the vessels in the face of the new requirements of the ship owner. In addition, Portugal considered that the technical difficulties incurred by the shipyard were not foreseeable when it signed the contracts. Regarding the special coating used, the ship owner requested that this be extended to a larger number of tanks at an advanced stage of the project, which further delayed production.
- (20) In support of its arguments, Portugal submitted statements by the ship owner and by the classification society for the vessels in question, Det Norske Veritas, certifying that these new buildings should be considered of 'high technical complexity on their segment'. The classification society noted in particular that the new tanks comply with the highest ice strengthening requirements, high electronic technology for nautical safety, as well as high demanding building contract specifications for steel preparation and finishing as well as coating.
- (21) Portugal also noted that there had been no known competition for these particular contracts from shipyards in the EU, which limited any distorting effects of the aid vis-à-vis EU shipyards.

V. ASSESSMENT OF THE AID

Presence of aid within the meaning of Article 87(1) of the EC Treaty

- (22) Under Article 87(1) any aid granted to a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.

- (23) The operating aid in question concerns financing from State resources of part of the costs the yard concerned would normally have to bear when building a vessel, thus benefiting the yard. Moreover, shipbuilding is an economic activity involving trade between Member States. Therefore, the aid in question falls within the scope of Article 87(1) of the EC Treaty.

Compatibility of the aid with the EC Treaty

- (24) According to the Shipbuilding Regulation ⁽⁸⁾, 'shipbuilding' means building of self-propelled seagoing commercial vessels. Estaleiros Navais de Viana do Castelo S.A. builds these ships and consequently the aid to this shipyard falls under the scope of this Regulation.
- (25) Article 3(1) of the Shipbuilding Regulation states that a maximum ceiling of 9 % (for contract values bigger than EUR 10 million) of contract related operating aid for ships is allowed until 31 December 2000. According to Article 3 (2) of the same Regulation, the aid ceiling applicable to the contract is the one in force at the date of the signature of the final contract. However, this does not apply to ships delivered more than three years from the signing of the contract. In such cases, the ceiling applicable to that contract shall be that in force three years before the date of delivery of the ship. Consequently, the final delivery date for a vessel still qualifying for operating aid is 31 December 2003.
- (26) Article 3(2) of the Regulation stipulates, however, that the Commission may 'grant an extension of the three-year delivery limit when this is found justified by the technical complexity of the individual shipbuilding project concerned or by delays resulting from unexpected disruptions of a substantial and defensible nature in the working programme of a yard due to exceptional circumstances, unforeseeable and external to the company'.
- (27) It is noted that Portugal based its request on the technical complexity of the project associated with unforeseeable events, thereby addressing both types of exceptions.
- (28) As regards the issue of technical complexity of the project, the Commission services requested the opinion of an outside expert. The following examines the Commission's conclusions in the light of the comments submitted by the expert, as well as those submitted by Portugal and interested parties.

⁽⁸⁾ Cf. Footnote 1. The Shipbuilding Regulation expired on 31 December 2003. However, it must still be used to assess requests for the extension of the delivery time limit, since the issue is related to aid granted under this Regulation and since the Shipbuilding Framework, effective since 1 January 2004, does not provide any guidance for such requests.

Eligibility of the contracts for aid

- (29) It is noted that further to the transfer of ownership from Alpha Navigation to ABB Credit OY, the product type of the contracts remained the same — product/chemical tanker. The weight of the vessels did not vary significantly when considering the range of variation for this product type⁽⁹⁾. Furthermore, according to the information submitted by Portugal, ABB Credit Oy took over all rights and obligations that were those of Alpha Navigation in the original contracts and reimbursed the latter payments already made to ENVC. On the basis of the foregoing it can be concluded that the transfer of ownership did not in itself change the nature of the contracts and thereby their eligibility for aid.

This led to halts in production and required perfection of work.

- (34) The 'Marineline' paint used in the constructions is of a special nature designed to create high resistance to corrosion. It requires rounding of corners and very clean surfaces. The cure of the paint is performed at very high temperatures (80 to 122 °C) which requires adjacent spaces to remain unpainted if they cannot withhold these temperatures. It presents high risks of defects and rejection with the necessary repair and touch-up that can have major implications on the scheduling of works.

Technical complexity of the project

- (30) The comments submitted further to the initiation of the procedure confirm that there were elements of complexity of the project which can justify the extension of the delivery deadline requested by Portugal.

- (35) The Commission accepted in the decision to open proceedings that the supply of steel plates with default, which had to be repaired by the yard, had contributed to delay the project by some 2 months.

- (31) The Class I-A Super applied to these vessels is the more demanding in a scale of four, according to the thickness of the ice the vessel will have to overcome. It prepares vessels to navigate in ice thickness of one metre and places specific demands on the structure. Such requirements have a major impact on the design of the project (hull, propulsion, networks) which must be adapted accordingly.

- (36) It appears, further to the information received subsequent to the initiation of procedure, that the above elements had major implications on the scheduling of the project. The degree of perfection of the steel surface was an essential element in this project which in turn conditioned the application of the special coating. Further, it is noted that such elements of complexity could not have been anticipated by the shipyard in so far as they depended on third parties (plate defects, quality level requirements of the ship owner) and the yard had no experience with the particular type of coating used.

- (32) The requirements concerning the preparation of the steel surface and the application of paint can be particularly demanding in the case of product/chemical tankers, in view of the risk associated with the type of products they are designed to transport. It appears that in the case of vessels of Class I-A Super, the quality of the steel itself must be of a special grade, to ensure structural integrity at low temperatures.

VI. CONCLUSION

- (33) In the present case, the shipyard was faced at the outset with difficulties linked to the quality of the steel supplied, which had defaults that had to be corrected. In addition, the level of difficulty concerning the preparation of the steel surface was apparently magnified by the ship owner's own standards. Portugal explained that the steel surface was prepared according to the specifications of a new standard⁽¹⁰⁾ that requires the steel to be 'free of all visible imperfections' and that the shipyard had difficulties in matching the ship owner's interpretation of this standard.

- (37) In the light of the foregoing, the Commission considers that in accordance with Article 3(2) subparagraph 2 of Regulation No 1540/98 an extension of the three year delivery limit can be approved for the two product/chemical tankers built by Estaleiros Navais de Viana do Castelo, S.A based on the technical complexity of the project. The Commission also notes that in the light of this conclusion, it does not consider necessary to further examine whether the reasons invoked by Portugal could qualify as exceptional circumstances, unforeseeable and external to the company within the meaning of the above Article. .

⁽⁹⁾ The original contracts concerned product/chemical tankers of 15 500 tonnes deadweight (tdw). This was modified to 14 000 tdw in the amended contracts. On the basis of the information available product and chemical carriers may typically start from below 4 000 tdw and go up to more than 40 000 tdw.

⁽¹⁰⁾ ISO 8501-3, concerning the grade of preparation of the steel surface before paint.

- (38) The extension of the delivery deadline is authorized up to the actual delivery dates of the vessels (29 October 2004 and 5 February 2005).

HAS ADOPTED THIS DECISION:

Article 2

This Decision is addressed to Portugal.

Article 1

The three-year delivery limit foreseen in Article 3(2) of Council Regulation(EC) No 1540/98 is extended for two product-chemical tankers built at Estaleiros Navais de Viana do Castelo, to 29 October 2004 for ship C 224 and 5 February 2005 for ship C 225.

Done at Brussels, 6 September 2005.

For the Commission

Neelie KROES

Member of the Commission

COMMISSION DECISION

of 7 December 2005

on the State Aid implemented by Belgium for ABX Logistics (No C 53/2003 (ex NN 62/2003))

(notified under document number C(2005) 4447)

(Only the French and Dutch texts are authentic)

(Text with EEA relevance)

(2006/947/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

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

Whereas:

1. PROCEDURE

- (1) By letter dated 28 November 2002, registered in the Commission on 29 November 2002 (No DG Tren/A 71122), the Belgian authorities notified a scheme of rescue aid for ABX Logistics (F, D and NL subsidiaries, and group). The aid (case N 769/2002) was approved by Commission Decision on 21 January 2003.
- (2) By letter dated 17 February 2003, Belgium notified a restructuring plan for ABX Logistics, which was registered by the Commission on 17 February 2003 (No Tren A/13396). Through the notification and other pieces of information at its disposal, the Commission was informed that Belgium had implemented certain amounts from public funds for ABX Logistics in addition to the notified restructuring plan. By letters dated 7 May 2003, Belgium provided the Commission with further information.
- (3) By letter dated 24 July 2003 (SG(2003) D/231003), the Commission informed Belgium of its decision to initiate the procedure (case No C 53/03) laid down in Article 88(2) of the Treaty in respect of these measures.
- (4) After it had been agreed that confidential data should be removed, the Commission Decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽²⁾. The Commission invited interested parties to submit their comments on the measures in question.
- (5) By letter dated 29 August 2003 (Loyola de Palacio incoming mail No 2805), the Belgian authorities submitted their comments on the initiation of the procedure.

- (6) The Commission received comments on this subject from interested third parties. It transmitted them to Belgium by letter dated 18 February 2004 (No D (2004) 2823), giving it the opportunity to comment, and received its comments by letter dated 18 March 2004 (No A/15992).
- (7) In the meantime the Belgian authorities provided further information by letters dated 12 December 2003 (No A/37839), 19 December 2003 (No A/38582) and 12 November 2004 (No A/35928) and updated the ABX restructuring plan by letters dated 14 January 2005 (No A/2010), 24 February 2005 (No A/4889) and 14 March 2005 (No A/6690). Further information was received by letters dated 18 August 2005, 31 August 2005, 2 September 2005 and 26 September 2005.
- (8) By letter dated 4 May 2005 the Commission informed Belgium of its decision to extend proceeding No C 53/03 to cover the new information notified. After the Belgian authorities had agreed that confidential data should be removed, the Commission decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽³⁾. The Commission invited interested third parties to submit their comments on the measures in question.
- (9) The Commission received comments on this subject from the Belgian authorities and interested third parties. It transmitted the third parties' comments to Belgium by letter dated 18 July 2005, giving it the opportunity to comment, and received its comments by letter dated 18 August 2005. This correspondence was followed by notification letters dated 2 September 2005 and 29 September 2005.
- (10) By letter dated 3 August 2005, after the time limit allowed for submitting comments on the extension of the above procedure, the Italian authorities sent the Commission a letter of complaint concerning the sale of ABX Logistics Worldwide. By letter dated 19 August 2005 the Commission asked the Belgian authorities to send it their opinion on the facts given in the letter from the Italian authorities. The Belgian authorities replied by letter dated 15 September 2005.

⁽¹⁾ OJ C 9, 14.1.2004, p. 12.

⁽²⁾ See footnote 1.

⁽³⁾ OJ C 142, 11. 6.2005, p. 2.

- (11) Lastly, the Belgian authorities provided various other information during November 2005, in particular by letter dated 1 December 2005 (No A/30862).

2. GENERAL CONTEXT OF THE RESTRUCTURING OF ABX

2.1. The principal stages of the procedure

- (12) Further to the more detailed information provided when the procedure was initiated, the Commission notes briefly that between 1998 and 2001 the Belgian railways ('SNCB') acquired a collection of individual companies. At the time, the collection had not yet been legally gathered together under a holding company, but nevertheless it formed the ABX Logistics network, comprising some 107 consolidated subsidiaries worldwide, 89 % of whose sales were made in Europe, 6 % in Asia and 5 % in America.
- (13) This case concerns the restructuring of the network notified by the Belgian authorities on 17 February 2003.
- (14) The main information notified and the doubts expressed by the Commission when the procedure was initiated/extended are recapitulated below.

2.1.1. Notification of 17 February 2003

- (15) The original restructuring plan provided, firstly, that SNCB's 107 ABX subsidiaries, which were owned by different ABX holding companies, were to be consolidated under a general holding company. Secondly, since the subsidiaries ABX Logistics (Deutschland) GmbH ('ABX-D'), ABX Logistics Holding (Nederland) BV ('ABX-NL') and ABX Logistics (France) ('ABX-F') were in difficulty, they were to be restructured in order to become viable again.
- (16) The operational restructuring measures consisted essentially in (i) reorganising the legal structures by integrating all the legal entities of the group under one lead company ⁽⁴⁾, (ii) disposing of and closing assets ⁽⁵⁾, and (iii) other operational measures in Germany, the Netherlands and

⁽⁴⁾ In order to (i) create a cohesive, autonomous group; (ii) facilitate synergies between the entities in the group; and (iii) make it possible to open up the capital to an external industrial or financial investor.

⁽⁵⁾ This involved the sale of three subsidiaries (Rheinkraft, Safety First and Worldpack) with a combined turnover of EUR 98,5 million, the closure of sites (7 agencies and 3 warehouses in Germany, 4 agencies in France and 2 agencies in the Netherlands) and the sale and rent-back of buildings and other fixed assets.

France with a view to further improving operating profit ⁽⁶⁾.

- (17) To this end, the Belgian authorities had notified the Commission that SNCB would provide most of the finance needed for the restructuring. The amounts initially notified were EUR 91,6 million in conversion by SNCB of debt into capital (long-term financing) for ABX-D, -NL and -F, and EUR 140 million in refundable credit (short-term financing) granted by SNCB to the same undertakings.

2.1.2. The Commission's doubts as at 23 July 2003

- (18) When it initiated the investigation procedure, the Commission provisionally expressed its doubts about a number of aspects.
- (19) *Existence of aid:* First of all, it expressed doubts about the statement by the Belgian authorities that the disbursement of funds (in the form either of refundable loans or of conversion of debt into equity) by SNCB as part of the restructuring of ABX was an ordinary intra-group transaction and did not constitute state aid within the meaning of Article 87 of the Treaty.
- (20) *Restructuring — eligibility:* The Commission also expressed its doubts about the eligibility of ABX-D, -NL and -F for restructuring aid, since it was not clear how far the rest of the ABX group might support the restructuring firms financially.
- (21) *Restructuring — viability, distortion and limiting the aid:* The Commission also expressed its doubts concerning the financial part of the 'restructuring' plan, which proposed to meet the long-term financial requirements (need of equity) of the ABX entities concerned with essentially short-term financing (refundable credit of EUR 140 million). Accordingly, the Commission also doubted that such financing could allow the entities concerned to return to sustainable viability, that the proposed compensatory measures (especially capacity reductions) were enough to avoid distortion of the market contrary to the common interest and that such alleged aid would not enable ABX to have potentially surplus cash.

- (22) The Commission also expressed its doubts about the alleged absence of state aid and the compatibility of the (re) investments by SNCB in ABX and the means used to finance them (possible guarantees, cross-subsidies, direct

⁽⁶⁾ These measures were to be effected mainly by (i) improving productivity (cutting staff by some 690 FTE in the three restructuring countries, including the impact of closing agencies); (ii) reducing costs; and (iii) renegotiating lease contracts.

financing, compliance with the directives in force). This was particularly the case with the following measures:

- (a) *Acquisition of ABX by SNCB.* This concerns investments by SNCB between 1998 and 2001 amounting to EUR 672,4 million (since revised to EUR 433,8 million⁽⁷⁾) for the 'acquisition' of the ABX network, and certain information concerning the allocation of guarantees granted either by SNCB or by the government for financing (re)investments in ABX, whose substance had to be checked.
- (b) *Other amounts.* The Commission also had doubts about the legality/compatibility of the payment in 2001 of other subsidies totalling EUR 150 million (since revised to EUR 114,6 million⁽⁸⁾) granted by SNCB to ABX-D, -NL and -F, which were paid without being notified to the Commission in advance. The Commission's doubts in this respect concerned the presumed absence of aid and the compatibility of such potential aid.
- (c) *Parallel amounts.* The Commission also expressed its doubts about the statement by the Belgian authorities that the conversion into capital in 2004 of loans granted by SNCB to ABX totalling EUR 21 million (since revised to EUR 12,1 million⁽⁹⁾), hereinafter 'parallel amounts', for ABX Logistics (Ireland) Ltd (EUR 3,2 million), ABX Logistics (Portugal) Lda. (EUR 2 million), ABX Logistics (Singapore) Pte Ltd. (EUR 3,8 million) and ABX Logistics International (Belgium) NV/SA (EUR 12 million) ('ABX-Irl', 'ABX-P', 'ABX-Sing' and 'ABX-B' respectively), constituted a normal transaction within the SNCB group. The Belgian authorities considered that this amount would be paid 'outside the notified restructuring' and did not therefore constitute state aid within the meaning of Article 87 of the Treaty. The Commission's doubts in this respect also concerned, therefore, the compatibility of this potential aid.

2.1.3. Supplementary notifications

- (23) By letters dated 14 January and 24 February 2005, the Belgian authorities supplemented the original notification with information substantially altering the ABX restructuring plan. The changes concerned in particular an increase by SNCB and the ABX group in the financing for the restructuring, the sale of ABX-France in the form of a management buyout ('MBO') at less than the market price, further capacity reductions, substantial internal restructuring measures and the proposed sale at the market price of the entire ABX group.

⁽⁷⁾ See the section entitled 'Financial implications in figures'.

⁽⁸⁾ See the section entitled 'Financial implications in figures'.

⁽⁹⁾ See the section entitled 'Financial implications in figures'.

2.1.4. Extension of the procedure on 3 May 2005

- (24) The Commission extended the investigation procedure — supplementing rather than replacing the original procedure — with regard to two main aspects of this extra information: the change in the budget for the ABX restructuring and the terms of the sale of ABX-France in particular but also of ABX-WW (ABX Worldwide), the new ABX holding company set up during the restructuring.
- (25) In the new situation, therefore, the following amounts were to be contributed:
 - (a) EUR 157,4 million instead of the EUR 50 million in equity for the restructuring of ABX in Germany, to bring ABX-D to an equity level of EUR 14,4 million (at 31 December 2004), compared with a balance sheet total of EUR 234 million (at 31 December 2003);
 - (b) EUR 10,6 million instead of the EUR 12,6 million in equity for the restructuring of ABX in the Netherlands, to bring ABX-NL to an equity level of EUR 9,3 million (at 31 December 2004), compared with a balance sheet total of EUR 35,7 million (at 31 December 2003).

For ABX-D and -NL, these amounts take the form of a capital increase either through the conversion of existing debt or through the contribution of new equity;

 - (c) EUR 223 million to enable an MBO of part of ABX in France. This amount is permanent expenditure for SNCB and consists in particular of debt write-offs and covering future losses.

- (26) As to the sale at a loss of ABX-F (MBO), the Commission raised doubts about the presence of state aid in the funds contributed by SNCB to the purchaser. Concerning the proposed sale of ABX-WW, the Commission stressed the need to provide all the necessary information, so that it could check that the company was effectively being sold at the market price.

2.1.5. Further information

- (27) In particular by letter dated 9 June 2005, Belgium provided the Commission with a whole set of information concerning the extension of the procedure, while emphasising and supplementing other details concerning the case as a whole.
- (28) By letter dated 1 December 2005, Belgium submitted certain supplementary information basically clarifying earlier points and expressing a new commitment as regards the presence of ABX in Germany.

2.2. Activities of ABX

- (29) Apart from the ABX activities summarised above and described in the initiation of the procedure, the Belgian authorities state that the strategic and commercial positioning of ABX Logistics Worldwide is clearly that of a 'transport managing company' or 'freight forwarder'.
- (30) As such, ABX carries out transport logistics operations. According to the expert study commissioned by the Commission ('Jacobs')⁽¹⁰⁾, logistics consists generally speaking in 'managing how and when to transport resources to the place where they are needed'. According to this study, in the case of ABX it is a question more specifically of optimising the continuous flow of equipment over an interconnected transport network and through nodal warehousing points.
- (31) The Belgian authorities add that freight forwarders do not usually own transport assets (lorries, boats, planes, etc.) but use haulage companies; this is confirmed by Jacobs.
- (32) In this particular case, apart from a few exceptions mainly in the Netherlands, the ABX group's transport capacity is almost entirely subcontracted. The number of lorries owned in the Netherlands has been declining steadily since 2001, and the objective is to reduce it to zero. In 2001, ABX Logistics in the Netherlands owned 240 lorries, which figure was reduced to 166 in 2002, 138 in 2003 and 110 in 2004.
- (33) For domestic and international road transport operations, ABX Logistics subcontracts the transport activity proper to independent road hauliers. For air and maritime transport, ABX Logistics acts as a broker, buying the necessary transport capacity on behalf of its customers from shipping lines or airlines.
- (34) The table below clearly confirms this strategic positioning: only 3 % of the lorries used by ABX Logistics are owned or leased by group companies⁽¹¹⁾.
- (35) Transport capacity of ABX Logistics

	Owned (or leased)	Subcontracted
Transport capacity (lorries)	3 %	97 %
Transport capacity (planes)	0	100 %
Transport capacity (ships)	0	100 %

(36) *ABX's place in the different market segments:* According to the Belgian authorities, in 2003 49 % of ABX's operations were in the road transport market, 42 % in the air and sea markets and 8 % in the contract logistics market, which comes under the warehousing of goods.

(37) Given its level of activity in Germany, the Netherlands and France, ABX is not among the five leading firms in the individual markets at national level (road, air, sea and contract logistics), and this is confirmed by Jacobs.

(38) *Growth potential of the markets concerned — general:* According to both the Belgian authorities and Jacobs, despite recent difficulties due in particular to the events of 11 September 2001, demand for logistical services continues to grow. According to Jacobs, this is due to the growth of Europe's population, consumers' increasing preference for a variety of products to choose from, growth in consumers' purchasing power and increasing outsourcing of logistical services by producers to logistics specialists.

(39) *Growth potential in Germany:* Jacobs considers that there is considerable potential for growth in the German logistics market. The trend of subcontracting logistical services in the German market over the last eight years indicates that both supply and demand could grow by 15 % to 20 % annually in the years ahead.

(40) *Growth potential in the air market:* Both Airbus and Boeing forecast that the number of cargo aircraft will double in the next 15 to 20 years on account of the increase in air freight, which will exceed that in air passenger transport. Airbus forecasts a tripling of freight transport, with average annual growth of 5,7 % (6,4 % according to Boeing) between now and 2021. These high growth margins should also give a growth margin for carriers and logistics operators.

(41) *Growth potential in the road market:* The expert states that, in Europe as a whole, road transport is an industry with low barriers to entry which therefore suffers from long-term structural overcapacity⁽¹²⁾, which has been confirmed during the last five to seven years when prices have fallen. However, the overcapacity concerns the firms carrying out the transport operations in question; this is not the case with ABX, which 'organises' the transportation but does not carry it out. According to Jacobs, there is a strong growth trend in the road freight transport market. Consequently, such a market trend should also ensure a margin of growth for carriers and logistics operators.

⁽¹²⁾ Even though the recent enlargement seems to be calming the current situation temporarily. Nevertheless, the fact that many transport companies seem to subcontract the carriage of goods by road to cheaper transport operators from the new Member States should increase competitive pressure on prices in the road haulage market.

⁽¹⁰⁾ Jacobs Consultancy: Capacity of ABX Logistics and Sernam markets, final report, May 2004.

⁽¹¹⁾ Letter from the Belgian authorities, 24.2.2005, p. 13.

(42) *Growth potential in the maritime market:* According to Jacobs, growth in the maritime freight forwarding sector was 7 % on average between 1998 and 2002. Future growth in maritime freight transport will depend on more general, global developments.

2.3. Creation of the ABX network

2.3.1. Acquisition of companies in the ABX network by SNCB

(43) Although the transactions for the acquisition of the ABX network by SNCB, which by their very nature cannot contain advantages for ABX, are not the subject of this Decision, the Commission highlights their main stages below (as presented by the Belgian authorities) by way of general background.

(44) The Belgian authorities explained that SNCB decided to acquire the different companies in the ABX Logistics group on the basis of business plans which, at the time of the investment, suggested a rapid return to profitability. For Thyssen Haniel Logistik ('THL')/Bahntrans, Dubois and Saima Avandero (which became ABX in Germany, France and Italy), the acquisition conditions are briefly summarised below.

(45) *Acquisition of THL/Bahntrans (subsequently ABX in Germany):* According to the information provided by the Belgian authorities in October 2000, the purchase price for the THL group as a whole was DEM [...] (*) million (Thyssen group) plus DEM [...] million (Deutsche Bahn AG). The group's business had been valued at DEM [higher value than the above purchase price (**)] million by Coopers & Lybrand (of which DEM [...] million for the groupage business) and at DEM [...] million, taking account of the holding company's costs. When it made this acquisition, SNCB assumed the commitments of the former shareholders with regard in particular to an existing guarantee on a building in Munich. The lower-than-market price of EUR [...] million (DEM [...] million) was paid by the former shareholders of Bahntrans, Thyssen Handelsunion and Deutsche Bahn, on 1 October 1998.

(46) ABX-D made losses from the time of acquisition onwards. These considerably weakened the financial structure of the undertaking, whose equity turned negative in 1999. This situation, which lasted until 2005, led SNCB as the parent company to issue a comfort letter concerning the risk associated with the negative equity position.

(47) *Acquisition of Dubois (subsequently an important part of ABX in France).* The Belgian authorities state that, for the period 1998-2002, the calculation available to SNCB resulted in an internal rate of return (IRR) of 12,7 % for a weighted average cost of capital (WACC) of 9,5 % and a net present value (NPV) of EUR 9,7 million, making it possible to expect a reasonable return on investment.

(48) *Acquisition of Gruppo Saima Avandero (subsequently ABX in Italy).* The Belgian authorities state that, for the period 1998-2002, the calculation available to SNCB resulted in an internal rate of return (IRR) of 13,0 % for a weighted average cost of capital (WACC) of 9,0 % and a net present value (NPV) of EUR 51,8 million, making it possible to expect a reasonable return on investment.

(49) In response to the Commission's question about possible cross-subsidies used by SNCB to finance its investments in ABX, the Belgian authorities provided the following clarifications:

(a) They state that 'for the period from 1998 to 2002 as whole, state support is not enough to cover the public service mission expenses [of SNCB]' ⁽¹³⁾. They stress that in 2001 the Belgian Court of Auditors had already stated that 'as regards the investment and operating functions, for the period as a whole, except for 1997, appropriations cumulatively exceed resources for both functions, so that there is nothing to indicate a disposal, by balance, between the two public service missions and the other activities [of SNCB]' ⁽¹⁴⁾.

(b) They also state that 'since the operating and investment costs of SNCB in regard to its public service tasks are not even covered by the state support, SNCB has resorted to borrowing for the balance of its needs' ⁽¹⁵⁾. This is also valid, therefore, for the SNCB resources used for investments in ABX, which were 'not financed by specific borrowings, ... but from its general cash resources' ⁽¹⁶⁾.

(50) Lastly, the Belgian authorities explain that, following these acquisitions, SNCB addressed a number of comfort letters to the creditors of several ABX subsidiaries, in particular to creditors of ABX-D and ABX Spain. The Belgian authorities consider that these comfort letters are part of the usual relations between a parent company and its subsidiaries in a market economy.

⁽¹³⁾ Letters from the Belgian authorities dated 23.12.2003, registered on 29.12.2003 under No A/38604, and that registered on 20.6.2003 under No A/23465.

⁽¹⁴⁾ Report of the Belgian Court of Auditors, 18.5.2001, p. 221.

⁽¹⁵⁾ Letter from the Belgian authorities, registered 20.6.2003 under No A/23465.

⁽¹⁶⁾ Letter from the Belgian authorities dated 29.8.2003, registered on 29.8.2003 (Loyola de Palacio cabinet incoming mail No 2805), p. 12.

(*) Confidential data

(**) The exact figure has been deleted and replaced by this formula.

2.3.2. Reinvestments made by SNCB in 2001

(51) *Capital increase in Germany.* At the end of 2000 and in 2001, SNCB increased the capital of its German subsidiary (ex-Bahntrans) with a cash contribution of EUR 17,5 million and by converting short-term loans from SNCB amounting to EUR 55 million into capital. The decision was based on recommendations and analyses made by the Boston Consulting Group ('BCG').

(52) The BCG documents put forward the following arguments and recommendations:

- (a) the ABX Group presented an opportunity to create significant value and a strategic interest for SNCB;
- (b) financial investment and strengthened management were needed to capture this potential;

(53) The Belgian authorities state that the IRR of the total investment of EUR 72,5 million which could be expected at the time of the investment was 8 % to 10 %, depending on the profit forecasts selected. This internal rate of return is comparable to the cost of capital for SNCB at the time.

(c) the self-financing by SNCB of this financial investment was considered at the time to be the best option;

(d) in the implementation of this strategy of creating value through ABX Logistics, a priority matter for SNCB was to turn around Bahntrans;

(e) in conclusion, BCG's experts concluded that the recovery plan should be implemented for two reasons:

- if successful, the turnaround would make it possible to continue the ABX Logistics strategy, 'which has a value creation potential of more than EUR 300 million';
- even if only partly successful, the turnaround would make it possible to put a higher price on the resale value of Bahntrans.

Calculation of the IRR for SNCB's reinvestments in ABX Germany in 2001 of EUR [...]million

Yearly growth rate of EBIT	[...]						
Discount rate	[...]						Terminal value
Year	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Discount factor	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	2001	2002	2003	2004	2005	2006	Terminal value
Turnover	[...]	[...]	[...]	[...]	[...]	[...]	
Pre-tax operating profit	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Use of the surplus EUR [...]million at the acquisition price	[...]						
Investment of EUR [...] million in 2001	[...]						
Free Cash Flows	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Weighted average cost of capital	9 %						
Total discounted cash flow	[...]	[...]	[...]	[...]	[...]	[...]	[...]
IRR	10,04 %						

(54) *Capital increase of EUR 12,2 million in the Netherlands.* the strategic plan for the 'Dutch stage' (ex-Kerstin Hunik group, acquired in February 1999 and also comprising the holdings in Ireland) consisted in:

- (a) strengthening domestic activities through the acquisition of a company operating in national distribution in the Netherlands; the company's volume of business was 2 000 consignments a day, and SNCB's management considered that a volume of 6 000 consignments would be necessary to work profitably in national distribution;

- (b) continuing the restructuring of Kersten Hunik Holding (renamed ABX Logistics Holding BV), acquired in 1999;
- (c) selling the maritime transport activities ('rederijen') Kersten Hunik Scheepvaartmaatschappij BV and Link Line Europa BV, thereby generating EUR 1 million in cash;
- (d) in practice, the financing needs were supplied as follows:
- EUR 9,2 million in short-term credit from SNCB was converted into capital in March 2001;
 - in September 2001 SNCB increased the capital of ABX Logistics Holding by EUR 10 million. This sum was intended to finance the acquisition of Wegtransport BV by ABX Logistics Holding. The price paid for the shares was EUR [...] million, the balance of EUR [...] million remaining available to cover any price adjustments resulting from due diligence;

- altogether, the Belgian authorities consider that the amount of financing granted by SNCB to the Dutch subsidiary (excluding the acquisition price of EUR [...] million for Wegtransport) was therefore EUR 9,2 million in March 2001 plus EUR 3 million in September 2001, i.e. a total of EUR 12,2 million;
- in their view, this recapitalisation was justified by the prospect of a return to profitability in 2002 for the Dutch activities, as reflected in the positive profit trend forecast at the end of 2000:

	2000A	Budget 2001 (drawn up at end 2000)	Budget 2002 (drawn up at end 2001) (*)
Turnover	54,1	60,9	86,4
Operating profit (EBIT)	- 2,59	- 2,73	0,68

(*) includes the turnover from the acquisition of Wegtransport.

- (55) The Belgian authorities consider that, on the basis of the profit forecasts available at the time, the internal rate of return for this investment of EUR 12,2 million is about 11 %.

Calculation of the internal rate of return (IRR) for SNCB's reinvestments of EUR 12,2 million in ABX Netherlands in 2001 (EUR million)

Yearly growth rate of EBIT	[...]						
Discount rate	[...]						
		Terminal value					
Year	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Discount factor	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	2000A	Budget 2001 drawn up at end 2000	Budget 2002 drawn up at end 2001 (*)	Plan 2003 (**)	Plan 2004 (**)	Plan 2005 (**)	Terminal value
Turnover	[...]	[...]	[...]	[...]	[...]	[...]	
Pre-tax operating profit	[...]	[...]	[...]	[...]	[...]	[...]	
Recapitalisation of EUR 12,2 million in 2001	[...]						
Free Cash Flows	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Weighted average cost of capital	9 %						
Total discounted cash flow	[...]	[...]	[...]	[...]	[...]	[...]	[...]
IRR	11,3 %						

(*) includes the turnover from the acquisition of Wegtransport

(**) Historical data not available. Ex post revaluation carried out on the basis of (1) an expected gross operating margin of [...] % in 2003 and (2) an annual growth rate of [...] % of turnover and profit from 2004.

(56) *Capital increase of EUR 30 million in France.* In December 2001 SNCB increased the capital of the French company acquired in 1999-2000 in order to start a debt securitisation programme that would make it possible to obtain a line of bank credit of EUR 70 million. The capital increase had been imposed by Société Générale, the provider of credit for ABX Logistics (France) SA, as an essential precondition for the securitisation of that company's commercial debt portfolio.

(57) According to the Belgian authorities, the ABX Logistics (France) financial forecasts available at that time revealed the prospect of a return to profitability within the framework of a recovery plan. As a result of measures to improve operations (IT, audit of distribution processes, closures and disposals, harmonisation of working conditions, integration of activities), the plan forecast an improvement in operating profit (EBIT) from — EUR 19,6 million in 2001 to EUR 4,6 million in 2003.

(59) The Belgian authorities consider that the profit forecasts available at the time indicate an IRR of 14 % for this investment of EUR 30 million.

Forecast profit trend for ABX Logistics France (at September 2001)

	2000 actual	2001 bud- get	2002 fore- cast	2003 fore- cast
Turnover	516,0	631,0	626,0	664,0
Operating profit (EBT)	- 6,1	- 19,6	- 8,2	4,6
Net profit	- 2,1	- 28,4	- 11,6	4,0

Source: Recovery plan, page 43; conversion rate: EUR 1 = FRF 6,55957

(58) SNCB thought that this securitisation transaction would make it possible to substitute external financing for short-term financing by SNCB. In the short term, it was possible to inject a large proportion of the excess cash released by the securitisation into the ABX cash pool, thus enabling the companies which were members of it to partly reimburse their own exposures to SNCB.

Calculation of the internal rate of return (IRR) for SNCB's reinvestments of EUR 30 million in ABX France in 2001 (EUR million)

Yearly growth rate of EBIT	[...]						
Discount rate	[...]						
Year	[...]	[...]	[...]	[...]	[...]	[...]	Terminal value
Discount factor	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	2000 actual	2001 budget	2002 forecast	2003 forecast	Plan 2004 (*)	Plan 2005 (*)	Terminal value
Turnover	[...]	[...]	[...]	[...]	[...]	[...]	
Net profit	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Recapitalisation of EUR 30 million in 2001	[...]						
Free Cash Flows	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Weighted average cost of capital	9 %						
Total discounted cash flow	[...]	[...]	[...]	[...]	[...]	[...]	[...]
IRR	14,0 %						

(*) Historical data not available. Ex post revaluation carried out on the basis of (1) an expected gross operating margin of [...] % in 2004 and [...] % in 2005 and (2) an annual growth rate of [...] % for turnover and profit from 2004

(**) [...] % on the basis of pre-tax operating profit (EBT)

2.3.3. 'Parallel contributions' from SNCB to ABX

- (60) The Belgian authorities specified that, when it acquired the companies in Ireland and Portugal and the Air&Sea activities in Belgium, SNCB took over all or part these companies' debts of and then converted them into capital. According to the authorities, these capital conversions, which they describe as 'parallel contributions', were aimed:
- (a) either at making it possible for certain companies to merge and achieving the objective of simplifying the group in legal terms (Ireland, Portugal),
 - (b) or at maintaining transport licences (Ireland),
 - (c) or at enabling the companies to continue their Air&Sea activities with a minimum level of equity so as to obtain external means of financing (Air&Sea Belgium).
- (61) According to Belgium, the rebuilding of the equity and the rapid return to profitability were ensured by virtue of: (1) the ratio of their losses to their turnover, (2) the total amount of the conversions, and (3) by the financial projections (2003 budget) made by management at the end of 2002, which forecast a return to equilibrium towards the end of 2003. The subsidiaries were not to be regarded as

firms 'in difficulty', and their situation is not comparable therefore to the three undertakings in difficulty identified in the original restructuring plan. According to the Belgian authorities, the specific, one-off assistance given by SNCB to these subsidiaries is a normal financing transaction between certain subsidiaries and a parent company in the course of business and is therefore entirely compatible with the market-economy private investor principle.

- (62) The 2003 budget for the three companies concerned, drawn up at the end of 2002, indicated there was a prospect of a return to equilibrium, or quasi-equilibrium (losses of less than EUR 1 million), within 12 months from the introduction of the plan.

	Net profit 2002	Net profit budgeted for 2003 (*)
ABX Logistics (Ireland) Ltd.	- 0,3	0,0
ABX Logistics (Portugal) Lda	- 3,5	- 0,3
ABX Logistics Int. (Belgium) SA/NV	- 2,0	- 0,8

(*) Budget drawn up by the management in September 2002.

Key financial data for 2002 of the companies in Ireland and Portugal and Air&Sea Belgium (EUR million)

	Turnover 2002 (actual)	Operating profit (EBIT) 2002 (actual)	Net profit 2002 (actual)	Net losses 2002 as % of turnover	Total amount of conversions	
					Acc. to original plan (*)	Actually carried out
ABX Logistics (Ireland) Ltd.	31,4	0,2	- 0,3	-1 %	3,2	4,3
ABX Logistics (Portugal) Lda.	13,7	- 1,3	- 3,5	-25 %	2,0	2,0
ABX Logistics Int. (Belgium) SA/NV	39,0	- 0,5	- 2,0	-5 %	12,0	2,0
					17,2	8,3

(*) Conversions into capital: EUR 91,6 million + provision of extra funds: EUR 140 million, including a safety margin of EUR 21 million allocated to the subsidiary.

- (63) The Belgian authorities provided calculations of the internal rate of return (IRR) for each transaction. The calculations, which are not presented here in detail, are comparable in method to those for the reinvestments in 2001 (which are presented). In each case they give an IRR of between 9,6 % and 12,7 %.
- (64) SNCB also made an investment of EUR 3,8 million in ABX Singapore. According to the Belgian authorities, the assistance concerning ABX Singapore definitely does not fall within the scope of Article 87 of the Treaty.

Nevertheless, at the Commission's request, the Belgian authorities provided an estimate of the internal rate of return for this investment, which was 10,9 %.

- (65) SNCB also issued, in 2000, a guarantee of EUR 3 million for the construction of a building in Singapore. The Belgian authorities consider that this transaction is also outside the scope of the Treaty. They subsequently stated that the debt guaranteed is covered primarily by the building, which is regarded as a property situated in a dynamic, booming market. The building was sold in 2005.

2.4. Role of the state in SNCB's decisions concerning ABX

- (66) Further to the information provided on this subject in the initiation of the procedure, the Commission here summarises certain aspects concerning SNCB and the potential influence of the state on its decisions.

2.4.1. SNCB's board of directors and activities

- (67) SNCB is an autonomous public undertaking. As such it is not subject to bankruptcy law under the Law of 21 March 1991 reforming certain economic public undertakings⁽¹⁷⁾. Its object is to carry passengers and goods, but it can carry on any commercial activity directly or indirectly associated with that object. Its organs are the board of directors (BoD), the management board (MB) and the managing director (MD). The BoD has ten members, including the MD. The directors⁽¹⁸⁾ are appointed by the King and chosen according to the complementarity of their qualifications⁽¹⁹⁾.
- (68) Although SNCB is free to carry on any activities compatible with its object, the Belgian legislator has introduced certain limited mechanisms for checking whether an autonomous public undertaking is infringing the law, its statutes or the management contract. The main mechanism is the presence in the management bodies, particularly the board of directors and the management board, of a government commissioner, who ensures that the law, the statutes of SNCB and the management contract are observed.

2.4.2. Conclusions of the Court of Auditors

- (69) In May 2001 the Belgian Court of Auditors issued a report⁽²⁰⁾ on SNCB which provides several important clues about clarifying the influence of the state on the decisions taken by SNCB with regard to its commercial activities. The report states, firstly, that 'the object of SNCB is defined as follows: "The object of the company is the carriage of passengers and goods by rail. The Company may, on its own or through a stake in Belgian, foreign or international

bodies, whether existing or prospective, undertake any commercial, industrial or financial operations directly or indirectly relating, in whole or in part, to its object or which would be likely to facilitate or promote the attainment or development thereof"

The original text of the Law of 23 July 1926 setting up SNCB did not specify the object of the company. The Law of 1 August 1960 (amending the above Law) included the object in its provisions, on the basis of the following considerations: "The draft Law submitted to you therefore determines the object of SNCB, stipulating that the latter may lawfully undertake any activity associated with the operation of the network, in particular the running of buffets, snack bars, etc. ..., the building of rolling-stock for its use, the organisation of all road transport with a view to facilitating the carriage of goods"

The object of SNCB, therefore, is deliberately defined very widely. Furthermore, the definition contains no geographic restriction ... The object may be determined in such a way as to justify any commercial or even financial activity.'

- (70) Secondly, with regard to SNCB's expenditure on ABX, the Court of Auditors describes the approach to drafting certain parts of the report: 'Given the autonomy of SNCB, the level of risk to be prevented and the challenges, special attention has been paid to acquisition decisions in the context of the development of the ABX network. This analysis is concerned basically with clarifying the conditions in which those decisions were taken and are followed up, in order in particular to illustrate the difficulties of implementing the legal provisions which enable the state to avoid any threat to the undertaking's ability to fulfil its public service obligations' (21).

- (71) Accordingly, the Court of Auditors reaches the following conclusions:

- (a) 'the change in the strategy of expanding the ABX network was manifestly initiated by the management [of SNCB]' (22).

⁽¹⁷⁾ In particular Articles 2, 3, 8, 12 and 41.

⁽¹⁸⁾ According to the information provided by Belgium, the function of director (all members of the BoD) is incompatible with the task or functions of a Member of the European Parliament, a member of the legislative chambers, a Minister or Secretary of State, a member of the Council or Government of a Community or a Region, a governor of a province, a member of a Provincial Executive or a member of SNCB's staff.

⁽¹⁹⁾ According to the Court of Auditors (p. 46), the removal of directors currently requires the assent of a two-thirds majority of the board of directors.

⁽²⁰⁾ Court of Auditors: The sound use of public funds by SNCB. Audit carried out pursuant to the resolution of the House of Representatives of 11 May 2000, Brussels, May 2001

⁽²¹⁾ Report of the Court of Auditors, 18.5.2001, p. 142.

⁽²²⁾ Report of the Court of Auditors, 18.5.2001, p. 151.

(b) 'a wide-ranging autonomy has been granted to the public undertaking [SNCB] as regards its non-rail investments and its acquisition of holdings in commercial activities' ⁽²³⁾.

(c) 'the decisions taken by SNCB in regard to these [commercial] activities are limited only by compliance with its object and the provisions of the Law of 21 March 1991 which are designed to prevent the risk of a threat to the performance of its public service tasks' ⁽²⁴⁾.

(d) 'investments in non-rail commercial activities are not ... approved in advance, so that state control relies entirely on the intervention of the Government Commissioner' ⁽²⁵⁾.

(e) 'The current legal provisions, which grant the Government Commissioner a right to bring proceedings and the Minister a right of cancellation in respect of decisions jeopardising the performance of the public service tasks [of SNCB], do not provide a sufficient guarantee that the objective of the permanence of those tasks is satisfied' ⁽²⁶⁾.

(72) It is in this context of awareness of the risk threatening SNCB's public service activities and the inadequacy of the means of supervision available to the state for limiting such risks that the action of the Government Commissioner and the Minister responsible reported by the Court of Auditors should be seen. Thus, on 2 March 2000, the Government Commissioner was concerned to check whether the investment in the Italian arm of ABX '... does not prejudice the performance of the public service tasks [of SNCB] ...' ⁽²⁷⁾. On 28 April 2000, the Minister for Mobility and Transport expressed the wish that 'the strategic operations of the undertaking should be long-term ones and should make it possible to ensure its viability and sustainability' ⁽²⁸⁾. On 31 May 2000, the Minister for Mobility and Transport spelt out '... the conditions for the exercise of supervision by the state in the event of an acquisition or equity participation ...' ⁽²⁹⁾, remarks which followed those of the Government Commissioner on 26 May 2000 when he emphasised '... the need for commercial activities to be compatible with the object of SNCB and the task conferred on it by statute ...' ⁽³⁰⁾.

⁽²³⁾ Report of the Court of Auditors, 18.5.2001, p. 142.

⁽²⁴⁾ Report of the Court of Auditors, 18.5.2001, p. 141.

⁽²⁵⁾ Report of the Court of Auditors, 18.5.2001, p. 154.

⁽²⁶⁾ Report of the Court of Auditors, 18.5.2001, p. 154.

⁽²⁷⁾ Report of the Court of Auditors, 18.5.2001, p. 152.

⁽²⁸⁾ Report of the Court of Auditors, 18.5.2001, p. 150.

⁽²⁹⁾ Report of the Court of Auditors, 18.5.2001, p. 153.

⁽³⁰⁾ Report of the Court of Auditors, 18.5.2001, p. 153.

2.4.3. Council of Ministers involvement in the restructuring of ABX

(73) When it initiated the investigation procedure, the Commission referred to the record of the Council of Ministers meeting of 22 February 2002 and the related press release ⁽³¹⁾, which clearly show the involvement of the Government, at that date, in the decision on the restructuring of ABX: 'On a proposal from the Prime Minister, the Council of Ministers approved a set of measures concerning the activities of ABX. The following decisions were taken on the basis of the information and strategic considerations transmitted by SNCB: the setting-up by SNCB of a holding company bringing together all the activities of ABX, ...'.

2.4.4. SNCB's financing capacity from 1998 to 2001

(74) The Commission found that between 1998 and 2001 SNCB was by itself in a sufficiently good financial position to obtain loans on the market. This is borne out in particular by:

(a) the fact that in 1998 SNCB had a healthy balance sheet structure, with a debt to equity ratio of 51 % in 1998, 54 % in 1999, 62 % in 2000 and 90 % in 2002, and made a consolidated profit ⁽³²⁾;

(b) the study by the independent expert, Nera, which indicates that SNCB's average indebtedness during this period was sustainable when compared with that of similar undertakings in the same sector. According to Nera, such a sustainable level corresponds to a debt/equity ratio of between 0,8/1 and 1,25/1 ⁽³³⁾. In the same study, Nera concludes that SNCB's ratio did not exceed these values between 1997 and 2001 ⁽³⁴⁾.

(75) Nevertheless, from 2002 SNCB's financial position deteriorates. Its financial debts, as expressed in the consolidated accounts, went up from EUR 3,9 billion in 2001 to EUR 5 billion in 2002 and EUR 6,2 billion in 2003, compared with total consolidated debts of EUR 8,6 billion in 2001, EUR 9,6 billion in 2002 and EUR 10,7 billion in 2003, whereas its equity fell from EUR 4,9 billion in 2001 to EUR 4,4 billion in 2002 and EUR 4,2 billion in 2003. Taking account only of financial debts with less than one year and more than one year to run ⁽³⁵⁾, the ratio increases from 80 % in 2001 to 114 % in 2002 and 150 % in 2003, years when SNCB posted a consolidated loss.

⁽³¹⁾ Available on the web at: <http://www.belgium.be/>

⁽³²⁾ Letter from the Belgian authorities dated 29.8.2003, registered on 29.8.2003 (Loyola de Palacio cabinet incoming mail No 2805), p. 4.

⁽³³⁾ Nera report, p. 58.

⁽³⁴⁾ According to Nera (appendix D.1. p. 7), the debt/equity ratio changed from 0,6 in 1997, 1998 and 1999 to 0,8 in 2000 and 1,0 in 2001.

⁽³⁵⁾ For the period 1998 to 2001, SNCB established the abovementioned ratio by including long-term financial debts due within the year, which explains the difference between 90 % and 80 % for 2001 and a difference for the following years.

3. DETAILED DESCRIPTION OF THE ABX RESTRUCTURING AND PRIVATISATION MEASURES

- (76) The activities of the ABX group were brought together in a holding company called ABX Logistics Worldwide NV/SA ('ABX-WW') ⁽³⁶⁾. In addition, the Air&Sea activities, which hitherto came under the different ABX national entities, are already largely gathered under ABX Logistics Air&Sea Worldwide SA/NV, a subgroup of the newly founded ABX-WW, hereinafter referred to as ABX Air&Sea ⁽³⁷⁾.

This consolidation is part of a thorough restructuring of all the group's activities, begun in 2002. The restructuring also includes both operational measures (integration of different entities, setting-up of a central service, organisation into profit centres, capacity reductions and productivity efforts, etc.) and financial measures intended to restore the group's financial structure and viability. Taking account of these restructuring measures, SNCB signed a sale agreement for ABX-Worldwide group with an investor, subject to the Commission's approval of the restructuring.

The main features of the restructuring are described below.

- (77) The Belgian authorities state that, as a result of this restructuring, ABX-WW returned to operating profitability in 2004 (EBIT of EUR 11,6 million) and should return to net profitability in 2006 (net profit of EUR 10,7 million) ⁽³⁸⁾.

3.1. Integration and reorganisation of the ABX group

- (78) Various measures integrating the companies of the ABX group have been put into effect: integration of the group's management structure (Phoenix programme), the IT systems, financial management and human resources management.
- (79) *Phoenix*. The Belgian authorities state that the programme is intended to integrate the international management of the group's various activities, harness operational synergies, concentrate purchasing volumes at a smaller number of suppliers, strengthen the Corporate Centre by providing it with the IT processes, skills and tools necessary for the performance of its tasks, coordinate commercial and

operational activities between countries and the quality of customer service through 'product' teams, and strengthen local management's desire, and awareness of the need, to work together with the other entities in the group.

- (80) *IT*. The Belgian authorities state that the integration of IT systems is intended to integrate existing systems, rationalise applications and introduce general solutions for the group.

- (81) *Financial centralisation*. The team for the financial management of the group's headquarters was strengthened so as to centralise this function within the group. Thus the financial control and cash management teams were strengthened, and new teams were installed for the consolidation of profits and the management of accounts receivable. The quality of the financial information was improved by the above-mentioned IT integration projects and the standardisation of the financial information transmitted from the countries to group headquarters.

- (82) As part of the financial centralisation, ABX introduced a mechanism for pooling the cash of all the companies in the group. This cash pooling led the ABX group in January 2001 to open, with a guarantee from SNCB, a single cash credit line for a maximum amount of EUR [...] million at a financial establishment.

The Belgian authorities informed the Commission that the lending bank receives a commercial consideration for this line of EUR [...] million, and that there is a consideration of [...] basis points for the guarantee provided in January 2001 by SNCB for the credit line.

⁽³⁶⁾ This consolidation took place on 29 December 2003, except for the international activities of ABX Logistics (France), which were disposed of at the end of December 2004. According to the Belgian authorities, these activities are profitable or close to being so. The entities concerned are ABX Logistics Air&Sea (France) SAS, Road International, Mitjaville S.A.S. and Lacombe Transports Internationaux Sarl.

⁽³⁷⁾ The Air&Sea activities in Belgium, Asia and America have already been consolidated under ABX-Air&Sea. The Air&Sea activities in the Netherlands were so consolidated in early January 2005. The transfer of the Air&Sea activities in Germany was deferred for two reasons: (i) it was apparent that the transfer would generate an accounting profit of EUR [...] million in the books of ABX Logistics (Deutschland) GmbH in the year of the transfer but would subsequently entail a recurrent cash drain of EUR [...] million a year; and (ii) the transaction would make ABX Logistics (Deutschland) lose the financial resources generated by the securitisation of the debts associated with these activities, i.e. EUR [...] million. These resources should be obtained from other sources of financing, which is impossible to achieve while the company's balance sheet structure has not been strengthened.

⁽³⁸⁾ Letter from the Belgian authorities, 9.6.2005. These are updated figures, which may therefore differ from the forecasts of January 2005.

- (83) *Human resources*. A director of human resources for the group was hired in November 2003, with the task of introducing the structures and processes for coordinating the management of the subsidiaries' human resources and common procedures for the recruitment, assessment and remuneration of the group's senior executives and 'high potentials'. A European Works Council will be set up in 2005.

- (84) The Belgian authorities state that the centralisation of the coordination functions makes the central services more efficient. The cost of the central service, which consists of the costs of international customer and/or multiproduct global accounts, central IT costs and the costs of the structure (financial, legal, human resources and commu-

nication), is reinvoiced to the ABX-WW subsidiaries through licence and service fees. The reinvoicing amounts to about [...] % of the turnover of the ABX-WW subsidiaries and covers the costs associated with the protection and use of the brand and all the services which headquarters performs for the subsidiaries.

(85) In addition, citing a recent study ⁽³⁹⁾, the Belgian authorities point out that the costs of the ABX-WW structure are lower than average for groups of similar size, taking all sectors together. As regards the size of the headquarters relative to the size of the group, the figures show that the geometric mean of all the groups studied is 186 staff at headquarters out of a total staff of 10 000. The mean is higher than the figure for ABX, which has 60 staff in the central service out of a total of 10 000.

(86) ABX's operations are divided into a number of profit centres, each being an activity that is meant to be viable in its own right by 2006 (including the Road Domestic activities in Germany, where the difficulties were greatest).

3.2. Measures specific to ABX Germany

(87) *Operational measures.* Apart from the operational restructuring measures described in the initiation of the procedure, additional measures involving the disposal of subsidiaries and activities, closures of agencies and activities, and productivity gains will result in an overall reduction of 64 sites (- 69 %), EUR 184 million in turnover (- 30 %), 1 589 full-time jobs (- 43 %) and 405 062 m² in surface area (- 56 %) ⁽⁴⁰⁾ by the completion of the restructuring plan in principle at the end of 2005, with a return to viability for the group in 2006-2007.

(88) By letter dated 1 December 2005, the Belgian authorities also stated that 'given the unfavourable trend of the market in Germany, and taking the requirements in the Commission's guidelines into account, ABX is working on a plan allowing it to reduce [...] the scope of its domestic road transport activities in Germany. (...)

The plan has not yet been finalised. ABX Logistics can, however, give the Commission a commitment that by [...] it will reduce its domestic road courier service in Germany through closures, disposals or partnerships, with the goal of reducing the current number of agencies (30) controlled by ABX to [...]. ABX could, moreover, remain a [...] shareholder in about [...] of the [...] sites.'

(89) *Productivity gains.* According to the information communicated by the Belgian authorities, the operational

restructuring measures in Germany will generate an improvement (theoretical, at constant turnover) in ABX Germany's operating margin of some EUR 14,6 million.

(90) *Financial restructuring.* SNCB plans to convert a debt of EUR 50 million into capital, to make EUR 100 million of additional equity available and to convert EUR 7,4 million of interest into capital. The measures will be carried out as soon as they have been approved by the Commission. This capital contribution should enable ABX-D to bring its equity level at 31 December 2004 up from — EUR 143 million (since updated to — EUR 141,2 million) to EUR 14,4 million. According to the Belgian authorities, such a total is needed for ABX-D in order to bring about the proposed privatisation of ABX-WW ⁽⁴¹⁾.

(91) *Expected results.* The application of all these measures should, according to the business plan, restore ABX-D to operational viability from 2006 (EBIT of EUR [...] million) and to net viability from 2007 (net profit of EUR [...] million).

3.3. Measures specific to ABX Netherlands

(92) *Operational measures.* Apart from the operational restructuring measures described in the initiation of the procedure, the disposals of subsidiaries and activities, closures of agencies and subsidiaries, and productivity gains will result in an overall reduction of 4 sites (- 44 %), EUR 14 million in turnover (- 21 %), 93 FTE staff (- 22 %) and 18 400 m² in surface area (- 28 %).

(93) *Productivity gains.* According to the information communicated by the Belgian authorities, the operational restructuring measures in the Netherlands will generate an improvement (theoretical, at constant turnover) in ABX Netherlands' operating margin of some EUR 5,7 million at the latest by the return of the group to viability, expected for 2006-2007.

(94) *Financial restructuring.* SNCB plans to convert a debt of EUR 10 million and interest of EUR 0,6 million into capital, as soon as these measures have been approved by the Commission. This capital contribution should enable ABX-NL to bring its equity level at 31 December 2004 up from — EUR 1,3 million (since updated to — EUR 1,5 million) to EUR 9,3 million. According to the Belgian authorities, such a total is needed for ABX-NL in order to bring about the proposed privatisation of ABX-WW ⁽⁴²⁾.

⁽³⁹⁾ Source: Collis D., Young D. and Goold M., 'The Size, Structure and Performance of Corporate Headquarters', Harvard Business School Strategy Working Papers Series, 2003; ABX Logistics.

⁽⁴⁰⁾ Letter from the Belgian authorities, 14.1.2005, p. 23.

⁽⁴¹⁾ Letter from the Belgian authorities, 24.2.2005, p. 12.

⁽⁴²⁾ Letter from the Belgian authorities, 24.2.2005, p. 12.

- (95) *Expected results.* The application of all these measures should, according to the business plan, restore ABX-NL to operational viability from 2005 (EBIT of EUR [...] million) and to net viability from 2006 (net profit of EUR [...] million).

3.4. Divestiture of domestic road activity in France

- (96) The Belgian authorities stated that, faced with the difficulties of ABX-F, regarded as critical for the viability of the whole ABX group, SNCB was divesting the domestic road activities of ABX France through an MBO. Since the MBO was described in detail when the procedure was extended, it is only pointed out here briefly that the domestic activities of ABX-F were sold in an MBO at a negative market price of EUR [...] million. The sale became effective on 31 March 2005 at midnight. The other activities of ABX-F were transferred to ABX-WW.
- (97) Two auditing firms, Deloitte and Ernst & Young Transaction Advisory Services, reached the conclusion that the negative sale price of EUR [...] million for the domestic division of ABX-F is appropriate and represents a market value.
- (98) According to the Belgian authorities, 'SNCB decided not to continue with its investment in ABX France: the recapitalisation measures notified in February 2003 will not be implemented. The measures concerning France — including the MBO — were part of a rationale of controlled, socially responsible disengagement, allowing more than 2 300 jobs to be saved. SNCB is withdrawing from France: once the MBO has been completed, the only activity of ABX

France is three profitable logistics contracts, which will be maintained until the end of [...] and which generate a turnover of only EUR 29 million. ABX France will then no longer have any operational activity and will probably be put into liquidation' ⁽⁴³⁾. 'Therefore, while the divestiture in France may be considered to be part — in the broad sense — of the restructuring of the ABX Logistics group, the activities of ABX Logistics in France are not being restructured in the same sense as the measures notified for Germany and the Netherlands' ⁽⁴⁴⁾.

3.4.1. Selection of an MBO

- (99) It should be noted that with regard to the domestic part of ABX's activities the Belgian authorities compared the MBO scenario (management buyout) with a voluntary liquidation scenario and concluded that the MBO was the less costly solution. When it extended the procedure, the Commission questioned this reasoning, saying that it would also be pertinent to compare the MBO with a compulsory liquidation scenario, on the grounds that a private investor placed in a comparable position would seek the least costly solution, without excluding a court-ordered liquidation if this should prove more attractive economically.
- (100) The Belgian authorities maintain that a court-ordered liquidation would in any event be more expensive than the MBO and also that, despite the Commission's doubts, the comparison with a voluntary liquidation is not only socially more responsible, but is still the pertinent comparison, for the reasons summarised below.

3.4.2. Cost of the different scenarios

- (101) The Belgian authorities compared the costs of the three options — MBO, voluntary liquidation and court-ordered liquidation — as detailed in the table below ⁽⁴⁵⁾:

	MBO	Voluntary or amicable liquidation	Court-ordered or compulsory liquidation
Negative equity at 30/9/2004	[...]	[...]	[...]
Losses expected in last quarter 2004	[...]	[...]	[...]
Negative equity estimated at 31/12/2004	[...]	[...]	[...]
Of which, debt to SNCB	[...]	[...]	[...]
Reductions in value of intangible assets	[...]	[...]	[...]
Capital gain on sale of Contract Logistics to MGF, not yet recorded	[...]	[...]	[...]
Capital gain on transfer of Eurocargo, Air&Sea, Mitjavile and Lacombe	[...]	[...]	[...]
Finalisation of current redundancy programme (PSE4) — 2004 expenditure	[...]	[...]	[...]
Coverage of losses 2005 for activities not included in the MBO	[...]	[...]	[...]

⁽⁴³⁾ Letter from the Belgian authorities, 9.6.2005, p. 18.

⁽⁴⁴⁾ Letter from the Belgian authorities, registered on 16.6.2005 under No 15050, p. 18.

⁽⁴⁵⁾ Letter from the Belgian authorities, 2.9.2005.

	MBO	Voluntary or amicable liquidation	Court-ordered or compulsory liquidation
Cash impact for SNCB before choice of divestiture scenario	[...]	[...]	[...]
(Negative) transfer price — maximum	[...]		
Coverage of losses during redundancy programme negotiation period — 2005		[...]	
Coverage of losses for 4 extra months — 2006 (risk)		-15	
New redundancy programme for remaining staff		[...]	
Termination of lease contracts		-8	
Termination of other contracts		-6	
Risk [...] for SNCB [...]			
Commercial debts to suppliers at 31.12.2004			
Company's debts to staff			
Redundancy programme for staff of ABX France			[...]
Compensation of creditors — Leases			-8
Compensation of creditors — Other contracts			-6
Risk of the SNCB guarantee being used for debts to Soc. Gen/Natexis			
Loss of value of the ABX LOGISTICS group			-112
Cost of additional redundancies following drop in volume			[...]
Impact on the need for operating capital			-45
Impact on cost of financing SNCB's bank debt			-14
Impact on cost of financing bank debt of ABX LOGISTICS			-7
Total cost SNCB	- 137,5	-183	-346

(102) As for the difference in cost between the MBO and the voluntary liquidation (basically the cost of a redundancy programme for the remaining staff and the coverage of losses while the programme was being negotiated), the Belgian authorities state that this was verified and confirmed by Ernst & Young. The accounting firm concluded as follows: '... we conclude that on an overall level the price differential between the scenario of the Management Buy-Out and the scenario of the Liquidation of Domestic Road Transport Activities amounting to EUR 45,5 million to be fair and reasonable'.

(103) According to the Belgian authorities, the cost of the court-ordered liquidation is much higher than the net assets of ABX France at the time when the transaction was effected (i.e. — EUR [...] million) on account of:

- (a) the risk for SNCB [...];
- (b) the loss of customers that would result from the deterioration of ABX's image, and the impact of that loss on the value of the ABX Logistics Worldwide group;
- (c) the costs of making staff redundant who had become surplus following the loss of customers;

(d) the impact on the group's need for working capital, and

(e) the impact on the cost of financing the ABX Logistics group and SNCB itself following a default by one of their subsidiaries.

(104) *Risk of [...] (EUR [...] million).* According to the Belgian authorities ⁽⁴⁶⁾, 'the scenario of a court-ordered liquidation would expose SNCB to a [...] risk that would call its responsibility into question. [...] ⁽⁴⁷⁾, [...] ⁽⁴⁸⁾, [...] ⁽⁴⁹⁾' ⁽⁵⁰⁾.

(105) The Belgian authorities also cite as an example a recent decision [...] ⁽⁵¹⁾.

(106) The Belgian authorities consider that 'the Commission should confine itself to ascertaining the existence of the risk and its plausibility, and to establishing that, faced with that risk, a private operator would have probably sought, in the same situation, to avoid a court-ordered liquidation and opted for a voluntary liquidation. [...] ⁽⁵²⁾.

⁽⁴⁶⁾ Letter from the Belgian authorities dated 9.6.2005, registered on 16.6.2005 under No 15050, p. 22.

⁽⁴⁷⁾ [...].

⁽⁴⁸⁾ [...].

⁽⁴⁹⁾ [...].

⁽⁵⁰⁾ Letter from the Belgian authorities dated 9.6.2005, registered on 16.6.2005 under No 15050, p. 22.

⁽⁵¹⁾ Letter from the Belgian authorities, 9.6.2005, Annex C 4.

⁽⁵²⁾ Letter from the Belgian authorities dated 9.6.2005, registered on 16.6.2005 under No 15050, p. 22.

(107) The French law firm Grand, Auzas et Associés drew SNCB's attention to this risk at the end of 2004 and confirmed its analysis of it in writing.

(108) Similarly, the law firm Linklaters informed the Belgian authorities that if '[...]' ⁽⁵³⁾ '[...]' ⁽⁵⁴⁾.

(109) If SNCB [...], the Belgian authorities consider that it should have at least financed a redundancy programme for the remaining 1 300 employees, i.e. at a cost of EUR [...] million, and compensated the creditors of ABX France (EUR 8 million for the property creditors and EUR 6 million for the others).

(110) *Loss of value for the ABX group following the loss of customers (EUR 112 million).* The Belgian authorities consider that a court-ordered liquidation of the domestic road activity in France would have caused a serious and permanent deterioration in the group's image and reputation and entailed a loss of customers detrimental to the group as a whole. Their estimate of the loss of value for the ABX group is given in the table below.

The Belgian authorities consider that the loss of turnover would have been partly compensated by the immediate disappearance of the direct transport costs. But the indirect costs (structural costs) could have been reduced only gradually (by staff redundancies in proportion to the volume of activities lost) over a three-year period in order to return to the situation prior to the application for a court-ordered liquidation. The impact of the loss of customers on operating profit (EBIT) would have been greatest, therefore, in the first year and would have declined in the following two years until the return to the situation prior to the application for a court-ordered liquidation.

Reduction in the value of the group due to the decline in volume following the court-ordered liquidation of ABX LOGISTICS France S.A.

EUR million, based on the forecasts available at end 2004		2005	2006	2007	Total
In France					
Road International France					
Budgeted gross margin	[...]	[...]	[...]		
Loss of customers in %	30 %	15 %	7,5 %		
Estimated impact on EBIT	[...]	[...]	[...]		8,8
Air&Sea France					
Budgeted gross margin	[...]	[...]	[...]		
Loss of customers in %	10 %	6 %	2 %		
Estimated impact on EBIT	[...]	[...]	[...]		3,1
Outside France					
Road Germany					
Budgeted gross margin	[...]	[...]	[...]		
Loss of customers in %	30 %	15 %	7,5 %		
Estimated impact on EBIT	[...]	[...]	[...]		46,7
Air&Sea Germany					
Budgeted gross margin	[...]	[...]	[...]		
Loss of customers in %	5 %	3 %	1 %		
Estimated impact on EBIT	[...]	[...]	[...]		3,1
Road Domestic Netherlands					
Budgeted gross margin	[...]	[...]	[...]		
Loss of customers in %	30 %	15 %	7,5 %		
Estimated impact on EBIT	[...]	[...]	[...]		3,3

⁽⁵³⁾ [...]

⁽⁵⁴⁾ Letter from the Belgian authorities, 9.6.2005, Annex C.2.

EUR million, based on the forecasts available at end 2004		2005	2006	2007	Total
Road Domestic Belgium					
	Budgeted gross margin	[...]	[...]	[...]	
	Loss of customers in %	30 %	15 %	7,5 %	
	Estimated impact on EBIT	[...]	[...]	[...]	16,5
Other countries and product lines					
	Budgeted gross margin	[...]	[...]	[...]	
	Loss of customers in %	5 %	3 %	1 %	
	Estimated impact on EBIT	[...]	[...]	[...]	25,2
Total					
	Budgeted gross margin	455,6	489,7	519,7	
	Loss of customers in %	14 %	7 %	3 %	
	Estimated impact on EBIT	61,6	34,4	16,4	112,4

(111) In this respect the Belgian authorities also stated that, according to the Court of Justice of the European Communities, 'It must ... be accepted that a parent company may also, for a limited period, bear the losses of one of its subsidiaries in order to enable the latter to close down its operations under the best possible conditions. Such decisions may be motivated not solely by the likelihood of an indirect material profit but also by other considerations, such as a desire to protect the group's image or to redirect its activities' ⁽⁵⁵⁾.

(112) *Costs of shedding staff who had become redundant following the fall in volume (EUR [...] million).* As indicated above, the Belgian authorities assumed that the indirect costs could have been gradually reduced by layoffs over a three-year period in order to return to equilibrium. The estimates adopted by the Belgian authorities are approximately 1 000 layoffs (i.e. some 550 persons in Germany, 200 in France, 100 in Belgium and 200 in the rest of the world).

(113) *Impact on the ABX group's need for working capital (EUR 45 million).* The Belgian authorities consider that a court-ordered liquidation of the group would have led to significant pressure from the suppliers of the rest of the group to renegotiate the time limit for payment of their invoices (e.g. immediate payment required instead of payment within 30 days of the end of the month). They calculate that a reduction of 7 days in the average time for paying suppliers would have led to an immediate need for cash of about EUR 45 million.

(114) *Impact on the average cost of financing for SNCB and ABX Logistics Worldwide (EUR 14 million + EUR 7 million).* According to the Belgian authorities, the average cost of financing for SNCB and ABX Logistics at their respective banks could have been increased if one of their subsidiaries

had suspended payments. The potential extra cost of financing is estimated at 100 basis points (1 %) for the bank debt of ABX Logistics (about EUR 240 million) and at 50 basis points for the bank debt of SNCB (about EUR 900 million) not assumed by the Belgian state. On the premise that the extra cost would be neutralised over three years, the Belgian authorities consider that the extra cost of financing SNCB's debt would therefore be about EUR 14 million and that of financing the debt associated with ABX Logistics would be about EUR 7 million.

3.4.3. Other considerations put forward by the Belgian authorities

(115) As well as the comparisons of the estimated costs of the different scenarios, the Belgian authorities consider that other factors are taken into account by investors when the question of the disposal or closure of an activity arises.

(116) Thus they consider that an adjudication of bankruptcy could have caused industrial trouble leading to an interruption of ABX Logistics' activities at the sites not affected by the liquidation (international activities), which would have had an impact on traffic to other countries or even on SNCB's traffic. A private company in the same situation would, according to them, also have taken account of the very considerable, similar risks and opted for voluntary liquidation.

(117) More generally, according to the Belgian authorities, 'it is not correct that a private investor, especially a European one of the size of SNCB, would definitely choose compulsory liquidation if it were less expensive than voluntary liquidation. Other private companies, in the same circumstances, have opted for a voluntary liquidation

⁽⁵⁵⁾ Case C 303/88 *Italian Republic v Commission (Eni-Lanerossi)* [1991] ECR I-1433, paragraph 21.

scenario with the financing of a redundancy programme for the workers affected by the closure of activities' ⁽⁵⁶⁾. According to the assessment requested by the Belgian authorities from a law firm specialising in labour law (Claeys & Engels), there are several recent examples of private companies which have adopted such conduct.

(118) The Belgian authorities also state that the private company TNT acted in the same way as SNCB by deciding to divest itself of its loss-making national transport activities and part of its contract logistics activities in France rather than have them wound up voluntarily or by a court ⁽⁵⁷⁾.

(119) Lastly, with regard to corporate restructuring, the Belgian authorities quote the Commission communication of March 2005, which states in particular that 'the preservation of social cohesion, which is a distinctive characteristic of the European social model, requires the introduction of accompanying policies designed to reduce the social costs to a minimum and to promote the search for alternative sources of jobs and income. (...) The restructuring of enterprises is often seen to be an essentially negative phenomenon, and its immediate effects on employment or working conditions are highlighted in most cases. (...). It is therefore necessary to accompany these changes in such a way as to ensure that their effects on employment and working conditions are as short-lived and limited as possible' ⁽⁵⁸⁾.

(120) In conclusion, the Belgian authorities state that SNCB chose the MBO scenario for the following reasons:

- (a) cost and risk significantly less than in the court-ordered or voluntary liquidation scenarios;
- (b) limited impact on the value and image of the ABX Logistics Worldwide group;
- (c) more acceptable social consequences (preservation of 1 300 jobs in France in the new private company Cool Jet);
- (d) social responsibility of SNCB towards its suppliers and creditors to act in a responsible way, like any other European undertaking of its size.

3.5. Reduction of the ABX network

(121) The restructuring of the ABX group involved considerable reductions in its freight forwarding capacity. In this activity, capacity is measured in an appropriate way by indicators such as invoiced turnover, number of sites, warehousing area or number of wage-earners.

(122) According to the Belgian authorities, the total operational restructuring measures applied to the ABX-WW group go significantly beyond the measures originally planned.

The original plan provided for the sale of 3 subsidiaries with a turnover of EUR 98,5 million, the closure of 7 agencies and 3 warehouses in Germany, 4 agencies in France, 2 agencies in the Netherlands, and a reduction of 690 FTE (including the impact of the agency closures).

The capacity reduction measures notified during 2005 will have the effect by the end of the restructuring exercise of reducing the number of sites by 176 (- 31 %), turnover by EUR 624 million (- 21 %), staff by 5 827 FTE (- 40 %) and surface area by 917 377 m² (- 54 %) ⁽⁵⁹⁾.

The additional commitments regarding Germany, which Belgium made in November 2005, will increase this reduction.

(123) The Belgian authorities state that the area reductions and disposals carried out since 2002 and those provided for recently are as large as possible, and that further reductions would lead to the dismantling of the ABX Logistics network. In their view, the existence of an international network is essential for the strategic and commercial positioning of ABX and its competitors; dismantling the network would have a serious adverse effect, which would jeopardise the group's competitive structural position in the market, the possibility of carrying out the restructuring plan and the group's attraction for potential partners in the context of a privatisation.

They consider in this respect that the divestiture of the domestic parcel delivery services in France cannot be replicated in Germany; the integration of the domestic and international activities of the group's companies in Germany and the Netherlands is more advanced than in France because of the integration of IT operations and systems and the high proportion of common customers; this greater integration is the result not only of the structure of the German market but also of the history of ABX Logistics — the international and domestic departments in France having been integrated in 2003 only and in a partial manner, whereas in Germany domestic parcel delivery services and international freight forwarding by road had coexisted in a single entity since the merger in 1996 of THL and Bahntrans (which became ABX in Germany).

⁽⁵⁶⁾ Letter from the Belgian authorities dated 9.6.2005, registered on 16.6.2005 under No 15050, p. 21.

⁽⁵⁷⁾ Letter from the Belgian authorities, 2.9.2005, p. 6.

⁽⁵⁸⁾ Commission communication — Restructuring and employment — anticipating and accompanying restructuring in order to develop employment: role of the European Union, COM(2005) 120 final, pp. 2-3.

⁽⁵⁹⁾ According to the data at the Commission's disposal, this consists basically of warehousing area.

They add that, both in Germany and the Netherlands, a further decline in the density of the Road network would lead to exit from the German market, given the comparison of the number of sites owned by ABX Logistics and its competitors in each of these countries.

Comparison of the number of Road sites of ABX Logistics and its main competitors in the German and Dutch markets (before allowing for further reduction commitments in Germany) ⁽⁶⁰⁾

Germany		Netherlands	
Schenker/Stinnes	57	DHL/Danzas (Van Gend&-Loos)	17
IDS (Elix)	37	Frans Maas	13
Dachser	34	Vos Logistics	10
DHL/Danzas	32	Wim Bosman	8
ABX Logistics	30	ABX Logistics	4

Source: Websites; estimates by ABX Logistics

They emphasise that the divestitures occur at a time when ABX's main competitors are acquiring parcels delivery and groupage companies, particularly in Germany, with a view to expanding their own domestic courier network in that country.

3.6. Loans granted by SNCB to ABX in 2002

(124) SNCB granted loans to various ABX subsidiaries.

In April-May 2002, SNCB granted its Belgian subsidiary ABX Logistics group NV three loans (EUR 50 million, EUR 10 million and EUR 29 million), which were remunerated at variable rates. According to the Belgian authorities, the average rate for these loans was [...] %, [...] % and [...] % respectively.

On 30 June 2004 the loans were called in by SNCB and allocated direct to ABX Germany, ABX Netherlands and ABX France at the respective interest rates of [...] %, [...] % and [...] %.

3.7. Privatisation of ABX-WW

(125) According to the Belgian authorities, 'SNCB confirmed its willingness to privatise ABX Logistics Worldwide within six months of the Commission decision approving the restructuring plan. (...) A binding agreement in principle ("Term sheet") was concluded by SNCB Holding with a potential buyer and signed on 22 March 2005. The agreement was subject, however, to a condition precedent that the Commission would adopt a positive decision authorising the restructuring plan.' ⁽⁶¹⁾

(126) The Belgian authorities stated that, following its decision to restructure and dispose of ABX, SNCB started negotiations with various potential buyers. Accordingly, it mandated ABX-WW and Petercam to represent it for the purposes of the sale.

(127) In June 2003 ABX-WW began preliminary discussions with an initial partner, an industrial group. In March and June 2004 a draft memorandum of understanding was drawn up. Between June and August 2004 the negotiations were suspended for reasons peculiar to this initial potential partner.

(128) In June 2004 ABX-WW contacted a second industrial partner. However, in September 2004, this second potential partner indicated that it wanted to put an end to the negotiations with ABX-WW.

(129) At the end of August 2004 contact was established with a third potential partner, another industrial group. However, these negotiations ended when successful talks were held with a fourth partner, which in November 2004 transmitted to SNCB the above-mentioned binding offer for the takeover of ABX-WW. It was with this candidate, hereinafter referred to as 'Yvan', that SNCB signed the sale agreement and the above-mentioned Term Sheet (letter of intent) in March 2005.

(130) According to the Term Sheet, Yvan undertook, subject to a positive decision from the Commission, to invest an amount of between EUR [60 and 150 ("")] million, of which EUR [...] million for the payment of ABX Logistics Worldwide shares to SNCB Holding. The remainder of the investment by Yvan would be used as follows:

- (a) EUR [...] million to provide back-to-back cover (borrowing and on-lending operations) for an SNCB guarantee for a building in [...];
- (b) EUR [...] million in the form of a subordinated loan granted to ABX Logistics Worldwide in order to finance:

- the transaction costs, including the costs of Yvan and in particular its strategic, legal and financial advisers. These costs are estimated to be between EUR [...] and [...] million;

- the financing needs associated with possible withdrawal or possible requests for guarantees on the part of certain financial institutions following the change of shareholder. The balance of the amount of EUR [...] million after transaction costs, i.e. EUR [...] to [...] million, is intended to meet the need for financing resulting from such withdrawals.

⁽⁶⁰⁾ Table submitted by the Belgian authorities.

⁽⁶¹⁾ Letter from the Belgian authorities, 9.6.2005, p. 26.

- (131) The Term Sheet provides that, subject to the usual conditions and due diligence in disposal cases, Yvan and SNCB will be obliged to sell the ABX group as soon as the condition precedent concerning the Commission's decision is removed.

If this condition is not removed, Yvan and SNCB could in certain circumstances no longer be bound by the sale agreement.

- (132) Lastly, the Belgian authorities stated that 'after the privatisation of ABX-WW, SNCB will be free from all off-balance sheet commitments, guarantees and comfort letters. [...] There will no longer be any need for the comfort letters, which will cease to apply once the financial measures for the recapitalisation of the German subsidiary are authorised by the Commission and implemented' ⁽⁶²⁾.

4. OBSERVATIONS FROM INTERESTED PARTIES

4.1. Initiation of the procedure

- (133) In light of the circumstances of the case, and in particular the conclusions outlined by the Commission in the initiation of the procedure, the following interested parties have separately and independently submitted the following observations.
- (134) Firstly the arguments of an initial group of third parties were presented, namely 1. Association for the promotion of competition and fair play in the haulage, logistics and transport industry, Cologne, 2. H.A.L.T.E., 3. Ziegler, 4. Freshfields, Bruckhaus, Deringer (representing Deutsche Post AG), 5. The Professional body of Flemish freight transporters and logisticians (SAV). Their arguments are summarised below ⁽⁶³⁾.
- (135) *Regarding the restructuring plan.* The interested parties stress the intrinsic weaknesses of the original restructuring plan proposed by ABX. It is disputed whether the entities concerned are eligible for restructuring aid since they are part, at least financially, of a group of companies which should be able to co-finance the proposed measures. It is stressed that restructuring aid can be authorised only in conjunction with a viable restructuring plan ensuring the long-term restoration of profitability. However, the interested parties take the same line as in the initiation of the procedure, which found that, given the lack of funding and that the operational restructuring measures are inadequate, this plan would not restore viability. It follows that approving aid which does not lead to viability would distort competition in a way contrary to the Community's interests.
- (136) In general terms, the probability of restoring a normal level of capital profitability was not made explicit, any more so than the conditions for this development in terms of overall market growth, increases in market share, improving productivity and quality of service and changing client behaviour.
- (137) The planned restructuring and rationalisation measures are adaptations to changes in the parcel service and logistics business which ABX should have carried out several years ago and which other companies in the sector have already completed at considerable cost. Approval of the plan by the Commission would only prolong a long-standing distortion of the market and shift the financial difficulties onto the companies which have already restructured, in particular medium-sized, privately funded businesses, even confronting some of them with insurmountable difficulties.
- (138) *Regarding state interference.* The delays in restructuring ABX are to a large extent the result of continued interference by SNCB in the daily running of ABX and the fact that members of ABX's board of directors are appointed for political reasons. Some interested parties point out the lack of transparency in the selection of directors both in the ABX Logistics group and, therefore, in ABX Logistics Worldwide. These directors are appointed in a discretionary way by the management of SNCB based on political criteria, which prevents the company being managed autonomously. It was noted in particular that management decisions are taken for ABX either by the Council of Ministers or the management of SNCB, and that it cannot be claimed that ABX has been managed by its own executive committee.
- (139) *Regarding the restructuring of the subsidiary in France.* The sum needed to refinance this subsidiary has been underestimated. The original plan underestimates the level of aid required simply to balance the losses incurred since the network of ABX subsidiaries was set up. Overall, the business recovery forecasts are unrealistic and cannot be achieved without subsequent additional aid, and without capturing the market to the detriment of competitors through a policy of market disruption.
- (140) *Regarding the privatisation of ABX.* Some interested parties called for ABX to be privatised. One criticism voiced is that this privatisation is merely a plan, without any signs to indicate that such a sale is actually going to be made.
- (141) *Regarding the purchase and expansion of the ABX network.* The third parties mentioned above feel that ABX has operated in the parcel delivery and logistics services sector since 1998 through illegal state aids which have seriously distorted competition on the market. It was only possible to create the ABX network because of massive sums of state aid granted by SNCB.
- (142) The following is a list of arguments put forward by a second group of interested third parties, namely 6. FGTE CFDT Route (Federal Road-Users' Union), 7. National Federation of Transport Unions CGT, 8. the Royal Belgian

⁽⁶²⁾ Letter from the Belgian authorities, 9.6.2005.

⁽⁶³⁾ Although not all the arguments set out below have been made individually by the above parties, they still summarise the main points made in this group of comments.

Road Hauliers' Federation, 9. ABX Logistics — representatives of the German group ABX Logistics. Their arguments are summarised below ⁽⁶⁴⁾.

- (143) The interested parties made several comments on the situation of ABX's employees. They point out that several hundred employees have already been affected by earlier social plans in France and that jobs in logistics are under threat. The representatives of the German subsidiary note also that around 4 000 jobs have been lost since 1998, and that 2 000 related sub-contracting jobs have also been cut. In addition they point out that ABX is on the verge of being privatised and that the work done to this end should not be undone.
- (144) The National Federation of Transport Unions CGT calls more specifically for the creation of a mandatory social pricing policy in order to fight 'economic dumping' which appears to be practised by ABX's competitors in France.
- (145) However, the Royal Belgian Road Hauliers' Federation (FRBT) points out that ABX cooperated by voluntarily showing it its books. The FRBT can therefore confirm that current rules on licences and vehicle insurance are complied with.
- (146) It is also noted that the management of ABX (Belgium) S.A. sent the Commission, after the deadline for comments to be submitted, a petition from drivers working in ABX Belgium's various regional distribution centres explicitly calling for a positive decision in the ABX restructuring case.

4.2. Extension of the procedure

- (147) The following interested parties have separately and independently submitted the following observations with the aim of extending the procedure.
- (148) Firstly the arguments of an initial group of third parties are presented, namely 1. 'HALTE'; 2. Freshfields Bruckhaus Dehringer; 3. BCA — Belgian Courier Association; 4. Mr Robert Ziegler ⁽⁶⁵⁾; 5. Febetra (Royal Belgian Federation of Carriers and Logistics Service Providers); 6. SAV — the Royal Professional Association of Freight Transporters in the Flemish Region and Brussels Capital Region. Their arguments are summarised below ⁽⁶⁶⁾.
- (149) These parties essentially express their doubts regarding the compatibility of aid received by ABX and call for fair competition conditions to be restored, in particular in the

light of the increase in aid notified and taking account of the considerable share of this highly competitive market held by ABX, particularly in Germany. Any aid approved should, however, be accompanied by sufficient concessions from ABX. Regarding the sale of part of ABX France, the parties call for checks to ensure the sale was made without giving rise to new aid payments. Selling ABX is considered a positive step provided that it is done in line with market conditions. However, the sale should only lead the Commission to take a less severe decision regarding the aid received by ABX if it is not sold.

- (150) Furthermore, Mr Ziegler indicated that one repayment of a EUR 140 million loan granted to ABX was not made, that there is a risk that ABX will be given an advantage when the ABX group is privatised given the conditions of this privatisation, that SNCB did not go through with the sale of ABX-France, that it is unrealistic to restructure ABX under current management and business strategy conditions and that the impact of ABX going bankrupt would be significant.
- (151) The following is a list of arguments put forward by a second group of interested third parties, namely 1. ABARENT N.V., 2. DOL & SERVICES, 3. Pierre Lepoint, 4. Geert Lagae BVBA, 5. WEVETRA — Werner Vranckx Transport, 6. Claude Bogaerts, 7. Johan Vergote, 8. Cooljet, 9. UPTR — the Professional Road Transport Union, 10. Van Hauwermeiren Transport 'BA.AN' BVBA, 11. SD Transport BVBA, 12. Gincotrans, 13. Vervoer Marc Cobbaert, 14. François Timmermans, 15. Tractrans, 16. GPF, 17. Transport Fabrice, 18. SOS Transport, 19. Eddy Ommeslag. Their arguments are summarised below ⁽⁶⁷⁾.
- (152) Most of these third parties indicated that they did not wish the Commission to jeopardise the jobs of thousands of subcontractors working for ABX by adopting a negative decision.
- (153) Cool Jet stated that the activities acquired in the MBO could be viable following recovery, and that this should be carried out in line with a detailed strategic plan of action within 3 years of work resuming; the sale price takes account of reasonably expected and budgeted losses; the activities taken over do not account for a significant market share (1,5 % of the parcel and express delivery market in France) and lastly that Cool Jet employs 1300 people, jobs which would have been lost if Cool Jet had not been able to purchase the activities in question.

⁽⁶⁴⁾ Although not all the arguments set out below have been made individually by the above parties, they still summarise the main points made in this group of comments.

⁽⁶⁵⁾ According to the letter sent by the Chairman of the Board of Directors of the Ziegler Group dated 18.8.2005, Mr Robert Ziegler is not authorised to address the Commission alone on behalf of the Ziegler Group or Ziegler SA.

⁽⁶⁶⁾ Although not all the arguments set out below have been made individually by the above parties, they still summarise the main points made in this group of comments.

⁽⁶⁷⁾ Although not all the arguments set out below have been made individually by the above parties, they still summarise the main points made in this group of comments.

(154) However, UPTR states that it was able to access ABX's books in all transparency and notes the group's improved results. The group became profitable at operational level for the first time in 2004. UPTR encourages the Commission to take a decision quickly in order to enable ABX to be privatised, thereby ensuring the stability of a loyal operator whose presence benefits the Belgian road transport sector.

(155) The Commission also received, after the procedural deadlines, a complaint regarding the sale of ABX-WW claiming that SNCB Holding did not comply with the conditions of a transparent, open and non-discriminatory procedure when privatising ABX Logistics and thereby deterred the investors lodging the complaint.

5. COMMENTS FROM BELGIUM

5.1. Initiating and extending the procedure

(156) The basic points made in Belgium's comments regarding the initiation and extension of the procedure are mainly set out in the descriptive section. The other points are summarised below.

(157) *Regarding the imputability of some actions to the Belgian State.* The Belgian authorities have pointed out throughout this case that the Belgian State was in no way involved within the meaning of the Court of Justice's *Stardust* decision in SNCB's decision-making regarding ABX Logistics. They also reiterated that the onus is on the Commission to prove any such imputability.

(158) Regarding investments in ABX, the Belgian authorities have repeated throughout the proceeding that the State did not intervene in decisions taken by SNCB.

(159) Regarding the press release from the Council of Ministers of 22 February 2002, the Belgian authorities pointed out ⁽⁶⁸⁾ that:

(a) 'the public authorities cannot legally impose decisions or guidelines on the managing bodies of autonomous public companies (such as the SNCB) in matters which do not concern their public service task (such as the management of ABX Logistics)'.

(b) 'in the press release of 22 February 2002 the Council of Ministers merely expressed its support for some guidelines on the restructuring of ABX Logistics (guidelines which in any case were not finally accepted by SNCB's board of directors, except for one which it had already adopted itself before 22 February 2002)'.

(c) 'the fact that at their inter-cabinet meetings or on other occasions the public authorities were made aware of reports or studies pertaining to SNCB and ABX Logistics is simply the normal behaviour of a

shareholder who ensures that he keeps abreast of the major developments in his investments'.

5.2. Reply from the Belgian authorities on the observations made by third parties

(160) In response to the observations made by the interested parties regarding the selection of directors on the basis of their political affiliation, the Belgian authorities state that the operations of ABX Logistics do not concern SNCB's public service tasks. These activities, and management of them, therefore come completely under the autonomous management of the SNCB. Consequently, the procedure for appointing directors for ABX Logistics is simply that laid down in Belgian law for every public limited company to which that law applies. The appointment of directors to ABX Logistics or its subsidiaries thus complies with transparent procedures laid down in law, and is therefore not done arbitrarily on the basis of political affiliation.

(161) *Regarding the funding of the ABX Logistics network.* The Belgian authorities confirm that SNCB's balance sheet structure was healthy until 2001 and that the consolidated result was in the black between 1998 and 1999.

(162) *Belgium's arguments regarding the (re)investments.* In addition to the indications from the Belgian authorities regarding the (re)investments as summarised in the statement of facts, the Belgian authorities also point out that SNCB's timely intervention regarding the subsidiaries in question (Germany, France, the Netherlands, Ireland, Portugal, Belgium) is in line with the principle of the private investor in a market economy. What is more, it should be noted that the interventions concerning ABX Logistics Singapore are not covered by Article 87 of the Treaty.

(163) Regarding the comments made by third parties on the extension of the procedure, the Belgian authorities point out that in their previous reactions they have already responded to comments which only echo the Commission's misgivings.

(164) Regarding the statement by Mr Robert Ziegler, the Belgian authorities state that the Commission has been notified of the temporary loan of EUR 140 million and the new measure aimed at capitalising this loan. Neither SNCB nor ABX can make any commitment pending approval. The same applies to the contribution of EUR 157,4 million of own funds for restructuring ABX-Germany as well as for the other notified measures. Regarding the potential advantage which ABX could gain through being privatised, the Belgian authorities refer to the 'fairness opinion' prepared by KPMG and sent to the Commission which indicates that 'the terms of the proposed sale to [Yvan] are

⁽⁶⁸⁾ Letter from the Belgian authorities, 29.8.2003, p. 16.

fair and reasonable and represent fair market value'. Regarding the alleged failure to sell ABX France, the Belgian authorities note that they indicated which parts were sold. Regarding the conditions of this sale, they refer in particular to the report by Ernst & Young which states that 'the price valuation for Road Domestic Transport Activities amounting to (...) is fair'. Finally, regarding the question on the consequences of the possible bankruptcy of the ABX group, the Belgian authorities can only stress the serious consequences both for ABX Logistics Worldwide and for SNCB Holding were the Commission to adopt even a partially negative decision.

(165) *Sale of ABX-WW*. According to the Belgian authorities, SNCB Holding was under no obligation to privatise ABX Logistics Worldwide by issuing an invitation to tender.

(166) The Belgian authorities point out that close examination of the Commission's state aid practices relating to privatisations shows that, in the absence of an invitation to tender, the Commission only checks that assets are sold at market price on the basis of an assessment by an independent expert. Therefore, in line with this, the Belgian authorities submitted to the Commission an independent assessment, carried out by the consultants KPMG Corporate Finance, of the conditions of the sale of ABX Logistics Worldwide.

6. COMMISSION'S ASSESSMENT

6.1. Presence of state aid

(167) Under Article 87(1) of the Treaty, 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market'.

(168) Firstly the Commission notes that the above measures concerned a number of companies which had formed part of the ABX network since it was established and which had then been integrated into the ABX group when the holding company ABX-WW was founded. It considers that even before this holding company was legally established these companies formed, within the SNCB group, a distinct financial unit ('the ABX group') which should be seen as the relevant entity in the following assessment.

(169) The Commission notes straight away that three of the four criteria set out in Article 87(1) of the Treaty are met ('favouring certain undertakings' 'threatening to distort competition' and 'affecting trade between Member States').

The funds which the SNCB made available to the ABX group favour that company over other companies operating on its markets.

By exclusively favouring the ABX group or its subsidiaries, these measures distort or threaten to distort competition in those activities which are subject to free competition.

Lastly, these measures affect trade between Member States as the investigated competitive activity is also carried out in several other Member States. This conclusion also applies to measures favouring the group's companies operating outside the Community. Firstly, in accordance with the 'Tubemeuse' decision⁽⁶⁹⁾ and taking account of the interdependence between the markets on which Community undertakings operate, it is possible that aid might distort competition within the Community, even if the undertaking receiving it exports almost all its production outside the Community. Secondly, as this is a case of an international transport group operating globally in competition with other Community operators, the aid granted to one of the group's companies operating in third countries strengthens the group as a whole and therefore affects trade between Member States and distorts, or threatens to distort, intra-Community competition.

(170) In addition, as the measures in question mobilise SNCB's resources, they must be regarded as implementing State resources (public funds).

(171) Due to the fact that SNCB is state-owned and its specific status as a public undertaking, the SNCB's resources remain constantly under public control. This conclusion is backed up by the observation that SNCB is subject to the Law of 21 March 1991 under which it is granted specific protection against the risk of bankruptcy, comparable to a guarantee from the State.

(172) The Court states in *Stardust Marine*⁽⁷⁰⁾ that: 'it should be recalled that it has already been established in the case-law of the Court that Article 87(1) EC covers all the financial means by which the public authorities may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector. Therefore, even if the sums corresponding to the measure in question are not permanently held by the Treasury, the fact that they constantly remain under public control, and therefore available to the competent national authorities, is sufficient for them to be categorised as State resources'.

⁽⁶⁹⁾ Case C-142/87 *Belgium v Commission*, (Tubemeuse) [1990] (ECR I-959, paragraph 35).

⁽⁷⁰⁾ Case C-482/99 *France v Commission*, (Stardust Marine) [2002] (ECR I-4397, paragraph 37).

(173) In addition, also in *Stardust Marine*, at paragraph 52, the Court states that: '...the mere fact that a public undertaking is under State control is not sufficient for measures taken by that undertaking, such as the financial support measures in question here, to be imputed to the State. It is also necessary to examine whether the public authorities must be regarded as having been involved, in one way or another, in the adoption of those measures'.

(174) Another condition needed for measures taken by a public undertaking to constitute State aid is that the measures are not the same as those which would be taken by a private investor in a similar situation.

(175) As a result, the Commission will assess each of the measures taken by the SNCB in favour of the ABX group to check whether each one is both imputable to the State and not the likely behaviour of a private investor in this situation. If both these conditions are fulfilled, the measures are deemed to constitute State aid and the Commission will analyse the subject and amount of this.

6.1.1. Investments made in 2001 and parallel contributions

(176) The Belgian authorities pointed out that the reinvestments made in 2001 by SNCB in the ABX group's German, Dutch and French operations were based on positive financial forecasts and the advice of business development experts.

(177) The profitability calculations set out above appear to be based on acceptable business development forecasts, as far as SNCB was able to predict in 2001.

(178) The investments in Germany are based on an expert opinion which calculated that by successfully turning around ABX-D the ABX strategy could be continued, potentially creating EUR 300 million compared with the injection of EUR 50 million, and based on an adequate intrinsic return.

(179) Regarding the investment of EUR 30 million in France, the profitability calculations indicate that the SNCB could achieve an internal rate of return of between 8 and 14 %. Moreover, this investment has made it possible to start a programme to securitise receivables so the company can get a bank credit line of EUR 70 million.

(180) The Commission considers that there is insufficient justification, in the case of the investment made in 2001 in ABX-NL, for basing the calculation of the IRR on the capital gain after deducting the costs of acquiring Wegtransport, as is proposed by the Belgian authorities. However, considering that the SNCB's total investment includes this acquisition cost and as a result is EUR 19,2 million rather than EUR 12,2 million, the IRR of the investment is between 8,9 % and 10,2 %, and therefore remains acceptable, in particular in the light of the fact that when the investment was made, the entire ABX-NL was expected

to become profitable again within the very short period of two years.

(181) Likewise, the estimation of rates of profitability of the 'parallel contributions' to the capital of the companies in the ABX group in Ireland, Belgium, Portugal and Singapore (which were not in financial difficulty) gave an expected IRR of between 9,6 % and 12,7 %, and appears acceptable.

(182) The Commission also points out that until the end of 2001 SNCB's financial structure allowed it to finance its commercial development without placing an excessive burden on its financial structure (debt/equity ratio rising from 0,6 to 0,9 between 1997 and 2001), which was not the case from 2002.

(183) Lastly, it should be noted that all these investment decisions are part of a group strategy. In these circumstances SNCB was justified in taking account not only of the expected intrinsic return on each of these operations, but also the positive effects expected at group level.

(184) The Commission therefore concludes that, in the light of the prospects at the time, SNCB acted as a private investor would have done by making reinvestments in 2001 and making 'parallel contributions', and that these measures do not constitute state aid.

(185) However, the Commission notes that SNCB gave a guarantee to ABX Singapore without requiring payment, which is not what a private investor would have done. Given that this guarantee was granted in June 2000 when ABX started arousing public interest and the public authorities intervened with regard to SNCB, and taking account in its analysis of all potential forms of aid, the Commission feels that granting this guarantee without payment may involve state aid. As this guarantee was awarded to a company in the ABX group at a time when the decision to reorganise and restructure the network had already been taken and this was underway, the Commission will investigate this aid together with the other restructuring measures taken by the ABX group, which has incorporated ABX Singapore.

6.1.2. Recapitalisation measures

(186) The meeting of the Belgian Council of Ministers in February 2002 constitutes irrefutable proof of the Belgian Government's involvement, from that day on, in SNCB's management of the ABX case. The measures taken to recapitalise ABX Germany (for a sum of EUR 157,4 million) and ABX Netherlands (for a sum of EUR 10,6 million) were notified by Belgium after this date, and have not yet been implemented. Belgium has presented these measures not as wise investments, but as restructuring aid. There is therefore no doubt that these measures must be classed as state aid and investigated as restructuring aid.

(187) The letter of intent which SNCB had to issue for its German subsidiary because the latter's equity was negative from the month in which it was bought, was re-issued annually until 2005 by SNCB, including during a period when there is no doubt that SNCB's decisions regarding ABX can be imputed to the State. As this letter contains commitments comparable to a guarantee and SNCB received no payment for this, the Commission considers that there are elements of state aid. However, since the recapitalisation of ABX Germany by SNCB, which is the subject of this Decision, effectively and definitively gives the company's creditors the security which they sought through the letter of intent, which then becomes inapplicable, there will be no need to conduct a separate, redundant investigation relating to the recapitalisation measures themselves.

6.1.3. Loans in 2002

(188) SNCB granted loans to ABX Logistics NV and to ABX-D, -NL and -F from April and May 2002, i.e. during a period in which there is no doubt that SNCB's decisions regarding ABX can be imputed to the State.

(189) As indicated in the descriptive section, these loans resulted in remuneration of between [...] and [...] %. The Commission considers that this level of remuneration is inadequate in view of the situation of the companies concerned. It uses the Commission's reference rate, set at 5,06 %, as an indicator of an appropriate level, which was also used for setting the rate of the rescue aid granted in January 2003 to ABX Germany.

(190) The Commission concludes that these loans contain an element of state aid. On the basis of the above reference rate increased by 400 basis points for a firm in difficulty, but also undergoing restructuring, the Commission estimates the sum of the aid element corresponding to this loan at around EUR 8 million.

(191) As the loans were given to several companies in the ABX group at a time when the decision to reorganise and restructure the network had already been taken and was being implemented, the Commission will investigate this aid together with the other measures to restructure the ABX group, which has incorporated the retained activities of the companies which benefited from these loans.

6.1.4. Guarantee granted for setting up a cash pool

(192) As stated in the description of the restructuring measures, the Belgian authorities pointed out that the overdraft facility of EUR [...] million opened by the ABX group with a financial establishment results in commercial remuneration, and that the guarantee set up in January 2001 by SNCB for this credit line is subject to a remuneration of [...] basis points.

(193) This rate is permitted in view of the usual bank rates given in similar situations⁽⁷¹⁾. The Commission concludes that this guarantee has not given the ABX group an advantage constituting state aid. Besides, even if it were considered that the rate demanded by a private investor would have been a few basis points higher or even double, it would have resulted in a negligible advantage in view of the other aid measures (EUR 0,07 million per year) and would not have changed the following assessment of the compatibility of all the restructuring aid measures.

6.1.5. Other SNCB off-balance sheet commitments

(194) The Belgian authorities maintained that in addition to the guarantees taken out at the time of the original acquisition of some companies in the network, the only new guarantees issued by SNCB in favour of the ABX group are the two above guarantees in favour of ABX Singapore, taken out at the end of 2005, and the approval of the overdraft facility for the cash pool. However, SNCB did issue a number of letters of intent.

(195) The Belgian authorities are of the view that these letters of intent, which do not involve any remuneration, are standard practice in a market economy in dealings between a parent company and its subsidiaries. In the case in point, with the exception of the letter for ABX Germany which has already been assessed and a letter of intent in favour of ABX Spain for EUR 12,3 million, the Commission noted that none of the new letters of intent of which it is aware and which have been issued since 2000 (when ABX started arousing public interest) contains terms which are legally binding on SNCB. The Commission deems that the letter of intent in favour of ABX Spain is equivalent to a bank guarantee, given that SNCB undertakes to grant ABX Spain the funds needed to repay its debts to the bank. The Commission recalls that the aid element in question is made up of the cost of the guarantee which the company would have had to pay to obtain the loan and which is in addition to the cost of the loan itself; in any case this amount remains limited and corresponds to a few basis points. Therefore, even though the margin of [...] basis points paid by the ABX group to SNCB is adequate, the resulting aid element remains marginal (EUR 0,02 million per year). Even if the cost of a guarantee should be considerably higher, for example double this amount, or [...] basis points, which seems high, the aid element itself would still be marginal (EUR 0,04 million per year) and would not alter the conclusions on the restructuring aid.

⁽⁷¹⁾ For example, the rate of [...] basis points paid by a subsidiary of ABX to its banks for their bank guarantee.

6.1.6. Disposal of the Road domestic France business

- (196) As the choice and the conditions of ABX France disposing of its Road domestic France business were clearly imputable to the Belgian State, the Commission must check the arguments put forward by the Belgian authorities to justify the choice of an MBO as being in line with what a private investor would have done under the same circumstances.
- (197) *Cost of the scenario chosen by SNCB.* the total cost of the divestiture scenario chosen by SNCB is EUR 137,5 million, or EUR [...] million corresponding to the business' negative net assets at the time of disinvestment, and a negative selling price of EUR [...] million.
- (198) The Commission notes that two independent experts have confirmed that this sum of EUR [...] million corresponds to the negative value of the Road domestic France business sold to the employees.

Deloitte Corporate Finance reviewed the business plan of the company in question and evaluated it using the discounted cash flows method. The business plan covers the years 2005 to 2008. The assessment concludes that the value of ABX-F domestics corresponds to the above negative price. This was confirmed by Ernst & Young Transaction Advisory Services who reviewed the estimates made by Deloitte.

Given that these two independent experts used the standard and appropriate assessment methods, the Commission accepts that this price corresponds to the market price and that the buyer of the Road domestic France activity did not receive state aid when making this purchase.

- (199) *Cost of voluntary liquidation:* according to the Belgian authorities, the cost of voluntary liquidation would be EUR 183 million, or EUR [...] million for the negative net assets when the disposal decision was taken, and EUR [...] million in other additional costs.
- (200) In the case of a voluntary liquidation plan, SNCB would have to pay off all the creditors of the liquidated company which were not covered by the liquidated assets. It is therefore legitimate to include the amount of EUR [...] million.
- (201) The other additional costs taken into account by the Belgian authorities comprise in particular EUR [...] million for the redundancy programme which should have been carried out by SNCB during the liquidation, and EUR [...] million incurred through losses which would have been made by the ABX group throughout the negotiations for this programme.
- (202) Both these estimates seem reasonable. In terms of the redundancy programme, the amount breaks down into an acceptable redundancy cost of EUR [...] per employee; the expected amount of losses incurred while this programme was carried out is comparable to the level of losses for 2005 in the company's business plan at the time of

disposal (between EUR [...] million and EUR [...] million). Further, the Belgian authorities take account in their assessment of an additional amount of EUR 15 million for losses incurred in the first four months of 2006.

- (203) As a result, as ABX France would also have had to pay various penalties for breach of contracts (at a cost estimated by the Belgian authorities of EUR 14 million) and cope with the consequences for the group's other businesses of loss of access to the French market, it is reasonable to consider that amicable liquidation would have led SNCB to bear a higher cost than that of the employees purchasing Road domestic France.
- (204) *Cost of court-ordered liquidation.* According to the Belgian authorities, the cost of court-ordered liquidation would be EUR 346 million, or EUR [...] million for the sold company's negative net assets when the disposal decision was taken, and EUR [...] million in other additional costs.
- (205) In the Commission's view, given the difference between the options of disposal and voluntary liquidation, it is unjustified to consider that, in the case of obligatory liquidation, SNCB would have had to bear all the EUR [...] million amounting to the net negative assets at the time the disposal decision was taken, as by definition it would not have sought to pay off the creditors of its subsidiary.
- (206) Among the other additional costs, the Belgian authorities consider that, in this case, SNCB should have been able to bear a risk [...] of EUR 58 million.
- (207) The Belgian authorities provided the Commission with several points to back up this theory, in particular an opinion from the experts Linklaters and Grand Auzas et Associés stating that the option of court-ordered liquidation would expose SNCB to a real and non-negligible risk [...] calling its liability into question.
- (208) The Commission does not deny that, in certain exceptional cases, some national legislation provides for the possibility of third parties to bring proceedings against the shareholders of a liquidated company, in particular if these shareholders may be considered [...] and/or as being guilty of mismanagement.
- (209) However, in the case in point, although French law does provide for this possibility and the Belgian authorities have provided some indications of such a risk, they have not sufficiently erased the doubts expressed regarding this case when the procedure was extended in April 2005. The Commission concludes that it is not legitimate in this case to include among the costs of this scenario the EUR 58 million which, according to the Belgian authorities, are linked to the risk of [...].
- (210) Similarly, the Commission considers that, in view of the special status of SNCB, it is unlikely that SNCB's financing cost would have been significantly affected by the court-

ordered liquidation of Road domestic France, contrary to the view taken by the Belgian authorities. However, it is possible to accept that this liquidation could have entailed an additional cost to paying the ABX group's bank debts, estimated by the Belgian authorities at no more than EUR 7 million.

(211) The Belgian authorities' simulation also takes account of an impact on the group's need for working capital, as the creditors of the entire group could, once Road domestic France was put into liquidation, demand a drastic reduction in their repayment schedules. The estimated impact of this at EUR 45 million, based on the average deadline for repayment given by suppliers being reduced by one week, or around 15 %, seems acceptable. Even if the impact could have been reduced for the clients of the group's subsidiaries which were in good financial health, it could have been considerably more than one week in the case of the clients of the other subsidiaries in financial difficulties when the business went into liquidation in France.

(212) Lastly, the Belgian authorities consider that liquidating Road domestic France would also have resulted in the group's other activities losing between 5 and 30 % of clients in the year of liquidation. As the group offers integrated services in Europe, and its different operations are highly interdependent, it is reasonable to expect that a court-ordered liquidation could have tarnished the image of the other activities in the group and caused business to drop off, especially since the activity and/or the country in question are close to the activity and country of the company which would have been liquidated, as is reflected in the assessments made by the Belgian authorities. This reasoning cannot be applied to the chosen MBO option. On one hand this solution actually protects the group's image; on the other, the disposal contract for Road domestic France contains a cooperation agreement between the company consolidating the activities sold by MBO and the international operations of ABX-F remaining within the ABX group, meaning that the ABX group's clients will still have access to a service in France. The Commission notes that it is difficult to confirm client losses of up to 30 %. Thus, bearing in mind the fact that the group's various subsidiaries share several joint major clients, and given the importance of France in the group's international activities in France, Germany and the Netherlands (which is between 14 and 36 %), rather than the additional cost of EUR 112 million expected by the Belgian authorities, the Commission considers that, when assessing the impact this will have, it is wise to work with estimated costs of a maximum loss of 20 % of clients in the first year in the worst affected activities, totalling around EUR 75 million.

(213) It is also reasonable to accept the possibility that this drop in business would have led the group to make staff cutbacks, as the company could have been forced to lay off more staff in order to avoid losing too great a gross margin.

The Belgian authorities estimated this additional cost at EUR 35 million. As the scale and therefore the cost of these redundancies should correspond to the amount of business lost, the same cautious hypothesis as above results in an estimated value of two thirds of additional costs, or EUR 24 million.

(214) Overall, the Commission considers that, rather than the sum of EUR 346 million cited by the Belgian authorities, the court-ordered liquidation of Road domestic France could have resulted in SNCB bearing a cost of at least $7 + 45 + 75 + 24$, or EUR 151 million (excluding the possible risk of [...]) which is higher than the cost of the scenario put forward by SNCB.

(215) *Conclusion.* Upon completing this assessment the Commission feels that the choice made by SNCB to sell its Road domestic France business to the employees, and the arrangements it adopted for this, can be considered in line with the choice which a private investor, guided solely by financial considerations, would have made and therefore that this operation contains no elements of state aid.

(216) The Commission based the above analysis only on the assumptions which it considered reasonable and sufficiently motivated. These estimates lead one to consider that the discrepancy between the scenario chosen by SNCB and the alternatives to liquidation would be at least EUR 13 million, which should more than cover any margin of error in the estimates selected following the assessment.

6.1.7. Sale of ABX-WW

(217) The Commission notes that the SNCB went to great lengths to find a buyer for ABX-WW, in particular by using a specialised company.

(218) Regarding the sale price and conditions of ABX-Worldwide, the Commission takes account of the report by KPMG who were asked to check, from a financial ('fairness') point of view, the offer for sale of all ABX-WW's remaining assets, as described above.

(219) KPMG's report ⁽⁷²⁾ is based essentially on a comparison between two methods of evaluation: the discounted cash flow method (DCF) which involves calculating the current net value of expected future revenue; and the capitalised earnings method (CEA) which consists of comparing several levels of a company's expected revenue (turnover, EBITDA, EBIT, etc.) in relation to others in the same sector by applying the multiplier coefficients of the market in question.

(220) Given that the expert carried out a detailed assessment of the disposal and used recognised calculation methods for this type of fairness option, the Commission considers that

⁽⁷²⁾ KPMG: Yvan Project — Valuation summary, Presentation to NMBS/SNCB Holding NV/SA, 26 May 2005 v2.2.

KPMG's final conclusion that 'the term of the proposed sale to Yvan is fair and reasonable and represents fair market value' is acceptable. It concludes that the disposal of ABX-WW does not involve any element of state aid in favour of the purchaser, provided that this is done at the agreed price and is subject to only the usual and financially justifiable adjustments applicable in the event of disposal.

- (221) The conditions of disposal will ensure that Yvan gives Belgium a sale price and a commitment to make substantial contributions which will reduce public money earmarked for this by Belgium. These conditions also ensure that SNCB effectively disposes all the ABX group's operations.

6.2. Compatibility of restructuring aid

- (222) The Commission will now look at the compatibility of the state aids which it has just identified with its Guidelines on State aid for rescuing and restructuring firms in difficulty. The Belgian authorities' original notification was made in 2003 and resulted in proceedings being opened in 2003 on the basis of the 1999 Community Guidelines for State aid for rescuing and restructuring firms in difficulty⁽⁷³⁾ ('the 1999 guidelines'). However, on one hand, updating the restructuring plan after the new guidelines came into force allows for a considerable increase in the amount of aid originally planned; on the other, the above assessment shows that SNCB granted illegal aid to the ABX group. In the light of these factors and points 103 and 104 of the 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty⁽⁷⁴⁾ ('the 2004 guidelines') the Commission will examine all these aids in the light of the latter text, while taking account of the fact that the plan was originally notified under the 1999 guidelines. In any case, the following assessment shows that the aid in question may be declared compatible under both the 1999 guidelines and the 2004 guidelines.

6.2.1. Eligibility

- (223) The Commission notes, on the basis of several relevant indications, that the ABX group as a whole must be considered a firm in difficulty within the meaning of point 11 of the 2004 guidelines. Firstly, the group's operating losses ballooned during 2001 and 2002 up to EUR 50 million in 2002; losses also increased, the net result rising from -EUR 73 million in 2000 to -EUR 186 million in 2002; financial charges rose throughout the same period from EUR 15 million to EUR 41 million, while debt increased from EUR 442 million to EUR 512 million.

Secondly, and more importantly, ABX's operations in Germany, France and the Netherlands faced serious financial difficulties, which are described in the decision approving rescue aid to ABX, and thereby indisputably constitute firms in difficulty, as noted by the Commission in that Decision⁽⁷⁵⁾. However, at the time, these played a key role in the ABX group's strategy and in its ability to provide integrated logistics and transport services in Europe. They also made a decisive contribution (about 60 % in 2002) to the group's turnover, such that the serious difficulties they faced threatened the survival of the group as structured at the time.

- (224) Furthermore, the Commission considers that the rest of the ABX group was unable to make a greater contribution to funding its restructuring.

- (225) The Belgian authorities stated that, through disposals, external funding and productivity gains (particularly in Italy, the Netherlands and Spain), ABX-WW generated EUR 24,3 million which enabled it to partially fund the restructuring of the group.

- (226) The sale of assets, combined with the internal rationalisation measures, substantially reduces the scale of the ABX group: the number of sites will be reduced by 31 %, turnover by 21 %, staff (FTE) by 40 % and (warehousing) area by 54 %. These figures are significantly higher in Germany, with reductions up to 69 %, before taking account of the commitments made by Belgium in November 2005. It is considered that further disposals of assets could ensure the group becomes viable as an integrated network of multimodal logistic services in Europe.

- (227) The healthy parts of the group have supported the other parts which are in difficulty, thereby helping them recover. For example, ABX Logistics (Belgium) NV/SA wrote off a sum of EUR 10,6 million owed by ABX Netherlands.

- (228) Lastly, it should be noted that the entire group, whose cash has been pooled since 2001, is [...] in a negative liquid position as the cash released by the profit-making parts of the business has been absorbed by the loss-making ones.

- (229) The overdraft of the cash pool is still negative and often close to the authorised overdraft limit of EUR [...] million (for example EUR -[...] million in June 2005), and the group owes [...] in short-term liquid assets:

⁽⁷⁵⁾ Decision No C(2003) 245 final of 21.1.2003: State aid No 769/2002 Rescue aid for ABX Logistics (F, D, NL subsidiaries and the group). Published on the Commission website at: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/transport-2002/n769-02-fr.pdf (available in French only).

⁽⁷³⁾ OJ C 288, 9.10.1999, p. 2.

⁽⁷⁴⁾ OJ C 244, 1.10.2004, p. 2.

**Consolidated liquid position of ABX Logistics
Worldwide S.A.**

	EUR million		
	31.12.2003	31.12.2004	30.06.2005
Bank current accounts	[...]	[...]	[...]
Financial debts of over one year maturing during the year	[...]	[...]	[...]
Short-term bank over- draft	[...]	[...]	[...]
Net liquid position	- 36,8	- 62,2	- 114,4

(230) Lastly, the Commission notes that, although the holding company ABX-WW was only created in 2003, as a financial entity the group is not a new firm within the meaning of the 2004 guidelines as it was formed by merging several pre-existing entities in the same sector, and that the group's new structure was set up precisely to aid restructuring.

6.2.2. Restoring viability

(231) The provisional results expected for ABX-WW, ABX-D and ABX-NL, as indicated in the descriptive section above and based on realistic assumptions, predict a return to viability between 2006 and 2007.

(232) Moreover, the financial results have improved significantly since 2002, the year in which the restructuring plan was drawn up. The operational results (EBIT) of ABX-Logistics Worldwide S.A. have improved from -EUR 28,7 million (2002) to +EUR 11, million (2004). The operational result of ABX Logistics (Deutschland) GmbH (excluding Air&Sea) went from -EUR 32, million to -EUR [...] million over the same period, and that of ABX Logistics Holding (Nederland) BV is almost balanced by going from -EUR 6, million to -EUR [...] million.

(233) In addition to this undeniable financial recovery witnessed in recent years, the descriptive section shows that the ABX group is evidently undergoing a real organic restructuring which will restore its viability in a sustainable manner.

(234) Lastly, the Commission considers that signing a preliminary contract of sale for the entire ABX Logistics WW group which makes disposal obligatory, subject to approval and the normal conditions in the event of disposal, and accompanied by substantial investment commitments from the private buyer, is a further indicator which determines

the quality of the ABX group's restructuring plan and its return to sustainable viability.

6.2.3. Avoidance of undue distortions of competition

(235) According to the 2004 guidelines, compensatory measures must be taken to attenuate as far as possible any adverse effects the aid may have on competitors. Otherwise, the aid will be regarded as contrary to the common interest.

(236) The ABX group has already embarked on greatly reducing its capacity. As previously mentioned, between now and the end of the restructuring operation it will make dramatic cut backs in the number of its sites, its operating area, turnover and staff numbers in order to make reductions in ABX-WW of up to 54 %, in ABX-D of up to 69 %, in ABX-NL of up to 44 % and in ABX-F of up to 76 % (mainly in the form of disposal and by closing offices). These cuts will be boosted further still, on the German market, by the additional commitments taken by the Belgian authorities in [...] 2005. These cuts, which go considerably further than those set out in the original plan, will free up parts of the market to competitors.

(237) The Commission feels that these closures and disposal measures can be considered proportionate given their quantitative scale, the weakness of ABX's residual market share in freight forwarding (less than 2 % in Germany, 1 % in the Netherlands in 2002), the necessity of having a minimum network in several European countries in order to maintain a viable intermodal logistics service in Europe, and lastly the fact that the transport logistics market is not saturated and is a growth sector, as analysed in Section 2.2. It should not be forgotten that the ABX group owns almost no means of transport and is therefore practically non-operational as a road haulier.

(238) In addition, on the basis of information submitted by the Belgian authorities, the Commission has verified that a very large part of the cuts in capacity are in short-term ancillary activities. These additional cuts affect around 19 % of a total of 31 % of sites cut, 12 % of a total 21 % reduction in turnover, 15 % of a total 40 % in staff cuts and 40 % of a total 54 % reduction in warehousing area.

6.2.4. Aid limited to the minimum

(239) The 2004 guidelines require the amount and intensity of the aid to be limited to the minimum.

- (240) In the light of this the Commission notes, firstly, that the recapitalisation will cause the group to have a debt/equity ratio of 80 % once the notified measures have been implemented. This rate would be 155 % after eliminating the goodwill of EUR 146 million currently in the group's accounts.

ABX LOGISTICS Worldwide S.A., consolidated balance sheet

	31.12.03	31.12.04	30.6.05	31.12.05 before con- version	31.12.05 after con- version	31.12.05 after con- version and elim- ination of goodwill	31.12.06	31.12.07
Consolidated equity	185,8	173,9	158	131,9	300	154	[...]	[...]
Financial debts	369	414,3	407	407	239	239	[...]	[...]
Debt ratio	199 %	238 %	258 %	309 %	80 %	155 %	[...]	[...]

- (241) The Commission feels that this second figure of 155 % can also justifiably be taken into consideration given that much of this goodwill comes from the original acquisition of ABX-D (EUR [...] million) and NL (EUR [...] million), the capacities of which will be greatly reduced by the restructuring (exacerbated by the [...] commitments to reduce presence in Germany communicated by the Belgian authorities in December 2005). The Belgian authorities also feel that instigating restructuring measures would lead to all the goodwill for the German and Dutch subsidiaries disappearing from SNCB's accounts [...].

restructuring plan, either from his own resources or through external funding obtained at market conditions.

- (247) To do this, the Commission starts by determining the total cost of the restructuring, net of productivity gains and the reduced need for working capital.

Net cost of restructuring

Redundancies, closures	- 49,0
Cash drain during restructuring (net productivity gains)	- 121,0
Debt to SNCB (prior to 2002)	- 60,0
Interest on SNCB debts (debt prior to 2002 + rescue aid)	- 8,0
Repayments of credits and loans following bank withdrawals	[...]
Repayments by Yvan of other guarantees and debts to ABX's creditors	[...]
Reduction in working capital needed	29,1
Total	- 296,6

- (242) However, these two ratios of 80 and 155 % are still significantly higher than the equivalent ratios noted in the cases of competitors comparable to the ABX group. For example, the average (weighted by turnover) of the ratios of competitors is around 43 % (and would fall to 16 % were account taken of DPWN, which did not, however, seem sufficiently comparable to be included).
- (243) This shows that the ABX group will be recapitalised at a lower level than the sector average and will not have any surplus resources due to its financial structure.

- (248) The Commission feels that it is justified in deducting the costs set out in the above table, in particular for the following reasons:

- (244) Secondly, the Commission reiterates that ABX-WW's net liquid position has been negative since 2003, so the ABX group has no surplus cash available.
- (245) Thirdly, account should be taken of the fact that the price which the SNCB should receive in payment of the sale of ABX-WW shares helps reduce the effective amount of aid. It would have been the same for the group and its competitors, as well as for SNCB and Yvan, if the aid contributed by SNCB were reduced by as much, the sale were made for a token price, and the corresponding funding contributed directly by the buyer.

- (a) the amount of EUR 49 million corresponds to costs incurred directly by the restructuring, such as redundancy fees and the cost of closing subsidiaries;

- (246) Furthermore, the Commission must also ensure that the aid recipient makes a substantial contribution to the

- (b) the amount of EUR 121 million corresponds to the cash drain of the entities restructured between 2003 and 2005. It corresponds essentially to the corrected EBITDA of investment needed for restructuring, financial charges and some exceptional items. The

Commission is assured, on the basis of information sent by the Belgian authorities, that the investments taken into account are mainly IT-related investments, and in any case remain below the amount of repayments. IT-related investments make up one of the important elements of the reorganisation and increase in productivity of the group. The Belgian authorities have confirmed that these investments do not involve any increase in capacity. The Commission has also assured itself that the exceptional elements mainly cover costs linked to restructuring the company; this concerns the reorganisation and productivity measures (redundancies in the central operations, legal simplification measures, other productivity measures, etc.) needed to ensure viability is restored.

It should be noted that the cost of the cash drain during the restructuring period itself, totalling EUR 150,9 million, is here reduced by the positive effects expected as a result of the restructuring and which generates a positive cash flow in this period of EUR 29,9 million, making a net cost presented here of EUR 121 million.

- (c) Other funding needs at the end of 2005 must be covered before ABX-WW is transferred in order to restore the group's financial structure. These concern either the debts owed to SNCB which will be converted into capital (EUR 60 million) and the resulting interest (EUR 8 million), or withdrawals from bank accounts made between 2003 and 2005 (EUR [...] million), or lastly the planned take-over by Yvan of existing guarantees and debts (EUR [...] million);

- (d) The reduction in working capital needed results from improved management of the group's commercial relations with its clients and suppliers, and is deducted from the restructuring costs.

- (249) The ABX group has mobilised a number of its own resources or external resources obtained at market conditions in order to finance these measures. These were mainly generated by the sale of assets to third parties (EUR 24,2 million), the previously described repurchase of the operations being restructured by the healthy parts of ABX or by the holding company ABX-WW (EUR 22,6 million) and by the healthy parts of the group writing off debts and providing funding (EUR 10,6 million + 6 million). These concerted efforts made by the healthy parts of the group make a real contribution to the recipient, which is the group as a whole. In addition to this is the funding provided by Yvan (EUR [...] million). The total amount of these own contributions is EUR [...] million.

- (250) The above assessment shows that the percentage of the recipient's own contributions is at least 43,4 % of funds

needed for restructuring. In this case, the Commission feels it can accept an own contribution of less than 50 % in the light, particularly, of the specific difficulties of the restructuring operation (on which 13 000 jobs depend directly in Europe), the scale of the cuts in capacity (cuts up to 50 % mainly in short-term ancillary activities), the risk that a further reduction could pose to the viability of the ABX-WW's international transport logistics network, the fact that the original notification was made under the 1999 guidelines which did not provide for a minimum rate, and the privatisation of ABX-WW, which is also a factor which determines the group's viability and the absence of future aid to the group.

- (251) Other elements show that the markets believe the viability of the company can be restored, in accordance with the 2004 guidelines. For example, the Commission again points out that the ABX group was able to obtain an overdraft of (EUR [...] million) from a financial establishment, guaranteed by SNCB, which for reasons of caution has not been taken into account in the above calculation of the recipient's contributions, given that the Commission was not able, in the light of the premiums paid to the bank and to SNCB, to completely exclude the possibility of any state aid. Furthermore, private banks continue to grant sizeable amounts of short-term credit to the ABX group without comfort letter or public guarantee.

- (252) The Commission therefore feels that this meets the condition that aid must be limited to the minimum and that the firm has to make a sizeable contribution to its restructuring costs from its own resources.

6.2.5. *One time, last time*

- (253) The Commission again notes that the ABX network was established from 1998 and that at no time has the Commission approved restructuring aid for this network prior to this Decision.

- (254) The Commission also considers that the planned privatisation of the ABX group should not only guarantee its return to sustainable viability, but also uphold the 'one time, last time' principle by making it considerably less likely that public funds will be injected into the firm once it has been privatised.

6.2.6. *Conclusion*

- (255) In the light of the above, the Commission concludes that the aid granted by SNCB as part of the restructuring of the ABX group are in line with the criteria set out in both the 1999 and the 2004 guidelines, and are therefore compatible with Article 87(3) of the Treaty. It notes in particular that the healthy parts of the ABX group have

made substantial contributions to funding those parts in difficulty and, in addition to this contribution, that the group has substantially reduced its capacity in exchange for the aid. In addition, the privatisation of the ABX group means not only that the group will be viable in future, but also precludes the possibility of it being granted any other State aid in future.

(256) Lastly, the Commission once again notes that the political guidelines in the field of state aid to the railways sector, which it set out in its Decision of 2 March 2005 in Case No N 386/2004, provide a horizontal examination of the issues raised by the unlimited guarantee which rail companies have in several Member States.

HAS ADOPTED THIS DECISION:

Article 1

1. The aid investigated in this Decision, granted by the Belgian railways (*Société nationale des chemins de fer belges*, SNCB) as part of the restructuring of the ABX Logistics group, is compatible with the common market under the conditions provided for in Article 2.

2. The funds used by SNCB to finance the divestiture of part of ABX Logistics (France), and the other financing operations investigated in this Decision, in particular the investments of capital in 2001 and the 'parallel contributions', do not constitute state aid.

Article 2

The Commission authorises the restructuring aids set out in Article 1(1) on the condition that the ABX Logistics group is sold within [...] of the date of notification of this Decision, at market price, to a buyer who has no legal links to SNCB, and in line with the commitments regarding conditions of purchase and financing proposed by the potential buyer as described in this Decision.

Article 3

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

Article 4

This Decision is addressed to the Kingdom of Belgium.

Done at Brussels, 7 December 2005.

For the Commission

Jacques BARROT

Vice-President

COMMISSION DECISION

of 4 July 2006

on State aid which Italy is planning to implement for Cantieri Navali Termoli S.p.A (No C 48/2004 (ex 595/2003))

(notified under document number C(2006) 2972)

(Only the Italian text is authentic)

(Text with EEA relevance)

(2006/948/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having regard to Council Regulation (EC) No 1540/98 establishing new rules on aid to shipbuilding ⁽¹⁾ (hereinafter the 'Shipbuilding Regulation'), and in particular Article 3(2) thereof,

Having called on interested parties to submit their comments ⁽²⁾ and having regard to their comments,

Whereas:

(5) Italy submitted its comments by letter dated 26 July 2005, registered as received on 29 July 2005. By letter dated 6 January 2006, the Commission requested additional information. The Italian authorities replied by letters dated 23 January 2006 and 2 February 2006, asking for extensions of the deadline, which the Commission granted by letters dated 27 January 2006 and 9 February 2006. By letter dated 6 March 2006, registered as received on the same day, the Italian authorities submitted the additional information requested and completed their submission by letter dated 6 April 2006.

(6) The Commission received no comments from interested parties.

PROCEDURE

- (1) By letter dated 22 December 2003, registered as received on the same day, the Italian authorities notified the Commission under Article 3(2) of the shipbuilding Regulation ⁽¹⁾ of a request to extend the three-year delivery date for a vessel named C.180, for which operating aid has been granted. The ship is being built by Cantieri Navali Termoli SpA. ('the shipyard').
- (2) By letter dated 30 December 2004, the Commission notified Italy of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the notified measure.
- (3) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽²⁾. The Commission invited interested parties to submit their comments on the measures.
- (4) By letters dated 28 January 2005, 1 April 2005, 1 June 2005 and 6 July 2006, registered as received on 2 February 2005, 6 April 2005, 6 June 2005 and 7 July 2005 respectively, Italy requested extensions of the deadline for submitting its comments on the Commission's decision to initiate proceedings. The Commission replied by letters dated 4 February 2005, 8 April 2005, 29 June 2005 and 17 July 2005 respectively.

DETAILED DESCRIPTION OF THE AID

- (7) Italy asked the Commission to agree to an extension of the delivery limit of 31 December 2003, which is laid down in the Shipbuilding Regulation as a condition for receiving contract-related operating aid for ships. The extension requested concerned the delivery of a vessel named C.180, which was being built by Cantieri Navali Termoli SpA., a shipyard located in the Molise region of Italy. The extension originally requested was until 31 October 2004 (10 months).
- (8) The shipbuilding contract was signed on 30 December 2000, and delivery was originally scheduled for 30 June 2003. The ship had been ordered by Marnavi SpA., an Italian shipowner, for the transport of chemical and petroleum products. In accordance with Article 3(1) of the Shipbuilding Regulation, the shipowner was promised operating aid of 9 % for this vessel, equivalent to some EUR 3,9 million.
- (9) However, according to the Italian authorities, construction took longer than anticipated because of a combination of factors, namely the impact of the events of 11 December 2001, the subsequent need to modify the ship to meet the changed market demands, and two natural disasters — an earthquake and floods. The shipyard therefore had to

⁽¹⁾ OJ L 202, 18.7.1998, p. 1.

⁽²⁾ OJ C 42, 18.2.2005, p. 15.

request an extension of the delivery limit for ship C.180 to a date 10 months over the 31 December 2003 limit laid down in the Shipbuilding Regulation.

changes were then set out formally in an addendum to the original construction contract on 10 December 2003.

(10) In their notification, the Italian authorities refer to the Commission decision of 5 June 2002 authorising a similar extension of the 31 December 2003 delivery limit for cruise ships under construction at Meyer Werft, Papenburg, Germany (the 'Meyer Werft decision'). Specifically, they emphasise several basic similarities between the two cases in terms of: (i) the reason invoked for the extension (i.e. the impact of the 11 September 2001 terrorist attack); (ii) the market concerned (i.e. maritime transport of petroleum and chemical products); and (iii) the consolidated commercial relations between the shipyard and the shipowner⁽³⁾. In short, they claim that the Meyer Werft decision sets a clear precedent for an exceptional authorisation in this case. Furthermore, they note that on 13 November 2002 the Commission took another decision granting, for similar reasons, an extension of the delivery limit for a cruise ship under construction at Kvaerner Masa yard, Finland (the 'Kvaerner Masa decision').

(11) The Italian authorities justify their request by referring to what they describe as exceptional factors which were unforeseeable and external to the shipyard and which resulted in unexpected, substantial and defensible disruptions to the shipyard's work programme. More specifically, these delays were attributable to the following events (see overview in Table 1):

(i) *Impact of the 11 September 2001 events*

On 1 October 2001, before construction started, the shipowner asked Cantieri Navali Termoli to suspend execution of the contract until 30 September 2003 rather than cancel it. The shipowner eventually withdrew its request for suspension of the contract on 29 September 2003.

(ii) *Need to modify the ship to meet changed market demands*

In addition to these events, the shipowner, when revoking the suspension order, requested changes to the original contract specifications in order to modify the ship to meet changed market demands. These changes concerned the size and number of the tanks and the overall length and width of the ship: the designs for these changes were submitted to RINA, the Italian naval certification body, for approval. The

(iii) *Impact of natural disasters*

On 31 October 2002 an earthquake hit the Molise region, affecting the shipyard, its employees and its suppliers. Subsequently, between 23 and 25 January 2003 the region was hit by floods which had further devastating consequences for the shipyard, its employees and its suppliers. Those two natural disasters caused the shipyard direct injury on account of the inactivity of the labour force and indirect injury following the unilateral revoking of contracts by local undertakings subcontracted for the work on ship C.180 because of the damage caused by the natural disasters to the production infrastructure of their suppliers. In particular, the Italian authorities argued that those events adversely affected the engineering work preparatory to the actual construction work on the ship.

The Italian authorities acknowledge that both events took place during the contract-suspension period but affirm that they still disrupted the shipyard's work programme and emphasise that, for both events, the state of emergency declared by decree of the President of the Council of Ministers lasted until 1 February 2004.

Moreover, the Italian authorities emphasise the urgency of the aid in light of the shipyard's limited financial and industrial resources⁽⁴⁾ and the fact that the contract price of the vessel was established on the basis of the aid provided for by law. The Italian authorities also affirm that, if the delivery limit is not extended (execution stood at 25,65 % at 16 December 2003) with the result that aid is not granted, the ship cannot be completed without enormous economic damage to the yard, together with job losses at both the yard and the undertakings working for it. The Italian authorities add that the shipowner Marnavi and the shipyard have agreed to cancel the contract for the construction of another ship, C.173, whose construction had been disrupted by the events referred to above, and to transfer the supplies available for that ship to ship C.180.

⁽³⁾ Between 2000 and 2004 Marnavi accounted for about 43 % of Cantieri Navali Termoli's turnover whereas, during the earlier period from 1995 to 1999, its share was close to zero.

⁽⁴⁾ The shipyard is a very small company employing 51 people.

Table 1

Overview of the delays incurred for the delivery of ship C.180

Ship	Cause of delay	Responsibility	Problems	Delay (months)	Additional months required
C.180	(i) Events of 11.9.2001: — suspension and late reactivation of order	Marnavi (shipowner)	Suspension of the contract from 1.10.2001 to 30.9.2003 Suspension revoked on 29.9.2003	24	Not specified
	(ii) Technical modifications	Marnavi (shipowner)	Modification of tanks' size and number, ship length and width	Not specified	Not specified
	(iii) Delays due to natural disasters affecting the Molise region: — Earthquake on 31.10.2002 — Floods 23 to 25.1.2003	Force majeure	Impact of natural disasters on the shipyard, its employees and its sub-contractors	> 2	> 2
	Total			More than 26 months	More than 2 months
	Extension requested				10 months

GROUND FOR INITIATING THE PROCEDURE

- (12) In deciding to initiate the procedure, the Commission thought it doubtful that any of the causes of delay invoked in this case complied with Article 3(2), second subparagraph, of the Shipbuilding Regulation and so doubted that the measure was compatible with the common market under Article 87(3)(e) of the EC Treaty.

In particular, they support their case by arguing that the Commission's appraisal was based on a report drawn up in the autumn of 2003 ⁽⁵⁾ i.e. two years after the events, whereas these events had an impact on the commercial strategies of economic operators who had to take decisions at the time the events occurred, i.e. in September 2001 or the months immediately after.

COMMENTS OF THE ITALIAN AUTHORITIES

- (13) In order to allay the doubts expressed by the Commission in the decision to initiate the procedure, the Italian authorities submitted additional explanations and data supporting their views concerning the eligibility of the grounds for extending the delivery limit and the compatibility of the measure in question.

- (i) *Concerning the impact of the events of 11 September 2001*

The Italian authorities state that the events of 11 September 2001 were exceptional factors that were unforeseen and external to the shipyard and maintain that, contrary to the Commission's view, these resulted in unexpected, substantial and defensible disruptions to the shipyard's work programme.

According to the Italian authorities, it was generally known and further confirmed by the Clarkson reports ⁽⁶⁾ that these events had an impact on the entire maritime goods transportation market, and not just on one type of vessel, i.e. cruise ships. In support of their case, they supplied new information supporting their opinion that the above events affected the building of the vessel in the form of copies of the contracts between the shipowner Marnavi and Novamar, a charter company based in Houston (US), for the chartering of two chemical tankers ordered by the shipowner from Cantieri Navali Termoli ⁽⁷⁾ and the revoking of the contracts by Novamar in the wake

⁽⁵⁾ The Italian authorities state that the Commission's reference to the Clarkson report in footnote 11 of the decision to initiate the procedure is incorrect because it refers to a report of November 2003 instead of October 2003.

⁽⁶⁾ The Clarkson Shipping Review & Outlook, autumn 2003, pp 7-44 and 127; Clarkson: 'Review of Tanker/Chemical/Small LPG Markets and Newbuilding Investment over 2001 and onwards', October 2003, pp.17-20.

⁽⁷⁾ The tankers in question are the C.173 and C.180, discussed below.

of the events of 11 September 2001. The Italian authorities thus maintain that these tragic events had a similar effect on the ship in question, and that contrary to the Commission's view, the impact of these events is not confined to cruise ships. Accordingly, they reiterate their view that the impact of the above events satisfies the provisions of Article 3(2), second subparagraph, third sentence, of the Shipbuilding Regulation.

(ii) *Need to modify the ship to meet changed market demands*

The Italian authorities supplied information concerning the changes made to ship C.180.

In particular, they explained that in 2000 the shipowner had signed contracts with the yard for two chemical tankers, C.173 and C.180, whose initial contract delivery dates were 31 March 2002 and 30 June 2003 respectively. These dates were subsequently postponed to 31 March 2003 and 31 December 2003. The Italian authorities further explained that the impact on the shipyard's work programme of the events of 11 September 2001 and of the two natural disasters described below was such that only one of these vessels could be delivered before 31 December 2003.

Thus, in November 2002 the shipowner decided to abandon construction of one of the ships at the yard so that the yard could focus its efforts on the completion of a single ship. In practice, this was done firstly by rebaptising C.173 as C.180, the larger of the vessels ordered by the shipowner; secondly by asking for substantial changes to C.180's basic structural specifications ⁽⁸⁾ · ⁽⁹⁾ · ⁽¹⁰⁾ and, finally, by revoking the contract for C.173. As a result, ship C.180 (ex C.173) is now larger and faster and has an increased capacity and a higher contract price compared with the original C.173, but its overall specifications are inferior to the original C.180 contract. However, the Italian authorities point out that these changes have contributed only indirectly to delaying the

construction of the ship and that the delay is, in fact, attributable to the impact of the natural disasters, which led to revocation of the contract by the consulting firm that had been hired to design the modifications to C.180 (ex C.173).

(iii) *Impact of natural disasters (earthquake of 31 October 2002 and floods of 23 to 25 January 2003)*

The Italian authorities underline the importance and impact of the disasters which struck the region where the shipyard is located.

Generally, they recall that, in view of the scale of the natural disasters that had occurred and the high risk to private and public welfare, a state of emergency was declared in the region until 30 June 2003 by the decree of the President of the Council of Ministers of 31 October 2002, which was subsequently extended until 1 February 2004 by the decree of the President of the Council of Ministers of 31 January 2003. The Italian authorities also draw the Commission's attention to the fact that following these events, the Commission authorised, as part of the revision of the regional aid maps, ⁽¹¹⁾ the extension of these maps in view of the impact of the natural disasters on the region of Molise and on Termoli, the area where the yard is located.

Concerning the shipyard, the Italian authorities supplied information showing that, in the wake of the above natural disasters, the yard's work programme suffered delays between November 2002 and February 2003 owing to the initial delay and subsequent cancellation of numerous contracts by several contractors supplying the yard with essential services ⁽¹²⁾ and supplies for the construction of the vessel C.180 (ex C.173) ⁽¹³⁾.

(iv) *Suspension of the work on C.180 (ex C.173) in 2004*

In July 2005, responding to the opening of the investigation, the Italian authorities informed the

⁽⁸⁾ These concern mainly the ship's size and number of tanks, and its length and width.

⁽⁹⁾ The Italian authorities say that these changes concerned both the original C.173 and C.180 (ex C.173) and had been agreed between the yard and the shipowner before suspension of the contract in 2001 following the letter from Novamar of February 2001, which indicated that both ships could be subject to changes. They further state that work on the modified C.180 (ex C.173) was already under way before being formalised in a contract addendum in December 2003.

⁽¹⁰⁾ According to the Italian authorities' interpretation of Commission Decisions 691/2003 of 9 July 2003 and 727/1993 of 21 December 1993, the type of ship and the changes in question would qualify for the 'technical complexity' exemption accepted by the Commission.

⁽¹¹⁾ Commission decision C(2004)3344 fin. cor. of 8 September 2004 concerning Case No 147/2004.

⁽¹²⁾ These subsystems of the hull, the carpentry and outfitting services for the vessel, the supply of stainless steel plate, the supply and installation of electrical fittings, and the supply of consultancy services for the modification of the vessel C.173 subsequently rebaptised C.180 to increase its capacity and power.

⁽¹³⁾ As a result of these contract cancellations, the yard was obliged to invoke the 'force majeure' clause with respect to the shipowner; this eventually prompted the latter's decision to abandon the construction of one of the two vessels it had ordered at the yard.

Commission that approximately 66 % of the construction work on the vessel had been completed but that work had been suspended by the yard and that the vessel had been launched in August 2004 pending the Commission's authorisation of the extension of the delivery limit. Accordingly, in line with the request of the shipowner and the yard, it is argued that the 10 months' extension should start from the Commission's decision to authorise the requested extension.

- (14) The Italian authorities conclude that the causes of the delays in this case comply with Article 3(2), second subparagraph, of the Shipbuilding Regulation and that the 10-month extension of the three-year delivery limit as from the date of adoption of the Commission's final decision is compatible with the common market within the meaning Article 87(3) (e) of the EC Treaty.

ASSESSMENT

- (15) According to Article 87(1) of the EC Treaty, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market. Pursuant to the established case-law of the European Court of Justice, the criterion of trade being affected is met if the recipient firm carries out an economic activity involving trade between Member States.
- (16) According to Article 87(3)(e) of the Treaty, categories of aid specified by a decision of the Council acting by a qualified majority on a proposal from the Commission may be considered compatible with the common market. The Commission notes that the Council adopted the Shipbuilding Regulation on this basis on 29 June 1998. Although the Shipbuilding Regulation expired on 31 December 2003, its provisions must still be applied in assessing requests for an extension of the delivery limit since the matter concerns aid granted under that Regulation and since the Shipbuilding Framework does not provide any guidance for such requests ⁽¹⁴⁾.
- (17) The Commission notes that the issue of the extension of the delivery limit is decisive for establishing the admissibility of the contract in question for operating aid under Article 3 of the Shipbuilding Regulation. The operating aid in question consists of financing from state resources for some of the costs that the yard in question would normally have to bear when building a vessel. Moreover, shipbuilding

is an economic activity involving trade between Member States. Therefore, the aid in question falls within the scope of Article 87(1) of the Treaty.

- (18) According to the Shipbuilding Regulation, 'shipbuilding' means the building of self-propelled seagoing commercial vessels. The vessel built by Cantieri Navali Termoli, a chemical tanker, is a self-propelled seagoing vessel providing specialised maritime services, namely the transportation of chemical and petroleum products, and thus falls within the scope of Article 1(a) of the Regulation.
- (19) Article 3(1) of the Shipbuilding Regulation provides for a ceiling of 9 % for contract-related operating aid for ships until 31 December 2000. According to Article 3(2), the aid ceiling applicable to the contract is that in force on the date on which the final contract is signed. However, this does not apply to ships delivered more than three years after the signing of the contract. In such cases, the ceiling applicable is that in force three years before the date of delivery of the ship. Therefore, the last delivery date for a vessel still to qualify for operating aid was, in principle, 31 December 2003.
- (20) The proposed aid for the vessel in question would be granted under Article 3 of Law No 88 of 16 March 2001, authorised by the Commission, as state aid No 502/00. It amounts to some EUR 3,9 million for ship C.180, which is no more than 9 % of the contract value.
- (21) Article 3(2), second subparagraph, third sentence, of the Shipbuilding Regulation stipulates that: 'the Commission may, however, grant an extension of the three-year delivery limit when this is found justified by the technical complexity of the individual shipbuilding project concerned or by delays resulting from unexpected disruptions of a substantial and defensible nature in the working programme of a yard due to exceptional circumstances, unforeseeable and external to the company.' The Commission notes that the extension is sought because Cantieri Navali Termoli could not finish the vessel referred to above on account of unexpected delays external to the company.
- (22) The Shipbuilding Regulation requires that the circumstances justifying the extension of the delivery limit be (a) exceptional, (b) unforeseeable and (c) external to the company. What must also be established is (d) causality between these events and the unforeseen disruptions which caused the delay, (e) their duration and (f) the substantial and defensible nature of these disruptions. The following

⁽¹⁴⁾ OJ C 317, 30.12.2003, p. 11.

paragraphs set out the assessment of the arguments invoked by the Italian authorities.

(i) *Impact of the events of 11 September 2001*

The Commission has here acknowledged that these events were unforeseeable and external to the shipyard. However, in line with past Commission's decisions, the impact of these events cannot be accepted in this case since, according to settled Commission decision-making practice, 'reduced economic growth, or a worsening of the market situation for a type of ship, cannot be considered an exceptional circumstance in the sense of Article 3(2) of the Shipbuilding Regulation' ⁽¹⁵⁾. This argument was admitted only for cruise vessels because of the direct effect of these events on such vessels, but not for other types of vessel, where such events are considered to have an indirect impact and a more general effect.

In fact, the Commission noted in the decision to initiate the procedure that, according to a report by Clarkson Research of November 2003, 'The 9/11 event certainly added problems in an already slowing world economy' ⁽¹⁶⁾. Furthermore, concerning investment in chemical tankers of less than 20 000 dwt such as ship C.180, the same Clarkson Research report states that 'Activity was fairly low over the period 1998 to 2000 and, despite a recovery in early 2001, levels did fall back in the final quarter of 2001 in line with the rest of the industry. However, the level of contracting picked up significantly in early 2002 and has been fairly strong since.'

As regards the argument of the Italian authorities which questions the relevance of the Commission's appraisal of the impact of such events on the basis of an *ex post* report, the Commission notes above all that it relied on a report submitted by the Italian authorities themselves. Secondly, it emphasises that in this procedure the Italian authorities themselves rely on reports dating from late 2003. Finally, the Commission notes that none of the additional reports to which the Italian authorities refer contradict the Commission's assessment of this point.

The Commission notes that its assessment of this argument is in line with other decisions in similar cases notified by Italy concerning extensions of the three-year delivery limit for chemical tankers and LPG tankers.

(ii) *Need to modify the ship to meet changed market demands*

As to the second argument, it is initially noted that the technical modifications were made at the shipowner's request in order to meet changed market demands. Also, as stated in the addendum of 10 December 2003 to the original shipbuilding contract, the shipyard intended to ask the shipowner for a postponement of the delivery date for ship C.180, shouldering all the costs and risks in relation to the awarding/granting of state aid for the latter.

The Commission observes that a shipowner may always demand changes to the shipbuilding contract and that such changes are not uncommon in the shipbuilding sector. Such events are part of the normal commercial activity of the yard. This argument cannot, therefore, be accepted in this instance.

For the sake of completeness, the Commission also notes that during this investigation the Italian authorities explained that the changes in question (concerning both ships C.173 and C.180) had already been flagged by the US charter company Novamar in its letter to the shipowner of February 2001 and were agreed between the yard and the shipowner before the contract's suspension in 2001. It further notes that, as explained by the Italian authorities, ship C.173, according to its original specification, should have been built long before by another shipyard that got into difficulties in the 1990s; and so this ship belonged to an older generation of ships now superseded by a new generation of larger vessels with enhanced capacity.

In light of the above, it is evident that the modifications were neither exceptional nor unforeseeable events. Accordingly, the Commission considers that the argument invoked by Italy here is not admissible.

(iii) *Impact of the natural disasters which hit the Molise region, where the yard is located*

It is acknowledged that earthquakes, floods and other acts of 'force majeure' normally constitute admissible grounds. Similarly, it is acknowledged that such events have had an impact on activity in the Molise region, as confirmed by the declaration of the state of emergency by decree of the President of the Council of Ministers, and potentially on the yard's overall activity.

⁽¹⁵⁾ See Case No 99/02 (OJ C 262, 29/10/2002), Odense shipyard — Prolongation of three-year delivery limits for two ships (Denmark).

⁽¹⁶⁾ 'Review of Tanker/Chemical/Small LPG Markets & Newbuilding Investment over 2001 and onwards', Clarkson Research, November 2003, pp. 19 and 20.

Nonetheless, under the Shipbuilding Regulation, an extension of the three-year delivery limit derogates from the normal provisions authorizing the granting of contract-related operating aid, which in turn constitute an exemption from Community state aid rules. Accordingly, the principle that rules governing exemptions are to be interpreted narrowly means that a direct causal link must be established between the circumstances allegedly causing the delay and the delay in the construction of the vessel. However, the information made available to the Commission, including the information submitted by the Italian authorities after the opening of the formal investigation, is rather vague, referring in only general terms to the disruptive effects of the disasters; it fails to demonstrate or quantify the exact impact of those events on the yard's work programme or on the construction of the vessel in question.

The Commission notes that, despite its explicit requests for information and the lengthy extensions of the reply deadlines, no detailed information has been supplied concerning the disruptions caused by these disasters on the shipyard's overall work programme and the precise causal effect on the specific work programme for ship C.180 (ex C.173). The Italian authorities have submitted copies of the letters by which suppliers of components and services to the yard revoked their contracts with the yard. However, they have failed to document in detail the causal link and have not quantified with precision the consequent delay in the yard's work programme and in the construction of ship C.180 (ex C.173) in order to justify the request to extend the delivery limit by 10 months.

launched in August 2004; therefore, in their opinion, the 10-month extension should now start from the Commission's decision to authorise the requested extension.

First, the Italian authorities' request that the 10-month extension start from the date of the Commission decision cannot be regarded as being in conformity with the Shipbuilding Regulation as it would lead to further unjustified delays. The decision to suspend construction of the vessel was made by the yard under its own responsibility and it generated an additional delay that finds no justification in the Shipbuilding Regulation.

Second, the Commission notes that, according to the notification, ship C.180 (ex C.173) should have been delivered by 31 October 2004. However, considering the Italian authorities' request that the 10-month extension should start from the Commission's decision to authorise the requested extension, taken in conjunction with the fact the yard launched the unfinished ship C.180 (ex C.173) in August 2004, it is clear that the yard would not have been able to deliver the vessel even within the original 10-month extension requested to the delivery limit.

Accordingly Italy's request must, in any event, be rejected because of the unwarranted suspension of work in 2004.

CONCLUSIONS

- (23) Consequently, the Commission considers that the exceptional circumstances described above have not had an impact on the specific programme of work on the ship in question that would justify the requested 10-month extension to the delivery limit. Therefore, the arguments set out in (i) to (iii) cannot be accepted.
- (24) Given the lack of substantial evidence, the extension cannot be authorised on these grounds.

- (25) In the light of the above, the Commission finds that the measure under examination constitutes state aid within the meaning of Article 87(1) of the Treaty. The information submitted by the Italian authorities, including that provided during the formal investigation, has confirmed the Commission's doubts as to whether the causes of delays invoked in this case satisfied Article 3(2), second subparagraph, of the Shipbuilding Regulation, and so the measure under examination is not compatible with the common market under Article 87(3)(e) of the Treaty.

In view of these conclusions, the Commission

(iv) *Suspension of work on C.180 (ex C.173) in 2004*

HAS ADOPTED THIS DECISION:

Article 1

In addition, the Commission observes that the Italian authorities informed it that construction of vessel C.180 (ex C.173) was approximately 66 %-complete, but that the work had been suspended and the vessel

The three-year delivery limit laid down in Article 3(2) of Regulation (EC) No 1540/98 may not be extended for ship C.180 (ex C.173) built by Cantieri Navali Termoli SpA.

The contract-related operating aid for that ship may not, therefore, be implemented.

Article 3

This Decision is addressed to the Italian Republic.

Article 2

Done at Brussels, 4 July 2006.

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

For the Commission

Nelly KROES

Member of the Commission

COMMISSION DECISION

of 19 July 2006

concerning a measure taken by the Netherlands with regard to VAOP

(notified under document number C(2006) 3224)

(Only the Dutch text is authentic)

(Text with EEA relevance)

(2006/949/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

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

Whereas:

1. PROCEDURE

(1) By letter dated 12 June 2002, recorded as incoming mail on 17 June 2002, the Commission received a complaint against four allegedly irregular aid measures benefiting the Association of Suppliers of Waste Paper (*Vereniging van Aanbieders van Oud Papier* — 'VAOP'), namely partial exemption from corporation tax and from value added tax, the provision of a loan by Bank Nederlandse Gemeenten ('BNG'), and the provision of a subordinated loan by a number of municipalities (*gemeenten*). By letters dated 30 July 2002 and 6 December 2002, the Commission requested information from the Dutch authorities, which replied respectively by letters of 10 October 2002 and 10 February 2003. A meeting between the complainant and Commission staff took place on 29 April 2003. By letter dated 5 May 2003, the complainant informed the Commission that it intended to collect more information on the case from the Dutch authorities and that, on that basis, it would then focus its complaint on certain measures.

(2) By letter dated 13 September 2004, the complainant submitted additional information and announced its intention to limit its complaint to the loan provided by BNG to VAOP. On the basis of this new submission, the Commission requested additional information from the Dutch authorities, by letter of 21 October 2004; they replied by letter dated 17 December 2004. By letter dated 3 May 2005, the Commission informed the Netherlands that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the loan granted

by BNG and the loan granted by the participating municipalities.

- (3) The Dutch authorities requested two extensions of the time allowed for a reply to the decision initiating the procedure, and ultimately replied by letter dated 29 August 2005. By letter dated 9 November 2005, the Commission requested additional information, which was submitted by letter of 8 December 2005. By email message of 4 May 2006, the Commission made an additional request for information, which was answered by letter of 2 June 2006 and by letter of 19 June 2006
- (4) The Commission's decision to initiate the formal investigation procedure was published in the *Official Journal* on 30 September 2005 ⁽²⁾. The complainant sent observations on this decision by letter dated 28 October 2005, and requested the Commission to attach the complainant's letters of 12 June 2002 and 13 September 2004 and the record of the discussions of 29 April 2003 to that submission and to consider them an integral part of the submission. A non-confidential version of the two letters was sent to the Netherlands by letter of 24 November 2005, and the Netherlands replied by letter of 16 December 2005.
- (5) By letter of 28 October 2005, the Commission received comments on the decision initiating the procedure from the alleged recipient, VAOP, which also requested a meeting. A meeting was held on 31 January 2006. By letter dated 27 March 2006, VAOP submitted further information to supplement the observations it had put forward at the meeting.

2. DESCRIPTION

2.1. The recipient

- (6) VAOP was set up in the beginning of the 1990s by a number of Dutch municipalities. It is a not-for-profit cooperative association with limited liability, which seeks to offer certain services to its members on terms as favourable as possible. More specifically, its object is to organise the optimal collection, initial treatment (sorting/pressing) and sale of waste paper from the municipalities which are its members. Its activities have subsequently been expanded to include waste glass and other recyclable waste.

⁽¹⁾ OJ C 240, 30.9.2005, p. 36.

⁽²⁾ See footnote 1.

- (7) VAOP is not a fully vertically integrated undertaking. It merely organises the tasks concerned for its members: most of the operational work, such as the transport of the waste, it subcontracts to other enterprises. This explains why it had only 20 employees in 2002 for a turnover of EUR 27,5 million. VAOP charges the local authorities for the cost of collection and initial treatment of the recyclable waste from their territory, and transfers to them the revenues generated by the sale of recyclable waste to producers of recycled material (e.g. recycled paper).
- (8) The Dutch tax authorities do not consider VAOP to be a branch of public administration.
- (9) The first entity that was set up was the cooperative association with limited liability *Coöperative Vereniging VAOP BV*. Over the course of the years, this parent body set up several subsidiaries to harbour the operational part of its activities. These subsidiaries are in the form of private limited companies. The Commission will consider all these companies as a group constituting one single economic entity ('VAOP'), because the parent holds majority stakes in all the subsidiaries. The subsidiaries are included in the consolidated accounts of the parent. In addition, BNG, which is VAOP's principal creditor, has concluded only a single loan contract with the group, and not one with each separate company, even though that contract lays down credit limits for some individual subsidiaries. Finally, the contract provides for cross-guarantees between the different companies of the group: each company is liable vis-à-vis BNG for the debts of any of the others.

2.2. The market

- (10) In the 1990s VAOP's activities grew strongly. Its share of the Dutch market for waste paper collection reached between 25 and 30 % by the beginning of the present decade. It is also an important player on the market for waste paper initial treatment (sorting/pressing). It entered the Dutch market for waste glass collection, where it became one of the market leaders. Some of the companies active on these markets are subsidiaries of foreign companies.
- (11) Dutch law requires local authorities to collect waste paper separately and to offer it on the market for recycling, but the way in which these operations have to be performed is not defined. Most Dutch municipalities put the work out to tender. VAOP has tendered for such work, thus competing directly with private-sector companies offering the same services⁽³⁾. VAOP also tries to attract new members by approaching municipalities and suggesting that they should

join. Here too VAOP can be considered to be in competition with private sector companies⁽⁴⁾ seeking to attract the same customers.

2.3. The two measures

- (12) Firstly, in March 1998, BNG granted VAOP a credit facility of NLG 16,3 million (EUR 7,4 million, 'the first measure'). On 31 December 1997, VAOP's consolidated balance sheet indicated that its equity amounted to NLG 0,8 million (EUR 0,4 million) and its balance sheet total amounted to NLG 17,3 million (EUR 7,9 million). One year later, after the provision of the loan, the equity was NLG 0,09 million (EUR 0,04 million) and the balance sheet total was NLG 29,1 million (EUR 13,2 million).
- (13) Secondly, in the course of 2001, the local authorities agreed to convert debts that VAOP owed them for the supply of waste paper into a loan of NLG 3 million (EUR 1,3 million, 'the second measure'). VAOP had undergone heavy losses at the end of 2000, following the insolvency of one of its subsidiaries. On 31 December 2000, the consolidated accounts of VAOP showed negative equity of NLG 3,4 million (EUR 1,5 million). At the same date, the balance sheet total was NLG 32,1 million (EUR 14,5 million). VAOP's main creditor, BNG, had obtained liens (*pand rechten*) on nearly all the assets, so that this unsecured loan could be considered subordinate to BNG's claims. It was therefore referred to as 'the subordinated loan' (*achtergestelde lening*).

3. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

- (14) As regards the first measure, the Commission initiated the formal investigation procedure because it doubted whether a normal market economy investor would have acted in the same way. At the material time VAOP had nearly no equity. In addition, the size of the new loan seemed very high in comparison with the borrower's balance sheet total. In short, the risk involved seemed too big for a normal market economy investor.
- (15) Regarding the second measure, the Commission doubted whether a normal market economy creditor would have agreed to convert its claim into a subordinated loan of this kind. The loan seemed to present a high degree of risk, as the borrower's financial situation was bad and all its assets appeared to be subject to a lien in favour of BNG. Finally, the Commission wondered whether a market economy creditor would not have requested a higher interest rate.

⁽³⁾ VAOP has tendered successfully only once. In recent years, VAOP has decided not to participate in such tenders any more.

⁽⁴⁾ Private sector companies may be vertically integrated to a greater degree than VAOP, but that does not mean they are not in competition with it.

- (16) In conclusion, the Commission suspected that the two measures might constitute state aid to VAOP falling under the prohibition laid down in Article 87(1) of the EC Treaty.

the municipalities a claim against it, and that was what the management of VAOP had decided to do.

4. COMMENTS FROM INTERESTED PARTIES

- (17) The Commission has received the following comments from the complainant. Regarding the first measure, the complainant asserts that the general policy and practice of BNG is to offer financial products to public bodies and associated institutions on terms that are not in line with the market. The complainant analyses the size of VAOP's equity, and concludes that at the time its balance sheet structure was far from healthy. There was a significant lack of equity. The complainant also points to the scale of debt. In these circumstances, the BNG financing allowed VAOP to expand its business despite its lack of equity and at low cost. The complainant reckons that a high-risk loan of that kind would not have been provided by a private bank, and constitutes state aid within the meaning of Article 87(1) of the EC Treaty.
- (18) The complainant also argues that given that VAOP's financial situation did not improve over the years, BNG should have not continued to finance it.
- (19) Turning to the second measure, the complainant argues that this subordinated loan carried a very high degree of risk, given the scale of the debts owed by VAOP that would have to be reimbursed first in the event of insolvency. The margin on the loan was not sufficient to compensate for that risk. This loan therefore constitutes state aid too.
- (20) The Commission has received the following comments from the alleged recipient, VAOP. VAOP claims that the first measure was a purely commercial transaction, in accordance with the market investor principle. VAOP says that at the time it was also in contact with several private banks, which were proposing to provide financing on terms closer to those offered by BNG. VAOP has provided a copy of a signed offer of financing made by [a private bank] (*) on 7 January 1998.
- (21) Regarding the second measure, VAOP asserts that it was not obliged to enter into the loan arrangement with the municipalities. On the basis of its constitution (*statuten*) and its supply contracts with the municipalities, VAOP cannot be required to pay its paper suppliers more than its liquidity position allows. In addition, VAOP is entitled to impose obligations on its members in the form of a 'yearly contribution', which may be used to cover operating charges or may be regarded as risk-bearing capital. VAOP's contract with the municipalities also allowed VAOP to give

5. COMMENTS FROM THE NETHERLANDS

- (22) Regarding the first measure, the Netherlands argues that the granting of the credit facility by BNG was not a matter for the State. BNG is a public limited company. The Dutch authorities acknowledge that BNG's shares are owned entirely by the State, the provinces and the municipalities. They also acknowledge that some members of the supervisory board are appointed by these authorities, but they argue that the supervisory board is not involved in the bank's day to day business, which is the responsibility of the management. There is no provision in the constitution of the bank requiring the management to comply with the directions of the supervisory board when offering financial products. There was no provision requiring that the supervisory board be consulted or that it give its authorisation for the loan concerned, which was the responsibility exclusively of the management. Finally, the Dutch authorities assert that there is nothing else to suggest that this transaction was attributable to the State.
- (23) Even if the loan was imputable to the State, the Netherlands submits that its terms would be acceptable to a market economy investor. A higher level of equity would indeed have been desirable, but the risk of loss to BNG was limited, thanks to several forms of security, notably a first-rank lien on VAOP's receivables, which had to amount to 100 % of the loan. The loan was granted at a time when the firm was not in difficulty and its prospects were good. The very serious deterioration in its financial situation could not have been foreseen.
- (24) With regard to the second measure, the Netherlands recalls that VAOP is a not for profit body that transfers to its members the net revenues generated from the sale of the recyclable waste collected on their territory. In the beginning of 2001, VAOP was in a difficult financial situation as a result of the insolvency of a subsidiary engaged in the recycling of glass; it decided not to pay to the participating municipalities a small part of the revenues generated by the sale of the waste in 2000 ⁽²⁾, and to convert it instead into a five-year subordinated loan. BNG was threatening that without additional resources such as this subordinated loan it would not continue to finance VAOP, which would then have been insolvent itself. The Netherlands asserts, first, that on the basis of its constitution and its contracts with the participating municipalities VAOP was not obliged to pay this NLG 3 million (EUR 1,3 million) to the municipalities, because the amount exceeded the resources it had available. VAOP

(*) covered by the obligation of professional secrecy.

⁽²⁾ In the year 2000, VAOP paid the local authorities a total of NLG 40,7 million (EUR 18,5 million).

nevertheless decided to give the municipalities a corresponding claim against it in the form of an interest-bearing loan. Second, from the point of view of the local authorities this conversion of part of their claims into a loan represented a more favourable option than insolvency. At that time they had claims against VAOP amounting to NLG 5,7 million (EUR 2,59 million) which were not secured. The Dutch authorities have calculated that, in the event of insolvency, the municipalities would have recovered around NLG 1,2 million (EUR 0,5 million), resulting in a net loss of NLG 4,5 million (EUR 2,05 million). The municipalities acted as market economy creditors would have done by accepting the conversion of NLG 3 million (EUR 1,3 million) of their claims against VAOP into a loan, which enabled VAOP to continue in business in the knowledge that BNG would continue to finance it.

6. ASSESSMENT

6.1. Existence of aid

The first measure

- (25) Article 87(1) of the EC Treaty indicates that 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.'
- (26) The Court of Justice has held that 'It should also be noted that, pursuant to the principle that the public and private sectors are to be treated equally, capital placed directly or indirectly at the disposal of an undertaking by the State in circumstances which correspond to normal market conditions cannot be regarded as State aid ... Therefore, in accordance with equally settled case-law, it is necessary to determine whether, in similar circumstances, a private investor of a dimension comparable to that of the bodies managing the public sector could have been prevailed upon to make capital contributions of the same size ... having regard in particular to the information available and foreseeable developments at the date of those contributions' ⁽⁶⁾.
- (27) In order to determine whether the grant of the credit facility by BNG constituted aid, the Commission has therefore to verify whether the transaction respects the market economy investor principle as expounded by the Court in the judgment referred to.
- (28) At the request of the Commission, in addition to a copy of the loan agreement of March 1998 itself, the Dutch authorities have provided a copy of the internal documents of BNG relating to each step of the decision-making process that led to the provision of this financing to VAOP: the proposal by the account managers, dated 21 January 1998, the opinion of the credit analyst, dated 22 January 1998, and the positive decision by the credit committee, dated 26 January 1998. These papers show that BNG identified and analysed the risks associated with the loan, including the very limited equity. On the basis of this analysis, BNG gave VAOP a low rating ('C-'). To offset the risks identified, BNG decided to impose strict conditions and to require substantial security. Among other things, BNG insisted that all the parties (VAOP and its subsidiaries) should be jointly and severally liable for all the liabilities of the other members of the group. It also demanded a first rank lien on various commercial claims held by VAOP. VAOP was to provide BNG with a monthly list of liens on commercial claims, the value of which had to amount to at least 100 % of the sum lent by the bank. The credit committee decided that the loan could be granted provided that the loan agreement comprised these various conditions and forms of security for BNG. The new loan agreement also included an existing NLG 5 million (EUR 2,2 million) financing. It increased BNG's potential claim on VAOP from the existing maximum of NLG 5 million (EUR 2,2 million) to NLG 16,3 (EUR 7,4 million). The net increase was therefore NLG 11,3 million (EUR 5,1 million).
- (29) These documents show that BNG conducted the lending operation in accordance with its normal procedures, and asked for substantial security for the loan.
- (30) The Commission also notes that in January 1998 [...] (*) proposed to grant VAOP a loan. This would have come on top of the existing NLG 5 million facility provided by BNG. The size of the loan offered by [...], at NLG 7,3 million (EUR 3,3 million), was not as large as the additional financing ultimately offered by BNG, which amounted to NLG 11,3 million (EUR 5,1 million), but did correspond to a large part of it. The interest rate margins which [...] planned to charge in this firm proposal, at 125bps and 150bps, are below those that applied for lending to a company in difficulty or for equity provision. This shows that contrary to the doubts expressed by the Commission when it decided to launch the formal investigation procedure a private bank might have agreed to grant a large loan to VAOP despite its very limited equity ⁽⁷⁾.
- (31) The Commission has compared the interest rate on BNG's loan with the rate proposed by [...] ⁽⁸⁾. BNG's interest rate is slightly smaller. However, the Commission notes, first of

(*) Business secret

⁽⁷⁾ As already indicated, this can be explained among other things by the securities available to the potential lender and by the fact that at that time the firm was considered to be an expanding enterprise with a stable and cost covering core business.

⁽⁸⁾ Both credit facilities comprise loans of different kinds. The Commission has compared those with similar maturities and conditions.

⁽⁶⁾ Joined Cases C-328/99 and C-399/00 *Italy and SIM 2 Multimedia v Commission* [2003] ECR I-4035, paragraphs 37 and 38.

all, that BNG had (and still has) very low operating costs, much lower than [...]’s⁽⁹⁾. Second, the loan agreement between BNG and VAOP included various commissions to be charged in the event that VAOP actually called upon certain loan facilities. The offer made by [...] explicitly excluded the payment of such charges. Finally, it is likely that the existence of [...]’s offer encouraged BNG to make the very best offer it could (within the limits of its lending guidelines and subject to substantial security), in order not to lose the business of an existing client with what appeared at the time to be real prospects of expansion. On the basis of the foregoing, the Commission concludes that even though BNG provided financing at an interest rate lower than the one proposed by a private bank, BNG, when it granted the loan in 1998, was acting as a market economy investor. The loan consequently does not constitute state aid within the meaning of Article 87(1) of the EC Treaty.

(32) The complainant also asserts that a market economy creditor would not have continued to finance VAOP given the poor financial situation of the enterprise in the succeeding years. The Commission has therefore analysed how BNG has dealt with the deterioration of VAOP’s financial situation.

(33) In 1999, when the financial situation of VAOP Glas BV and REVA deteriorated, BNG negotiated a new agreement, which was signed on 9 July 1999. First, the security was expanded to include liens on inventories, plant and other assets. Second, it was agreed that there would be a strict screening of the monthly list of claims subject to a lien. Third, no long-term loans would any longer be granted for investments in fixed assets. Any such loans would have to take the form of short-term financing instruments known as ‘cash drawings’ (*kasgeldtrekkingen*). Fourth, the price of the credit facility was increased.

(34) In October 2000 REVA became insolvent, and a new agreement was negotiated and signed on 19 January 2001. The credit facility was reduced to NLG 13,2 million (EUR 6 million) (the effective lending to VAOP at that point was NLG 15,2 million (EUR 6,9 million)); the credit facility was to be reduced further in accordance with a timetable laid down. A penalty premium of 3 % would be applied to the amount exceeding that credit limit. At the same time, the security was expanded further. On the basis of the liquidation value of VAOP’s assets BNG calculated that it stood to lose almost NLG 5,8 million (EUR 2,6 million) out of its total claim of NLG 15,2 million (EUR 6,9 million). In September 2002, a new contract was signed, modifying the previous timetable for the reduction of the size of the credit facility.

⁽⁹⁾ In the banking sector, the level of operating costs is often measured by the *efficiency ratio*, which is defined as operating expenses divided by total revenue. In 1997, [...]’s Netherlands division had an efficiency ratio of 64,8 %. In 1998 and 1999, it was respectively 65,2 % and 62,9 % (source: [...]). BNG’s efficiency ratio is one third of that level, indicating a very low cost base. This is explained in part by the fact that it does not have a large network of offices.

(35) From this account it will be clear that BNG could not simply stop financing VAOP or ask for the immediate reimbursement of the amount lent. This would have rendered VAOP insolvent, causing considerable loss to BNG. BNG sought to measure the potential loss against VAOP’s chances of recovery. Given the stability of VAOP’s core business (waste paper) and its ability to generate cash flow, BNG decided not to push VAOP into insolvency, and to go on financing it. The Commission has not found any manifest error in this assessment or the decision it led to. Nor has the complainant brought forward any convincing argument showing why this decision would have not been acceptable to a private bank.

(36) In conclusion, the Commission considers that BNG’s conduct in this case is in accordance with the market economy creditor principle, and consequently does not constitute state aid to VAOP.

(37) On the question whether BNG’s lending can be attributed to the State the Commission will not take a position, because in the light of the foregoing even if the lending could be attributed to the State it would not constitute state aid. Moreover, the Commission cannot and will not take a position on the question whether all lending by BNG in other cases conforms to the market economy investor principle.

The second measure

(38) At the beginning of 2001, VAOP was unable to pay the participating municipalities the NLG 3 million (EUR 1,3 million) it owed them for the supply of waste paper. It did not have sufficient liquidity available. As a condition for further financing of VAOP, BNG was demanding that there be positive resources available for guarantee purposes, defined as capital and reserves, provisions plus long-term subordinated loans. Paying the money to the municipalities would have pushed VAOP into insolvency. The Commission observes that the difficult financial situation was caused mainly by a one-off event, namely the insolvency of REVA in 2000. VAOP had invested in that company because it was active in the treatment of waste glass.

(39) The Commission would point out that the municipalities’ net claims on VAOP amounted to NLG 5,7 million (EUR 2,6 million)⁽¹⁰⁾. These claims were unsecured, because another major creditor, BNG, had a first-rank lien on important assets. If VAOP had become insolvent and its assets had been liquidated, the local authorities would have been unable to recover a large part of their claims. The

⁽¹⁰⁾ Financial situation at the end of 2000.

Commission has reviewed the calculation submitted by the Dutch authorities: from the creditors' point of view, it was on the optimistic side ⁽¹¹⁾. The Commission takes the view, therefore, that in the event of an insolvency the municipalities could have expected to recover no more than NLG 1,2 million (EUR 0,5 million) out of their claims of NLG 5,7 million (EUR 2,6 million). In addition, the money would have been recovered only after the substantial delay inherent in a liquidation. Instead of taking this loss of NLG 4,5 million (EUR 2 million), the members preferred to convert NLG 3 million (EUR 1,3 million) into an interest-bearing loan and to recover the balance. This second option was a more favourable solution. When it initiated the procedure, the Commission also doubted whether a market economy investor who did accept such a conversion would not have demanded a higher interest rate. These doubts have been allayed: the municipalities' bargaining position vis-à-vis BNG was not in fact such that they could have demanded a higher interest rate. In the longer term higher interest rate charges would have reduced VAOP's ability to repay its loan to BNG. BNG was in a position to resist such a demand on the part of the municipalities, by threatening to trigger the insolvency of VAOP, which, as indicated, would have been a less favourable outcome for the municipalities. Indeed even if the municipalities had had the bargaining power necessary, it would not have been in their interest to increase the interest rate, because that would simply have increased the VAOP's financial burdens over the next five years. As the members pay VAOP for the costs of the services they receive, the higher interest rates they would have obtained would have been offset by higher payments to VAOP during that period.

- (40) It can be concluded that for purposes of Article 87(1) of the EC Treaty the conversion of the debt into a subordinated loan does not constitute state aid granted by the local authorities to VAOP.

7. CONCLUSION

- (41) On the basis of the foregoing, the Commission concludes that neither of the measures constitutes aid,

HAS ADOPTED THIS DECISION:

Article 1

The measures taken by the Netherlands and Bank Nederlandse Gemeenten with regard to the Association of Suppliers of Waste Paper (Vereniging van Aanbieders van Oud Papier), for amounts respectively of NLG 3 million (EUR 1,3 million) and NLG 16,3 million (EUR 7,4 million), do not constitute aid within the meaning of Article 87(1) of the Treaty.

Article 2

This Decision is addressed to the Kingdom of the Netherlands.

Done at Brussels, 19 July 2006.

For the Commission

Neelie KROES

Member of the Commission

⁽¹¹⁾ The calculation submitted by the Dutch authorities is optimistic from the municipalities' point of view among other things because it does not deduct the costs of settling the insolvency. It has already been seen that BNG, which as a financial institution has greater expertise in such calculations, is more prudent regarding the capacity of the liquidated assets to cover the creditors' claims.

COMMISSION DECISION**of 26 September 2006****on aid measure No C 49/2005 (ex N 233/2005) for Chemobudowa Kraków S.A.***(notified under document number C(2006) 4214)***(Only the Polish version is authentic)****(Text with EEA relevance)***(2006/950/EC)*

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

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

Whereas:

I. PROCEDURE

- (1) The planned aid to Chemobudowa Kraków S.A. ('Chemobudowa Kraków' or 'the recipient'), a State-owned building company, was notified to the Commission by letter dated 29 April 2005, registered on 2 May 2005. On 20 June 2005, the Commission asked Poland to submit certain missing documents. These were provided by letter dated 9 August 2005 registered on 11 August 2005. The Commission requested further information by letter dated 15 September 2005, to which Poland replied by letter dated 26 October and registered on 27 October 2005.
- (2) On 21 December 2005, the Commission decided to initiate the Article 88(2) procedure in respect of two notified measures and two non-notified measures granted after Poland's accession to the EU because of doubts as to their compatibility with the common market. The Commission decision to initiate the procedure was published in the Official Journal of the European Communities on 28 June 2006 ⁽²⁾. The Commission called on interested parties to submit their comments on the aid measures. No comments were submitted.
- (3) By letter dated 25 January 2006, registered on the following day, Poland informed the Commission that it had withdrawn the notification. By letter dated 7 February 2005 the Commission called on Poland to comment on the two state aid measures granted after accession without prior

notification to the Commission. By letter of 7 March 2006, registered on 9 March 2006, Poland submitted its comments on these two measures and asked for the rectification of some incorrect data in the decision to initiate the Article 88(2) procedure. By letter dated 12 September 2006, registered on the following day, the Polish authorities provided further clarifications on the two aforementioned aid measures.

II. DETAILED DESCRIPTION**1. The aid recipient**

- (4) ChK is a large company created in 1949, which in 2004 employed 919 workers, 343 of whom in branches of the company located abroad (in the Czech Republic and Germany).
- (5) ChK is the parent company of Towarzystwo Budownictwa Społecznego Krak-System S.A. ('TBS'), in which it owns 78 % of shares. Its activity consists in building apartment blocks and renting them out. According to the Polish authorities its turnover is insignificant.
- (6) The recipient has a market share of 0,13 % of the Polish building market. It has branches in Germany and the Czech Republic and 42 % of its turnover comes from those two branches.

2. The aid measures

- (7) The Polish authorities have given notice that they intend to grant two measures for the restructuring of Chemobudowa Kraków. First, the recipient was supposed to receive a loan of about PLN 10 million (EUR 2,57 million). The loan was to be secured by a mortgage on real estate evaluated at PLN 17,35 million (about EUR 4,46 million). Second, Chemobudowa Kraków was to benefit from deferral of payments to the 'State Fund for Rehabilitation of Disabled Persons' ('PFRON') and these payments were to be made in instalments. The deferred amount was to be equal to PLN 693 000 (about EUR 178 000).

⁽¹⁾ OJ C 150, 28.6.2006, p. 51.

⁽²⁾ See footnote 1.

(8) In addition to the above notified measures, the Polish authorities have informed the Commission of 18 measures in favour of Chemobudowa Kraków granted between December 2001 and May 2004. According to the Polish authorities, the nominal value of these measures is PLN 8,511 million (EUR 2,19 million). Poland has requested that these measures not be treated as state aid, claiming that some of them are *de minimis* aid and that the others pass the private creditor test. The Commission concluded that two of these eighteen measures had been granted after accession without the Commission's approval and therefore had to be treated as potential new unlawful aid.

(9) The first measure granted after Poland's accession, i.e. on 12 May 2004, is an agreement for payment of debts of PLN 3,164 million (EUR 0,81 million) to the Social Insurance Fund (hereinafter 'ZUS') to be made in instalments. According to the Polish authorities, the amount of the aid is PLN 147 322 (EUR 37 874). Even before the decision to initiate the Article 88(2) procedure, the Polish authorities informed the Commission that the arrangement had been annulled because Chemobudowa Kraków did not meet the relevant conditions. The Commission had doubts as to whether the above-mentioned debts had been honoured by the recipient and whether failure to enforce the debts might not constitute additional state aid.

(10) The second measure granted after accession on 20 May 2004 was granted by the Head of Małopolska Treasury Office and consisted of an agreement for debts of PLN 280 000 (EUR 71 979) to be paid in instalments.

3. Grounds for initiating the procedure

(11) The Commission wished to clarify whether the eighteen measures referred to above constituted state aid as, in order to assess the compatibility of measures granted after accession, it had to take into account all aid measures granted in the context of restructuring, especially with a view to determining whether aid was limited to the necessary minimum. Moreover, two of the eighteen measures were granted after accession. The Commission has analysed this aid in the light of the 2004 Guidelines on rescue and restructuring aid for firms in difficulty.

(12) The Commission decided to initiate the Article 88(2) procedure because it doubted whether all the conditions for approving restructuring aid had been met, and in particular whether:

- the restructuring plan would restore the recipient's long-term viability, given that its main focus was financial restructuring;
- the recipient's contribution to restructuring costs was significant, as the Commission lacked sufficient information on its source;

- the company was eligible for restructuring aid as the recipient had managed to generate operating profits of PLN 5,4 million (EUR 1,388 million) in 2004.

III. COMMENTS FROM THE POLISH AUTHORITIES

(13) In their letter of 25 January 2006 the Polish authorities informed the Commission that they had withdrawn the notification of the measures referred to in paragraph 7 above.

(14) With regard to the two measures granted after accession without prior notification to the Commission, Poland stated the following:

(15) With regard to the first measure granted after accession, i.e. on 12 May 2004, described in paragraph 9 above, Poland indicated that the agreement had been annulled because Chemobudowa Kraków did not meet the relevant conditions. In addition, the company had paid off all its debts with interest.

(16) With regard to the second measure granted after accession, i.e. on 20 May 2004, described in paragraph 10 above, Poland stated that the measure passed the private creditor test and added that if the Commission did not agree with that assessment, the measure constituted *de minimis* aid. The Polish authorities indicated that most of the aid received by the recipient during the corresponding three-year period, including the aid measure referred to in paragraph 10, was below the EUR 100 000 threshold and as such constituted *de minimis* aid.

IV. ASSESSMENT OF THE MEASURES

(17) Poland withdrew notification of the two state aid measures referred to in paragraph 7 above. However, in order to terminate the Article 88(2) procedure, the Commission needs to assess the two non-notified measures described in paragraphs 9 and 10.

(18) With regard to the measure described in paragraph 9, Poland has confirmed that no state aid has been granted by ZUS since accession. The Commission takes the view that as this measure was annulled and never came into force and as all debts vis-à-vis ZUS were reimbursed with interest, the measure does not constitute state aid.

(19) Regarding the measure described in paragraph 10 above, on the basis of the information available, the Commission concludes that the measure does not constitute state aid within the meaning of Article 87(1) of the EC Treaty, since the Polish authorities have confirmed that the *de minimis* aid threshold was not exceeded.

V. **CONCLUSION**

- (20) The Commission notes that according to Article 8 of Council Regulation (EC) No 659/1999 ⁽³⁾, the Member State concerned may withdraw the notification in due time before the Commission has taken a decision on the aid. In cases where the Commission has initiated the formal investigation procedure, the Commission shall close that procedure.
- (21) Consequently, the Commission has decided to close the formal investigation procedure under Article 88(2) of the EC Treaty in respect of the notified aid measures, recording that Poland has withdrawn the notification.
- (22) With regard to the two non-notified measures, the Commission finds that they do not constitute state aid,

HAS ADOPTED THIS DECISION:

Article 1

The measures which Poland was planning to implement for Chemobudowa Kraków, amounting to PLN 10 693 000,

were withdrawn after the Commission opened the formal investigation procedure. The formal investigation procedure therefore no longer applies to these measures.

Article 2

The measure granted on 12 May 2004 was later annulled by the granting authority. The formal investigation procedure therefore no longer applies to this measure. Regarding the measure granted on 20 May 2004, the Commission concludes that it does not constitute state aid within the meaning of Article 87(1) of the EC Treaty.

Article 3

This Decision is addressed to Poland.

Done at Brussels, 26 September 2006.

For the Commission

Neelie KROES

Member of the Commission

⁽³⁾ OJ L 83, 27.3.1999, p. 1. Regulation as amended by the 2003 Act of Accession.

COMMISSION DECISION

of 12 October 2006

the United Kingdom's application of the tax on non-domestic property to telecommunications infrastructure in the United Kingdom (No C 4/2005 (ex NN 57/2004, ex CP 26/2004))*(notified under document number C(2006) 4378)***(Only the English text is authentic)****(Text with EEA relevance)**

(2006/951/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

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

Whereas:

I. PROCEDURE

(1) On 17 February 2004, the Commission registered a complaint from Vtesse Networks Ltd ('Vtesse'), a UK telecommunications operator, concerning alleged preferential tax treatment in favour of B T plc ('BT'), the incumbent telecommunications operator in the United Kingdom.

(2) By letter dated 19 January 2005, the Commission informed the UK authorities that it had decided to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the measure at issue ('decision to initiate the procedure'). The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* on 12 March 2005 ⁽²⁾. The Commission called on interested parties to submit their comments on the measure.

(3) Following the extension of the deadline, the UK authorities responded by letter of 4 April 2005 to the request for comments in the decision to initiate the procedure.

(4) The Commission received comments from the following interested parties:

— AboveNet Communications UK Ltd. ('AboveNet'), received by letter dated 29 April 2005

— Altnet Task Force ('Altnet'), received by letter dated 2 May 2005

— Broadband Stakeholders Group, received by letter dated 13 May 2005

— BT, received by letter dated 18 May 2005

— Cable and Wireless Group plc. ('Cable and Wireless'), received by letter dated 29 June 2005

— Communications Management Association, received by letter dated 30 March 2005

— Easynet Group Plc. ('Easynet'), received by letter dated 3 May 2005

— Gamma Telecom Ltd., received by letter dated 1 December 2005

— Hutchinson Network Services UK Ltd. ('Geo'), received by letter dated 6 May 2005

— Global Crossing Ltd., received by letter dated 6 May 2005

— GVA Grimley, received by letter dated 27 April 2005

— Kingston Communications Plc, received by letter dated 29 April 2005

— NTL Group Ltd., received by letter dated 29 April 2005

— Telewest Broadband Ltd., received by letter dated 28 April 2005

— Thus Plc., received by letter dated 4 May 2005

— UK Competitive Telecommunications Association ('UKCTA'), received by letter dated 25 April 2005

— Vanco Ltd., received by letter dated 19 April 2005

— Viatel (UK) Ltd., received by letter dated 6 July 2005

⁽¹⁾ OJ C 62, 12.3.2005, p. 10.

⁽²⁾ See note 1.

— Vtesse, which provided comments and further information by letters or e-mail dated 28 January 2005, 4 February 2005, 16 February 2005, 22 February 2005, 15 March 2005, 29 March 2005, 28 April 2005, 28 July 2005, 17 August 2005, 2 September 2005, 4 November 2005, 23 November 2005, 30 November 2005, 1 December 2005, 11 January 2006, 19 January 2006, 16 March 2006, 20 March 2006 and 8 July 2006

— Anonymous, received by letter dated 1 February 2005

- (5) The Commission forwarded these comments to the UK authorities by letters dated 20 June 2005, 4 August 2005 and 9 August 2005, in order to give them the opportunity to react. They provided their comments by letters dated 10 October 2005 and 22 November 2005.
- (6) By letter dated 26 July 2005, the Commission asked OFCOM, the UK independent authority regulating the telecommunications sector, to submit its comments on the decision to open the procedure. OFCOM replied by letter dated 21 September 2005. OFCOM provided further information on 7 December 2005, 6 January 2006 and 21 March 2006.
- (7) On 14 July 2005 and 4 October 2005, two meetings were held with representatives of BT, which provided further information on 23 November 2005 and on 23 March 2006.
- (8) On 16 March 2005, 9 September 2005 and 4 July 2006, three meetings with the UK authorities took place.
- (9) By letter dated 26 September 2005, the Commission requested further information from the UK Authorities, to which they replied by letter dated 18 November 2005. They provided further information on 23 November 2005, 23 January 2006, 21 February 2006, 13 March 2006, 21 March 2006, 27 March 2006, 20 April 2006, 2 May 2006, 4 July 2006 and 20 July 2006.
- (10) On 23 November 2005, a meeting took place with Vtesse, the complainant.

II. DETAILED DESCRIPTION OF THE MEASURE

A. Description of the measure

Rating system

- (11) Business rates are a UK property tax levied on non-domestic property. Its aim is to contribute towards the costs of services provided by Local Authorities. The primary legislation on non-domestic rating in England and Wales is

the Local Government Finance Act 1988 ('LGFA 1988'). The implementation of the system is further regulated by statutory instruments and case-law.

- (12) The property unit that is valued for rating purposes is called the 'rateable hereditament' and includes land, buildings and rateable plant and machinery. Liability for the rates falls on the person in occupation of the rateable hereditament, i.e. the person who is in 'paramount control' of the assets, defined by case-law as the actual, exclusive and non-transient occupation of the hereditament, which brings commercial benefits to the occupier.
- (13) The tax rate, which applies equally to all business properties is determined annually by the Secretary of State and applies equally to all operators. It was set at 45,6 % for the fiscal year 2004/5 in England and 45,2 % in Wales. The base of this tax, the so-called rateable value, is the hypothetical annual rent at which the hereditament might reasonably be expected to be let from year to year in an open market transaction at a certain valuation date. The full statutory definition is contained in Schedule 6 to the LGFA 1988. ⁽³⁾
- (14) The valuation of this hypothetical annual rent is carried out by the Valuation Office Agency ('VOA'), an executive agency of the Inland Revenue, part of central government. Revaluations are carried out every five years. For the period 1995-2000, the rateable value is the hypothetical annual rent of the property if available on the market on 1 April 1993, which is called the 'antecedent valuation date'. For the period 2000-2005, the antecedent valuation date was 1 April 1998 and for the on-going period 2005-2010, the date was 1 April 2003. The lapse of time between the antecedent valuation date and the date when the valuation enters into force is meant to allow the VOA to carry out the valuation based on actual evidence at the antecedent valuation date.

Valuation

- (15) The VOA has a choice of four methods for calculating the 'rateable value', i.e. the hypothetical annual rent, of the hereditament, with a hierarchy between the different methods according to the decision to initiate the procedure:
 - (a) If there is direct and actual evidence of the property's rent, the rental method is to be applied.
 - (b) If direct rental evidence is not available, a comparison with the rental evidence of other comparable properties can be made. This is the Tone of the list method. For matters of convenience, both the rental method

⁽³⁾ Available at http://www.opsi.gov.uk/acts/acts1988/Ukpga_19880041_en_1.htm

and tone of the list method, which both rely on market rental evidence, will be referred to in this decision as 'rental method'.

- (c) The Receipt and Expenditure ('R&E') method is to be applied for properties that are seldom let or are difficult to replicate, typically utilities. It seeks to replicate the thought process that a putative tenant might go through when assessing the profitability of a commercial venture involving the renting of a property. He would estimate his future receipts and deduct his future costs. From that, he would deduct the return he requires, the rest representing the maximum rent he would be prepared to pay.
- (d) The Contractor's basis method is based on the replacement costs of a business property: a putative tenant would be unwilling to pay more as an annual rent for a hereditament than it would cost him in the way of annual interest on the capital sum necessary to build a similar hereditament. This method is normally used for hereditaments that are not let or do not generate profits (e.g. hospitals).

Rating of telecommunications infrastructure

- (16) Business rates are levied on telecommunications infrastructure as on other non-domestic properties. The Valuation for Rating (Plant and Machinery) (England) Regulations 2000 ⁽⁴⁾ lay down that plant and machinery that are rateable for telecommunications infrastructure are 'cables, fibres, wires, conductors or any system of such items ..., used or intended to be used in connection with the transmission of communications signals'.
- (17) Telecommunication property has been subject to business rates since 1855. Following the privatisation of BT in 1984, this tax was also levied on the latter's infrastructure, as well as on Mercury Communications, BT's only competitor during the duopoly situation of the 1980's. Initially, for the 1990-1995 period, the tax amount was determined by applying a prescribed 'standard formula'. When the telecommunications industry was gradually opened to competition, starting in 1992, the tax was levied on all telecommunications infrastructures.

Application of the property tax to BT

- (18) For the period 1995-2000, the VOA applied the R&E method to BT. This valuation was adjusted following a negotiated settlement with BT which had constructed its own valuation on the Contractor's basis method and appealed against the original valuation to the Central London Valuation Tribunal and then to the Lands Tribunal.

BT and the VOA reached a settlement in 2000. The outcome was an agreement to set the rateable value of BT's network assets at GBP 445 million in England and GBP 25 million in Wales for the fiscal year 1995/1996. With a multiplier of 43,2 %, BT's tax liability amounted to GBP 203 million for that fiscal year, which represented 2 % of BT's relevant annual revenues.

- (19) For the 2000-2005 period, the VOA settled BT's asset valuation at GBP 467 million in England and GBP 26 million in Wales. The valuation was carried out on the basis of the R&E method and was based on the principles and values agreed at the same time the 1995 list was settled. For the 2005-2010 period, the VOA applied again the R&E method to BT's network.
- (20) In principle, a review of the valuation takes place every five years. However, in its decision to initiate the procedure, the Commission noted that subsequent downward revisions were made to reflect the loss of market share of the company in the UK fixed telecommunications market resulting from the physical roll-out of competing telecommunications networks. The decision to initiate the procedure noted that no similar upward adjustment was apparently made to reflect possible extensions or upgrades of the network.

Application of the property tax to Kingston

- (21) Kingston Communications plc ('Kingston') is the incumbent telecommunications operator and the owner of the only local access network in the region of Hull. During the privatisation of most publicly-owned telecommunications networks in the United Kingdom in the late 1980s, the company remained the property of the municipality, until the share capital was opened to the public in 1999. Hull City Council remains the only substantial single shareholder. Kingston was the only other telecommunications operator valued under the R&E method.
- (22) However, Kingston also owns a subsidiary, Torch Communications Ltd, which constructed a fibre backbone network outside Kingston's local access network area (i.e. Hull conurbation) and operates that backbone network as a separate subsidiary. As a result, the Torch backbone network can be separately valued on the basis of the rental method.

Application of the property tax to Vtesse

- (23) Vtesse is the complainant. It is a 'fibre to the business' service provider offering high capacity retail leased lines,

⁽⁴⁾ S.I. 2000/540.

mainly supplied to large corporate users. It directly competes with BT's leased line offers. In order to connect its customers, Vtesse leases 'dark' fibre from other backbone operators and complements this with its own built infrastructure. The property rented from other parties is included in the rateable hereditament of Vtesse. The VOA has decided to rate Vtesse based on the 'tone of the list' method, which is then applied each time new fibre is rented and lit.

(24) Based on benchmarks of actual rents paid, the VOA has set the annual rate under the rental method at GBP 1 200 per km of pair of optic fibre in the London metropolitan area and GBP 1 000 per km in the other parts of the United Kingdom for the 2000-2005 period. In addition, in 2001, a so called 'oversupply allowance' was granted by the VOA to fibre providers assessed under the rental method, equalling a 15 % discount on the rateable value effective as of 1 April 2001 and 25 % as of 1 April 2002. This allowance was meant to reflect the overinvestment in fibres during the telecommunications boom of the late 1990s and the subsequent drastic reduction in value of these assets due to physical oversupply. There is a further discount of 10 % for networks over 3 000 km. Following these discounts, the rental value of a fibre pair fell to GBP 900 per km in the London area and GBP 750 per km in the other parts of the country in the years 2002-2004. For the 2005-2010 period, the rental value of a fibre pair was set at GBP 600 per km in the London area and GBP 500 per km in the rest of the United Kingdom. ⁽⁵⁾ According to Vtesse, its tax liability was around 7 % of its recurring revenues in 2003/04.

(25) As to revisions, the tone of the list rate is applied to each fibre which is rented and lit. Vtesse has the obligation to regularly inform the VOA of extensions to its network so that the valuation of its hereditament can be adjusted. As a consequence, whenever it procures fibre to provide services to its customers, Vtesse claimed that it is liable for rates that may equal up to 20-30 % of the revenues of a new contract.

(26) As to the other telecommunications operators in the market, they are valued under the rental method, with the exception of cable TV operators, which are valued on the basis of a method derived from the contractor's basis method. ⁽⁶⁾

B. Reasons for initiating the formal investigation procedure

(27) In its decision to initiate the procedure, the Commission considered that the application of the property tax to BT

and Kingston could confer an advantage on these two firms. They seem to benefit from a reduction of their tax base as compared with the other competitors. This was reflected by the fact that BT paid in the range of around 2 % of relevant revenues in tax, while Vtesse and other competitors might have to pay in the range of around 7 %, and up to 20-30 % on an incremental basis.

(28) The decision to initiate the procedure expressed the view that this apparently discriminatory taxation could be the result of the application of a particular asset valuation method to BT and Kingston, while the other telecommunications operators are valued under the rental method, again with the exception of cable TV operators, which are valued on the basis of a method derived from the contractor's basis method. The non-uniformity of the system and the discretionary powers which are given to the VOA to apply the general provisions to specific operators and which were used in the context of the settlement negotiated with BT, may have resulted in a specific advantage to BT and Kingston.

(29) The decision to initiate the procedure questioned the view that the rental method could not be applied to BT's and Kingston's hereditaments. It suggested that the rent received by BT when renting out its own infrastructure could serve as guidance for the value of the network. Moreover, BT's retail business units effectively rent infrastructure and buy network services from BT Wholesale Ltd. ('BT Wholesale'), the business unit that manages BT's infrastructure: the internal transfer prices between BT's retail business and BT Wholesale could provide a basis for estimating the rental value. Moreover, liberalisation and network element unbundling have resulted in a variety of wholesale products which could serve as benchmarks for valuing the rental value of the various infrastructure elements of BT's and Kingston's networks. As to the argument that there is no network nearly as large or diverse as BT's whose rental value could serve as benchmark, the decision to initiate the procedure suggested that the taxation of cable TV companies, which are also active in the telecommunication market, could serve as a benchmark.

(30) As regards the application of the R&E method itself, the Commission noted that this method estimates the rental value of the assets concerned on the basis of the revenues derived from the use of these assets. The result would therefore depend on the level of profitability with which these assets are used, which could lead to results that

⁽⁵⁾ The 2005-2010 rental value of optic fibre set by the VOA is the object of an appeal, and could be lowered if the appeal is successful.

⁽⁶⁾ They are actually valued on a rateable value per home connected. This method is based on a contractor's valuation involving decapitalised costs with end allowances to reflect penetration rates.

penalise operators whose assets are valued under a different method. The Commission questioned whether the necessary adjustments were made when applying the R&E method to BT and Kingston in order to assume that their assets are used at capacity and profitability. The Commission also enquired how the universal service obligations are taken into account in the valuation of BT.

- (31) The decision to initiate the procedure further questioned the method used for revisions of the rateable value. It noted that BT seems to enjoy a downward revision mechanism, while there does not seem to be a similar systematic review of the market conditions faced by competitors. The apparent failure to take into account the increase in the value of BT's infrastructure between two five-year review periods while charging competitors incrementally as the value of their network increases appears to confer an advantage on BT.
- (32) Finally, the decision to initiate the procedure underlined the fact that the VOA apparently enjoyed broad discretionary powers, which enable it to negotiate settlements. It underlined that the settlement reached with BT should respect the principle of non-discrimination, and should not unduly discriminate among operators.

III. COMMENTS FROM INTERESTED PARTIES

A. Comments from interested parties other than BT and Kingston

- (33) The comments submitted by interested parties other than BT and Kingston generally support the view that the application of the property tax to BT and Kingston may give them an advantage.
- (34) Vtesse first pointed out that, after the decision taken in March 1998 by the Valuation Tribunal which confirmed that the R&E method had to be applied to BT's network and that its rateable value was GBP 553 000 000 for England and Wales, BT appealed the decision before the Lands Tribunal. Before the appeal was heard, BT and the VOA settled the valuation at GBP 470 000 000, which represents a 15 % reduction compared to the initial valuation. Vtesse suggests that BT and the VOA settled a final amount and that the VOA adjusted the numbers to match the agreed result.
- (35) Vtesse put forward new elements that tend to show that the hereditament of BT is under-valued under the R&E method. Thus, supposing that the rateable value of BT's whole network⁽⁷⁾ was attributed to its optic fibre network
- (7 300 000 km in 2005), the annual rateable value per km of fibre would be GBP 74. According to Vtesse, this figure is to be compared to the annual rateable values of GBP 1 000 and GBP 1 200 per km of optic fibre pair for telecommunication operators that are assessed under the rental method. Similarly, setting the value of BT's optic fibre to zero, and given that BT has 29 million final users connections, the annual rent per line would be GBP 18,57. This figure is to be compared with the annual GBP 122 paid by telecommunication operators for access to BT's unbundled local loops⁽⁸⁾.
- (36) Vtesse also notes that, in 2001, BT transferred the leasehold and freehold of most of its property portfolio to 'Telereal', a joint venture between Land Securities and the Williams Pears Group for GBP 2,4 billion. The deal involved 5,5 million sq m in total. Following the deal, BT paid GBP 190 million in annual rents for the freehold plus GBP 90 million for the leasehold in 2001. On the basis of this transaction, Vtesse concludes that BT pays GBP 35 per sq m in rents for its buildings, while, according to Vtesse, other telecommunication operators are rated on average at GBP 115 per sq m on their commercial property. Vtesse asserts that the actual rent paid in 2001 by BT for its buildings to Telereal, i.e. GBP 280 million, represented more than 50 % of its rateable value that year, despite the fact that most of this rateable value should be mainly attributable to its network and not to its buildings. Vtesse seems to imply that this is evidence that BT's network is undervalued under the R&E method.
- (37) In Vtesse's submission, the discrepancy between the rateable value of the different components of BT's network and those of the networks of the other telecommunication operators proves that the R&E method has resulted in a lower valuation of BT's hereditament than would have been achieved under the rental method.
- (38) Vtesse provides further elements to compare the respective burden of business rates on BT and on other telecommunication operators. Vtesse advocates the rates/receipts ratio, which allegedly amounted to 13,46 % in its case in 2004. It claims that this ratio must be adjusted in order to allow direct comparison with BT. According to Vtesse, since most operators pay significant fees for the carriage and termination of traffic and since those connection fees do not relate to their rateable assets, the fees should be deducted from their receipts when calculating their rates/receipts ratio. This view is supported by Gamma Telecom

⁽⁷⁾ GBP 554 100 000 in 2005 for England and Wales.

⁽⁸⁾ The local loop is the last mile connection linking the final customers to the local telephone exchange. BT has to provide access to these local loops to its competitors, at regulated conditions.

which, for the same reasons, argues that the most appropriate ratio for comparing the respective burden of business rates should be the rates/added value ratio.

- (39) Furthermore, Vtesse compared the prices of BT's Wholesale Extension Services ('WES') with the rates that an operator valued under the rental method would have to pay if it were lighting optic fibres for the purpose of providing the same service. Depending on the capacity and distances of the WES, Vtesse claims that such an operator could have to pay rates worth up to 87 % of the price charged by BT. Vtesse considers that this is further evidence of the fact that BT's optic network is undervalued: if its network were valued in the same way, BT should charge more for its WES in order to cover the real costs of the business rates.
- (40) Vtesse also makes the claim that the rates/receipt ratio is particularly high for new entrants such as Vtesse. More established firms can load up fibres with as much traffic as possible in order to amortise the rental and tax costs over as many customers as possible. BT is not subject to this constraint because allegedly it is not taxed marginally. That means that, for established firms, the rates/receipts ratio will decrease in the long run.
- (41) On the question of marginal taxation, Vtesse emphasises that the disadvantage that it suffers stems from the fact that BT is rated as an indivisible network, while Vtesse is rated on each individual metre of optic fibre cable that it lights. It considers that the unit of analysis should be the individual contract in the market, on which Vtesse and BT compete. Vtesse gives more precise figures on the impact of these differences in marginal taxation of contracts: taking the example of the bid launched by Kent MAN for the provision of backbone and access telecommunication links, Vtesse claims that its rates liability on that bid represented 16 % of its revenue. On the same bid, Vtesse claims that BT was not taxed marginally, or was taxed, at most, at the average of 2 % of revenues, which BT allegedly pays in rates. That difference would explain why Vtesse lost the bid to a consortium involving BT.
- (42) Vtesse also notes that BT has recently rented some 2 000 route kilometres of optic fibres on the network of Geo, one of Vtesse's suppliers, probably on the same commercial terms as Vtesse. In Vtesse's view, BT should be considered in occupation of these fibres. Vtesse questions whether this extension of BT's network was taken into account in its valuation, and suggests that BT should have been assessed on similar terms as Vtesse when it rents fibres from the same operator.
- (43) The Altnet Task Force, which represents a number of alternative fixed-line telecommunication operators, submits that the R&E method should only be applied to regulated monopolies with little comparable rental evidence. It considers that the VOA had ample evidence of rental value to evaluate BT on a rental method, such as BT's wholesale line rental tariffs or its published prices for Local Loop Unbundling products which could be used to evaluate the rental value of its copper cables. It also considers that the rental method has an incremental effect on the operators' tax liabilities. No such effect occurs under the R&E method, since the value of the infrastructure is established in advance and therefore BT's decision to light dark fibres is fiscally neutral. According to Altnet, the effects of these distortions were made worse by the fact that the settlement reached by BT and the VOA was perpetuated for two valuation periods, which gave a substantial advantage to the incumbent, in terms of increased certainty, while Altnet firms are facing costly and outstanding appeals and negotiations. Altnet claims that BT faces 74 % of the total tax burden, in relation to telecommunications networks, while its market share is at least 80 %.
- (44) Global Crossing confirms that incremental taxation (i.e. on newly lit fibres) favours BT since, when Global Crossing illuminates a new fibre, the incremental taxation liability is incurred on the entire length of the circuit from its customer's site to its core network nodes. Global Crossing claims that it has lost business to BT because of the unfavourable taxation treatment.
- (45) Thus plc and Viatel (UK) Ltd. also claim that they face incremental tax liability as a result of connecting new customers' sites to their networks, while BT, their main competitor, does not incur such an incremental tax liability. Above Net makes the same claim, indicating that it lost business to BT, possibly because of BT's alleged lower taxation.
- (46) UKCTA, a trade association representing the interests of fixed-line communications operators competing against BT for voice and data services, expressed the view that the property taxation system is severely lacking in transparency, since it is characterised by confidential bilateral deals agreed between network operators and the tax authorities. UKCTA considers that the settlement reached by BT has provided it with ten years of certainty and stability, while other operators did not benefit from a similar level of predictability. It notes that the property tax system has entrenched BT's dominant position, since taxation has been more affordable to BT and has therefore impaired new entrants' ability to compete fairly, and since BT, unlike other competitors, does not face direct increases in business rates liability for lighting more fibres. However, following a request from the Commission, UKCTA indicated that it was

impossible to indicate what Altnet operators might have had to pay in rates, had they been assessed on the same basis as BT.

- (47) GVA Grimley, consultants in the field of business rates for telecommunications companies, criticise the application to BT of an adjustment mechanism which reflects change in its market shares and whose application is opaque. GVA Grimley claims that for all other hereditaments valued under the R&E method, normal practice is for there to be a five yearly revaluation without a market share mechanism. Furthermore, they question the way this market share adjustment mechanism is applied to BT, noting that it is difficult to see why BT's rateable value should have been declining from 1995 to 1999, in a context of improving turnover and profit. They further claimed that the VOA declared that a pair of unbundled copper wires had a rateable value of circa GBP 50, while BT's local loops are valued at around GBP 16 (dividing BT's total rateable value by the number of local loops). The discrepancy would indicate that BT's network is undervalued.
- (48) Some of the respondents already mentioned and others, such as Telewest Broadband, Cable and Wireless, or Easynet, raise other issues that concern business rates, but do not appear to be directly related to the facts described in the decision to initiate the procedure. For instance, some of those firms are concerned about the possible application of the property tax treatment in the context of local loop unbundling. They also complain about the fact that the business rates are set at too high a level ⁽⁹⁾, which represents an impediment to investment, and that a period of five years is incompatible with the structure and pace of technological change in the telecommunications industry ⁽¹⁰⁾. One firm also claims that some competitors are not rated ⁽¹¹⁾.

B. Comments from BT and Kingston

Comments from BT

- (49) BT first explained that, contrary to what is claimed in the opening decision, there is no accepted hierarchy between the valuation methods, and no principle that the rental method, if rental evidence is available, is the most appropriate method. The method which the VOA uses is dictated by the nature of the property being assessed and by available evidence. Thus, there is not discretion for the VOA as to the choice of method.

- (50) Although BT is valued under a different method, there is no discriminatory treatment between BT and other ratepayers: the statutory test is the same, and all methods aim at assessing the hypothetical rent at which it is estimated that the business property in question might reasonably be expected to be let from year to year.
- (51) BT claims that there is no evidence that the rateable value assessed for BT's hereditament has given BT an advantage in the form of a reduced tax base compared to competitors. The only evidence the Commission has provided to support this allegation is a comparison of rateable values with respect to turnovers.
- (52) BT further submits that the VOA correctly concluded that the R&E method was the only appropriate method to value BT's network, mainly because of the lack of rental evidence to estimate the rateable value of BT's hereditament as a whole. Neither local loop ⁽¹²⁾ nor wholesale rental evidence ⁽¹³⁾ was available at the time of the 1995 and 2000 valuations.
- (53) BT denies that there was any bias in the appeal system or in its application to BT. Everybody has a right to appeal and a possibility to settle. The valuation of BT's network was the object of an appeal in 1995. Its settlement before the Valuation Court was not unusual, and does not imply discretion on the part of the VOA: the possibility of reaching a settlement does not relieve the VOA of its statutory duty to determine the annual rental value of the hereditament under the hypothetical tenancy. According to BT, it is also wrong to say that the 1995 valuation also served as a basis for determining the 2000 values and conferred ten years of certainty on BT: the settlement concerning the 1995 valuation only took place in 2000 because of delays in the legal proceedings. Thus, BT was subject to five years of uncertainty as regards the 1995 valuation. The 2000 list was settled at the same time.

- (54) BT explained that in the course of the five-year period, revisions of the valuation can take place in cases of 'material changes in circumstances' ('MCCs'). A market share adjustment mechanism was seen as an efficient means of reflecting, on an annual basis, the net effect of these MCCs ⁽¹⁴⁾.

⁽¹²⁾ The first local loop unbundling rental tariff applied from 31 May 2001, considerably after the relevant antecedent valuation dates of 1 April 1993 and 1 April 1998.

⁽¹³⁾ The first set of regulatory accounts that reflected transfer charges for BT's access services were produced for the year 2001/02.

⁽¹⁴⁾ The details of this market-share based mechanism are explained in the description of the comments from the UK Authorities.

⁽⁹⁾ Comments from Cable and Wireless, Telewest and Viatel.

⁽¹⁰⁾ Comments from Telewest.

⁽¹¹⁾ Comments from Easynet.

- (55) Therefore, BT explained that the Commission's decision to initiate the procedure was wrong to claim that any increase in the value of BT's infrastructure is not taken into account: in fact, BT has been subject to upward as well as downward revisions, depending on whether factors increasing BT's value outweighed decreasing factors ⁽¹⁵⁾.
- (56) According to BT, the revision system applicable to Vtesse appears to be based on the same principles, albeit on a different manner: newly occupied fibres become an additional part of its hereditament and are valued as part of it. In the case of Vtesse, market share is not a suitable means for assessing changes in rateable value since any changes are likely to be imperceptible due to Vtesse' small market shares.
- (57) Finally, if the Commission were to decide that BT did receive State aid, BT submits that the Commission could not order recovery because of BT's legitimate expectation that any such aid was lawful, or, alternatively, that it would constitute existing aid.

Comments from Kingston

- (58) Kingston claims that the Commission has not established the existence of an advantage, either by showing that BT and Kingston have benefited from a selective reduction in the burden of tax, or by showing that other operators face an exceptional increase. It notes that in the case of Kingston, the Commission has no idea how it has been rated.
- (59) Kingston considers that the only evidence that an advantage may have been granted to BT is the difference in the rates/revenue ratio between BT and Vtesse. However, this ratio is irrelevant in the case of property tax, which is not a tax on revenues. For such ratio to be relevant, Vtesse and Kingston or BT should be directly comparable firms, which is not the case given the differences in size, turnover and economic activities. Finally, it estimates Vtesse's ratio at 0,39 %, while its own rates/revenue ratio is allegedly at 4,5 % ⁽¹⁶⁾.
- (60) It denies that the existence of several methods bestows a selective advantage on Kingston. The VOA has, in its view, some discretion in the valuation process, but this is not unfettered discretion: the nature of the hereditament and the nature of the evidence determine its choice, which is further constrained by a considerable body of case-law. It is not possible to demonstrate that the R&E method favours Kingston or BT, since the rental method is not applicable to them, while the R&E method is not applicable to Vtesse, since it is not profitable.
- (61) It further submits that there is no demonstration of a distortion of competition, with no reference to the other operators that compete with Kingston. As a subsidiary legal submission, it suggests that any potential aid granted through the application of the UK rating system would be existing aid.

IV. COMMENTS FROM THE UNITED KINGDOM

- (62) The UK authorities submit that the rates system is a uniform statutory system, applicable to all non-domestic hereditaments in England and Wales, which aims at establishing a common yardstick, by which to assess the value of the premises. This yardstick is the rent at which it is estimated that the hereditament might be expected to be let from year to year, under certain statutory assumptions concerning the state of repair of the hereditament and the terms of the hypothetical tenancy.
- (63) This value is established by the VOA, which employs professionally qualified chartered surveyors, and is required by law to exercise its expertise independently. Its decisions are subject to the independent scrutiny of the Valuation Tribunal, and upwards to the Lands Tribunal and the Court of Appeal.
- (64) The UK authorities further explain that, in order to value this hypothetical rent, the VOA can use several methods. These valuation methods have the same objective, namely the ascertainment of the hypothetical tenancy and should all, properly applied, yield the same result. The existence of several methods is meant to cater for the wide range of circumstances to which rates are applied. The selection of the appropriate valuation method is not a discretionary decision: it will depend on the nature of the hereditament and the nature of the available evidence. Thus, for instance, if there is no profit motive (hospitals, schools) for occupation, the R&E method is not applicable and the VOA is likely to judge that the most appropriate method is the contractor's basis.

⁽¹⁵⁾ Thus, in 2003, BT's rateable value in England was increased from GBP 443,5 million to GBP 447,5 million. In 2004, it was increased in England to GBP 450,6 million.

⁽¹⁶⁾ Kingston' hereditament in the Hull conurbation area which was assessed under the R&E method was valued at GBP 5,1 million in the 2000 list. Kingston claims that the turnover derived from that area was approximately GBP 50 million. Applying the appropriate multiplier of 44 %, this would result in a revenue/rate ratio of about 4,5 %.

4.1. Choice of the method applied to BT and Kingston

- (65) The UK authorities explain that the R&E method was the only one that was available to assess BT's and Kingston's hereditament. They claim that the VOA's team of

independent experts⁽¹⁷⁾ that worked on assessing their hereditament concluded for all valuation periods, including 2005-2010, that there was not enough evidence to assess the rateable value of BT's and Kingston's networks on the basis of the rental method. This finding was accepted by the Valuation Tribunal in the case at hand⁽¹⁸⁾. They further claim that the R&E method is the only one that could reflect the unique advantage of ubiquity which BT enjoys.

(66) The UK authorities claim that the rental method was not applicable to BT and Kingston. On this point, they first emphasise that the question of the availability of rental evidence has to be assessed at the time when the valuation was conducted. Thus, for instance, the possibility of applying the rental method for the period 1995-2000 can be considered only on the basis of information that was available at the 'antecedent valuation date', i.e. 1 April 1993. Therefore, the UK authorities claim that third parties and the Commission are wrong to assume that market evidence that is now available is relevant to the question as to whether the 1995 and 2000 lists could have been compiled on the basis of the rental method.

(67) Therefore, with respect to the 1995 lists, only information available in 1993 could be taken into account. In its decision to initiate the procedure, the Commission suggested two possible sources of rental evidence: either the rent received by BT when renting out its own infrastructure or transfer prices between BT's retail business and BT's wholesale business. The UK authorities claim that neither of those approaches was available to the VOA in 1993. In 1993, BT was not renting out any significant part of its infrastructure and it was not structured in a way that separated its retail and wholesale businesses.

(68) Concerning the 2000 list, based on information available in 1998, the UK authorities admit that by that date, there was limited rental evidence from fibre optic networks which started to be provided to operators under so-called Indefeasible Rights of Use (IRU) contracts. However, that evidence was limited and applied only to fibre optic networks used for carriage of high volume services, and was therefore relevant to an extremely limited proportion of BT's hereditament. They also admit that there were separate retail and wholesale divisions in 1998, but the access business, which is an essential part of BT's activities, was operated on an 'end to end' basis with no transfers to the other divisions. Therefore, transfer payments could not be used to value the whole of BT's network.

⁽¹⁷⁾ These included specialist consultants from National Economic Research Associates (NERA), who were commissioned by the VOA to prepare a model providing an estimate of BT's future revenues and operating costs.

⁽¹⁸⁾ *British Telecommunications plc v Central Valuation Officer*, 19 March 1998.

(69) As to the 2005 list, the same remarks as above apply. The UK authorities also deny that, contrary to the suggestion made by Altnet, tariffs for local loop unbundling provide any rental evidence on the basis of which BT's hereditament could have been assessed. For instance, the Wholesale Line Rental (WLR) tariff was available from August 2002. It is a product which BT is obliged to provide to other telecommunications operators, and which enables them to offer both line rental and calls to customers over BT's local network. However, the payment made by the telecommunications provider to BT is not equivalent to a rent for the local network. It is a payment for a service, since BT has to provide, inter alia, maintenance of the line, exchange accommodation, billing and R&D, fault repair, pair gain equipment, and power. Therefore, the UK authorities claim that, contrary to Vtesse and Altnet's assumption, it cannot be equated with a rent per line for the local loops. They come to the same conclusion with respect to the Calls and Access tariff, which was a precursor to the WLR product, was available from 1998 and covered the same services as the WLR. Furthermore, BT's wholesale line rental tariff and local loop unbundling fee are regulated by OFCOM. They are not open market rents and as such little weight can be given to these tariffs as evidence of rental value⁽¹⁹⁾. Therefore, the VOA claims to have no rental evidence on the essential parts of the networks of BT and Kingston, i.e. their local access networks.

(70) Furthermore, the UK authorities explained that rental evidence used when applying the rental method to telecommunications operators other than BT and Kingston cannot be used to value the hereditament of these two firms. BT and Kingston, on the one hand, and other telecommunication operators, on the other hand, are not remotely comparable. The networks of BT and Kingston are primarily local access networks, serving millions of individuals in the case of BT, while the networks of most other telecommunication operators are primarily core networks serving a small number of high value, high volume customers. The value of a hereditament is influenced by a number of factors including its function, its physical layout, its extent and the regulatory environment under which it operates. Thus, given the differences in the hereditaments and the lack of comparability, rental evidence from telecommunications operators, for instance on their optic fibre network, cannot be applied directly to BT/Kingston. For the same reasons, the UK authorities

⁽¹⁹⁾ The UK authorities quote *Poplar Union Assessment Committee v Roberts* [1922] 2 AC 93

claim that, contrary to the suggestion made by the Commission in its decision to initiate the procedure, rental evidence from Cable TV companies cannot be applied to BT or Kingston.

- (71) As to the suggestion that parts of BT's hereditament could have been valued by reference to rental evidence derived from other networks and then on an R&E method for the remainder, the UK authorities claim that such an approach was not feasible. Such an approach would pre-suppose that there are distinct physical parts of the BT network for each of the different businesses in which BT is engaged. However, the UK authorities note that according to British case-law on the application of business rates ⁽²⁰⁾, contiguous property in the same occupation, such as BT's and Kingston's networks, must be valued as a single hereditament. Disaggregating property in single occupation would introduce valuation distortions, since the sum of the value of the parts of a property rarely equates to the value of the whole.
- (72) More specifically, to seek to disaggregate BT's core trunk route, high volume, fibre optic network, which competes with Vtesse's business, and to assess its rateable value by reference to rents paid by competing telecommunications providers is not possible. That is because that same infrastructure is also used by low volume telephony services provided to BT's 29 million domestic customers. BT's or Kingston's networks are physically incapable of being divided into self-contained units capable of being separately let or occupied, by reason of their physical and functional integration.
- (73) In any case, even if it were possible to value separate parts of BT's and Kingston's hereditaments and value them under a different method than the R&E method, the problem would remain of how to value the remainder, since the R&E method can be applied only in respect of the whole of those undertakings' networks.

4.2. The application of the R&E method to BT and Kingston.

- (74) The UK authorities provided detailed explanations on the way the R&E method is applied to BT and Kingston.

Valuation of BT

- (75) The valuations are carried out by independent experts in accordance with the general rules on the application of the R & E method ⁽²¹⁾. Although the modelling and the resulting calculations are complex, the following paragraphs provide a brief overview on how the valuation was done for the 1995-2000 period.
- (76) The R & E valuation takes the expected receipts, which are relevant to the rateable occupation of BT's hereditament, and deducts the relevant expenses. Specialist consultants (National Economic Research Associates — NERA) were commissioned by the VOA to prepare a model to provide an estimate of future revenues and operating costs over a five-year period arising from occupation of the BT Central List hereditaments in England & Wales, together with the remainder of the network in Scotland and Northern Ireland. A summary description of the NERA model and underlying spreadsheets for the 1995, 2000 and 2005 valuations were submitted by the UK authorities.
- (77) The objective of the NERA model was to predict the revenues and operating costs likely to arise from the BT network throughout the United Kingdom, in the context of the rating hypothesis over a five year period. That hypothesis envisages a letting of the rateable portion of the BT network at 1 April 1993, but having regard to its physical state and that of competing networks and the remainder of the physical environment as at 1 April 1995. The NERA model proceeded from the basis of actual revenues and operating costs, arising in the year preceding the antecedent valuation date, as these would be known to the bidders for the hypothetical tenancy. Observations of a long series of past statistics were used to derive elasticities which were used to forecast movements in the total telecoms market and BT's share thereof over a five-year period.
- (78) In the case of BT, the VOA decided to use forecast costs and revenues over a five-year period rather than the usual one-year period. The UK authorities explained that in certain circumstances, the application of the R&E method may involve considering levels of profitability over a number of future years if performance over a single year is not likely to be typical of the future. In the case of BT, the VOA anticipated that, viewed from the antecedent valuation date ('AVD'), the future pattern of profitability would be affected by the prospect of increased competition, regulatory price control, a significant growth in competitors' networks and changes in the types of services offered. For these reasons, an approach based on anticipated profitability over a five

⁽²⁰⁾ See for instance *Brewin (VO) v Railway Executive* (1952) 45 R&IT 553

⁽²¹⁾ The Receipts and Expenditure Method of Valuation for Non-Domestic Rating, A Guidance Note — July 1997. Published by the Royal Institution of Chartered Surveyors (RICS).

year period was necessary to value the rent that a hypothetical tenant, looking at the AVD, would be ready to pay for BT's network over that period ⁽²²⁾.

(79) Having anticipated receipts and operating costs over five years, the next stage in the R&E valuation is a deduction of the hypothetical tenant's estimated capital expenditure over the five-year forecast period on items which do not form part of the hereditament, but which are necessary in order to earn the forecast receipts. These items fall into two categories: (a) non-rateable plant & machinery required to be procured during the five year period, whether as replacement for existing equipment or otherwise; and (b) additions to the network not in existence at 1 April 1995, but which are forecast to be made over the five-year period.

(80) The next step is the predicted change in working capital over each of the five years of the forecast period. The annual change is deducted from receipts net of expenses and the capital expenditure described above. This produces a divisible balance representing the total of rent and the tenant's required cash flow. The next step is the estimation of the tenant's required cash flow.

(81) This is the tenant's required return on his capital at the commencement of the year, adjusted for change in that capital over the course of the year. The tenant's capital at the commencement of the hypothetical tenancy consists of working capital and tangible assets, namely non-rateable plant and machinery. The change in the tenant's total capital is estimated for each year. Changes in tangible asset values will occur each year as a result of changes in replacement asset costs, depreciation of existing assets, and acquisition of new or replacement assets, and these changes have been forecast over a five-year period.

(82) The tenant's required return was taken to be 16,2 % in nominal terms ⁽²³⁾. This is an estimate of BT's weighted average cost of capital ('WACC') in nominal pre-tax terms at 1 April 1993 — the relevant antecedent valuation date. In this way the tenant's required cash flow at the year end is computed. Since receipts, expenses and capital expenditure are incurred throughout the year, just as rent is payable during the year, the year-end required cash flow is expressed in mid year terms by applying a present value factor for 6 months at 16,2 %.

(83) The tenant's required cash flow is deducted from the divisible balance, leaving a residual cash flow for each year, since that cash flow arises from transactions taking place

throughout the year. The present value of each year's cash flow (at 16,2 %) is then summed up and divided by the sum of the present value factors (equalling 5 years purchase at 16,2 %).

(84) The result, GBP 700 636 855, represents the estimated rental bid which the hypothetical tenant could afford to make in order to retain a return of 16,2 % on the capital investment which he would of necessity make in order to generate the receipts upon which his bid would be predicated. The penultimate stage of the valuation involves the apportionment of the UK 'cumulo' value of over GBP 700 million to England and Wales. In the absence of any direct evidence of telecommunications traffic in each of the countries of the United Kingdom, it has been assumed that the apportionment most likely to be accurate should have regard to the distribution of economic activity between the constituent parts of the United Kingdom. On the basis of this evidence, 84,8 % of the UK 'cumulo' was apportioned to England and 4,2 % to Wales.

(85) The resulting figures include a number of properties which are owned and occupied by BT but not included in the Central List hereditaments. These properties were capable of being valued directly on the basis of the rental method and separately assessed at GBP 149 167 870 in England and GBP 3 822 485 in Wales. The final stage of the valuation involves the subtraction of those separately assessed rateable values in order to arrive at the final rateable value for the Central list hereditaments, which was GBP 445 million in England and GBP 25 million in Wales.

(86) The same method was applied for the following two valuation periods, using as a basis BT's actual accounts for the year 1997/98 for the 2000-2005 period, and for the year 2002/03 for the 2005-2010 period. The VOA used a tenant's required return of capital investment of 14,25 % for the 2000-2005 period and a required return of 12,25 % for the 2005-2010 period, this decrease reflecting the evolution of inflation.

(87) The application of the R&E method to BT has resulted in the following rateable values since 1995:

List	England	Wales
1995-2000	GBP 445 million	GBP 25 million
2000-2005	GBP 467 million	GBP 26 million
2005-2010	GBP 530 million	GBP 24 million

⁽²²⁾ It must be borne in mind that, although the hypothetical tenancy must be from year to year, it must not be assumed that it will last only for a year. On the contrary, it must be assumed that there is a reasonable prospect of continuance. See *R v. South Staffordshire Waterworks Co* (1865) 16 QBD 359 at 370.

⁽²³⁾ 12,27 % in real terms.

- (88) On the specific question of the 1995-2000 valuation, the UK Authorities acknowledge that the application of the R&E method to BT for that period was the object of a settlement, following more than five years of litigation and subsequent negotiations. The VOA is entitled to settle, which is common practice in the application of the property tax ⁽²⁴⁾. It cannot reach a settlement on a basis that does not represent the correct rateable value of the hereditament concerned. The UK Authorities emphasise that the settlement concluded with BT confirmed that its hereditament was to be valued on the basis of the R&E method rather than the contractor's basis method, which was favoured by BT, and that it resulted in a rateable value that was significantly higher than the value BT contended for.
- The VOA finally used a tenant's required return of 12,27 % in real terms, instead of 12,5 %, as initially adopted by the Valuation Tribunal.
 - Capital expenditure on the tenant's non-rateable assets were significantly revised downward, thanks in particular to the information provided by BT's 1993 business plan, which was not available in 1997.
 - The cost per redundancy was reduced from GBP 50 000 to GBP 33 900 in 1992/3.
- (89) Concerning the allegation made by Vtesse that, after the decision of the Valuation Tribunal ⁽²⁵⁾, the VOA and BT settled on a rateable value of BT's network that was 15 % lower than the initial valuation made by the VOA, the UK authorities explained that the difference can be accounted for by the fact that the valuation carried out after the Valuation Tribunal's decision was the product of a more thorough analysis. When preparing the first valuation, which was presented before the Valuation Tribunal, the VOA and its economic consultant NERA were not able to obtain full details of BT's historic revenues, prices, volumes and costs since, in particular they did not have the tools to force disclosure of this information by BT. BT appealed to the Lands Tribunal against the decision. The Lands Tribunal hearing is a de-novo hearing ⁽²⁶⁾. Furthermore, at that stage of the procedure, the VOA could issue information injunctions and obtain disclosure of relevant information by BT. In particular, for the 2000 valuation, the VOA and NERA were able to obtain significant data which were not available to them in 1997, such as a full breakdown of BT's 1992/3 revenues and costs, BT's five-year plan produced before the AVD, and historic data on line and call volumes and prices and leased line volumes and prices. This new information affected all the main parts of the valuation, including forecast of revenues and operating costs, future capital expenditure and the hypothetical tenant's required return.
- The X factor in price cap ⁽²⁷⁾ in 1997/8 was changed from - 4,5 % to - 7,5 % since the move to - 4,5 % which took place in 1997 and was used in the 1997 valuation could not have been reasonably anticipated at the AVD.
 - The forecast for the annual reduction in access deficit contribution per minute ⁽²⁸⁾ was increased from - 3 % to - 12 %, since the 1997 forecast did not take sufficiently into account the reduction in the size of the access deficit as exchange line prices increased faster than costs.
 - In the 1997 valuation, the VOA and NERA assumed that inland leased line prices would be rising with inflation. This assumption was not supported by the data on historic leased line prices which was subsequently released by BT, and these prices were assumed to remain constant in the context of the 2000 valuation.
 - In the 2000 valuation, an allowance was made for additional outsourcing costs.
- (90) Some of the changes tended to increase the rateable value. This was the case of the following factors:
- (91) The factor with the main downward effect on rateable value was the change in forecast of future receipts and costs. The revised version predicted higher profits in the first year but lower in the subsequent years, compared with the forecasts used in the 1997 valuation. More precisely, these changes can be attributed to the following elements:
- (92) The combined effect of these factors meant that the final valuation was lower than that which had initially been calculated by the VOA in 1997.

⁽²⁴⁾ For instance, for the valuations of the 2000-2005 rating lists, there were more than 1,17 million appeals, of which about 845 000 were withdrawn or have been settled.

⁽²⁵⁾ See note 18.

⁽²⁶⁾ The appeal to the Lands Tribunal involves a complete de novo hearing over a period of 13 weeks before a panel of two surveyors members and a QC. In contrast, the Valuation Tribunal featured a lay panel and took a mere four weeks.

⁽²⁷⁾ BT's core retail telecommunications services were subject to regulatory price control. In a given year, the price change for BT's regulated retail services was not allowed to exceed RPI-X, where RPI is the annual percentage change in the whole economy retail price index. The X factor was set by OFCOM. In 1992, OFCOM had determined that the value of the X factor would be 7,5 % in each year from 1993/4 to 1996/7.

⁽²⁸⁾ BT's access deficit is the loss it made in providing exchange lines.

- (93) Finally, on the point raised by the Commission in its decision to open the procedure as to whether the R&E method correctly takes account of the possible inefficiencies and lower profitability of the firms to which the R&E method is applied, the UK authorities reply that valuation proceeds on the assumption of an average level of efficiency. Where there is evidence of less than average efficiency, the valuer using the R&E method must make adjustments to the estimated fair receipts and expenses. The UK authorities claim that there is evidence that BT has an average level of efficiency⁽²⁹⁾ and no adjustment was deemed necessary to make a correct valuation of their hereditament. On the question of the universal service obligations ('USO') and the way in which they are taken into account in the valuation of BT, the UK authorities explained that no specific allowance is made for such USO. The costs of the USO are included in the overall predicted capital expenditure for growing the network and in the overall operating expenses. The increased revenues resulting from the service of customers under the USO and from the brand enhancement resulting from the USO, if it exists, are included in the anticipated receipts.

Valuation of Kingston

- (94) A similar but much simpler staged approach to the R&E method was applied to Kingston. No model predicting the turnover likely to be derived from occupation of the hereditament over a five-year period was prepared. The reason for this is that there are no networks serving residential customers competing with Kingston in the Hull conurbation area, no cable TV and little competition for commercial lines. Due to the more stable situation in Kingston's Hull market, it was decided that a five-year projection was not necessary.
- (95) Instead, for the 1995-2000 period, regard was had to actual turnover and operating costs for the 3 years preceding the AVD and based on this, it has been assumed that the hypothetical tenant might reasonably anticipate a net income of around GBP 9,5 million per year before rent. The tenant's required return has been taken to be 12,5 % on the value of the non-rateable assets (assumed to be GBP 64 million), giving a return of GBP 8 million to be deducted from net income. The residue of GBP 1,5 million is available for rent and was set as Kingston's rateable value for that period. The same method, using the figures

available in 1998 and 2003 gave a rateable value of GBP 5,1 million for the 2000-2005 period and GBP 7 million for the 2005-2010 period respectively.

4.3. Revision mechanism

- (96) The UK authorities also provided explanations concerning the revision mechanism applied to BT. They explained that under Schedule 6 to the LGFA 1988 BT, like any other rate payer, is entitled to have its rateable value altered if a material change in circumstances ('MCC') occurs during its five year valuation period. The MCC is taken into account as if taking place at the antecedent valuation date. In the case of BT, MCCs take place every day, either because of the extension of BT's network (upward effect) or because of the roll-out of competing networks (downward effects)⁽³⁰⁾. Theoretically, a valuation using the R&E method should take place every year, taking into account how these MCCs may have changed BT's five-year plan at the time of the antecedent valuation date. In preference to this complex method, the UK authorities and BT agreed on a proxy method of adjustment, based on the evolution of BT's market share in comparison with its market share in the year preceding the commencement of the rating list, and using data published by OFCOM.
- (97) This market share was calculated by dividing the total of all categories of BT's relevant revenues by the total of all corresponding categories of UK market revenues for fixed telephony. The relevant categories are: (a) local calls; (b) national calls, (c) international calls, (d) calls to mobiles; (e) other calls, (f) exchange line connections, (g) exchange line rentals, (h) inland private leased rentals (this category includes the market on which BT and Vtesse compete), (i) inland private leased connections, (j) international private leased circuits, (k) interconnect and (l) telex (in 1995 list only).
- (98) Taking the example of the 2000-2005 list, BT's market share thus calculated was 68,47 % in 2000. The rateable value of its hereditament was GBP 467 million in England and GBP 26 million in Wales in 2000. For the subsequent year, BT's market share had fallen to 65,03 %. The rateable value for 2001 for therefore set at GBP 467 million $\times 65,03 \div 68,47 \%$ = GBP 443 million for England and GBP 26 million $\times 65,03 \div 68,47 \%$ = GBP 24,7 million for

⁽²⁹⁾ The UK authorities had regard to evidence from studies indicating that BT is efficient. For example, when compared with US local exchange carriers, which are generally regarded as being reasonably efficient and for whom detailed cost and volume data is available, BT is at or close to the upper decile in terms of efficiency.

⁽³⁰⁾ The matters that can be considered as material changes of circumstances are described in paragraph 2(7) of Schedule 6. These matters include in particular 'matters affecting the physical state or physical enjoyment of the hereditament', and 'matters affecting the physical state of the locality in which the hereditament is situated'.

Wales. The following year, OFCOM data suggested a small reduction of its market share, which however led to no reduction of BT's rateable value. In the years 2003/4 and 2004/5, BT's market share increased to 67,6 % and 68,0 % respectively. Compared to the benchmark market share in 2000 ⁽³¹⁾, it led to rateable values of GBP 447,5 million and GBP 450,6 million respectively ⁽³²⁾.

- (99) This method gave the following results for the 1995-2000 and 2000-2005 periods:

BT	List	England	Wales
01.04.1995	1995	GBP 445 million	GBP 25 million
01.04.1996	1995	GBP 412 million	GBP 23 million
01.04.1997	1995	GBP 392 million	GBP 22 million
01.04.1998	1995	GBP 366 million	GBP 20 million
01.04.1999	1995	GBP 347 million	GBP 19 million
01.04.2000	2000	GBP 467 million	GBP 26 million
01.04.2001	2000	GBP 443,5 million	GBP 24,7 million
01.04.2002	2000	GBP 443,5 million	GBP 24,7 million
01.04.2003	2000	GBP 447,5 million	GBP 24,9 million
01.04.2004	2000	GBP 450,6 million	GBP 25,1 million

- (100) For the 2005-2010 period, the UK authorities indicated that, due to the lack of available data from OFCOM, the revision mechanism applied for the first two periods will be discontinued ⁽³³⁾. In place of the former system, the UK authorities intend to apply a full R&E method annually, which will reflect all physical changes, including new lit fibres, but in the context of the economic conditions existing at the antecedent valuation date ⁽³⁴⁾. This system is still being finalised.

- (101) In the case of Kingston, no revision mechanism was applied. According to the UK authorities, no adjustment

⁽³¹⁾ Using a revised market share for BT in 2000, following fresh data provided by OFCOM. This market share was 70,5 %.

⁽³²⁾ [...]. The VOA is contending that the loss of traffic to mobile telephony is not a material change within the 2000 rating list.

⁽³³⁾ Since BT's position in the market has changed, OFCOM no longer has the same competence as before to gather relevant market data.

⁽³⁴⁾ It means that the forecast will be that which would have been anticipated looking forward from 1 April 2003, but on the assumption that the physical environment (including the physical extent of the network of both BT and other operators) was in the same state as it actually was at the commencement of the year in which the revision is made.

was undertaken for the 1995 and 2000 rating lists on the basis that no competitors built networks in the Kingston upon Hull conurbation area and that Kingston already had a network coverage of almost 100 % in the area, so it did not extend its network.

4.4. Existence of an advantage

- (102) The UK Authorities first emphasise that all valuation methods should arrive at the same result: the hypothetical rent that would be paid for the hereditament. Therefore, the fact that a different method of valuation was applied to BT and Kingston, on the one hand, and to the other telecommunications operators, on the other, is not an indication that an advantage could have been granted to the former.

- (103) They are of the opinion that there are two means by which the existence of a selective advantage could be demonstrated:

- Either by showing that an R&E valuation of telecommunications operators other than BT and Kingston would have yielded a lower rateable value than that derived from the rental method, so as to demonstrate that the R&E method is flawed or systematically understates value;
- Or by showing that, using correct and relevant comparisons, other telecommunications operators had a disproportionately high rateable value when compared with BT and Kingston.

- (104) In order to establish point (a), it would be necessary to carry out an R&E valuation of the other telecommunications operators in order to see whether comparable results were obtained under the R&E method and under the rental method. None of the telecommunications operators has undertaken such an exercise and the UK authorities assume that if indeed the valuation of their network had been lower under the R&E method, members of Altnet and Vtesse would have raised this point ⁽³⁵⁾. As to the VOA, it does not have these telecommunications operators' business plans. Therefore, it is not in a position to assess their anticipated receipts and expenditure deriving from the occupation of their network, and determine the rent they would be ready to pay for it under the R&E method.

⁽³⁵⁾ The UK authorities note that, in its submission, Altnet suggested that an R&E valuation for their networks for the 2000 list would have yielded a nil valuation. The UK authorities responded that this is inconsistent with the rents actually paid and with the business plans upon which those actual rents must have been justified.

(105) Concerning point (b), the UK authorities note that Vtesse and the Commission suggested comparing the percentage of receipts paid by Vtesse in rates compared with the percentage of receipts paid by BT and Kingston. The UK authorities first submit that this ratio is irrelevant. They argue that rates are a tax on the value of property, not a tax on receipts, profits or capital gains. The value of a property is not a function of the turnover of the particular occupier: two businesses may occupy identical properties, yet their turnover could be very different depending on the nature and success of their business. Even tenants in the same area of business may have dramatically different turnovers depending on their efficiency. Consequently, revenue is no indication as to the rent which would be arrived at in the 'haggling of the market' and placing any weight on an alleged disparity between the percentage of receipts spent on rates is wrong.

(106) In any case, the UK authorities submit that the correct rates/receipts ⁽³⁶⁾ ratio for BT and Kingston in the UK were the following :

	1995/96	2000/01	2005/06
BT	3,0 %	2,7 %	3,6 %
Kingston	1,0 %	4,0 %	3,4 %

(107) The UK authorities explained that the difference between the ratio that they obtain for BT and the ratio calculated by Vtesse for BT (2 %) can be explained by the fact that Vtesse compared BT's receipts in the UK with its network rateable value in England and Wales. Vtesse failed to take into account separately assessed properties and the rateable value of BT's hereditament in Scotland and Northern Ireland. The difference between the ratios provided by Vtesse and the UK authorities can be further explained by the fact that the UK authorities calculated the rates/receipts ratio by using revised revenues for BT and Kingston which were adjusted to take account of non-relevant revenues and were normalised to reflect projected future trends.

(108) In any case, even if the percentage-of -receipts approach was to have any validity, the UK authorities claim that the figures provided by Vtesse and used by the Commission in the decision to initiate the procedure, do not show the existence of an advantage to BT. On the contrary, they note that, when all the Altnet telecommunication operators as a whole are compared with BT, the percentage of receipts shows that BT does not pay less than the Altnet operators. In the final year of the 2000 list, BT had about 70 % of the total fixed telecoms rateable value and about 71,6 % of call and access revenues and a smaller percentage of other fixed market revenues. According to the UK authorities, these

figures show that there is no systemic problem with the valuation in the 1995 and 2000 lists.

(109) On the question of marginal taxation, the UK authorities deny that the different way of rating additional fibres confers any advantage on BT or Kingston. The trigger for rateability of telecommunication operators' fibres under the rental method is the lighting of the fibres. This is not the way new fibres are treated in the case of BT/Kingston under the R&E method.

(110) The R&E method anticipates the receipts and expenditures over the next five years. The fibres necessary for BT's business throughout the five-year life of the list are taken into account in the assessment of the rateable value because the receipts from these fibres are included in the R&E valuation. Business rates are therefore payable in respect of optic fibres from the commencement date of the rating List, not merely from the day when they are lit. Physical additions to BT's hereditament are further taken into account by the annual revision mechanism which is based on the evolution of BT's market shares described in recitals 96 to 100.

(111) The UK Authorities acknowledge that the valuation methods, of necessity, require a different approach to the treatment of the lighting of additional fibres, but underline that the end result of the valuation exercise in both cases is that the value of the fibres to the occupier is reflected in the rateable value.

V. COMMENTS FROM OFCOM

(112) OFCOM is the independent regulator and competition authority for the UK communications industries. The comments from the UK authorities were provided by the UK central government and do not represent the views of OFCOM. As a result, the Commission asked OFCOM to provide its comments on the decision to initiate the procedure by letter dated 26 July 2005. They were provided by OFCOM by letter dated 21 September 2005.

(113) OFCOM considered the extent to which differences in methodology and practice may have effects on the conditions of competition. Its general conclusion was that the non-domestic rating system is currently not having an adverse effect on the conditions of competition in the telecommunications market.

(114) Concerning the rates/revenue ratio, OFCOM is of the view that this ratio is not pertinent for assessing the fairness of the non-domestic rates system. It points out that rates are related to the expected market rents, which are likely to reflect the efficient use of the assets. If an asset is used

⁽³⁶⁾ The level of receipts used in these valuations is a figure adjusted to the United Kingdom, which takes out non-relevant revenues.

inefficiently by a firm, rates may be a significant proportion of its revenues. For example, the rates/revenues ratio for a fibre network may depend on the amount of data for which it is used. Differences in the rates/revenue ratio of different companies may thus simply reflect differences in the value of the services they provide to customers through similar rateable assets.

- (115) Furthermore, OFCOM calculated the rates/revenue ratio for a certain number of telecommunications operators in the United Kingdom:

	2005 rate liability (GBP million)	2005 revenues (GBP million)	Rates/revenue (%)
BT	238,31	18 623	1,28
NTL	24,26	1 930	1,26
Telewest	15,49	1 300	1,19
C&W	16,37	1 602	1,02
Kingston	3,35	364	0,92
Energis	3,27	720	0,45
Global Crossing	3,13	270	1,16
Easynet	1,77	78	2,28
Thus	2,41	341	0,71
Your Communication	1,09	186	0,59
Fibernet	1,08	47	2,32
Gamma Telecom	0,46	72	0,63

- (116) OFCOM also calculated Vtesse's ratio for 2003, the only year for which it had available figures. This ratio was 2,1 %. These figures show that the rates/revenue ratio differs significantly and with no clear pattern to volumes of revenues. OFCOM concluded that not only is this ratio a flawed methodology for assessing the fairness of the non-domestic rating system, but the allegation that BT generally pays a smaller amount in rates compared to its revenues than its competitors appears to be false.

- (117) OFCOM underlines the difficulty of making appropriate comparisons between very different telecommunications operators (e.g. the average rateable value of a route kilometre of a fibre network can be very different according to the characteristics of the network to which it belongs and to the number of lit fibres on that route). It nevertheless suggested some alternative ways of comparing BT's taxation with that of its competitors. For instance, it calculated the ratio rateable value/connection for BT and the three

companies which are most similar to it regarding the local access network, i.e. Kingston, NTL and Telewest. All four are primarily local access providers. BT and Kingston are valued on the basis of the R&E basis and NTL and Telewest are valued on a method derived from the contractor's basis method. The results of OFCOM's calculations are shown in the table below. In the view of OFCOM, these rateable values per connections do not vary much from one operator to the other.

	Rateable value/connection
BT	GBP 21
NTL	GBP 22
Telewest	GBP 21
Kingston Communication	GBP 26

- (118) Therefore, in general, OFCOM concludes that there is little evidence to support an argument that BT pays significantly less than fibre backbone operators on any measure.
- (119) OFCOM also analysed whether the rating system introduces undue asymmetry in terms of marginal rate liability. On this point, OFCOM notes that the R&E method uses projected figures for revenues and costs and therefore conceptually includes any network build required to meet these business plans. The R&E basis is not limited to the state of BT's network at the start of the five-year period but reflects the necessary changes that will be made to it over the following five years, with annual reassessments to capture and rate material changes to BT's hereditament. In the view of OFCOM, although the incremental charge is more apparent to smaller operators, as each fibre lit leads to a specific additional rates charge, this does not mean that BT's rateable value does not include amounts for similar changes. OFCOM concluded that it has no evidence to suggest that, unlike telecommunication operators assessed under the rental method, BT pays no additional rates when it lights a fibre. The system would appear to provide a materially symmetrical outcome in the long term in each case, albeit through different routes and with low levels of transparency.

VI. LEGAL ASSESSMENT

State aid assessment pursuant to Article 87(1) EC

- (120) According to Article 87(1) EC, 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.' Therefore, a measure constitutes State aid

within the meaning of Article 87(1) EC if it fulfils the following four criteria:

- It confers a selective advantage on the recipient(s)
- It is granted by the State through State resources
- It distorts or threatens to distort competition
- It is likely to affect trade between Member States.

(121) In order to determine whether the application of the property tax to BT and Kingston has resulted in an economic advantage to these two firms, the Commission's analysis must be two-fold:

- It must first determine whether the rules concerning the property tax have been correctly applied to BT and Kingston and in particular whether the application of the R&E method was justified and properly applied.
- It must also consider whether the application of the R&E method to BT and Kingston confers an advantage on those firms in comparison with their competitors that are valued under the rental method.

6.1. *Correct application of the rules on property tax to BT and Kingston*

6.1.1. *Choice of the method applied to BT and Kingston*

(122) The first point considered is whether it was appropriate for the UK authorities to apply the R&E method to BT and Kingston instead of the rental method, which appears to be the generally applied method in the telecommunications sector. The question is whether there was enough rental evidence to assess BT's and Kingston's networks taking into account the rental evidence for the 1995-2000, 2000-2005 and 2005-2010 periods.

(123) In its decision to initiate the procedure, the Commission suggested that the internal transfer prices between BT's retail businesses and BT wholesale as well as the rent received by BT when renting out its own infrastructure could provide a basis for applying the rental method. Among the third parties that commented on the decision, the Altnet Task Force suggested specific sources of rental evidence, such as BT's wholesale line rental tariffs or its published prices for unbundled local loops, which could be used to determine the rental value of its copper cables.

(124) On these points, BT and the UK authorities have explained that the rental method could not be applied to assess BT's and Kingston's hereditaments. First, the evidence which the Commission or Altnet suggested using was not available for

the first two valuation periods (i.e. 1995-2000 and 2000-2005). That is the case of the LLU rental tariffs, which were applied from 31 May 2001 or the set of regulatory accounts that reflected transfer charges for BT's access services. Furthermore, even when that information was available, for instance for the latest valuation period of 2005-2010, it was not relevant and could not be used for a valuation of BT's and Kingston's very specific networks. For instance, the UK authorities have explained that the Wholesale Line Rental Tariff and the LLU Tariff are a payment for a service and, under existing case-law on the property tax, cannot be considered rental evidence to value the relevant part of BT's network. Furthermore the tariffs are regulated by OFCOM and as such are not 'open market rents'. As such, little weight can be given to those fees as evidence of rateable value. For these reasons, there is no actual market-based evidence concerning the access part of BT's or Kingston's networks, which is a unique characteristic of their networks.

(125) It also appears that even when rental evidence derived from other telecommunication operators exists, for instance on optic fibres, the differences between the use of optic fibres by those operators and the use that is made of them by BT and Kingston means that this rental evidence is not fully relevant to value the latter undertakings' hereditaments. The fibre rent quoted by Vtesse is based on market evidence for fibre trunk networks serving a small number of high value, high volume customers. BT's and Kingston's network are mainly local access networks serving millions of individuals in the case of BT. The role of their optic fibre network is mainly that of a backbone which interconnects their local loops. Their networks are for this reason unique and cannot be compared with any other in the United Kingdom, including large networks such as that of Cable & Wireless. It is true that parts of BT's network may be used by BT to provide services that compete with Vtesse, but they remain physically and functionally incapable of being disaggregated from BT's whole network. Therefore, on the whole, the two types of network do not fulfil the same function, and are unlikely to have the same rental value. This view is confirmed by OFCOM in particular, which pointed out that the average value of a route kilometre of a fibre network can be very different according to the characteristics of the network to which it belongs and that BT's core network topology is likely to be very different to that of a backbone operator catering for the corporate market.

(126) As to the possibility of applying the rental method to parts of BT's or Kingston's hereditaments for which rental evidence may be available and the R&E method to the rest,

that has also been ruled out by the VOA. The reason is that the R&E method can only be applied to the whole hereditament and it is not possible to separate parts of these firms' hereditaments, such as their optic fibre networks, since the hereditament has to be assessed as a whole under British case-law, since these parts are fully integrated with the rest of the network ⁽³⁷⁾.

- (127) The independent experts of the VOA therefore concluded that the rental method cannot be applied to BT and Kingston. That conclusion that the R&E method was the correct one, was confirmed by the Valuation Tribunal ⁽³⁸⁾. The Commission considers that there is no probative evidence showing the contrary. Consequently, the Commission concludes that there was not enough rental evidence to assess BT's and Kingston's networks in the periods under consideration and that the application of the R&E method to assess the rateable value of their networks was therefore justified.

6.1.2. Correct application of the R&E method to BT and Kingston

- (128) The next question is whether the R&E method has been correctly applied to BT and Kingston. On the basis of the extended explanations provided by the UK authorities and described at recitals 74 to 93, it appears to the Commission that the method was applied in accordance with the general rules on the R&E method, as laid down in the RICS Guidance Note on the R&E method of valuation for non-domestic ⁽³⁹⁾. The use of anticipated revenues and costs over a five-year period in the case of BT is not explicitly contemplated in the RICS Guidance Note. However, the guidance note does refer to the estimated future profitability when considering the hypothetical tenant's bid in the light of cyclical economic changes which are predictable as at the AVD. Furthermore, a method based on anticipated receipts and costs over a certain number of years has also been used in the assessment of the rateable values of hereditaments of gas and electricity operators, and is therefore not specific to BT. In the case of BT, given the prospect of increased competition and significant growth in competitors' networks which characterise the telecommunications sector, the use of forecast revenues and costs over five years is a reasonable methodology for assessing the hypothetical rent that a tenant with a reasonable prospect of continued occupation would be ready to pay for BT's network. Conversely, the stability of the market on which Kingston is present, which is characterised by limited competition, justified that a five year projection was not deemed to be necessary.

- (129) On the specific question of the settlement concerning the 1995-2000 period, the UK authorities have provided detailed explanations as to the reasons why the final rateable value (GBP 445 million in England, GBP 25 million

in Wales) was lower than the rateable value initially set by the Valuation Tribunal in its decision of 19 March 1998 (GBP 523 million for England and GBP 30 million in Wales). These explanations, which are summarised in recitals 88 to 92, show that the final lower rateable value of BT's network was not negotiated between the VOA and BT, as claimed by Vtesse, but was arrived at through the use of revised and more precise data, which were disclosed by BT following the decision of the Valuation Tribunal and which were not available at the time of the 1997 valuation, and through the use of more precise methods of valuation following the Valuation Tribunal's decision.

- (130) In relation to a point raised in the decision to initiate the procedure, it is also to be noted that, when applying the R&E method, the UK authorities do consider the level of profitability of BT. As already explained in recital 93, valuation under the R&E method must proceed on the assumption of an average level of efficiency, and the UK authorities have established that BT fulfils this criterion. The Commission also notes that the Universal Services Obligations are correctly taken into account since both the costs and revenues deriving from such obligations are included in the overall valuation.

- (131) Concerning the application of a revision mechanism based on the evolution of market shares, described at recitals 96 to 99, and discontinued in 2005, the information received indicates that this was an ad-hoc adjustment mechanism. It is the Commission's understanding that, under Schedule 6 to the LGFA, the VOA is under a statutory obligation to alter the rateable value of an undertaking if a material change in circumstances (MCC) takes place and to take this MCC into account as if taking place at the Antecedent Valuation Date. Given the size of BT's network, and the conditions of the telecommunications market, with the increasing development of competing networks, it is accepted that MCCs take place on a daily basis and are therefore difficult to take into account, especially in the context of the application of the R&E method. This market share based mechanism is supposed to reflect physical extensions of BT's network (which should result in an increase of its market shares) and the roll-out of its competitors' networks (which should result in a decrease of BT's market shares). Therefore, this revision mechanism appears to be a reasonable way of taking MCCs into account and can be justified by the characteristics of BT's network and the telecommunications markets.

- (132) The result of the application of this revision mechanism has led to fluctuations in the evolution of BT's rateable values. For instance, in 1999, in the last year of the 1995-2000 period, BT's rateable value in England and Wales was GBP 366 million. In 2000, in the first year of the 2000-2005 period, its rateable value was set at GBP 493 million. These

⁽³⁷⁾ See the explanations provided by the UK authorities, described at recitals 70 to 72.

⁽³⁸⁾ *British Telecommunications PLC v Central Valuation Officer*, 19 March 1998.

⁽³⁹⁾ See note 21.

fluctuations can be explained by the characteristics of the property tax and by the economic situation of the telecommunications sector in the United Kingdom ⁽⁴⁰⁾.

- (133) It must first be recalled that, under statutory requirements, for the 1995 valuation, BT's network was valued as it physically existed as at 1 April 1995, but on the assumption that it existed in that state in the economic conditions of 1 April 1993. Material changes in circumstances were also treated as having occurred at 1 April 1993. For the 2000 valuation, the same exercise was carried out, but having regard to the assumption that the hereditament was let in the economic context of 1 April 1998. This is also true for Kingston.
- (134) That means that the 1999 rateable value is the value of the hereditament as it physically existed in 1999, but in the economic context of 1993, i.e. at 1993 price levels and in a telecommunication market of the size it was in 1993. However, the following year's rateable value, i.e. in 2000, was calculated by reference to the economic conditions, price levels and size of the telecommunications market as they were in 1998. Similarly, the 2004 rateable value is set by reference to the economic conditions of the 1998 market, while the 2005 valuation is set by reference to the 2003 market conditions ⁽⁴¹⁾.
- (135) The UK authorities have pointed out that the economic conditions in the telecommunications sector were substantially different in 1993, 1998 and 2003. First, the telecommunications market grew significantly between 1993 and 1998, and between 1998 and 2003. Thus BT's physical network in 2000 was considered in a market that was bigger than the market in which BT's physical network was considered in 1999. This necessarily meant that its 2000 rateable value was likely to be significantly higher than in 1999. Furthermore, in 1993, the telecommunications sector was in the process of opening up to unprecedented competition and the effect on BT's trading position was likely to be profound. That is confirmed by the fact that BT's market shares fell from 87 % to below 70 % over that period. This anticipation had a downward effect on BT's rateable value for each of the years of that period. Conversely, in 1998, less competition could be anticipated, which is again confirmed by BT's relatively stable market shares of around 70 % over the 2000-2005 period. This anticipation was likely to have an upward effect on BT's valuation over that period.
- (136) Furthermore, the most valuable parts of BT's and Kingston's networks consist of their local access networks, the

value of which has significantly increased with the exploitation of broadband DSL technology. This development, which could not be fully anticipated in 1993, created an upward effect on the valuations of BT's and Kingston's networks and can explain why their valuations were significantly increased in 2000 and 2005.

- (137) The Commission also notes that the fact that only physical changes can be taken into account in the economic context of the AVD can explain why BT's rateable value fell over the life of the 1995-2000 and 2000-2005 rating lists despite the fact that its receipts or profits were stable or improving. Indeed, such elements as the growth of the market, the increase in price levels, technological changes or changes in the pattern of demand, which are factors that can have a positive impact on BT's results, cannot be taken into account by the VOA when carrying out its yearly revisions of the rating list.
- (138) The Commission finally takes note that a new annual revision system which will be applied to the 2005-2010 period is no longer based on the evolution of market shares, but will consist of the application of a full annual R&E valuation. The UK authorities have indicated that this system will fully reflect all physical changes, including newly lit fibres. However, since this revision system has not been finalised yet, the Commission has not had the opportunity to analyse it and its final conclusion in the Articles of this Decision will therefore be limited to the 1995-2005 period.
- (139) The Commission concludes that the UK authorities applied the appropriate valuation method to BT and Kingston and that the general principles concerning the application of the R&E method were respected by the UK authorities when they applied that method to BT and Kingston.

⁽⁴⁰⁾ The rateable values of the telecommunications operators valued under the rental method do not show the same fluctuations. It must, however, be stated that any comparison is likely to be misleading since their networks are rapidly expanding ones, while BT's and Kingston's networks are relatively stable. In any case, those telecommunications operators also enjoyed significant decreases in their rateable values, as explained in recital 173.

⁽⁴¹⁾ This explains why, contrary to the argument brought forward by BT, the VOA does not accept that BT's rateable value in 2003 and 2004 should be affected by the growing popularity of mobile telephony. The VOA considers that this is an economic change which took place in the life of the 2000-2005 list, and cannot be seen as a material change in circumstance to be taken into account as if taking place in the economic environment of 1998. Similarly, the VOA considers that it would not be correct to have regard to the opposite, upward effect of subsequent extra demand from internet access not predicted in 1998. Both economic phenomena could be taken into account only in the context of the elaboration of the 2005-2010 list.

6.2. Does the R&E method confer an advantage with respect to the rental method?

6.2.1. Does the R&E method result in an overall undervaluation of BT's and Kingston's networks?

- (140) The next point to be considered is whether the application of the R&E method to BT and Kingston confers an advantage on those firms in comparison with their competitors that are valued under the rental method. The question is whether this different treatment is likely to lead to a different result than that which would arise if the

valuation of those firms were carried out using the same methodology. In line with the comments of the UK authorities, the Commission is of the view that the existence of an advantage to BT and Kingston could be demonstrated in the following ways :

- (a) by showing that the application of the rental method to BT and Kingston would be possible and result in a higher rateable value than the R&E method, or
- (b) by showing the application of the R&E method to the other telecommunication operators would be possible and would systematically result in a lower rateable value than that derived from the rental method, or
- (c) by showing that, using other correct and relevant comparisons, telecommunication operators that are assessed under the rental method are taxed more heavily as compared with BT and Kingston.

(141) Demonstrating the existence of a possible advantage to BT and Kingston following the reasoning under point (a) supposes that the rental method is applicable to BT and Kingston. For the reasons explained in recitals 124 to 127, there is not enough rental evidence to assess the rateable value of their hereditaments. Consequently, the Commission concludes that it is not possible to establish that BT's and Kingston's rateable values would have been higher if the rental method had been applied to them.

(142) Demonstrating the existence of an advantage to BT and Kingston following the reasoning under point b) would involve applying the R&E method to a representative sample of telecommunication operators which have been valued under the rental method. The Commission is not in a position to carry out these valuations itself. The VOA has also explained that, without the business plans of these firms, it cannot carry out these valuations under the R&E method. It is also noted that none of the third parties has produced evidence that the application of the R&E method would result in lower valuations of their hereditaments: in its submission, UKCTA indicated that it could not calculate what its members would have paid in rates under the R&E method.

(143) On the basis of those considerations, the Commission must therefore conclude that the method in point b) cannot be used to demonstrate the existence of a possible advantage to BT and Kingston.

(144) The method suggested in point c) would be to use relevant comparisons to establish that BT and Kingston are under-taxed under the R&E method. This method was suggested by the Commission in the decision to initiate the procedure: according to the information that was then

available, BT was paying 2 % of its receipts in property tax, while Vtesse was paying two or three times as much.

(145) As a preliminary remark on the use and application of the rates/receipts ratio, the Commission notes that, according to Vtesse's comments, the revenue of telecommunications operators should be adjusted in order to allow a direct comparison of BT's rates/receipts ratio with that of other telecommunication operators. Vtesse claims that most operators pay significant fees to BT for the carriage and termination of traffic and that these fees do not relate to the rateable assets of these operators and therefore should not be used in any comparison of the rates burden.

(146) That argument cannot be accepted. The ratios to be compared should relate rates either to gross receipts or to net receipts. The 'halfway' approach suggested by Vtesse which consists of deducting some specific costs, such as interconnection fees, and not others does not seem accurate. First, it is not correct to assert, as Vtesse does, that the fees for the carriage and termination of traffic do not relate to the rateable assets of the operator under consideration: those fees are on the contrary necessary for the origination and termination of some of the traffic carried over their networks and therefore they directly relate to the operation of those networks. Secondly, those fees have a direct impact on the hypothetical rent that a putative tenant would be ready to pay for the network under consideration, since they are part of the costs that are borne for the use of that network. Finally, those interconnection fees are also a significant part of BT's income and as a result, they have a clear upward effect on BT's rateable value. Since the fees affect the hypothetical rent and rateable value of all telecommunications operators concerned, there is no justification for deducting them from the revenues generated by the telecommunications operators when carrying out a proper comparison between their rates/revenues ratios.

(147) On the question of the relevance of the rates/receipts ratio, the Commission notes that, in the view of the VOA and OFCOM, the rates/receipts ratio is not pertinent for assessing the burden of rates on the different operators. In the light of their comments and objections, the Commission can agree that this ratio is not a correct tool for assessing the fairness of the rates system, which is a tax on the value of a property, and not a tax on receipts or added value⁽⁴²⁾. As argued by OFCOM in particular, it appears that this ratio will vary according to the value of the services the operators provide to customers through similar rateable assets and according to how efficiently they use their assets. The Commission can therefore conclude that this ratio is at best indicative and that no firm conclusion can be drawn from it.

⁽⁴²⁾ This point is sufficient to rebut the suggestion, made by Gamma Telecom in its comments, that the respective burden of the business rates should be assessed on the basis of a comparison between the rates/added value ratio of BT and its competitors.

- (148) Moreover, even if this ratio is to be taken into consideration, it does not allow any useful conclusion to be drawn. According to figures provided by OFCOM for twelve telecommunication operators, the rates/receipts ratio ranges from 0,59 % for Your Communication to 2,32 % for Fibernet, with BT standing at 1,28 % and Kingston standing at 0,92 %. It appears that neither BT nor Kingston pays a significantly smaller share of their revenues in business rates than most of the other telecommunications operators. On this question, it is further to be noted that there is some disagreement on the calculation of Vtesse's rates/receipts ratio. For 2004, Vtesse claims that this ratio was 13,46 %. This figure was based on a rateable value of GBP 429 000 (which implied rates of GBP 195 624) and 'recurring revenues' of GBP 1 453 146. However, according to the UK authorities, Vtesse's rateable value for 2004 was subsequently reduced to GBP 145 000 (implying rates of GBP 66 120), since it appeared that it was not actually in occupation of a hereditament in Hounslow, valued at GBP 284 000. Furthermore, it appears from Vtesse's report and financial statements for the year ended 31 December 2004 that its total turnover in 2004 was GBP 4 744 228. On the basis of its total turnover, which is the figure used by OFCOM for comparison in the case of the other telecommunications operators, Vtesse's rates/turnover ratio in 2004 falls to 1,4 %, or 2,2 % if one includes the rates paid by Vtesse on its offices, which are valued separately. These figures are more in line with the conclusions of OFCOM, which found that Vtesse had paid 2,1 % of its revenues in rates in 2003. On the basis of these figures, there is no clear difference in the tax burden borne by BT and by Vtesse.
- (149) Other ways of comparing the tax burden imposed on the different telecommunications operators have been suggested by OFCOM and the UK authorities. OFCOM suggested that the rateable value/connection ratio for BT, Kingston, NTL and Telewest should be compared. The ratio is very similar for these four companies. In fact, Kingston is valued at a slightly higher level than the other operators, which may be explained by the fact that, being significantly smaller than the others, it may not have the same economies of scale. OFCOM's suggested comparison is all the more relevant given the similarities between these four companies, as locally provided access network services are an important part of their overall business. It is true, however, that NTL and Telewest are valued on the basis of method derived from the contractor's basis method. Therefore, such a ratio is not directly pertinent for assessing the alleged discrepancy between the valuations carried out under the rental method and under the R&E method. Nevertheless, it shows that using different methodologies and comparing BT and Kingston with firms more directly comparable than Vtesse leads to similar results, which tends to corroborate the VOA's assertion that, in principle, all valuation methods should lead to the same result.
- (150) As to the UK authorities, they indicated that, in the final year of the 2000 list, BT represented about 70 % of the total rateable value in the fixed-line telecommunications sector, and about 71,6 % of fixed-line call and access revenues according to OFCOM figures ⁽⁴³⁾. The Commission can agree that a comparison of BT with all the Altnet operators taken together may provide more pertinent conclusions than a comparison of BT individually with small operators such as Vtesse. On this basis, it appears that BT pays a proportion of the total rateable value in the fixed-line telecommunications sector that is very similar to its share in the fixed-line telecommunications market. It must be recalled, however, that this is again a comparison between rates and revenues, the relevance of which is limited and at best only indicative.
- (151) It must be noted that, instead of BT's market share of the total call and access revenues, Vtesse recommends that BT's market share of access revenues be taken into account. On that market, BT commands a share of over 80 %. In the view of Vtesse, this is further evidence that BT's hereditament is undervalued since BT only represents 70 % of the total rateable value in the fixed line telecommunication sector. The Commission cannot agree with this argument. First, BT's share in total access and call revenues seems a more appropriate benchmark for the purpose of assessing the burden of business rates: call revenues represent a larger share of BT's total revenues than access revenues ⁽⁴⁴⁾. Therefore, call revenues have a very significant impact on the hypothetical rent and rateable value of BT's network and should be taken into account in any comparison between revenues and rateable values. Secondly, even if BT's share of access revenues only is to be used, the difference between that share (80 %) and BT's share in the total rateable value in the fixed-line telecommunications sector (70 %) at a specific moment in time is not such as to raise questions on the level of BT's rateable value, especially in view of the limited value of any comparison between rates and revenues.
- (152) Vtesse suggests another method for proving the existence of an advantage to BT. It consists of pointing to the alleged discrepancy between the rateable values per unit of the different components (e.g. optic fibres, connections, buildings) of BT's network and those applied to other telecommunications operators. On that basis, Vtesse concludes that the R&E method has resulted in a lower valuation of BT's hereditament than would have been achieved under the rental method. Vtesse points out, for instance, that BT is rated at GBP 34 per square metre for buildings compared with GBP 115 per square metre in the case of other telecommunication operators, at GBP 74 per kilometre of optic fibre compared with the GBP 1 000/1 200 per optic fibre pair in the case of other operators, and GBP 19 per connection per year, compared with the annual fee of GBP 122 actually paid by operators for unbundled local loops.

⁽⁴³⁾ Available at <http://www.ofcom.org.uk/research/cm/nov05/>

⁽⁴⁴⁾ In 2004, call revenues represented 59,5 % of BT's call and access revenues.

(153) That approach is not satisfactory for a number of reasons. First of all, the UK authorities have convincingly argued that those figures, if they are correct, are not directly comparable. For reasons already stated in recital 125, BT's and Kingston's optic fibre networks are of a different nature from, and not comparable with, those of other operators. It is therefore not possible to apply rental evidence derived from other operators' optic fibre networks to BT or Kingston. In any case, the calculations and comparisons made by Vtesse are flawed.

(154) First, for an appropriate comparison, it would be necessary to take only BT's lit fibres into account since only lit fibres are rated. More importantly, Vtesse compared BT's average rateable value of km of optic fibre with the rental value of a fibre pair per route. In fact, the rental value of an optic fibre as applied by the VOA will vary according to the number of optic fibres per route. The more fibres per route, the lower their rental value will be ⁽⁴⁵⁾. Thus, taking the lit fibre rent tone applied as of 2005, it appears that the rental value of two optic fibre (i.e. a single fibre pair) per route km for networks above 3 000 km ⁽⁴⁶⁾ will be GBP 450 ⁽⁴⁷⁾. The rental value of three optic fibres per route km will be GBP 540, i.e. GBP 180 per optic fibre ⁽⁴⁸⁾. At the lower end of the table, the rental value of 48 optic fibres per route km will be GBP 1 728, i.e. GBP 36 per optic fibre ⁽⁴⁹⁾. The VOA claims that these values are market based ⁽⁵⁰⁾.

(155) It is clear that BT's core network has, on average, dozens of lit fibres per route. It means that the rateable value of BT per km of optic fibre should be compared with the lower end of the rating list used by the VOA. On that basis, it appears that, contrary to what is claimed by Vtesse, a comparison between BT's rateable value per km of optic fibre and the rental values used by the VOA does not show any significant discrepancy or indicate an undervaluation of BT's network.

(156) Concerning the comparison between the LLU tariff and BT's rateable value per connection, it is noted, first, that, according to the UK authorities, the LLU tariff is not the same as the rent for the rateable asset, since a significant proportion of the tariff relates to system and maintenance costs, billing, and costs of using BT's non-rateable plant and machinery. It is therefore not directly comparable with the

legal definition of the rateable value. Secondly, the UK authorities have indicated that some local loops will in fact have a high value, some a low value and some may even have a negative value. On the other hand, according to OFCOM, the provision of LLU services is aimed at stimulating competition in broadband services ⁽⁵¹⁾. Local Loop Unbundling is therefore also affected by the demand for broadband services and there is no demand for broadband services on a large number of BT's local loops, which are only required for telephony. Therefore, the LLU tariff does not reflect the average value of all BT's connections, and no conclusion can be drawn from a comparison of BT's rateable value per connection and the LLU tariff. As shown by OFCOM in its comments on the decision to initiate the procedure, this ratio is almost identical for BT, NTL and Telewest, despite the fact that a different valuation method was applied to the last two companies. For the reasons explained above, the ratio for NTL and Telewest appears to be more appropriate a benchmark than the LLU tariffs quoted by Vtesse, and the comparison between these ratios does not show any discrepancy between the different operators. It is further to be noted that, under its assessment, the VOA is considering applying a rateable value in the range of GBP 15 — GBP 20 per unbundled local loop ⁽⁵²⁾, which again is in line with the valuation of BT's rateable value per connection.

(157) As to the alleged difference in rateable value per square metre for buildings, the Commission first notes that the correct figure derived from the Telereal transaction ⁽⁵³⁾ is not GBP 35 per square metre as alleged by Vtesse but, applying a calculation similar to that of Vtesse, GBP 51 per square metre. Furthermore, this figure is compared by Vtesse with an alleged GBP 115 per square metre for other telecommunications operators. The basis and comparability of this figure is not clear and it does not reflect the variations that are likely to exist as a result, in particular, of the respective geographical locations of the telecommunication operators. The UK authorities have pointed out that BT's property portfolio covers the whole of the United Kingdom, including its most deprived and isolated areas, which has a downward effect on the average rental value of its properties.

⁽⁴⁵⁾ It reflects the general principle that the rent per square metre of a large building rented as a whole will be lower than in the case of a small building. OFCOM confirmed in its comments that, on the basis of the available information, rental prices for fibres are lower where more fibres are rented.

⁽⁴⁶⁾ As explained above, networks above 3 000 km benefit from a 10 % reduction, which is based on market evidence. This is the proper benchmark to make a comparison with BT's network given its size.

⁽⁴⁷⁾ GBP 500 in the London area.

⁽⁴⁸⁾ GBP 720 and GBP 240 respectively in the London area.

⁽⁴⁹⁾ GBP 2 256 and GBP 47 respectively in the London area.

⁽⁵⁰⁾ It is the Commission's understanding that the VOA has no direct evidence above 12 fibres and therefore, the top of the scale is based on decapitalised costs, i.e. on the assumption that an operator would set its maximum rental bid a network with 13 fibres and above at no more than the decapitalised costs of building the network itself.

⁽⁵¹⁾ OFCOM consultation document, 'Local loop unbundling: setting the fully unbundled rental charge ceiling and minor amendment to SMP conditions', 7 September 2005.

⁽⁵²⁾ In their submissions, GVA Grimley indicated that the VOA was of the view that a pair of unbundled copper wires was worth circa GBP 50 rateable value. In fact, at the time, and at a very preliminary stage in the analysis, the VOA suggested that this rateable value could be in the range of GBP 12 to GBP 50.

⁽⁵³⁾ See recital 36.

(158) More importantly, it should be recalled that BT's general purpose buildings, such as offices, or warehouses, which are not related or linked to the network, are valued locally and separately, on the basis of the rental method. In 2000, their rateable value was GBP180 million. Operational and specialised buildings, such as telephone exchanges are considered to form part of BT's network and are centrally valued by the VOA using the R&E method. The rent paid by BT to Telereal following the transaction was GBP 280 million. The total rateable value of BT's buildings includes both the rateable value of BT's separately assessed buildings, which was approximately GBP 180 million in 2000, and the rateable value of the buildings included in the overall valuation of its network, which it is not possible to specifically identify but which represents a significant share of the GBP 560 million rateable value of BT's network in the United Kingdom. These figures do not show that there is a significant discrepancy between the actual market value of BT's buildings, reflected by the Telereal transaction ⁽⁵⁴⁾, and their rateable value as calculated by the VOA ⁽⁵⁵⁾. Therefore, these figures do not provide any evidence that this rateable value is undervalued.

(159) Vtesse put forward a secondary argument on the basis of the Telereal argument. Vtesse suggests that the rent paid by BT to Telereal for its buildings represents roughly 50 % of its rateable value in 2001, despite the fact that most of the rateable value should be mainly attributable to its network and not its buildings. From that, Vtesse seems to derive the conclusion that BT's network is obviously undervalued. This argument, however, is based on incorrect premises, since part of the property included in the Telereal deal are those that were separately valued at GBP 180 million. BT's overall rateable value for the whole of United Kingdom at the time of the transaction was therefore equal to GBP 560 million for the network and linked properties plus GBP 180 million for the separately valued buildings, which gives GBP 740 million. The rent of GBP 280 million paid by BT to Telereal amounts to 38 % of its overall rateable value. No useful conclusion can be drawn on the basis of this figure.

(160) In any case, a methodology that consists in separating parts of BT's hereditament and valuing them in isolation seems questionable. As confirmed by British case-law, the VOA must value the hereditaments of telecommunication operators as a whole. This rule is applied without discrimination to all operators. It is an inherent feature in any type of property valuation that the market rent of a whole property is usually different from the sum of the market rents of parts of that property: it is often lower ⁽⁵⁶⁾, it may also be higher in certain circumstances. It is therefore likely that the market rent of BT's property

portfolio in isolation will be different from its value when included in BT's hereditament.

(161) There is thus no clear evidence that the R&E method would generally result in a lower rateable value than the rental method, or that the VOA, when applying the R&E method to BT and Kingston, erred and undervalued the rateable value of their hereditaments.

6.2.2. Does the R&E method confer an advantage at the margin?

(162) It should be noted as a preliminary point that the question of marginal taxation, i.e. taxation on newly lit fibres, is relevant only as regards the rating assessment of BT but not as regards Kingston. As stated in recital 22, Kingston owns a subsidiary, Torch Communications Ltd, which operates a fibre backbone network outside Kingston's local access network and which is valued on the basis of the rental method. As a result, Torch Communications Ltd is fully taxed on newly lit fibre. The R&E method is applied only to that part of Kingston's network which is essentially a local access network. As already explained ⁽⁵⁷⁾, its hereditament is not subject to a revision mechanism. That reflects the fact that, according to the UK authorities, no competitor has built networks in the Kingston upon Hull conurbation area and Kingston already had network coverage of almost 100 % in the area, so it did not extend its network. There was therefore no claim of material changes of circumstances which could have significantly altered the rateable value of Kingston's network. The Commission accepts this argument and notes that no third party has claimed that Kingston was benefiting from any advantage at the marginal level.

(163) In the case of BT, however, the fact that there is no evidence of the existence of an advantage at the level of the overall valuation of its hereditament does not necessarily exclude the possibility that marginal taxation, i.e. on the rating of newly lit fibres, does grant an advantage to this firm. In fact, the comments provided by several third parties indicate that the different way of rating BT and the other telecommunication operators when they light a new fibre may result in distortions of competition when these firms compete for the same contract. This problem raises the more general question of the revisions of rateable values that are conducted annually by the VOA.

(164) As explained above, when a telecoms operator to which the rental method is applied connects and lights a new fibre, its rateable value is increased by the rateable value of this new fibre. The opposite takes place when it switches off and disconnects a fibre: the fibres' rateable value is then deducted. Telecommunication operators that are assessed

⁽⁵⁴⁾ The Telereal transaction covered almost the entirety of BT's portfolio: only 220 out of 6 700 properties remained in BT's ownership.

⁽⁵⁵⁾ Account should also be taken of the fact that the actual rental value of a property should not necessarily be equated with its hypothetical rateable value.

⁽⁵⁶⁾ Market evidence usually reflects the fact that the larger the property, the smaller the unit price. This principle is taken into account by the VOA, since, on basis of the market evidence, it grants a 10 % discount to networks over 3 000 fibre kilometres in length.

⁽⁵⁷⁾ See recital 98.

under the R&E method are not subject to this type of precise adjustment. In the case of BT, the annual revisions are based on a market adjustment mechanism: changes in BT's market shares are supposed to reflect changes in the value of its network. The question is therefore whether the different way of taking into account changes in the networks, such as the lighting of new fibres, is likely to confer an advantage on BT.

(165) It is the understanding of the Commission that, on the basis of the business plans provided by BT, the VOA assesses the hypothetical rent that can be expected from BT's hereditament on the basis of the anticipated receipts and expenditure deriving from the occupation of that hereditament. The valuation will therefore include any extension of the network, including the lighting of new optic fibres, which will be required to meet the anticipated demand. The lighting of new optic fibres, whether leased or actually owned by BT ⁽⁵⁸⁾, is therefore anticipated and taken into account by the VOA. In fact, because of this valuation method, and unlike the telecommunications operators that are assessed under the rental method, BT is rated on dark fibres as well, on the assumption that some of these dark fibres will be lit in the course of the following five year valuation period. Finally, the annual reassessment based on the evaluation of BT's market shares is meant to capture the material changes to BT's network ⁽⁵⁹⁾.

(166) Therefore, it is not correct to say that BT does not face any incremental tax liability, as suggested by the complainant or third parties such as Altnet. Certainly, with a network hereditament in England currently with a rateable value of GBP 530 000 000 which is valued as a whole, a small incremental change such as the additional lighting of a fibre is less likely to have a discernible impact on BT than on a small operator such as Vtesse. Furthermore, increases in value of BT's network are offset by factors resulting in a decrease of that value, such as the rolling out of competing capacity. This makes the impact of the lighting of new fibres by BT even less visible. That does not mean however, that these newly lit fibres are not rated.

⁽⁵⁸⁾ Vtesse raised the point that BT has allegedly rented some 2 000 km of optic fibres from GEO, one of Vtesse's suppliers and inquired whether this extension of its network had been properly assessed. The VOA has obtained confirmation from GEO that it had rented 1 717 route km of fibres to BT. It is not clear at this stage whether the fibres leased by BT have been lit, if they are replacement fibres for obsolete BT fibres or if they are new route. Concerning the way these fibres will be taken into account in the review of BT's rateable value, the VOA explained that the existing R&E valuation is based on a model which anticipates future income streams and it will, as part of the review, take into account the income stream expected from the fibres which BT has leased from GEO. This review will be carried out on the basis on the new revision mechanism, which is still being finalised.

⁽⁵⁹⁾ The UK authorities have confirmed that the revenues from broadband services were taken into account in the annual revision method applied to BT and based on market shares.

(167) It is also alleged by Vtesse that, in a typical bid such as the one for the provision of backbone and access telecommunication links to Kent MAN ⁽⁶⁰⁾, its rate liability represented 16 % of expected recurring revenues. On the same bid, it claims that BT was, at most, rated at 2 %, which is BT's alleged average rates/receipts ratio. Vtesse concludes that BT is much less taxed on a comparable and in this case identical transaction and therefore that it receives a clear advantage.

(168) That approach cannot be retained. First of all, it is not correct to assume that, since BT has an average rates/receipts ratio of 2 % ⁽⁶¹⁾, it was taxed at 2 % on that bid. That ratio is calculated on the basis of BT's overall rateable value, to which the value of the fibres lit by BT following the Kent MAN contract were added, either in anticipation or on the basis of the market share based revision mechanism. In order to make an appropriate and correct comparison with Vtesse's tax liability on that bid, it would be necessary to determine by how much the contract concerned increased the rateable value of BT's network, either in anticipation or via the annual revision mechanism. The anticipated valuation makes an overall assessment from which it is not possible to identify individual contracts. Therefore, it is not possible to determine by how much the Kent Man contract has increased the rateable value of BT's network. In any case, it would not lead to definitive conclusions concerning the possible existence of an advantage and therefore the existence of State aid. Vtesse's rate liability on this bid cannot be seen as a benchmark on the basis of which it is possible to assess the existence of an advantage to BT within the meaning of Article 87(1) EC. The tax liability is in fact likely to change depending on the technical solution chosen, the cost structure of the firms presenting a bid and the length of the optic fibre network operators will use to provide the services and, most importantly, will depend on the extent to which they will have to light new fibres ⁽⁶²⁾. Thus, under the rental method, a telecommunications operator who provided the service by using an already lit fibre would not face any increase in rates ⁽⁶³⁾.

⁽⁶⁰⁾ See recital 41.

⁽⁶¹⁾ As already explained the precise ratio for BT varies according to the assessments and varies from 1,28 % (OFCOM) and 2 % (Vtesse) and 3 % (UK authorities). The discrepancy between the figures provided by Vtesse and the UK authorities has been explained at recital 107. The lower figure obtained by OFCOM may be explained by the fact that it used the total turnover of the BT group, including the turnover of its activities outside the UK.

⁽⁶²⁾ It is technically feasible to use already lit fibres to supply high bandwidth services to corporate customers. In that case, under the rental method of valuation, there will be no increase in the rateable value of a telecommunications operator's network.

⁽⁶³⁾ The operator may have to pay rates only on the spurs linking the fibre to the customer's premises.

(169) The same reasoning can be applied to the argument Vtesse based on a comparison between the prices of BT's Wholesale Extension Services ('WES') and the rates that an operator valued under the rental method would have to pay if it were lighting optic fibres for the purpose of providing the same service. Depending on the capacity and distances of the WES, Vtesse claims that such an operator could have to pay rates worth up to 87 % of the price charged by BT and sees that as further evidence of the fact that BT's optic network is undervalued or not properly taxed at the margin. However, the argument is based on the assumption that the hypothetical operator would have a single pair of lit fibre on the same route as the one chosen by BT. However, if this operator uses an already lit fibre in order to provide its WES, the extra costs in rates under the rental method will be nil. Furthermore, if he lights new fibres on a route on which he already has several lit optic fibres, then the marginal costs of the operation will be much lower since the more optic fibres per route, the lower the rates per fibre. Again, no conclusion can be drawn from this argument.

(170) In the light of these facts, the allegation that BT is not rated at the margin is not correct. Even if, as suggested by Vtesse, the unit of analysis is the taxation of contracts on which Vtesse and BT compete, it appears that there is no obvious advantage to BT: it is taxed on newly lit fibres, albeit differently and less transparently. The Commission also notes that, because the R&E method is based on anticipated revenues, BT is rated on dark fibres on the assumption that these fibres will have to be lit to meet the anticipated demand. Therefore, unlike other telecommunications operators which are rated only once they light a fibre, BT is also rated on dark fibres.

(171) The Commission can therefore concur with OFCOM when it says that 'the system [of revisions] would appear to provide a materially symmetrical outcome in the long-term in each case, albeit through different routes and with low levels of transparency.'

(172) The absence of any obvious competition issue is further confirmed when the market shares on the market for the provision of high bandwidth services to corporate customers are considered, on which BT is in direct competition with Vtesse⁽⁶⁴⁾. According to figures provided by BT, BT's share on that market is 12 %, and it is only the fourth largest player. According to figures provided by OFCOM, BT has [10-15] % (*) of the market in the provision of traditional interface leased lines of 622 Mbit/s and above⁽⁶⁵⁾. Despite being the incumbent in the telecommunications sector, it therefore appears that BT had a relatively low market share in this specific market. It could be assumed that, if BT was indeed enjoying such a

substantial advantage in the form of an exemption from marginal taxation on new fibres, its market share would be significantly higher. Therefore, data available to the Commission do not confirm the allegation that BT benefits from a competitive advantage which would make it very difficult for other telecommunications operators to compete with it on this specific market⁽⁶⁶⁾.

(173) As a final point on the question of revisions, the Commission also raised the concern in its decision to initiate the procedure that 'while BT does enjoy a downward revision mechanism, there does not seem to be a similar systematic review of market conditions faced by competitors'. In view of the explanations provided by the UK authorities and BT, the Commission is satisfied that this concern is unfounded. BT is not subject to a downward revision mechanism only: as already explained, the revision mechanism applied to BT is based on the evolution of its market shares. It is true that for a certain number of years, its market shares, and therefore its rateable value, decreased, which reflected a loss in value due to increased competition. In 2003 and 2004, however, its rateable value increased by GBP 4 million and GBP 7,1 million respectively. As to competitors, they can, and have indeed, benefited from downward revisions: for instance, they received a 15 % discount on the rateable value of their optic fibre networks as of 1 April 2001 and a 25 % discount as of 1 April 2002 in order to reflect oversupply in that sector. As a result, the rateable value of a fibre pair fell from GBP 1 000 per km outside the London area in 2000 to GBP 850 per km in 2001, and GBP 750 between 2002 and 2004. Under the 2005-2010 list, the rateable value of km of fibre pair has further fallen to GBP 500. It means that an operator whose optic fibre network remained stable over that period would have enjoyed a 50 % reduction of its rateable value.

CONCLUSION

(174) In conclusion, it should be recalled that business rates are a tax on the value of the property concerned. They are not a tax on profits or revenues. They are normally applied on all non-domestic properties, and consequently are applied to all telecommunications networks. According to British case-law, all telecommunications networks are valued as a whole. There are several methods for valuing such property. When all methods can be applied, they should result in the same valuation. The use of a specific valuation method depends on the circumstances of the case.

(175) It now appears that the VOA has applied to BT and Kingston the general rules concerning business rates as laid

⁽⁶⁴⁾ Vtesse describes itself as a carrier providing innovative very high capacity services (up to 66 Gigabits per second).

(*) Confidential information.

⁽⁶⁵⁾ For the lower bandwidth segment, it is also useful to point out that OFCOM considers that BT does not have significant market power in the retail market of leased lines of 8 Mbit/s and above. See <http://www.ofcom.org.uk/consult/condocs/llmr/>

⁽⁶⁶⁾ Vtesse actually won a large contract against BT, in 2004, for the provision of high bandwidth services to Lloyds TSB.

down in the legislation and case-law. It is clear that the valuation of BT's and Kingston's hereditaments as well as the revisions of these rateable values, are carried out on the basis of a different method than in the case of their competitors. However, the Commission can conclude that there is no evidence that the use of this different method is not justified by the objective differences between those firms and their competitors and by the extent of the evidence available to the VOA.

- (176) There is no evidence that the application of a different valuation method to BT and to Kingston has resulted in an advantage to these firms in comparison with their competitors. Since there is no evidence of an advantage, the Commission can conclude that the non-domestic rates system has not provided State aid to BT and/or Kingston within the meaning of Article 87(1) EC during the period considered by the Commission i.e. 1995-2005.

HAS ADOPTED THIS DECISION:

Article 1

The application by the United Kingdom of the tax on non-domestic property to BT plc and Kingston Communications plc from 1995 until the end of 2005 does not constitute aid within the meaning of Article 87(1) of the Treaty.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 12 October 2006.

For the Commission

Neelie KROES

Member of the Commission