

Commission Decision of 4 August 2010 on State aid C 40/08 (ex N 163/08) implemented by Poland for PZL Hydral S.A. (notified under document C(2010) 5406) (Only the Polish version is authentic) (Text with EEA relevance) (2010/690/EU)

COMMISSION DECISION

of 4 August 2010

on State aid C 40/08 (ex N 163/08) implemented by Poland for PZL Hydral S.A.

(notified under document C(2010) 5406)

(Only the Polish version is authentic)

(Text with EEA relevance)

(2010/690/EU)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(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(2008) 4753 final⁽¹⁾ by which the Commission decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union and decision C(2008) 6371 final⁽²⁾ extending the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union in respect of aid C 40/08 (ex N 163/08),

Having called on interested parties to submit their comments pursuant to the provisions cited above,

Whereas:

I. **PROCEDURE**

- (1) By letter of 27 March 2008, the Polish authorities gave notification of a restructuring plan for PZL Hydral S.A. ('PZL Hydral'). The Commission requested additional information by letter of 6 May 2008. By letter of 4 June 2008, the Polish authorities requested that the deadline for replying be extended until 27 June 2008; the Commission agreed by letter of 10 June 2008. The Polish authorities provided additional information concerning the restructuring plan by letter of 7 July 2008.
- (2) Proceedings under Article 108(2) of the Treaty on the Functioning of the European Union (the formal investigation procedure) were opened on 10 September 2008. The formal investigation procedure was subsequently extended by a decision adopted on 12 November 2008.

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- (3) Poland submitted its observations on 14 October and 22 December 2008 and additional information on 7 April 2009. The Commission received no comments from third parties.
- (4) Meetings with the Polish authorities took place on 27 April and 14 October 2009 and 12 February 2010. On 18 December 2009 the Commission requested further information. Various exchanges of emails took place between the Commission and the Polish authorities and additional information was submitted by the Polish authorities by email on the following dates: 20 October 2009, 23 November 2009, 15 December 2009, 13 January 2010, 16 January 2010, 9 February 2010, 10 February 2010, 26 February 2010, 1 March 2010, 3 March 2010, 4 March 2010, 19 March 2010, 5 May 2010, 12 May 2010, 20 May 2010, 28 May 2010, 3 June 2010, 4 June 2010, 7 June 2010, 8 June 2010, 9 June 2010, 17 June 2010, 23 June 2010, 24 June 2010, 28 June 2010, 7 July 2010, 8 July 2010, 9 July 2010, 12 July 2010 and 13 July 2010.

II. DESCRIPTION

II.1. The beneficiaries: PZL Hydral and PZL Wrocław

PZL Hydral

- (5) PZL Hydral was established in 1946 as a State enterprise. It is now a large company which until 2008 specialised in the production of civil and military industrial hydraulics, the design, manufacture and service of electronic hydromechanic fuel-regulating systems for aviation engines of all types, hydraulic control systems for aircraft and power hydraulics for helicopters. Since 2008 PZL Hydral has operated as the parent company of a group and no longer has any industrial activities of its own.
- (6) In 2003 the state-owned Industrial Development Agency ('the IDA') acquired 80,94 % of shares in PZL Hydral (1 284 686 shares) from the Treasury. Further transfers of shares from the Treasury to the IDA took place in 2005 (499 103 shares), increasing the IDA's shareholding to 87,39 %, in 2007 (64 374 shares), increasing the shareholding to 90,54 %, and on 12 January 2010 (38 399 shares), increasing the shareholding to 92,42 %. Each of these transactions was effected at the symbolic price of PLN 1. Since 12 January 2010 the IDA has held 18 886 562 shares with a nominal value of PLN 18 865 620. The remaining shares (7,58 %), with a nominal value of 1 547 210, are currently held by the employees.
- (7) In 2007 PZL Hydral controlled the following subsidiaries: Zakład Odlewniczy 'Hydral' Sp. z o.o., whose main activity is casting, founding, processing and treating steel parts; Zakład Ciepłowniczy Term 'Hydral' Sp. z o.o., which produces and sells thermal energy; Przedsiębiorstwo Usługowo Handlowe Zakład Produkcji Hydrauliki 'Hydral' Sp. z o.o., which produces valves and hydraulic distributors, processes metal equipment and provides repair services for hydraulic machinery and equipment, and PZL Wrocław Sp. z o.o. ('PZL

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Wrocław'). In addition, PZL Hydral controlled two other companies, now in the process of liquidation. At end-2006 the group as a whole had 795 employees.

PZL Wrocław

- (8) PZL Wrocław was founded as a fully-owned subsidiary of PZL Hydral in 2004 in order to create an operating company which would take over the operational arm of PZL Hydral, thereby allowing the latter to act as holding company and manage the restructuring process of the PZL Hydral group.
- (9) A part of PZL Wrocław's assets was transferred from PZL Hydral to PZL Wrocław either by way of an in-kind contribution to the capital of PZL Wrocław or a sale at the book value in the books of PZL Hydral as of 2004, as shown in Table 1.

TABLE 1

Transfer of assets by way of an in-kind contribution or sale (in PLN)

Date of transfer	Type of assets	Method of transfer (sale/in-kind contribution)	Book value of assets
30.12.2004	fixed assets - movable	in-kind contribution	3 917 321,0
30.12.2004	intangible assets	in-kind contribution	801 332,0
30.12.2004	work in progress	in-kind contribution	1 251 352,0
30.12.2004	materials	in-kind contribution	251 719,0
30.11.2006	fixed assets - movable	in-kind contribution	138 516,44
30.11.2006	materials	in-kind contribution	679 915,73
30.11.2006	fixed assets - movable	in-kind contribution	1 186 803,54
30.11.2006	intangible assets	in-kind contribution	290 268,95
20.6.2007	fixed assets - movable	sale	1 250 000,0
30.12.2007	fixed assets - movable	in-kind contribution	1 293 600,0
21/23.12.2008	work in progress	sale	5 230 644,91
27.3.2008	materials	sale	2 985 631,15
10.3.2009	materials	sale	304 294,33

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- (10) The tangible fixed assets which PZL Wrocław acquired from PZL Hydral were transferred either as an in-kind contribution to the capital of PZL Wrocław or by way of a sale, as shown in Table 2. In both cases the value of the transaction was based on the assessment of an independent expert. When these fixed assets were transferred they had already been encumbered with mortgages on real estate in favour of the following public creditors: the Social Security Office, the Lower Silesia Region Tax Office and Wrocław City Council in an amount of PLN 142,558 million.

TABLE 2

Transfer of real estate (in PLN)

Date of transfer	Type of assets	Method of transfer (sale/in-kind contribution)	Book value of assets
30.12.2007	fixed assets – real estate	in-kind contribution	8 337 000,0
30.12.2007	fixed assets – real estate	sale	10 309 508,56

- (11) On 31 December 2007, PZL Hydral transferred to PZL Wrocław funds with a nominal value of PLN 918 900 by way of a contribution to the capital of PZL Wrocław.
- (12) The rest of the assets transferred from PZL Hydral to PZL Wrocław between 17 January 2006 and 27 April 2010 were sold at their book value and consisted of numerous transfers of assets under construction which were free of any pledges or mortgages.
- (13) The overall value of the assets transferred from PZL Hydral to PZL Wrocław between 2004 and 2010 amounted to PLN 44 708 791,02.
- (14) 559 employees were transferred from PZL Hydral to PZL Wrocław in 2008 and 37 employees were transferred in 2009.
- (15) PZL Wrocław produces components for aircraft used by the Polish armed forces (until end-2007 this production was carried out by PZL Hydral) and provides services comprising the maintenance and repair of equipment used by the Polish army. Military products undergo certification specific to the product type in accordance with the technical requirements of the Polish armed forces. Individual documentation is provided at each stage and these products (and the associated maintenance services) are supervised by a resident military representative.

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- (16) PZL Wrocław currently operates on the basis of Permit No B-007/2007 issued by the Minister for Internal Affairs and Administration on 17 January 2007 for the performance of business activities in the area of:
- production and marketing of devices to shoot off alarm, signal and gas munitions as defined in paragraph 8 (Types of arms and ammunition) of Appendix No 1 to the Cabinet Regulation dated 3 December 2001 on types of arms and ammunition and a list of military and police products and technologies for the production and marketing of which a permit is required⁽³⁾,
 - production and marketing of military or police products as defined under heading ‘WT V’ and components and constituents of products as defined under heading ‘WT II’, ‘WT III’ and ‘WT XIV’ (Paragraphs 1-4 and 7-10) of Appendix No 2 (List of military and police products and technologies for the production and marketing of which a permit is required) to the above-mentioned Cabinet Regulation,
 - production and marketing of equipment for the manufacture of military or police products and marketing of technology for the manufacture of products intended for that purpose as defined under heading ‘WT XIII’ of Appendix No 2 (List of military and police products and technologies for the production and marketing of which a permit is required) to the above-mentioned Cabinet Regulation.
- (17) PZL Wrocław holds the following certificates:
- certificate of compliance with the requirements of ISO 9001:2000 awarded by Bureau Veritas Certification,
 - certificate of compliance with the requirements of AS9100-B awarded by Bureau Veritas Certification,
 - certificate authorizing the production of aviation accessories meeting the requirements of the PART 21 aviation regulations awarded by the Polish Civil Aviation Office,
 - certificate for performance of the technical servicing of products meeting the requirements of the PART 145 aviation regulations awarded by the Polish Civil Aviation Office,
 - NADCAP certificate awarded by the Performance Review Institute for selected special process: heat treatment (HT), non-destructive testing (NDT), chemical processes (CHP) and electro-discharge machining (EDM).

The role of PZL Hydral in the economic development plan

- (18) The Polish authorities informed the Commission that the product line of PZL Hydral (and now PZL Wrocław) is an important part of the economic development plan launched by the Polish Government in 1995 for 1996-2000 and in 2000 for 2001-2006.
- (19) Moreover, explicit reference is made to PZL Hydral or to its business activities in a number of implementing measures and governmental guidelines for the economic development plan, such as:

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- guidelines of the Minister/Head of the Central Planning Office dated 30 January 1995 on the economic development plan for 1996-2000,
 - guidelines of the Minister for Economic Affairs of July 2000 on the central economic development plan for 2001-2006,
 - Organisation of Work Implemented by Companies for the Purposes of National Defence Act of 23 August 2001⁽⁴⁾,
 - Cabinet Regulation of 24 June 2003 on facilities of particular significance to the security and defence of the state and special protection thereof⁽⁵⁾,
 - Cabinet Regulation of 20 August 2004 listing companies of particular economic and defence significance⁽⁶⁾,
 - Cabinet Regulation of 9 November 2007 listing companies of particular economic and defence significance⁽⁷⁾.
- (20) Companies entered on lists of this type are required to provide detailed annual reports on their defence production capacity (quantities, profile, values) in order to enable the Ministry to ensure that the military tasks are performed.
- (21) The Polish authorities informed the Commission that the relevant permits and certificates (points 16 and 17) enable goods and services of specific quality to be supplied to special customers (enterprises of particular significance to the defence of the state and the Ministry of Defence). PZL Wrocław (PZL Hydral in the past) does not just supply components of hydraulic systems, fuel systems and control systems; repairs to installed sub-assemblies are crucial to the functioning of the aircraft operated by the Polish armed forces (W-3, Mi-2, M28 Bryza and PZL 130 Orlik); the Polish authorities also emphasised that the W-3 and Mi-2 are the main helicopters used by the Polish army.
- (22) The goods produced by PZL Hydral for the use of the armed forces have the corresponding NATO code under the NATO Standardisation Agreement and the company itself has a NATO code.

Financial relationships between PZL Hydral and PZL Wrocław

- (23) As explained above in point 9 et seq., as of December 2004 PZL Hydral transferred assets to PZL Wrocław. Only the assets transferred on 30 December 2007 (real estate) were encumbered by mortgages in favour of public creditors.
- (24) The Polish authorities confirmed that since it started operating PZL Wrocław has settled all its liabilities vis-à-vis public creditors on time, including social security contributions and taxes for its employees.

II.2. Financial difficulties of PZL Hydral

- (25) PZL Hydral started to have difficulties in repaying liabilities to both its private and public creditors in 1998.

Liabilities vis-à-vis private creditors

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- (26) At the end of 1998, PZL Hydral's private liabilities vis-à-vis banks and suppliers amounted to PLN 90,4 million. The bulk of these debts were owed to two banks: Bank [...] ⁽⁸⁾ and Bank [...].
- (27) PZL Hydral owed Bank [...] PLN 54 million at the end of 1998 and PLN 86,4 million by November 2006, when a settlement agreement was signed, and its claim was finally settled in 2007. PZL Hydral owed Bank [...] PLN 23 million at the end of 1998 and PLN 55,6 million by October 2003, and its claim was finally settled in 2004.

TABLE 3

Changes in the total amount owed by PZL Hydral to [...] (PLN thousand)

	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006
Principal	44 447	48 424	51 605	49 628	37 416	39 041	38 741	38 291	35 377
Interest	19 583	17 683	26 194	34 449	29 157	38 184	40 920	43 776	51 018
Total	54 030	66 107	77 798	84 077	66 573	77 225	79 721	82 067	86 395

TABLE 4

Changes in the total amount owed by PZL Hydral to [...] (PLN thousand)

	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006
Principal	18 571	21 986	21 959	21 127	20 741	19 825	4 000	0	0
Interest	4 572	5 983	10 842	16 759	23 975	35 773	0	0	0
Total	23 143	27 969	32 801	37 886	44 716	55 598	4 000	0	0

- (28) These private banks had first-rank collateral (see detailed description in points 32 and 34 below) and could have easily enforced their claims on the basis of bank enforcement orders. Under the 1997 Banking Act ⁽⁹⁾, banks can issue bank enforcement orders on the basis of their records or other documents relating to banking transactions. A bank enforcement order can serve as a basis for enforcement after the court has attached an enforceability clause to it. This is a much quicker way than is the case for other creditors, who must apply to the competent court prior to enforcement for a decision to be handed down. Despite this, the private creditors have not taken any forced enforcement action; in other words, they have not applied for bankruptcy proceedings to be instituted against PZL Hydral and nor have they taken any other action to enforce their claims against the assets.
- (29) When PZL Hydral experienced difficulties in repaying its loans in 1998-2006, the banks could, under the Civil Code, have charged it statutory interest at a rate determined by the Cabinet, as shown in Table 7. However, instead of

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charging this interest systematically, at times they merely charged interest at the rates shown in Table 5 and Table 6.

TABLE 5

Interest rates charged by Bank [...] (USD loans based on LIBOR)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
%	8,53	8,71	9,87	8,5	8,5	8,5	8,5	8,5	8,5	8,5

TABLE 6

Interest rates charged by [...] (USD loans based on LIBOR)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
%	7,78	7,96	9,12	6,08	4,45	3,62	4,37	6,26	7,63	7,37

TABLE 7

Statutory interest rates

Rok	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
%	34	23	23	30	18	13	12	13	11,5	11,5

- (30) The Polish authorities argue that these banks thought that they would receive a higher return if they contributed to the restructuring process of PZL Hydral. They closely followed negotiations with the first company that showed an interest in acquiring PZL Wrocław, namely [...] (see point 57 et seq.). The banks regularly monitored the economic situation of PZL Hydral on the basis of its financial reports, visits to its premises and market analysis.
- (31) Bank [...] finally settled its liabilities by way of a settlement agreement concluded in April 2003. It wrote off PLN 51,6 million and accepted the repayment of only PLN 4 million (7 %). The write-offs resulting from the settlement agreement were entered in PZL Hydral's books for the 2004 financial year.
- (32) Bank [...] agreed to settle on the basis of its own economic assessment despite holding first-rank priority mortgages. In particular, the bank secured its credit by establishing collateral of PLN 13,7 million on real estate, assigning all licence and commercial rights under the licence agreement concluded with [...] regarding the production of air conditioning equipment to a value of USD 1,2 million (PLN 3 968 000 approx.)⁽¹⁰⁾, transferring machines and equipment supplied by [...] under the licence agreement to a value of USD 2,4 million (PLN 7 938 000 approx.) and assigning receivables from the sale of air conditioners to a value of at least USD 8 million annually (PLN 26,5 million approx.)⁽¹¹⁾.

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- (33) In November 2006 Bank [...] agreed in a settlement agreement to write off PLN 86,4 million and accepted the repayment of only PLN 11,5 million. As such, only 13 % of the liability was eventually repaid by PZL Hydral. The rest, i.e. PLN 74,9 million, was written off.
- (34) Bank [...] accepted this low amount despite the fact that it had first-rank collateral on the most significant real estate on which most of the production depended and the administrative structures were located. This collateral consisted in particular of first-rank mortgages on two real properties for a total amount of PLN 19,75 million, a first-rank pledge on a technological line for the production of compressors in an amount of PLN 20 million, a first-rank assignment of receivables under sales agreements concluded for compressors worth PLN 20 million, a first-rank registered pledge on machinery and equipment with a total value of PLN 2,8 million and first-rank transfer agreements for movables worth PLN 2,65 million, PLN 2,4 million, PLN 0,56 million and PLN 1,1 million respectively. Moreover, the nature of the collateral would enable any potential buyer to continue production after purchase; would also be possible to transport the machines either as a whole or as sub-assemblies without dismantling them, should any potential buyer decide to move them.
- (35) After the agreements with the banks, the collateral on the fixed assets was released. As a result, the public creditors' position in respect of this collateral improved, i.e. they received a higher mortgage ranking⁽¹²⁾.

Liabilities vis-à-vis public creditors

- (36) In 1998, the company's liabilities vis-à-vis public creditors based on claims arising under public law (i.e. claims from the Social Insurance Office, the Lower Silesia Region Tax Office, Wrocław Psie Pole Tax Office, Lower Silesia Regional Office, Wrocław City Council, the State Fund for the Rehabilitation of the Disabled) amounted to PLN 29 million. In addition, the Ministry of Finance had civil-law claims of PLN 9,4 million. These liabilities to individual public creditors evolved as shown in Tables 8, 9, 10, 11, 12, 13 and 14.

TABLE 8

Liabilities of PLZ Hydral vis-à-vis the Social Insurance Office (PLN thousand)

	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	2007
Principal	27	35	42	47	55	62	69	74	74	
	028	477	107	963	695	935	395	296	187	903
Interest	219	20	32	46	60	68	76	84	88	102
		000	651	100	810	421	653	040	835	223
Total	29	47	67	89	108	124	139	153	163	177
	247	477	758	063	505	356	048	336	022	126

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TABLE 9

Liabilities of PLZ Hydral vis-à-vis Lower Silesia Regional Tax Office (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	2007
Principal	700	2 700	3 656	4 750	6 198	10 928	12 471	18 655	20 769	38 946	
Interest	750	1 100	1 500	1 950	2 900	3 200	3 800	5 347	8 450	10 553	
Total	2 450	3 800	5 156	6 700	9 098	14 128	16 271	24 002	29 219	49 499	

TABLE 10

Liabilities of PLZ Hydral vis-à-vis Wrocław Psie Pole Tax Office (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	2007
Principal	0	0	0	0	0	0	0	0	0	0	
Interest^a	0	0	0	0	0	0	532	532	532	532	
Total	0	0	0	0	0	0	532	532	532	532	

a This amount represents the recovery costs calculated by Wrocław Psie Pole Tax Office.

TABLE 11

Liabilities of PLZ Hydral vis-à-vis Wrocław City Council (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	2007
Principal	682	3 058	4 510	5 972	7 556	9 404	11 299	13 180	14 465	16 389	
Interest	800	2 200	3 500	5 500	7 100	7 950	8 500	9 065	9 951	10 698	
Total	3 482	5 258	8 010	11 472	14 656	17 354	19 799	22 245	24 416	27 087	

TABLE 12

Liabilities of PLZ Hydral vis-à-vis Lower Silesia Regional Office (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	2007
Principal	0	15	37	57	76	90	90	90	567	935	
Interest	0	2	8	14	21	29	35	40	75	136	
Total	0	17	45	71	97	119	125	130	642	1 071	

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TABLE 13

Liabilities of PLZ Hydral vis-à-vis the State Fund for the Rehabilitation of the Disabled (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	31.12.2007
Principal	2 446	2 937	3 457	3 394	4 313	4 771	4 927	5 510	5 577	5 639	
Interest	5 550	3 900	4 100	4 308	4 807	5 080	5 518	6 040	6 898	7 245	
Total	5 996	6 837	7 557	7 702	9 120	9 851	10 445	11 550	12 476	12 884	

TABLE 14

Liabilities of PLZ Hydral vis-à-vis the Ministry of Finance (PLN thousand)

	31.12.1997	31.12.1998	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	31.12.2007
Principal	14	64	64	19	19	19	18	18	18	18	
	018,8	395,5	717,1	717,1	687,7	646,5	422,5	773,1	260,3	260,3	
Interest	2	9	28	0	0	0	0	0	193,7	1	
	372,9	639,2	627,6	741,3						117,1	
Total	9	17	74	93	19	19	19	18	18	19	
	391,7	034,7	344,7	458,4	687,7	646,5	422,5	773,1	454,0	377,4	

- (37) The public creditors charged the interest rates on arrears shown in Table 15. It is important to note that Tables 8 to 14 take into account partial repayments of sums and show the level at the year-end; therefore, the interest due in any given year is not directly related to the principal, which can fluctuate.

TABLE 15

Interest on tax arrears⁰

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
%	50	35	44	40	23	15	15	14	11	12	14	11	10

- a Interest on tax arrears applies to all public-law receivables falling to tax authorities and public bodies. While authorities such as the Social Insurance Fund have their own legal provisions requiring the recovery of contributions not paid in time, as regards the rules governing the calculation on interest on these amounts, the legal provisions refer to the Tax Code of 29 August 1997. The table shows the annual interest rates as these are subject to frequent changes. This follows from the obligation incumbent on the Minister for Finance under Article 56 of the Tax Code to set and publish current interest rates on tax arrears in line with market developments and the rates charged by the National Bank of Poland. The detailed rules governing the calculation of interest charged on tax arrears are set out in the Regulation of the Minister for Finance of 22 August 2005 (Journal of Laws No 165, item 1373) and previously in the 1997, 2001 and 2002 Regulations of the Minister for Finance. Changes in liabilities vis-à-vis public-law creditors take account of any partial repayments of the amounts owed.

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- (38) Apart from charging the appropriate interest on tax arrears, the Social Security Office, the Lower Silesia Region Tax Office, Wrocław Psie Pole Tax Office, Wrocław City Council and the Lower Silesian Regional Office secured their claims vis-à-vis PZL Hydral by registering mortgages on its immovable assets. Tables 16, 17, 18, 19 and 20 show changes in the mortgages on PZL Hydral's assets held by these public creditors.

TABLE 16

Collateral on PZL Hydral assets held by the Social Security Office

	Year	Amount	Comments
1	1998	PLN 21 996 411,92	total amount of mortgages
2	1999	PLN 21 996 411,92	total amount of mortgages
3	2000	PLN 21 996 411,92	total amount of mortgages
4	2001	PLN 28 660 990,95	total amount of mortgages a mortgage of PLN 6 664 579,03 was added
5	2002	PLN 29 602 956,07	total amount of mortgages a mortgage of PLN 941 965,12 was added
6	2003	PLN 37 315 430,58	total amount of mortgages a mortgage of PLN 7 712 474,51 was added
7	2004	PLN 68 984 278,13	total amount of mortgages a mortgage of PLN 31 668 847,55 was added
8	2005	PLN 82 625 551,83	total amount of mortgages

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			a mortgage of PLN 1 364 127,7 was added
9	2006	PLN 91 511 663,94	total amount of mortgages a mortgage of PLN 8 886 112,11 was added
10	2007	PLN 96 153 021,0	total amount of mortgages a mortgage of PLN 4 641 357,06 was added

TABLE 17

Collateral on PZL Hydral assets held by the Lower Silesia Region Tax Office

	Year	Amount	Comments
1	1998	—	—
2	1999	—	—
3	2000	—	—
4	2001	—	—
5	2002	—	—
6	2003	—	—
7	2004	—	—
8	2005	PLN 5 692 649,25	total amount of mortgages
9	2006	PLN 5 692 649,25	total amount of mortgages
10	2007	PLN 5 692 649,25	total amount of mortgages

TABLE 18

Collateral on PZL Hydral assets held by Wrocław Psie Pole Tax Office

	Year	Amount	Comments
1	1998	—	—
2	1999	—	—

Changes to legislation: There are currently no known outstanding effects for the Commission Decision of 4 August 2010 on State aid C 40/08 (ex N 163/08) implemented by Poland for PZL Hydral S.A. (notified under document C(2010) 5406) (Only the Polish version is authentic) (Text with EEA relevance) (2010/690/EU). (See end of Document for details)

3	2000	PLN 112 759,61	total amount of mortgages
4	2001	PLN 212 138,61	total amount of mortgages a mortgage of PLN 99 379,0 was added
5	2002	PLN 212 138,61	total amount of mortgages
6	2003	PLN 212 138,61	total amount of mortgages
7	2004	PLN 212 138,61	total amount of mortgages
8	2005	PLN 212 138,61	total amount of mortgages
9	2006	PLN 212 138,61	total amount of mortgages
10	2007	PLN 212 138,61	total amount of mortgages

TABLE 19

Collateral on PZL Hydral assets held by Wroclaw City Council

	Year	Amount	Comments
1	1998	PLN 710 074,3	total amount of mortgages
2	1999	PLN 710 074,3	total amount of mortgages
3	2000	PLN 710 074,3	total amount of mortgages
4	2001	PLN 945 962,8	total amount of mortgages a mortgage of PLN 235 888,5 was added
5	2002	PLN 2 119 622,4	total amount of mortgages a mortgage of PLN 1 173 659,6 was added

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6	2003	PLN 2 119 622,4	total amount of mortgages
7	2004	PLN 11 217 294,85	total amount of mortgages a mortgage of PLN 9 097 672,45 was added
8	2005	PLN 11 217 294,85	total amount of mortgages
9	2006	PLN 12 589 452,85	total amount of mortgages a mortgage of PLN 3 538 324,0 was added
10	2007	PLN 15 379 758,25	total amount of mortgages a mortgage of PLN 2 790 305,4 was added

TABLE 20

Collateral on PZL Hydral assets held by Lower Silesia Regional Office

	Year	Amount	Comments
1	1998	—	—
2	1999	—	—
3	2000	—	—
4	2001	—	—
5	2002	PLN 634 594,1	total amount of mortgages
6	2003	PLN 634 594,1	total amount of mortgages
7	2004	PLN 634 594,1	total amount of mortgages
8	2005	PLN 634 594,1	total amount of mortgages
9	2006	PLN 634 594,1	total amount of mortgages

Changes to legislation: There are currently no known outstanding effects for the Commission Decision of 4 August 2010 on State aid C 40/08 (ex N 163/08) implemented by Poland for PZL Hydral S.A. (notified under document C(2010) 5406) (Only the Polish version is authentic) (Text with EEA relevance) (2010/690/EU). (See end of Document for details)

10	2007	PLN 634 594,1	total amount of mortgages
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- (39) The Polish authorities also noted that public creditors had taken into consideration the considerable increase in value of industrial real estate in Wrocław from 2003 to 2008. Real estate prices increased by 100 % overall and the value of PZL Hydral's real estate increased by 300 %. Public creditors with mortgages on PZL Hydral's assets therefore experienced a *de facto* increase in the value of their collateral.
- (40) The Polish authorities informed the Commission that the State Fund for the Rehabilitation of the Disabled and the Ministry of Finance did not hold any collateral (mortgages) on PZL Hydral's assets. However, the Ministry of Finance enforced part of its claims by way of an agreement with PZL Hydral concluded on 20 May 2002, under which PZL Hydral was to repay a substantial part of its liabilities by end-2002, as shown in Table 14.
- (41) According to the Polish authorities, public creditors – contrary to private creditors – undertook forced enforcement action through a court enforcement officer. Between 1998 and 2007 the Social Security Office issued enforcement titles for an amount of PLN 119,95 million, the Lower Silesia Region Tax Office for an amount of PLN 43,8 million and the State Fund for the Rehabilitation of the Disabled for an amount of PLN 2,1 million, but the amount actually obtained from enforcement did not reach the level of the liabilities indicated in the enforcement titles. The Polish authorities stressed that alternative options, such as taking possession of assets, were not deemed reasonable by the court enforcement officer to execute and made no economic sense. Other public creditors did not take any enforcement action but they observed the privatisation and restructuring process which, they believed, would provide them with a higher return than direct execution of their claims.

TABLE 21

Summary of public creditor enforcement action vis-à-vis PZL Hydral (1997-2009)

	Year	Repaid public liabilities
1	1998	PLN 206 349,9
2	1999	PLN 0,0
3	2000	PLN 674 100,75
4	2001	PLN 4 922 525,14
5	2002	PLN 3 209 042,05
6	2003	PLN 223 928,7
7	2004	PLN 1 960 765,69

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8	2005	PLN 3 641 223,35
9	2006	PLN 4 472 476,92
10	2007	PLN 9 455 133,89
11	2008	PLN 54 590 790,45
12	2009	PLN 4 500 000
Total		PLN 87 846 336,84

(42) Between 1998 and 2009 public liabilities of PLN 87,846 million (26 %) were repaid.

(43) There has been a considerable increase in repayment of PZL Hydral's public liabilities since 2003.

II.3. PZL Hydral as a company in difficulty

(44) Table 22 shows the financial data of PZL Hydral for 1998-2009.

TABLE 22

Selected data from PZL Hydral's financial reports (PLN thousand)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Revenue	1 088	46 403	45 691	37 933	35 500	37 111	34 651	47 560	48 618	55 741	32 757	11 870
Profit (loss) on sales	(10 839)	(1 546)	2 004	(8 772)	(10 005)	(9 420)	(6 857)	972	49	3 641	(6 454)	(165 020)
Net profit (loss)^a	(13 661)	(13 354)	217	18,473	349,346	(177 982)	(48 151)	(14 927)	(1 076)	61 578	23 902	46
Total assets	203 936	212 834	228 344	250 115	192 013	113 255	86 966	92 011	76 986	111 051	35 661	30 617
Shareholders' (negative) equity	1 077	1 078	268	18 440	15 074	(166 664)	(214 815)	(229 743)	(250 500)	(188 922)	(165 020)	(164 974)
Long term liabilities	194 231	209 756	228 075	231 675	176 939	279 920	301 781	321 753	327 486	299 973	200 681	195 592

^a Net profit is defined here and for the remainder of this decision as pre-tax profit.

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and											
reserves											

a Net profit is defined here and for the remainder of this decision as pre-tax profit.

- (45) From 1998 until 2002, PZL Hydral had positive equity. As of 2003, it had negative equity and recorded systematic net losses until 2007. From 2007 until 2009, PZL Hydral made a profit. The value of PZL Hydral's assets decreased from PLN 203,936 million in 1998 to PLN 76,986 million in 2006. Long-term liabilities consistently increased from 1998 to 2001 and from 2003 to 2006, when they reached PLN 327,486 million.
- (46) As explained above, from 2008 onwards PZL Hydral derived its income predominantly from selling services and stock produced in previous years and, to a limited extent, from its subsidiaries.

II.4. **PZL Wrocław as a company in difficulty**

- (47) As regards the financial situation of PZL Wrocław, neither in 2007, 2008 nor 2009 did PZL Wrocław lose more than 50 % of its capital and nor did it meet the eligibility requirements for insolvency proceedings under Polish law. PZL Wrocław's turnover amounted to PLN 5,3 million in 2006, PLN 23 million in 2007 and PLN 60 million in 2008. The net loss in 2006 was PLN 1 million, while in 2007 the net profit was PLN 0,04 million, increasing sharply to PLN 8,7 million in 2008.
- (48) According to PZL Wrocław's financial reports, the value of its non current assets increased from PLN 4,8 million in 2006 to PLN 25,7 million in 2007, PLN 27 million in 2008 and PLN 29 million in 2009. Under the Polish Budget Act, financial resources for military purchases are allocated annually by the Ministry of Defence. In 2008 PZL Wrocław received contracts for and sold military goods (e.g. hydraulic systems, pneumatic components for fuel control systems) to an amount of [...] and provided the Ministry of Defence with maintenance services worth [...], i.e. an overall amount of [...].
- (49) The Polish authorities also maintain that, until end-2008, the market on which PZL Wrocław operated, i.e. the aviation and defence market, did not show any signs of slowing down.
- (50) In 2009, however, PZL Wrocław experienced financial difficulties as a result of a sharp fall in orders by the Ministry of Defence due to the economic crisis. In 2009, the value of ordered and sold military goods (e.g. hydraulic systems, pneumatic components for fuel control systems) fell to [...], and the value of maintenance services provided fell to [...]. As a result, sales of military goods decreased by [...] % compared with 2008. Consequently, PZL Wrocław recorded a net loss of PLN 8,3 million in 2009. Its turnover decreased from PLN 60 million in 2008 to PLN 41 million in 2009.

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- (51) The liabilities of the company increased from PLN 31 million in 2008 to PLN 35 million in 2009. Liabilities amounted to PLN 7 million in 2006 and to PLN 18,4 million in 2007.
- (52) The Polish authorities informed the Commission that under Polish law⁽¹³⁾ PZL Wrocław was not yet eligible for bankruptcy proceedings. However, should the ongoing restructuring process of the Hydral Group based on the assumptions underpinning the restructuring plan for public-law liabilities and the framework agreement with the investor be unsuccessful, PZL Wrocław will have to lodge an application for bankruptcy.

II.5. The restructuring plan and the privatisation process

- (53) The restructuring plan for PZL Hydral and PZL Wrocław ('the Plan') has to be seen in the context of Poland's attempts to privatise the viable parts of the business, particularly in the aviation and defence field.
- (54) In 1998 a private consulting group, Business Management Finance S.A., prepared a strategy for restructuring PZL Hydral. The strategy comprised a diagnosis of the current financial status of PZL Hydral along with an analysis of costs and restructuring activities. It indicates that it would be reasonable to isolate some of PZL Hydral's assets and sell them to a private investor in order to restructure PZL Hydral's liabilities.
- (55) The shareholders of PZL Hydral and, following its incorporation in 2004, of PZL Wrocław, met regularly to consider privatising the group or parts thereof (PZL Wrocław) and negotiated the terms of the transaction with the interested parties.
- (56) Consequently, the Polish authorities entered into negotiations with potential investors, which were closely followed by private (only for the first privatisation attempt with [...]) and public creditors. The negotiations took place with the following companies: [...] (2002-2006), [...] (2007-2008), [...] (2008) and, as of 2009, with the current investor, [...] ('[...] ' or 'the investor').

Negotiations with [...] for the privatisation of PZL Hydral

- (57) In 2002, as a result of industrial cooperation, talks on the sale of PZL Hydral commenced with [...], a global producer of aviation components with annual turnover in 2009 of [...]. On 25 November 2002 [...] and PZL Hydral concluded an agreement regarding non-disclosure of information. On 22 April 2003 [...] sent a letter of intent to PZL Hydral in which it expressed its interest in the potential purchase of PZL Hydral's shares and its willingness to carry out a due diligence study. The due diligence study was performed in May 2003. In April 2005 [...] extended the scope of the due diligence with a view to the potential purchase of PZL Wrocław, which had been incorporated in 2004. In June 2005 the documentation was given to [...]. In the second half of 2005 and the first half of 2006, numerous meetings were held with the

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representatives of [...]. However, [...] has not taken action to complete the transaction since November 2006.

(58) According to the Polish authorities, [...] withdrew from the negotiations because no solution had been found to the issue of the company's debt.

(59) During these negotiations, the public and private creditors were regularly updated, sometimes on a weekly basis, on their progress.

Preparations for a second privatisation attempt, establishment of the 2007-2010 restructuring plan and the 2007 loan

(60) The Polish authorities pursued a new privatisation strategy, which focused on making PZL Wrocław a viable business to be sold and winding up PZL Hydral afterwards with the proceeds of the sale of PZL Wrocław and its other subsidiaries and assets. This strategy was agreed by the IDA, PZL Hydral and the public creditors of PZL Hydral and was formalised as the 2007-2010 restructuring plan ('the Plan') in the fourth quarter of 2007.

(61) According to the Plan, the public creditors were to be repaid from the proceeds of the sale of PZL Hydral's assets, shown as follows: Zakład Ciepłowniczy 'Term-Hydral' Sp. z o.o. - PLN 1 million, Zakład Produkcji Hydrauliki 'Hydral' Sp. z o.o. - PLN 3 million. The sale of PZL Wrocław was supposed to bring PLN 65,9 million (including the casting plant). The sale of the other financial assets was expected to yield PLN 0,5 million and a real estate asset called the BBCenter PLN 47,5 million, a car park PLN 2 million and a power station (GSZ) PLN 0,9 million. The Plan was therefore based on an assumption that the asset sale would generate total revenue of at least PLN 120,8 million.

(62) The Plan also provided for a capital injection of PLN 36 million to guarantee the repayment of PLN 156,8 million to public creditors. It also anticipated the possibility of the IDA granting an additional capital injection of PLN 77,4 million to repay the Social Security Office's liabilities for 1996-1998.

(63) Subsequently, in January 2007, PZL Wrocław acquired military certificates and permits to trade in arms (see point 16). In the course of 2007 it acquired more assets, machinery, equipment and know-how. This acquisition was financed by a loan of PLN 12,5 million, which the IDA granted to PZL Wrocław on 24 May 2007 ('the 2007 loan'), and through an in-kind contribution to the capital of PZL Wrocław by the parent company, PZL Hydral, in the form of an asset transfer in December 2007.

(64) The Polish authorities also emphasised that the 2007 loan had been granted with a view to the IDA obtaining a share of approximately [...] % in PZL Wrocław (corresponding to a debt-for-equity swap) and that the IDA would realise an adequate return on the capital invested after it sold its shares in PZL Wrocław, whereas PZL Hydral would use its shareholding to satisfy the public creditors.

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- (65) The 2007 loan was granted at a variable 3M WIBOR plus 200 basis points, at that time 6,45 % for an initial duration until 2007 and was based on the understanding that it would be extended until the debt-for-equity swap took place prior to the sale of PZL Wrocław. The loan was secured by the following collateral:
- a registered pledge⁽¹⁴⁾ on the fixed assets of PZL Wrocław (machinery) of PLN 5,5 million which was entered in the register of pledges,
 - an ordinary pledge⁽¹⁵⁾ on 66 850 shares, representing 100 % of the company at the time of the transaction in May 2007 and [...] % at end-2007.
- (66) The Polish authorities informed the Commission that the value of PZL Wrocław had been assessed at the request of the IDA in March 2007 by consultants Realizacja Inwestycji Techniczno-Ekonomicznych, acting as an independent expert. Three valuation methods were used: revenue method based on the discounted net profit (method 1), revenue method based on the discounted net profit plus depreciation (method 2) and discounted cash-flow method (method 3)⁽¹⁶⁾, including a sensitivity analysis (moderate, optimistic and pessimistic scenarios).
- (67) Using these three methods, the value of PZL Wrocław was estimated at:
- Method 1:
- (a) under the moderate scenario the value is estimated at [...];
 - (b) under the optimistic scenario the value is estimated at [...];
 - (c) under the pessimistic scenario the value is estimated at [...].
- Method 2:
- (a) under the moderate scenario the value is estimated at [...];
 - (b) under the optimistic scenario the value is estimated at [...];
 - (c) under the pessimistic scenario the value is estimated at [...].
- Method 3:
- (a) under the moderate scenario the value is estimated at [...];
 - (b) under the optimistic scenario the value is estimated at [...];
 - (c) under the pessimistic scenario the value is estimated at [...].
- (68) The following three elements were used for the valuation of PZL Wrocław:
- the company's financial forecasts, including cash flow, net profit and depreciation for 2007-2011 with a sensitivity analysis (moderate, optimistic and pessimistic scenarios); see Table 23 below,
 - the discount rate based on the Weighted Average Cost Of Capital (WACC) equal to 10,25 %, and
 - the assumption that cash flow becomes constant after 2007-2011.

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TABLE 23

The different scenarios incorporated into the 2007 study (PLN thousand)

Year	2007	2008	2009	2010	2011
Moderate scenario					
Cash flow	[...]	[...]	[...]	[...]	[...]
Net profit	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]
Net profit + depreciation	[...]	[...]	[...]	[...]	[...]
Optimistic scenario					
Cash flow	[...]	[...]	[...]	[...]	[...]
Net profit	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]
Net profit + depreciation	[...]	[...]	[...]	[...]	[...]
Pessimistic scenario					
Cash flow	[...]	[...]	[...]	[...]	[...]
Net profit	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]
Net profit + depreciation	[...]	[...]	[...]	[...]	[...]

- (69) The discount rate for all three methods of evaluation is based on Weighted Average Cost of Capital equal to 10,25 %⁽¹⁷⁾. The company's financial forecast, including cash flow, net profit and depreciation for 2007-2011 with a sensitivity analysis (moderate, optimistic and pessimistic scenarios for 2007-2011) is based on data supplied by PZL Wrocław. According to the study these data are to a large extent based on forecast orders by the Ministry of Defence.
- (70) On the basis of this assessment, when determining of the value of the company's shares, the Polish authorities relied on the pessimistic scenario, which produced the lowest result. On that basis they assumed that the collateral in the form of the ordinary pledge on PZL Wrocław's shares had a market value of at least PLN 20,3 million⁽¹⁸⁾. Therefore, taken together with the pledge on machinery, which at the time had a value of PLN 5,5 million, the

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Polish authorities consider that the value of the collateral at that time exceeded the value of the loan.

- (71) Moreover, on the basis of the expert study the IDA took the view in 2007 that it would be reasonable to rely on a value of PZL Wrocław at end-2007 of [...] and to take the moderate scenario into consideration. The IDA also took the view that it would realise a return on its investment. The direct return that the IDA could obtain, on the basis that it would carry out a debt-for-equity swap before the sale and would hold [...] % of shares (which is an approximate percentage and was the working assumption used by the IDA) would be at least PLN 48,5 million.
- (72) Accordingly, the Polish authorities claimed that, as regards the 2007 loan, the IDA acted as an investor within the framework of the sale of PZL Wrocław. The Polish authorities also pointed out that the 2007 loan had not therefore been granted to PZL Hydral as stated in the opening decision.

Negotiations with [...]

- (73) Based on the new privatisation strategy and the 2007-2010 restructuring plan, [...], a [...] leading global supplier of systems and services to the aviation, space and defence industry which had revenue of [...] in 2009 entered into negotiations for the sale of PZL Wrocław in the first quarter of 2007 and carried out a due diligence study for PZL Wrocław in July/August 2007 and February 2008. These negotiations were the result of existing industrial cooperation.
- (74) On 31 January 2008, [...] made an offer for PZL Wrocław's shares which it increased for the first time on 14 February 2008. On 17-18 March 2008 [...] representatives held a meeting with the IDA. On 2 April 2008 [...] increased its offer for the second time. The price offered for the shares on 2 April 2008 was [...] (which reflected the value of PZL Wrocław on 31 December 2007), plus changes to current assets calculated according to a specific formula. The Polish authorities informed the Commission that application of the formula to reflect the growth in profit would result in a price increase of [...].
- (75) This offer was in line with an independent expert valuation commissioned by the IDA. This valuation, carried out by Doradztwo Ekonomiczne Dariusz Zarzecki, concluded that the value of PZL Wrocław in March 2008 was [...] on the basis of the net asset value method ('the NAV method'). This method takes an asset-oriented approach to the valuation and takes into account the value of assets and the credit and debit side both on and off balance sheet. At the same time, the value of PZL Hydral on the basis of the discounted cash-flow method ('the DCF method'), which takes into account future revenue not only from the material but also the immaterial assets in the possession of PZL Wrocław. The study does not have any sensitivity analysis (i.e. it does not describe different scenarios).

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- (76) Under the DCF method cash-flow forecasts for 2008 onwards are based on PZL Wrocław's financial plan for 2007-2013, which assumes that inflation will be the same as predicted by the Polish National Bank in February 2008 for the period in question. The cost of capital is evaluated at 16,65 %, incorporating the risk free rate (4,70 %), the market risk premium (7,17 %), the sector risk premium (1,78 %) and the market size premium (3 %) and enabling account to be taken of the size of PZL Wrocław in comparison with its competitors (such as [...] or [...]). From 2014 onwards the study assumes that cash flow will increase by 3 % per annum (on the basis of 2 % inflation).

TABLE 24

PZL Wrocław's future cash flow estimates (PLN thousand)

Year	2008	2009	2010	2011	2012	2013
Cost of own capital (%)	16,65	16,65	16,65	16,65	16,65	16,65
Future cash flow estimates	[...]	[...]	[...]	[...]	[...]	[...]
Discounted future cash flow estimates	[...]	[...]	[...]	[...]	[...]	[...]

- (77) The adjusted net assets value method is a way of valuing a 'going concern' by adjusting the value of all assets and liabilities to the fair market value⁽¹⁹⁾. The adjustment of liabilities with a book value of PLN 18,35 million to a net asset value of [...] was realised on the basis of the planned 2007 debt-for-equity swap. The last adjustment took off-balance sheet assets into consideration.

TABLE 25

PZL Wrocław - adjusted NAV method (PLN thousand)⁰

	Book value	Net asset value
Fixed assets	25 710	[...]
Current assets	9 945	[...]
Liabilities	18 350	[...]

^a The adjusted net assets value method is a way of valuing a 'going concern' by adjusting the value of all assets and liabilities to the fair market value. The fair market value is defined in economic literature as the price at which a business or assets would change hands between a willing buyer and a willing seller, neither of whom are compelled to buy or sell and both of whom have a reasonable knowledge of all relevant facts at the time.

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Off-balance sheet assets	0	[...]
Total	17 305	[...]

a The adjusted net assets value method is a way of valuing a ‘going concern’ by adjusting the value of all assets and liabilities to the fair market value. The fair market value is defined in economic literature as the price at which a business or assets would change hands between a willing buyer and a willing seller, neither of whom are compelled to buy or sell and both of whom have a reasonable knowledge of all relevant facts at the time.

(78) The adjusted net value of the fixed assets is [...], whereas their book value amounts to PLN 25,71 million. The adjustment is essentially made by computing the fair market value of all the assets on the basis of a study prepared on 29 March 2007 and submitted to the Commission by an independent expert, Realizacja Inwestycji Techniczno-ekonomicznych. The study basically assesses the value of real estate such as buildings and land. The value of buildings was assessed on the basis of the following formula:

$$V = Cn(1-Lu/100) \times R$$

‘Cn’ is the cost of constructing a new building; ‘Lu’ is the level of use of the building and ‘R’ is a coefficient which factors in price differences between different regions. The value of land is determined on the basis of a comparative approach which considers the price of land to be equal to the price obtained for a similar plot of land, adjusted to reflect inflation differentials.

(79) The adjustment of liabilities with a book value of PLN 18,35 million to a net asset value of [...] was realised on the basis of the planned 2007 debt-for-equity swap.

(80) The last adjustment took off-balance sheet assets into consideration. The items which do not appear in the balance sheet but which should appear in the valuation according to the authors of the study are: ‘organisation of human resources’ and ‘organisation of the production process’, taking into account the non-quantifiable aspects in the evaluation linked to the value of the company's management.

(81) Following the offer from [...], the Polish authorities provided the Commission with notification of the Plan as restructuring aid to PZL Hydral in March 2008, assuming that PZL Wrocław would be sold for [...]. They also included the 2007 loan and an additional loan of PLN 4 million to be granted to PZL Wrocław as part of measures to finalise negotiations with [...].

(82) The additional loan (‘the 2008 loan’) was awarded on 2 April 2008, the day on which the IDA received details of the second increase in the offer. The IDA granted this loan as a bridging loan until such time as a deal was closed with [...]. PZL Wrocław needed the money in order to process the upturn in orders from the Ministry of Defence.

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- (83) The loan was granted for a period of five years at a variable interest rate based on the Commission reference rate for Poland (6,42 % when it was awarded) and was secured by the following collateral:
- registered pledge on fixed assets of PZL Wrocław (four machines and items of equipment) of PLN 2,8 million which was entered in the register of pledges,
 - assignment of receivables under a commercial contract in an amount of PLN 5,2 million.
- (84) The Polish authorities therefore consider that the value of the pledges exceeded the value of the loan.
- (85) The loan was granted in order to enable PZL Wrocław to acquire machinery necessary for the production process. The IDA granted the 2008 loan at an advanced stage of negotiations with [...] on the assumption that it would be repaid either by PZL Wrocław using its own funds or by the investor.
- (86) On that basis, the Polish authorities claimed that the IDA did not just act in a manner comparable to a private investor but as the entity selling PZL Wrocław.
- (87) The Commission likewise was informed by the Polish authorities that the activity of PZL Wrocław in 2008 was partially financed by operating leasing. In June 2008 two operating leasing agreements, [...] and [...] were signed with a private company [...]. The net value of the lease under these agreements amounted to EUR 271 002 and EUR 401 263,2 (PLN 0,82 million including value added tax)⁽²⁰⁾. The cost of the lease for PZL Wrocław under these agreements was: EUR 88 762,3, which is the difference between the net value of the machinery and the net value of the lease. These agreements function similarly to loans with the leased object serving as collateral. Following the expiry of the lease, PZL Wrocław will acquire the right to purchase the machinery for an amount of EUR 5 835. Before entering into these leasing contracts with PZL Wrocław, [...] made a thorough analysis of the financial and economic situation of the company, including its capacity to generate sufficient cash flow for repayment of the instalments.
- (88) The Polish authorities also referred in their initial notification to the debt-for-equity swap provided for in the Plan of PLN 13,5 million (plus interest).
- (89) In March and April 2008 negotiations on the terms and provisions of the share transfer agreement were concluded. However, on 14 April 2008, [...] withdrew its offer. According to the Polish authorities, the probable reason for the withdrawal was the considerable changes which had occurred on the world market as a result of the economic crisis.

The 2008 buyer selection procedure

- (90) As a result of [...]’s withdrawal from the negotiations, the sale process was relaunched. The sale was advertised in the domestic and international press

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in the form of an invitation to take part in negotiations for the purchase of 100 % of PZL Wrocław's shares. On 19 May 2008 the invitation was published in Puls Biznesu (Business Pulse), the largest specialist publication in Poland and in Rzeczpospolita, the country's largest daily newspaper. On 20–26 May 2008 it was also published in Flight International, the global specialist aviation magazine. In November 2008, details of the planned sale were published in Raport Wojsko Technika Obronność, an aviation magazine in Polish with an international readership. No offers to purchase the shares were received.

- (91) Accordingly, further efforts were made and the information referred to above was forwarded and presented directly by PZL Hydral to companies potentially interested in purchasing PZL Wrocław. The Polish authorities have pointed out that the sale was advertised during fairs and industry events, including air shows⁽²¹⁾, as well as by letters sent to more than 80 companies. The Polish authorities have also indicated that information on the sale was permanently available on PZL Hydral's website, which records 500 000 visits each year. Taking into account the specific nature PZL Wrocław's production (as a supplier of goods and services for the Polish armed forces, PZL Wrocław is of particular importance to national security) and the fairly high level of concentration of the aviation industry throughout the world, resulting in a relatively low number of potential investors, the Polish authorities have argued that all the potential investors had the opportunity to obtain information on the sale of PZL Wrocław and to take part in this privatisation process. Therefore, according to the Polish authorities, the whole sector knew about the sale.
- (92) The sale notice was only an invitation to negotiations, and did not contain any specific conditions.
- (93) Following the renewed efforts of the Polish authorities, in the second half of 2008, the IDA received a first indication of interest, and later an offer, from [...]. In the second half of 2008, the IDA received a second indication of interest, this time from [...].

Negotiations with [...] for the sale of PZL Wrocław's shares

- (94) On 30 September 2008 [...] submitted a preliminary non-binding offer for the purchase of 100 % of shares in PZL Wrocław ('the offer of 30 September 2008') for an amount of [...]. [...] is an investment fund which invests in the private equity market and whose owner (a private person) also has a 100 % stake in [...]⁽²²⁾. The offer of 30 September 2008 was made for a debt-free company and was conditional upon the financial results for 2009 (in particular, net profit and EBITDA) being similar to 2008. In particular, EBITDA of at least [...] was to be achieved and the net profit in 2009 had to be at least [...]; in addition, sales growth of 5 % was required. However, as a result of the financial crisis PZL Wrocław's income declined by some 35 %, and the benchmarks laid down in the offer were not achieved. By the first quarter of 2009 PZL Hydral was already fully aware that the financial

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result would not meet the minimum threshold laid down in [...]’s offer. In addition, the reduction of orders from the Ministry of Defence was confirmed at the beginning of 2009, with significant implications for the company’s profitability in that year. There have been no subsequent contacts with [...].

Negotiations with [...] for the privatisation of PZL Wrocław

- (95) [...], a [...] company that is among the world’s largest suppliers of technologically advanced aviation products (for commercial, regional, corporate and military aircraft) and industrial products, and which had turnover in 2009 of [...] commenced talks with a view to purchasing shares in PZL Wrocław in the first quarter of 2009.
- (96) This company carried out a due diligence study between 20 April 2009 and 12 May 2009. On the basis of this study, it signed a memorandum of understanding (indicating the general outline of the planned transaction) with the IDA on 20 August 2009 for the purchase of PZL Wrocław’s shares for an amount of [...]. The IDA undertook to ensure that all PZL Wrocław’s assets were free of any claims on the part of PZL Hydral’s public creditors. The memorandum of understanding assumed that the IDA would itself buy 100 % of shares in PZL Wrocław and sell them subsequently to the investor. The investor undertook to carry out its own detailed investment plan worth an additional [...] after the sale. On 18 December 2009, the IDA, PZL Hydral and [...] signed a framework agreement. Annex 2 to the Agreement, which sets out the rules governing the partial debt-for-equity swap, partial cancellation and partial repayment of the 2007 and 2008 loans, was concluded on 12 March 2010.
- (97) The Polish authorities confirmed that the sale was not conditional, in particular on jobs being maintained. The Polish authorities also informed the Commission that the investor was free to determine its business dealings with the Ministry of Defence.
- (98) A detailed description of the negotiations with [...] can be found in point VI.

II.6. Legal assessment of the Plan by the Polish authorities

- (99) The Polish authorities indicated that the overall costs of restructuring would amount to PLN 262,2 million, broken down as follows: restructuring of public debt in an amount of PLN 234 million, other financial restructuring in an amount of PLN 11,5 million, investments of PLN 11 million, asset restructuring of PLN 5,6 million and employment restructuring of PLN 0,3 million.
- (100) According to the Polish authorities, the overall costs of restructuring PZL Hydral would be funded by state aid of PLN 130,5 million and by an own contribution of PLN 132 million. Under the Plan, the own contribution represents 50,3 % of the restructuring costs. The own contribution comprises

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revenue from the sale of fixed assets and shares as well as funds to be provided by the future investor in PZL Wrocław.

- (101) As regards compensatory measures, the Plan proposed the sale of some production assets, which was partially implemented between 2004 and 2006, resulting in capacity reduction. According to the Plan, the sale of machinery and equipment would reduce the company's capacity by 380 000 machine hours in total, i.e. by 42 %. The bulk of the planned reduction (315 000 machine hours) has already been implemented. The Polish authorities claimed that one third of this reduction was not necessary to restore viability but was designed to cut production in the field of industrial hydraulics, a low-profit segment in which the company had decided to limit its involvement.
- (102) In addition, the Plan indicated that the planned withdrawal from certain (allegedly profitable) activities and the sale of assets not related to production should be regarded as compensatory measures within the meaning of the Guidelines on state aid for rescuing and restructuring firms in difficulty⁽²³⁾ ('the rescue and restructuring guidelines'). Lastly, the Polish authorities claimed that the privatisation of PZL Wrocław, which will allow the company's competitors to acquire PZL Hydral's capacity, know-how and market share, should also be regarded as a compensatory measure.

III. **DOUBTS EXPRESSED BY THE COMMISSION WHEN OPENING AND EXTENDING THE FORMAL INVESTIGATION PROCEDURE**

- (103) The Plan was notified as a restructuring scenario under the rescue and restructuring guidelines. The Commission therefore based its preliminary assessment on the information at its disposal at that stage. On the basis of that information, the Commission voiced the following concerns:
- (104) As regards the eligibility of the company for restructuring aid under the rescue and restructuring guidelines, the Commission doubted that PZL Hydral had not benefited from any rescue or restructuring aid in the previous ten years.
- (105) In particular, the Commission wondered whether the non-enforcement or late enforcement of public liabilities should not be treated as state aid. The Commission pointed out that, where a public body collecting social security contributions tolerates the non-payment or late payment of such contributions over a long period of time, it undoubtedly gives the recipient an advantage by reducing the burden which the normal application of the social security system represents for the recipient⁽²⁴⁾. The Commission, while recognising that the public creditors had taken certain enforcement measures, doubted whether these were sufficient or, if they had been taken at a late stage, effective, especially in respect of the collateral held by the public creditors and which could have been relied on. At this stage of the proceedings, therefore, the Commission doubted that the conduct of the public creditors was in line with the way that private creditors would have behaved in those circumstances.

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- (106) The Commission also expressed doubts with regard to other measures reported by the Polish authorities as free of state aid.
- (107) The Commission doubted whether the partial repayment and partial write-off of public liabilities reported by the Polish authorities as free of state aid, was in line with the private creditor rule.
- (108) The Commission also expressed doubts regarding the Plan's compatibility with the internal market in the light of point 31 et seq. of the rescue and restructuring guidelines.
- (109) The Commission doubted that the proposed contribution was real and actual and thus that the Plan complied with points 43-45 of the rescue and restructuring guidelines. The Commission doubted whether the planned revenue from the sale of PZL Wrocław, even if achieved, could be regarded as an own contribution to the restructuring. As mentioned above, PZL Wrocław was set up at end-2004. Under the Plan, the production assets were to have been transferred and the privatisation process was to have been launched as early as 2007. Initial offers by potential investors were to be submitted by the fourth quarter of 2007 and, following negotiations, a preliminary sales agreement was to be concluded in the first half of 2008. However, at the time when the opening decision was adopted, the Commission had not been informed of any interest on the part of potential investors in acquiring PZL Wrocław.
- (110) The Commission also expressed doubts that the Plan would ensure long-term viability as required under points 34-37 of the rescue and restructuring guidelines. The Commission observed that the planned restructuring concentrated on financial restructuring, i.e. circa 90 % of all restructuring costs had been earmarked for the repayment of public debt arrears. Consequently, the remaining restructuring measures were rather limited. The Commission also noted that, as already explained, at the time when the opening decision was adopted, it had not been informed of any interest on the part of potential investors. Poland also indicated that further restructuring measures might be necessary after the company was privatised, which raised additional doubts as to the Plan's viability.
- (111) The Commission also stated that it needed further clarifications as regards the compatibility of the proposed compensatory measures with points 38-42 of the rescue and restructuring guidelines. The Polish authorities argued in the notification that at least one third of the capacity reduction was designed to cut capacity in the low-profit industrial hydraulics segment. On the basis of the information at its disposal, the Commission doubted that the reduction in production capacity implemented or planned by the company was sufficient. The Commission also noted that at least some of the proposed measures appeared to be necessary in order to achieve long-term viability. In particular, the Commission pointed out that the sale of some production assets in the past

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seemed to have been specifically designed to restore viability. Similarly, the planned sale of real estate would serve as a source of financing rather than as compensation for a distortion of competition.

IV. COMMENTS OF POLAND ON THE OPENING OF THE FORMAL INVESTIGATION PROCEDURE

- (112) The Polish authorities submitted their comments on the opening decision with regard to the possibility of applying the private creditor test in the reported scenario, i.e. in conjunction with capital injections.
- (113) The Polish authorities stated that the proposed write-offs were in line with the private creditor rule in view of the fact that the public creditors would obtain more in the event of PZL Hydral's assets being sold than in the event of the company going bankrupt. The Polish authorities also stated that this viewpoint was based on economic and financial analysis and was shared by the public creditors concerned.
- (114) The Polish authorities claimed that the two capital injections to be granted by the IDA to PZL Hydral and which, according to the notification, were to be earmarked for the repayment of public creditors, did not preclude applying the private creditor rule.
- (115) In addition, the Polish authorities claimed that the market value of PZL Wrocław was closely linked to its ownership of aviation certificates and arms-trading permits and its uniquely experienced and qualified workforce. In the event of bankruptcy, it would be impossible to restore this organisation to an extent acceptable to the aviation supervision services.
- (116) The Polish authorities valued the own contribution at PLN 130 million, which would amount to 50 % of the restructuring costs even if non-enforcement of public debts were to be treated as state aid. Moreover, the Polish authorities noted that the sale of assets was under way, and so all the assets provided for in the Plan would be disposed of within the framework of restructuring.
- (117) As regards the long-term viability of the Plan, the Polish authorities affirmed that the objectives of the restructuring were being implemented properly. In particular, the process of concentrating production in the eastern part of PZL Hydral's site had yielded a reduction in fixed costs, operational improvements in production and additional revenue from renting out the space freed up. Moreover, production and sales (including 570 employees) had been relocated to PZL Wrocław, which was economically viable at that time (data for the first ten months of 2008). PZL Wrocław's net profit at end-2008 was estimated at PLN 6 million approx., with sales of PLN 50 million. The Polish authorities added that since agreement was reached on the private creditor scenario in the fourth quarter of 2007, both PZL Hydral and PZL Wrocław had paid their current liabilities to public creditors on time.

V. THIRD PARTY COMMENTS

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(118) The Commission did not receive any third party comments.

VI. EVENTS FOLLOWING THE OPENING OF THE FORMAL INVESTIGATION PROCEDURE - THE REVISED PLAN

(119) The Polish authorities consider that the sale price for PZL Wrocław's shares offered by [...] corresponds to the market value of this company. According to the Polish authorities, the price offered reflected the company's financial situation, which worsened in 2009 as a result of the financial crisis and a downturn in orders from the Polish armed forces.

(120) The Polish authorities also indicated that this price reflected macroeconomic conditions. On the Warsaw stock exchange alone the Warsaw Stock Exchange Index (WIG) fell by 36 %. Between April 2008 (withdrawal of [...] from negotiations) and June 2009, the market ranking of listed aviation sector companies with a similar production profile to PZL Wrocław dropped dramatically. Shares in [...], to which [...] belongs, fell by [...] %, shares in [...] by [...] % and shares in [...] by [...] %.

(121) [...] carried out a due diligence study (see point 96). The study compared the figures concerning [...] of 32 aviation sector companies. The study then calculated average coefficients which determined how these [...]. These coefficients were then applied to [...]. The result was [...].

(122) However, talks with the IDA on the investor's evaluation suggest that at this stage [...] is highly dependent on one customer, the Polish armed forces, from which it is expected to derive [...] % of its planned revenue in 2010-13 under the modernisation programme, the outcome of which is uncertain, and bankruptcy proceedings could be launched if PZL Wrocław's financial situation does not improve in 2010.

(123) On that basis the investor maintains that in offering [...] for PZL Wrocław's shares, he will *de facto* pay a premium for them.

Settlement of outstanding claims of public creditors

(124) Once the price offered by the investor was known, the IDA started negotiations with the public creditors on partial repayments and partial write-offs of their claims as specified in the Plan, on the basis of the proceeds of the sale of PZL Hydral's assets without any additional capital injections.

(125) For that purpose, a study was commissioned by the IDA from Ernst&Young on 15 January 2010. Ernst&Young was instructed, as an independent expert, to produce a comparison between the following two scenarios:

- bankruptcy proceedings for PZL Hydral, including its subsidiary PZL Wrocław,
- settlement of liabilities on the basis of the proceeds of the sale of PZL Wrocław to [...] for [...] and the proceeds of the sale of PZL Hydral's other assets.

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- (126) Ernst&Young assessed the situation for each individual public creditor: the Social Security Office, the Lower Silesia Region Tax Office, Wrocław Psie Pole Tax Office, Wrocław City Council, the State Fund for the Rehabilitation of the Disabled, the Lower Silesia Regional Office and the Ministry of Finance. The analysis does not include the IDA as it was not a creditor of PZL Hydral but only a shareholder.
- (127) The Ernst&Young study was completed on 24 February 2010. The study was based on a conservative approach: only the amounts expected to be directly recovered under each scenario were quantified. Therefore the analysis did not take account of alternative costs⁽²⁵⁾, long-term profit forecasts and inflation.
- (128) The bankruptcy scenario leading to liquidation was analysed on the assumption that liquidation would be reasonably effective. It refers, as the basis for its methodology, to the requirements of a proper private creditor test based on case-law (*Spain v Commission* and *Hamsa v Commission*) which analyses the behaviour of a public body from the point of view of a private creditor seeking to obtain payment by a debtor in financial difficulties⁽²⁶⁾. The report is based on an analysis of each individual creditor, taking into account, in particular, the creditor's collateral on the debtor's assets and the extent to which claims can be satisfied in the event of the debtor going bankrupt⁽²⁷⁾.
- (129) In order to establish the bankruptcy value of the assets, the Ernst&Young study assumed that the fire sale value of the immovable fixed assets was 50 % of their fair value. To establish the fair value, Ernst&Young relied on the methods defined in International Accounting Standard 16 on property, plant and equipment, and used any available assessments by independent experts. The 50 % reduction is justified by the low effectiveness of bankruptcy proceedings in Poland, where revenue from sales of assets constitutes on average 26,86 % of their fair value.
- (130) The Ernst&Young study also notes that the proceeds which public creditors can expect in a bankruptcy scenario depend on the respective ranking of their collateral on the assets to which the mortgages are attached. The Ernst&Young study provides for this purpose an overview of the mortgages attached to each asset component of PZL Hydral, the value of the respective mortgages and the ranking of the creditors.
- (131) On the basis of the assumptions set out in the previous two paragraphs, Ernst&Young estimates that the total amount recoverable in the event of bankruptcy from the assets secured by mortgages is PLN 52,4 million; three public creditors (the State Fund for the Rehabilitation of the Disabled, the Lower Silesian Regional Office and the Ministry of Finance) will not be able to recover anything and the remaining creditors will be able to recover the following amounts: the Social Security Office – PLN 44,8 million, the Lower Silesia Region Tax Office – PLN 2,3 million, Wrocław Psie Pole Tax Office – PLN 0,457 million and Wrocław City Council – PLN 4,9 million.

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- (132) The actual amount of the proceeds under the bankruptcy scenario should then be corrected by adding the amount recovered from the other assets of PZL Hydral, i.e. PLN 13,5 million⁽²⁸⁾. Accordingly, the bankruptcy proceeds amount to PLN 66 million, as shown in Table 26.
- (133) The sale of assets scenario provides for the sale of all PZL Hydral's assets referred to in the Plan for PLN 122 323 202,31: Zakład Produkcji Hydrauliki 'Hydral' Sp. z o.o. for [...], BBCenter's real estate for [...], car park for [...], Zakład Ciepłowniczy 'Term-Hydral' Sp. z o.o. for [...], power station (GSZ) for [...], PZL Wrocław for [...], the casting plant for PLN [...], minority shareholdings for [...] and repayment of PZL Hydral's receivables in an amount of [...].

TABLE 26

Comparison of the sale scenario and bankruptcy scenario from the perspective of PZL Hydral in 2010 (in PLN) in the Ernst&Young study

Public creditor	Total amount of liabilities ^a	Proceeds in bankruptcy scenario	Proceeds in sale of assets scenario
Social Insurance Fund	192 427 569,63	58 326 475,0	91 857 554,58
Lower Silesia Region Tax Office	59 579 407,58	2 294 047,11	18 250 999,45
Wrocław – Psie Pole Tax Office	532 432,6	456 768,68	456 800,0
Wrocław City Council	27 087 078,25	4 928 184,34	4 930 000,0
State Fund for the Rehabilitation of the Disabled	12 884 457,46	—	5 007 169,46
Lower Silesian Regional Office	1 320 678,82	—	1 320 678,82
Ministry of Finance	24 050 232,71	—	500 000,0
Total	317 881 857,5	66 005 475,13	122 323 202,31

^a The Polish authorities also specified that the companies total debt vis-à-vis Wrocław City Council amounted to PLN 32 094 812,25 and, vis-à-vis the State Fund for the Rehabilitation of the Disabled, to PLN 14 578 542,46. For these two creditors the study did not include backdated interest, as stated in point 135.

- (134) Table 26 indicates that under the Ernst&Young study the Social Security Office would recover 47,7 % of its claims, Lower Silesia Region Tax Office would recover 30,6 %, Wrocław Psie Pole Tax Office 85,8 %, Wrocław

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City Council 18,2 %, the Lower Silesian Regional Office would recover the entirety of its claims, the State Fund for the Rehabilitation of the Disabled would recover 38,9 % and the Ministry of Finance 2,1 %.

- (135) Under Polish law, once the public creditors agree to the settlement of their claims by partial write-offs, interest ceases to accrue on these claims and is charged only if settlement is not implemented, which would be the case in a bankruptcy scenario. Therefore the liabilities shown in Table 26 include appropriate interest backdated to the date of the 2007 agreement for all public creditors apart from the Lower Silesia Region Tax Office (to which interest is still being charged on some tax liabilities) and the Lower Silesian Regional Office (to which interest is still being charged) due to the special legal nature of their claim.
- (136) It should be noted that as regards Wrocław City Council, the State Fund for the Rehabilitation of the Disabled and the Lower Silesia Region Tax Office, the revised Plan provided for the partial deferral of repayment to public creditors and on the repayment in instalments of part of these liabilities until the sale of PZL Hydral's assets took place, i.e. the liabilities would be repaid in part. In particular, the agreement makes detailed provision for:
- repayment of the amount of PLN 4,9 million owed to Wrocław City Council is deferred;
 - repayment of the amount of PLN 5 million owed to the State Fund for the Rehabilitation of the Disabled is deferred;
 - PLN 18,25 million will be used to partially repay the amount owed to the Lower Silesia Region Tax Office; part of this repayment is deferred, part will be repaid into instalments⁽²⁹⁾ and part will be repaid with interest calculated on the payment date.
- (137) On this basis, according to the Ernst&Young study (see Table 26) the creditors would receive PLN 122 million in total in the event of the sale of PZL Wrocław and the other assets of PZL Hydral, while in the event of bankruptcy resulting in the liquidation of PZL Hydral the creditors would receive only PLN 66 million, and three of them (the Ministry of Finance, Lower Silesian Regional Office and the State Fund for the Rehabilitation of the Disabled) would not receive anything.
- (138) In the sale scenario, the public creditors will write off PLN 195 million of public liabilities in total. Despite this, each public creditor is better off in the sale scenario than in the bankruptcy scenario. In total, the public creditors would recover 38,5 % of the amount owed to them.
- (139) The Polish authorities informed the Commission that on the basis of the findings of the Ernst&Young study, the public creditors agreed to the partial repayment of their claims in 2010.

Debt-for-equity swap for the outstanding loans awarded by the IDA

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- (140) In the framework of the talks with [...], the IDA agreed that its credits would be partially swapped, partially repaid and partially waived. Under Annex 2 to the Framework Agreement, the IDA was to convert part of the 2007 loan principal and part of the 2008 loan principal totalling [...] into PZL Wrocław's share capital and liquid assets and to waive interest in an amount of [...] on the 2007 loan. Following this swap, PZL Wrocław's share capital was to be reduced by lodging an application to that effect with the court with jurisdiction.
- (141) The Polish authorities pointed out that the deterioration in PZL Wrocław's financial situation only occurred in 2009 and was caused by the economic downturn, which could not have been predicted and which resulted in a decline in orders from the Polish armed forces of almost [...]. Consequently, the IDA's situation as a creditor worsened considerably, as did the prospects for recovering its claims in full.
- (142) The provisions of Annex 2 to the Framework Agreement were negotiated in close correlation with the results of the supplement to the Ernst&Young study. This supplement was prepared on 24 February 2010. It analyses two scenarios, bankruptcy leading to the liquidation of PZL Wrocław and its sale to the investor. In particular, it focuses on what the IDA would obtain from its collateral in the bankruptcy scenario and compares this with the amounts it could expect if PZL Wrocław were sold to the investor.
- (143) The supplement to the Ernst&Young study points out that the assets of PZL Wrocław were encumbered by pledges and mortgages. The book value of all PZL Wrocław's assets on 31 December 2009 was PLN 52,5 million, of which secured assets accounted for PLN 21,3 million and unsecured/non-encumbered assets PLN 31,2 million.
- (144) Even if the unsecured/non-encumbered assets represented [...] % of the value of PZL Wrocław's assets, if the sale of PZL Wrocław did not take place, the tax authorities would issue a tax decision pursuant to Articles 112 and 118 of the Tax Code⁽³⁰⁾ declaring that PZL Wrocław was liable for PZL Hydral's 2006-07 liabilities in order to enforce their claims. This is confirmed by a letter from the Lower Silesia Region Tax Office of 23 November 2007, which states that should the restructuring fail, enforcement steps will be taken under Article 112 of the Tax Code.
- (145) As PZL Wrocław owns PZL Hydral's production assets (which it purchased between 2004 and 2007), this decision would impact on some of PZL Hydral's public liabilities. The value of the claims that would be affected by such proceedings would correspond to PZL Hydral's public liabilities generated in 2006-07 and would amount to a minimum of PLN 64,4 million⁽³¹⁾. According to the supplement to the Ernst&Young study, the value of these claims would exceed the book value of the unsecured/non-encumbered assets. At the same

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time, the book value of these assets should be considered in the light of their market value as they are receivables, cash and other monetary assets.

- (146) In the event of PZL Wrocław going bankrupt, only assets secured by mortgages and registered pledges would therefore take priority over the claims of the tax authorities. The claims of PZL Wrocław's unsecured private creditors could not have been satisfied from PZL Wrocław's assets. In the light of the fact that not all creditors' claims would be satisfied from the bankruptcy estate, PZL Wrocław shares would have zero value in the event of bankruptcy. Equally, as only the holders of registered pledges and mortgages would be satisfied, ordinary pledges are worthless.
- (147) On that basis, the supplement to the Ernst&Young study analyses the value of the IDA's registered pledge on PZL Wrocław's assets. The value of the collateral in the form of registered pledges on machinery is determined on the basis of the assumption that the value of the assets pledged in the event of bankruptcy would be 50 % of their net book value, as their fair value was not available and the value of movable fixed assets was subject to change in line with the applicable depreciation rate. Ernst&Young took the view that the value in the event of a fire sale was representative in the light of the possibility of using the evaluated assets for certain purposes and as part of certain production processes, the possibility of using them for alternative purposes and the nature of the contracts with which they were associated. The Ernst&Young study points out that when the assets to be sold are highly specific and are used to produce for a specific buyer, their liquidation value can be very low and can amount to 30 % of their net book value. By way of an example, Autoglass Group SA, which had a balance-sheet value of PLN 19,8 million, was sold in bankruptcy proceedings for PLN 6 million. In addition, the PZL Wrocław assets in question which served as a registered pledge include many low-value items. In particular, the 2007 loan was secured by a list of 1 709 items which depreciated over the years and around 1 400 items with a value of less than PLN 3 500; consequently, a one-off depreciation was carried out.
- (148) As did the main report, the supplement to the Ernst&Young study disregarded the effect of inflation, i.e. in view of potentially lengthy bankruptcy proceedings, on the assessment of the bankruptcy scenario from the perspective of PZL Wrocław's creditors.
- (149) According to this study, the net book value of the assets serving as a registered pledge on machinery was PLN 2 106 392,71 on 31 January 2010. If this formula is applied to the net book value of the assets, their value (in bankruptcy) in the event of a fire sale is estimated at PLN 1 053 196,36.
- (150) The supplement to the Ernst&Young study concludes that the IDA obtains PLN 1 053 196,36 under the bankruptcy scenario and [$>$] PLN 1 053

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196,36] under the sale scenario (as specified in Annex 2 to the Framework Agreement).

- (151) The Polish authorities informed the Commission that the net book value of assets serving as a registered pledge for the 2007 loan amounted in the audited 2007 financial reports to PLN 5 480 861,37 and in the audited financial reports as at 31 January 2010 to PLN 818 967,55.
- (152) The Polish authorities informed the Commission that the net book value of assets serving as a registered pledge for the 2008 loan amounted to PLN 2 763 000 according to the independent expert report dated 1 February 2008. The book value of these assets according to the audited financial reports amounted to PLN 1 883 098,97 on 1 February 2008 and the net book value of these assets according to the audited financial reports amounted to PLN 1 287 425,16 on 31 January 2010.
- (153) Accordingly, the Polish authorities withdrew from the two capital injections to PZL Hydral, arguing that the partial write-offs and partial repayments of public liabilities were free of state aid in the light of the private creditor rule. They also stated that the public creditors' conduct in the past (1998-2007) was in line with the private creditor rule. They also indicated that the sale of PZL Wrocław had been open, transparent and unconditional and that the price offered by the investor could be regarded as a market price. The Polish authorities argued that both the 2007 and 2008 loans had been awarded on market terms. They also withdrew from the debt-for-equity swap for the 2007 loan described above but proposed a partial swap for both the 2007 and 2008 loans prior to the sale, arguing that this complied with the private creditor rule.

VII. COMPETENCE OF THE COMMISSION

- (154) The initial part of certain measures, namely the non-enforcement of public liabilities against PZL Hydral, started in 1998, i.e. prior to Poland's accession to the EU on 1 May 2004.
- (155) Under the Accession Treaty, aid measures put into effect in the new Member States before accession and still applicable after accession which constitute state aid within the meaning of Article 107(1) of the TFEU and are not existing aid are to be treated as new aid for the purpose of applying Article 108(3) of the TFEU.
- (156) Point 3 of Annex IV to the Accession Treaty sets out the interim mechanism procedure. It constitutes a legal framework for the assessment of aid schemes and individual aid measures which are put into effect in a new Member State before the date of its accession to the EU and are applicable after accession.
- (157) Aid measures that were put into effect before accession and are not applicable after accession cannot be examined by the Commission, either under the interim mechanism procedure or under the procedure laid down in Article 108(2) of the TFEU. On the other hand, measures that were not put into effect

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until after accession will be assessed by the Commission as notified aid or as unlawful aid pursuant to the procedure laid down in Article 108(2) of the TFEU.

- (158) A measure is applicable after accession if it was put into effect before accession but can still give rise, after accession, to the granting of additional aid or to an increase in the amount of aid already granted, i.e. if the precise economic exposure of the state is not known on the date on which the measure was put into effect and is still not known on the date of accession.
- (159) In the present case, the Commission notes that the non-enforcement of public creditors' liabilities started in 1998, and continued at the date of accession. The Commission considers that the non-enforcement of all liabilities outstanding on 1 May 2004 fell under its jurisdiction as of that date.
- (160) In the light of the foregoing, the non-enforcement of the public liabilities outstanding on 1 May 2004 constitutes a measure applicable after accession and falls under the Commission's jurisdiction pursuant to Article 108 of the TFEU.

VIII. ASSESSMENT

- (161) According to Article 107(1) of the TFEU, state aid is 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 in so far as it affects trade between Member States.
- (162) The conditions laid down in Article 107(1) of the TFEU are cumulative and therefore for a measure to be qualified as state aid all the conditions must be fulfilled simultaneously.
- (163) In the following sections, the Commission assesses possible state aid to PZL Hydral and PZL Wrocław separately.
- (164) It identifies the following measures concerning PZL Hydral:
- the planned and withdrawn capital injections for PZL Hydral,
 - the enforcement of public liabilities against PZL Hydral (1998-2007),
 - the settlement with the public creditors of PZL Hydral (2007-10).
- (165) It identifies the following measures concerning PZL Wrocław:
- the 2007 loan,
 - the 2008 loan,
 - the debt-for-equity swap concerning the 2007 and 2008 loans.
- (166) The Commission notes that the Polish authorities contested the classification of the above-mentioned measures as state aid, claiming that the measures passed the private creditor test (in the case of the measures for PZL Hydral and the 2010 debt-for-equity swap for PZL Wrocław) and the market investor test (in the case of the 2007 and the 2008 loans to PZL Wrocław).

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VIII.1. **The withdrawn capital injections to PZL Hydral**

- (167) Pursuant to Article 8 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty⁽³²⁾ ('the Procedural Regulation'), a Member State may, after the opening of the formal investigation procedure, withdraw the notification in due time before the Commission has taken a decision on whether the notified measure constitutes aid. In such cases, the Commission terminates the procedure on the basis that it no longer serves any purpose.
- (168) The Polish authorities withdrew the two notified capital injections (PLN 113 million). Accordingly, the Commission's investigation into these measures no longer serves any purpose.

VIII.2. **Non-enforcement of public liabilities against PZL Hydral (1998-2007)**

- (169) State aid may have been granted to PZL Hydral in the form of continued non-enforcement of public liabilities against the company by various public creditors.
- (170) The Commission points out that Article 107(1) of the TFEU covers interventions in various forms which reduce a company's normal costs and which, without therefore being subsidies in the strict sense of the word, are similar in character and have the same effect. It is universally accepted in case-law that the conduct of a public body with responsibility for collecting social security contributions which tolerates late payment of such contributions gives a company in financial difficulties which benefits from that conduct a significant commercial advantage by mitigating the burden associated with the normal application of the social security system which cannot be wholly removed by the interest and default surcharges applied to it⁽³³⁾. This reasoning applies *mutatis mutandis* to other fees, charges and taxes collected by public authorities.
- (171) In the present case, the public collecting bodies had not recovered their claims against PZL Hydral 1998–2007 in full when the public creditors adopted the Plan (see point 60 et seq.).
- (172) It follows from case-law that, in order to determine whether any state aid was granted by the public authorities by way of non-enforcement of public claims, it has to be ascertained whether the company concerned would manifestly have been unable to obtain comparable facilities from a private creditor in the same situation vis-à-vis that company as the public collecting body⁽³⁴⁾.
- (173) The Commission notes that in order to ensure the long-term economic viability of PZL Hydral, its owner at that time, the Polish Treasury, and subsequently the IDA, developed a privatisation strategy on the basis of a 1998 study carried out by private consultants, and started a search for investors

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(see point 54). The private and public creditors supported this approach and were closely involved in it.

- (174) In 2002 the Polish authorities, still with the support of private and public creditors, entered into negotiations with [...]. These creditors were given regular updates on the progress made (see points 30 and 56).
- (175) The Commission notes that both private and public creditors took the view that the value of PZL Hydral, and in particular of its aviation and defence activities, as a going concern by far exceeded the value of its assets, in particular by virtue of its military certificates and arms-trading permits, as well as its human capital, and that for that reason they agreed to refrain from instituting bankruptcy proceedings against PZL Hydral.
- (176) The Commission notes in particular that the main private creditors, i.e. Bank [...] and Bank [...], refrained from forced enforcement of their liabilities in spite of holding first-rank collateral (see points 32 and 34) which was enforceable directly on the basis of bank enforcement orders and could be relatively easily disposed of (see point 28).
- (177) The public creditors, on the other hand, took enforcement actions via the court enforcement officer, and by end-2007 had recovered a total amount of PLN 28,76 million (see point 41).
- (178) The Commission therefore concludes that between 1998 and 2007, PZL Hydral was able to obtain comparable facilities from two private creditors, i.e. Bank [...] and Bank [...], which were not merely in the same but actually in a better situation vis-à-vis that company than the public collecting bodies.
- (179) The Commission also concludes that the decision of both private and public creditors to refrain from instituting bankruptcy proceedings against PZL Hydral was justified by the good prospects for restoring viability to the aviation and defence activities once their debt arrears had been repaid, as indicated in the strategy developed in 1998 (see point 54).
- (180) Therefore, the non-enforcement of the public collecting bodies of the amounts owed to them in 1998-2007 does not confer an advantage on PZL Hydral because the public authorities acted in the same way as a private creditor would have acted, and this therefore does not constitute state aid within the meaning of Article 107(1) of the TFEU.

VIII.3. **Repayment of PZL Hydral's public liabilities (2007-10)**

- (181) After the failure of the privatisation negotiations with [...], the main private creditors of PZL Hydral, i.e. Bank [...] and Bank [...], settled their claims vis-à-vis PZL Hydral.
- (182) The private creditors' claims were settled in April 2003 (Bank [...]) and November 2006 (Bank [...]) respectively. Despite the good quality of their

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collateral, Bank [...] accepted the settlement of PZL Hydral's debts of PLN 51,6 million against a payment of PLN 4 million and Bank [...] accepted the settlement of PZL Hydral's debts of PLN 86,4 million against a payment of PLN 11,5 million respectively (see points 31 and 33).

- (183) The public collecting bodies reached a debt settlement agreement with the IDA and PZL Hydral in 2007, which was incorporated into the Plan in November 2007. This agreement contained four essential elements:
- PLZ Hydral would pay all new taxes, charges and contributions on time,
 - PZL Hydral would pay off part of its outstanding liabilities in instalments; payment for the remainder would be deferred until PZL Hydral had sold off its subsidiaries and assets,
 - PLZ Hydral would sell all its subsidiaries and assets, and use the proceeds to pay its debt arrears,
 - the aviation and defence business of PZL Hydral would be hived off into the subsidiary PZL Wrocław, which would subsequently be privatised and public creditors would be repaid from the proceeds. This would leave PZL Hydral as an empty shell, which would be liquidated.
- (184) In accordance with the estimated proceeds from sales in 2007-2010, the Plan provided for the public collecting bodies to recover PLN 120,8 million (see point 61). *Ex post*, this turned out to be a good estimate, as the amount established in 2010 is PLN 122,3 million (see point 133).
- (185) The Commission notes that the Plan also provided for two capital injections to PZL Hydral, which were designed to increase the amount of money available for settling past liabilities. The inclusion of these capital injections in the Plan was to be subject to the Commission's prior authorisation; therefore, it was clear to the public creditors when agreement was reached on the Plan that they could not view the inclusion of these additional amounts in the Plan as acquired and certain.
- (186) The Commission also notes that the Plan does not include a final decision on how the proceeds will be divided between the different public creditors. This division was to be done after the process of selling the subsidiaries and assets had been carried out on the basis of the actual proceeds of the sale, taking account of the collateral of the different public creditors on these assets.
- (187) With regard to the assessment of the conduct of public creditors from 2007 to 2010, the Commission considers that two different decisions on the part of the public creditors need to be assessed: first, the decision in 2007 to agree to the Plan, and second, the decision in 2010 to accept the final settlement as detailed in Table 26 of this Decision.
- (188) According to Court case-law, in such situations the Commission must apply the private creditor rule, i.e. in order to determine whether the reduction of some of the debts owed by a firm in difficulty to a public-law body constitutes

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state aid, it must compare that body to a private creditor seeking to recover amounts owed to it by a debtor in financial difficulty⁽³⁵⁾.

- (189) However, according to case-law, when a company facing a significant deterioration in its financial situation proposes an agreement or series of agreements for debt restructuring to its creditors with a view to remedying the situation and avoiding bankruptcy, each creditor must take its decision in the light of the amount offered to it under the proposed agreement on the one hand, and the amount it expects to be able to recover in the event of the company's liquidation on the other. Its decision is influenced by number of factors, including the creditor's status as the holder of a secured, preferential or ordinary claim, the nature and extent of any collateral it may hold, its assessment of the likelihood of the company being restored to viability and the risks of its losses increasing in the event of this not taking place and the amount it would receive in the event of liquidation. If it turned out, for example, that in the event of the company being liquidated, the realisation value of its assets sufficed only to cover mortgage and preferential claims, ordinary claims would have no value. In these circumstances, acceptance by an ordinary creditor of the cancellation of a major part of its claim would not really be a sacrifice⁽³⁶⁾.

Agreement to the Plan in 2007

- (190) The Commission notes that the terms of the settlement with the public collecting bodies are different from the terms of the settlement with the two private banks.
- (191) First of all, the private banks opted for an immediate payout, whereas the public collecting authorities agreed to await the results of the sale of PLZ Hydral's assets and subsidiaries.
- (192) Second, the expected recovery rate of the public collecting authorities by far exceeds the recovery rate of the private banks: Bank [...] recovered 7 %, Bank [...] recovered 13 %, whereas the public collecting authorities could expect to recover 38,5 % on the basis of sale proceedings of PLN 122,3 million.
- (193) The Commission must assess whether the decision of the public creditors to agree in 2007 to the Plan, which is different in nature to the settlement obtained by the private creditors, would have been taken by a private creditor in their place, applying the principles set out in points 188 and 189 above.
- (194) First, the Commission notes that the public creditors had only limited collateral, and that their collateral was of an inferior quality to that of the private banks (see Tables 16 to 20 above). They were therefore in a weaker negotiating position. At the same time, following the settlement with the private creditors, the quality of their collateral increased significantly, giving them additional security that, even in the event of the Plan not working out as predicted, they would still obtain an acceptable recovery rate from the assets.

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- (195) Second, the Commission notes that the public creditors could expect, on the basis of the assumptions underpinning the Plan, a substantially higher recovery rate than the private creditors, which had opted for a quick settlement.
- (196) Third, the Commission notes that the private creditors obtained assurances from PZL Hydral and PZL Wrocław that all new liabilities would be paid on time.
- (197) Fourth, the Commission observes that as regards outstanding liabilities, PZL Hydral agreed to a payment schedule which provided for part of the debt to be repaid in instalments and for the remainder to be repaid once the proceeds of the sale of assets and subsidiaries were known. These payments constituted a substantial improvement in comparison with recovery in the years before the Plan was agreed: in 2008, the first year of the Plan, PZL Hydral repaid PLN 54,6 million, against only PLN 9,5 million in 2007 (see Table 21).
- (198) The Commission concludes that on the basis of these guarantees and the assurances received from PZL Hydral, the public creditors acted as a private creditor placed in a comparable situation would have acted.
- (199) The Commission also observes that due to the failure of negotiations with [...] and [...] (see point 94), the actual realisation of the Plan took longer than initially envisaged. The Commission considers that this was a risk inherent to the agreement given to the Plan by the public collecting bodies.

Agreement to the final settlement in 2010

- (200) The final settlement between PZL Hydral and its public creditors is described in Table 26. Once the sale price for PZL Wrocław had been established following an offer made by [...], the public creditors agreed to settlement from the sale of PZL Hydral's assets, without any capital injections, in accordance with the private creditor rule, taking into account the value of their claims and the quality of their collateral (see point 96).
- (201) The Commission must therefore determine whether, in the event of a sale without capital injections, each of the public creditors is better off than in the event of bankruptcy, and whether a sale to [...] is the best sale scenario the public creditors could expect.
- (202) All the public creditors will recover more than the private creditors (see point 134), except the Ministry of Finance, which, however, did not hold any collateral and thus cannot be compared with private creditors holding first-rank collateral (see points 32 and 34).
- (203) It should also be noted that the Ernst&Young study commissioned by the IDA compared the amounts each public creditor could expect to receive in the event of bankruptcy and in the event of a sale (which took place in 2010) (see point

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- 137). The study concludes that each public creditor is better off in the event of a sale.
- (204) The Commission has critically assessed the Ernst&Young study in order to determine whether its findings withstand scrutiny and demonstrate that by agreeing to the settlement, each public creditor behaved like a private creditor in a comparable situation, relying on the case-law cited in points 188 and 189 above.
- (205) First, the Commission notes that the Ernst&Young study used as methodology the relevant case-law of the European courts to assess the private creditor rule and took into consideration the status of each public creditor, the collateral it held, its ranking and the amount it would recover in the event of liquidation.
- (206) Table 26 of the present decision shows that on the basis of this assessment, each public creditor (the Social Security Office, the Lower Silesia Region Tax Office, Wrocław Psie Pole Tax Office, Wrocław City Council, the State Fund for the Rehabilitation of the Disabled, the Lower Silesia Regional Office and the Ministry of Finance) is better off in the event of the sale of all PZL Hydral's assets, i.e. each recuperates a higher proportion of its outstanding liabilities, than in a bankruptcy scenario leading to liquidation, taking into consideration the ranking and the respective collateral of the public creditors (see point 134).
- (207) The Commission then verified the plausibility of the bankruptcy scenario developed by Ernst&Young. The starting point of the assessment is that the value of PZL Hydral is nil, as its liabilities by far exceed the value of its assets and subsidiaries. Therefore any creditor in a bankruptcy scenario would only be able to recoup the portion of its outstanding liabilities that was secured by collateral, in so far as its rank enabled it to benefit from the liquidation value of the secured assets.
- (208) Tables 16 to 20 show the collateral for each public creditor. The extent to which each public creditor is to be satisfied from its collateral, taking its ranking into account, in the event of PZL Hydral being declared bankrupt is shown in point 131. With a view to estimating the fire sale value of the real estate, Ernst&Young took the current fair value of assets forming part of the company in accordance with point 30 and international accounting standard (IAS) 16 on property, plant and equipment⁽³⁷⁾. The Commission notes that the use of this IAS is mandatory in the EU and is therefore an appropriate starting point for assessing the liquidation value. The Commission regards it as reasonable that the bankruptcy value of these assets is reduced in the fire sale by 50 % due to the fact that these assets will be sold separately, that it will not be possible to apply the 'going concern' rule due to decreased demand for industrial assets in the economic crisis and that this value is above the average revenue from the sale of assets in bankruptcy in Poland, which is 26,86 % compared to their fair value.

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- (209) The Commission concludes that each public creditor is better off under the scenario of a sale to [...] than under a bankruptcy scenario.
- (210) It remains to be determined whether the offer from [...] is the best offer the public creditors could expect. The Commission notes that when it became clear in the first of half of 2009 that the conditions contained in the offer from [...] had not been met, [...] was the only buyer interested in purchasing the PZL Wrocław shares. Despite the publication of an invitation to express interest and an active search for possible investors as of May 2008 (see point 90 et seq.), no other investors came forward. Therefore the public creditors did not have reasonable grounds to believe that any other investor would offer a better price in the future.
- (211) On this basis, the Commission considers that by agreeing in 2010 to the settlement structure shown in Table 26, the public creditors behaved like a private creditor seeking to recover amounts owed to it by a debtor in financial difficulty. Therefore the public creditors did not confer an advantage on PZL Hydral. Accordingly, the settlement of outstanding liabilities in the form of a partial write-off of public liabilities as per the Ernst&Young study does not constitute state aid within the meaning of Article 107(1) TFEU.

VIII.4. Measures with regard to PZL Wrocław

The 2007 loan granted to PZL Wrocław

- (212) The Commission needs to determine whether the 2007 loan conferred an advantage on PZL Wrocław. For that purpose, the Commission must establish whether a private investor ('market economy investor principle') would have concluded the transaction in question on the same terms and, if not, on which terms it would have done so⁽³⁸⁾.
- (213) The Commission notes that in order to ascertain whether a loan granted by a state body which is already a shareholder in the company complies with the market economy investor principle, its investment should be compared with investments by a private holding company or private group of companies pursuing structural policy and being guided by the longer-term prospects⁽³⁹⁾.
- (214) The Commission takes the view that the IDA is not an external creditor which invests in order to obtain profits based on the return on its investment in the form of an interest rate, but that it is a shareholder with more than 90 % of shares in PZL Hydral, which in turn holds 100 % of shares in PZL Wrocław. It must therefore be determined whether a private investor would have granted the 2007 loan in the same circumstances.
- (215) As regards the 2007 loan to PZL Wrocław, the Commission notes first that it was granted to PZL Wrocław, a company which at that time was financially viable and not in financial difficulty within the meaning of the rescue and restructuring guidelines (see points 47 and 48). Instead it was a new company without debt which already had a significant number of orders on its books,

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mainly in the form of contracts with the Polish Ministry of Defence, with which it had a longstanding business relationship.

- (216) The Commission notes that the IDA anticipated securing a return on its investment by way of a debt-for-equity swap of [...] % and the subsequent sale of this stake in PZL Wrocław to a private investor (for an estimated [...]), as stated in the Plan.
- (217) The IDA took into consideration the ongoing negotiations with [...] (see point 74).
- (218) In order to establish whether the IDA had acted in accordance with the private investor principle, it is therefore necessary to determine what sales price IDA could expect for its stake, what the level of risk was, and whether the return on the investment resulting from that sale was adequate in relation to the risk taken by the IDA.
- (219) Prior to granting the loan, the IDA had commissioned a study from an independent expert in order to establish the value of PZL Wrocław once the hive-off from PZL Hydral had been completed (see point 66).
- (220) The Commission critically assessed this study and concluded that it was reasonable to expect a sales price of at least [...] (see point 71 et seq.). By selling approximately [...] % of the shares, the IDA could therefore expect a considerable return of at least PLN 48,5 million in the event of a successful sale.
- (221) The Commission acknowledges that there are always considerable risks inherent in any privatisation. In the present case a first attempt had already failed. At the same time, the Commission notes that the overall prospects for a Polish aviation and defence company were relatively stable taking into account the Polish army's ongoing duties abroad and Poland's commitments to NATO regarding its defence capabilities. Furthermore, in view of the need to hold special permits, barriers to entry to the relevant market segment are high, which in turn increases the attractiveness of the established players.
- (222) The Commission also notes that the expected return on investment was sufficiently important to justify a relatively high risk, and that in addition the IDA had obtained collateral in the form of a registered pledge on machinery for PLN 5,5 million and an ordinary pledge on [...] % of the shares (see point 65).
- (223) On this basis, the Commission is satisfied that the 2007 loan was granted in line with the private investor principle and therefore does not constitute state aid within the meaning of Article 107(1) of the TFEU.

The 2008 loan granted to PZL Wrocław

- (224) The Commission needs to determine whether the 2008 loan conferred an advantage on PZL Wrocław. To that end the Commission will apply the private

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investor principle as set out in points 212 to 214 and for the reasons explained therein.

- (225) As regards the 2008 loan to PZL Wrocław, the Commission notes first that it was granted to PZL Wrocław, a company which at that time was financially viable and not in financial difficulty within the meaning of the rescue and restructuring guidelines. Instead it was a new company without debt which already had a significant number of orders on its books, mainly in the form of contracts for an amount of [...] with the Ministry of Defence (see point 48). The Commission takes the view that this loan was granted specifically for the purpose of processing the increasing number of orders from the Ministry of Defence. Moreover, in 2008 the company obtained private funding in the form of an operating lease (see point 87).
- (226) The Commission notes that the IDA granted the 2008 loan shortly before the expected end of negotiations with [...] regarding the sale of PZL Wrocław (see point 74). It did so in order to provide a bridging loan for the period prior to closing the deal, when PZL Wrocław had to expand its capacity rapidly in order to cope with increasing orders from the Ministry of Defence. The IDA's main motivation for granting the loan was therefore to ensure that the company could take advantage of business opportunities before the deal with [...] was closed and to ensure that the deal would be concluded swiftly.
- (227) The Commission notes that the loan is limited to PLN 4 million, the amount necessary to acquire the assets needed to meet the additional demand from the Ministry of Defence.
- (228) Furthermore, the Commission observes that the loan was secured by a registered pledge on machinery to a value of PLN 2,8 million and by an ordinary pledge on receivables from commercial contracts to a value of PLN 5,2 million, and that it had a variable interest rate which was identical to the applicable reference rate published by the Commission (see point 83). Nevertheless, before granting the 2008 loan, the IDA examined PZL Wrocław's financial situation and found it to be profit-making. On that basis the IDA could expect PZL Wrocław to generate sufficient cash flow for it to repay the loan and for the IDA to receive a return on its investment.
- (229) The Commission observes that it is normal business behaviour for a majority shareholder that is in the process of selling a company to grant a small bridging loan, if that loan is necessary to take advantage of business opportunities and ensures that the sale is concluded smoothly. The Commission takes the view that the 2008 loan, which, furthermore, was adequately secured and provided for interest at the reference rate, was granted by the IDA in line with that logic.
- (230) On this basis, the Commission is satisfied that the 2008 loan was granted in line with the market economy investor principle and therefore does not constitute state aid within the meaning of Article 107(1) of the TFEU.

The debt-for-equity swap in connection with the 2007 and 2008 loans

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- (231) By agreeing to first swap its debt for equity and then passing on the entire proceeds of the sale of the equity to PZL Hydral to enable it to settle its outstanding liabilities to public bodies as provided for in the Plan, the IDA effectively waived debts of PLN 17,2 million, recovering only [$>$ PLN 1 053 196,36].
- (232) It is necessary to establish whether the debt-for-equity swap involves an advantage granted by the IDA to PZL Wrocław. To that end, the Commission must determine whether, in performing this transaction, the IDA complied with the private creditor rule as defined in points 188 and 189.
- (233) The Commission notes first that [...]’s 2009 offer ([...]) was [...] lower than [...]’s 2008 offer. The Commission takes the view that this difference reflects the deterioration in the situation of PZL Wrocław, which in 2008 had been profitable and with good prospects, whereas by 2009 it was showing signs of difficulties, mainly as a result of the significant downturn in orders from the Ministry of Defence.
- (234) The Commission also notes that the IDA had no expectation of finding a buyer other than [...] for the shares it had obtained in PZL Wrocław as a result of the debt-for-equity swap (see point 210). In order to ensure that the deal was successful, the IDA had to ensure that it could settle the liabilities of the public creditors, in so far as they had mortgages on the assets of PZL Wrocław, as otherwise it would not have been in a position to honour the commitment to transfer all assets free from collateral.
- (235) Moreover, if the sale of PZL Wrocław - which was the event on which restructuring of public liabilities by way of partial repayments was based - did not proceed, the tax authorities would enforce their claims pursuant to the Tax Code (see point 144). In addition, in view the financial situation of PZL Wrocław, the failure of the sale agreement would lead to PZL Wrocław’s bankruptcy (see point 52).
- (236) Therefore the Commission concludes that the only alternative to accepting the *de facto* waiver of PLN 17,2 million was to put PZL Wrocław and PZL Hydral into liquidation.
- (237) The supplement to the Ernst&Young study assessed these two scenarios. The Commission has critically assessed the Ernst&Young study to determine whether its findings withstand scrutiny and demonstrate that, by agreeing to the settlement, the IDA behaved like a private creditor in a comparable situation, relying on the case-law quoted in points 188 and 189.
- (238) In the event of bankruptcy, the study concludes that ordinary creditors will not receive anything, as many of the assets are encumbered by pledges and mortgages and, in addition, the tax authorities will be able to enforce their claims against PZL Wrocław (see points 143 et seq.). The Commission has confirmed this information by examining the financial reports of PZL

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Wrocław and by analysing implementation of Polish law, and has reached the conclusion that Ernst&Young's assessment is justified.

- (239) As a result, the Commission considers that the value of the ordinary pledge on receivables which secures the 2008 loan is without any value in a liquidation scenario. Furthermore, the pledge on [...] % of the shares is without any value in the liquidation scenario, as the value of the shares themselves is nil.
- (240) Therefore, in order to establish what the IDA would obtain in a liquidation scenario, it is necessary to estimate the profits it could expect from selling the items on which it has registered pledges.
- (241) The supplement to the Ernst&Young study notes that the machinery on which the IDA had pledges for the 2007 loan had a book value in 2007 of PLN 5,5 million, whereas the machinery on which it had pledges for the 2008 loan had a book value of PLN 2,8 million in 2008.
- (242) In the supplement to the Ernst&Young study the assessment of the liquidation value of the pledges registered in favour of the IDA was based on the book value of the assets entered in PZL Wrocław's audited financial reports (see points 151 and 152) as at 31 January 2010, i.e. PLN 2,1 million.
- (243) The Commission considers that the book value of the fixed movable assets (serving as a pledge for the 2007 and 2008 loans), as entered in the audited financial report, is an appropriate starting point for assessing their liquidation value. The Commission notes first that the large difference between the book value and the net asset value which the 2008 study evaluating PZL Wrocław had found was due to a significant increase in the value of real estate. No correction was made for the value of machinery. Second, the Commission notes that, in view of the short period of time between the establishment of the pledge and the assessment, there are no other indications that the book value does not reflect the conservatively estimated value of the machinery.
- (244) The supplement to the Ernst&Young study argues that in the event of liquidation, these assets would have to be sold in a fire sale at a 50 % reduction, and that therefore the expected value is PLN 1 053 196,36. The Commission acknowledges that assets such as machinery that are put up for sale in the context of liquidation are usually sold below their book value.
- (245) The Commission considers that the 50 % discount is justified for the reasons stated by Ernst&Young, and described in point 147 above. It considers in particular that the evaluation of their hypothetical value in the event of bankruptcy was done using a methodology which can be considered appropriate for the purpose of determining the realisable value of claims vis-à-vis borrowers under threat of bankruptcy, taking account of the specific type of machinery to be sold, the contingency of sales on a specific customer (the Ministry of Defence) which is cutting its spending in the light of the need to adapt to the downturn in tax revenue resulting from the crisis.

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- (246) The Commission therefore concludes that, on the basis of the information available to it when the present decision was adopted, the bankruptcy value of the IDA's outstanding loans was PLN 1 053 196,36.
- (247) In the sale scenario, the value of the IDA's outstanding loans was higher, as [...] offered to pay IDA [> PLN 1 053 196,36].
- (248) The Commission concludes that a private creditor placed in the situation of the IDA would have accepted to waive PLN 17,2 million, because it could not reasonably expect to recover more of its claims under bankruptcy proceedings. Therefore, on that basis, the Commission is satisfied that the behaviour of the IDA with regard to the 2010 debt-for-equity swap is in line with the private investor principle and that the debt-for-equity swap does not contain state aid within the meaning of Article 107(1) of the TFEU.

IX. CONCLUSION

- (249) The Commission notes that the formal investigation into the capital injections of PLN 113 million notified but subsequently withdrawn by the Polish authorities no longer serves any purpose pursuant to Article 8 of the Procedural Regulation.
- (250) With regard to the non-enforcement of public creditors' liabilities and their eventual settlement, the Commission finds that the public creditors acted in line with the private creditor rule. Consequently, the behaviour of the public creditors does not involve state aid within the meaning of Article 107(1) of the TFEU.
- (251) The Commission finds that the planned partial debt-for-equity swap by the Industrial Development Agency within the framework of the Plan, as amended, does not constitute state aid in the meaning of Article 107(1) of the TFEU as it complies with the private creditor rule. The Commission also considers that the 2007 loan and the 2008 loan in favour of PZL Wrocław do not constitute state aid within the meaning of Article 107(1) of the TFEU as they comply with the private investor principle,

HAS ADOPTED THIS DECISION:

Article 1

The Commission has decided to close the formal investigation procedure under Article 108(2) of the Treaty on the Functioning of the European Union in respect of the capital injections of PLN 113 million, noting that Poland has withdrawn its notification and will not pursue this aid project further.

Article 2

1 The partial non-enforcement from 1998 to 2007 of the claims that the Polish public authorities had against PZL Hydral and the settlement of these debts from 2007 to 2010 does not constitute aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

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2 The loans granted by the IDA to PZL Wrocław in 2007 (PLN 12,5 million) and 2008 (PLN 4 million) do not constitute aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

3 The subsequent partial write-off of these loans concerning PLN 17,2 million, carried out in the form of a debt-for-equity swap, does not constitute aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

Article 3

This Decision is addressed to the Republic of Poland.

Done at Brussels, 4 August 2010.

For the Commission

Joaquín ALMUNIA

Vice-President

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- (1) OJ C 324, 19.12.2008, p. 17.
- (2) OJ C 158, 18.6.2010, p. 9.
- (3) Journal of Laws No 145, item 1625, as amended.
- (4) Journal of Laws No 122, item 1320, as amended.
- (5) Journal of Laws No 116, item 1090, as amended.
- (6) Journal of Laws No 192, item 1965, as amended.
- (7) Journal of Laws No 214, item 1571, as amended.
- (8) Confidential information.
- (9) Journal of Laws 1997/140, item 939, as amended.
- (10) USD 1 = PLN 3,3 as at 22 June 2010. The exchange rate on that day has been used for all amounts converted from USD into PLN in this decision; these amounts are provided as a basis of comparison with the PLN for guidance only.
- (11) The actual amounts depend on the volume of sales achieved.
- (12) Under Polish law, the rule that a lower mortgage ranking is automatically changed to a higher ranking is enshrined in Article 12 of the Land Register and Mortgages Act, Journal of Laws No 19, item 147.
- (13) Bankruptcy and Restructuring Act of 28 February 2003, Journal of Laws No 60, item 535, as amended.
- (14) Registered pledges are governed by the Registered Pledge and Register of Pledges Act (Journal of Laws of 6 December 1996 No 149, item 703, as amended). A registered pledge requires a written contract between the creditor and the person authorised to dispose of the object of the pledge and an entry in the register of pledges kept by the district courts. The property in question may remain in the possession of the owner, who continues to be entitled to dispose of it, or may be held by a third party, subject to that party's agreement.
- (15) Ordinary pledges are governed by the Civil Code. The pledge is established by virtue of a contract between the owner and the creditor and, except where otherwise stipulated in law, the object of the pledge must be released to the creditor or a third party.
- (16) All three methods are revenue methods in which either the forecast net profit, forecast net cash flow or forecast net profit plus depreciation are used as to evaluate future revenue. The net profit plus depreciation is the first step in the process of obtaining an analysis of cash flow in the financial accounting system.
- (17) WACC is defined in economic literature as a calculation of the total cost of the firm's capital in which each category of capital (whether it be equity or debt) is proportionately weighted. All capital sources - common stock, preferred stock, bonds and other long-term debt - are included in the WACC calculation. The WACC is the weighted average cost of individual capital components. Hence the calculation of the WACC cannot be disputed as it is a result of an applied mathematical formula.
- (18) The Polish authorities regarded it as reasonable to assume that the value of PZL Wrocław was at least [...]. On that basis, [...] % of PZL Wrocław's shares had a value of PLN 20,3 million.
- (19) The fair market value is defined in economic literature as the price at which a business or assets would change hands between a willing buyer and a willing seller, neither of whom are compelled to buy or sell and both of whom have a reasonable knowledge of all relevant facts at the time.
- (20) The euro was the nominal currency for these agreements.
- (21) In particular, ILA Berlin, the international Paris air show, Farnborough Air Show in the UK and the defence industry fair (MSPO) in Poland.
- (22) [...] is one of the largest outsourcing companies in Europe, employing nearly [...] workers with an estimated value of approximately [...] (according to the wording of the proposal of 30 September 2008).
- (23) OJ C 244, 1.10.2004, p. 2.

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- (24) Case C-256/97 *DMT* [1999] ECR I-3919, paragraph 21.
- (25) The costs that would be generated if an alternative set of conditions or assumptions were to prevail (as compared with the costs incurred or generated in the current circumstances).
- (26) Case C-342/96 *Spain v Commission* [1999] ECR I-2459.
- (27) Case T-152/99 *HAMSA v Commission* [2002] ECR II-3049, paragraph 170.
- (28) This amount is used to repay amounts owed to the Social Security Office.
- (29) An extension fee will be charged.
- (30) Tax Code of 29 August 1997 (Journal of Laws 2005/8, item 60, as amended). Article 112 states that a purchaser of a company or stand-alone part of a company is liable with all of its assets jointly and severally with the taxpayer for tax arrears generated prior to the date of purchase and which are related to business activities, unless the purchaser could not have known about these arrears having performed due diligence. Article 118 states that a decision on tax liability cannot be issued to a third party where five years have elapsed from the end of the calendar year in which the tax arrears were generated.
- (31) This includes an amount of PLN 7,5 million owed to the Social Security Office, PLN 19,1 million owed to the Lower Silesia Region Tax Office, PLN 24,9 million owed to Wrocław City Council and PLN 12,9 million owed to the State Fund for the Rehabilitation of the Disabled.
- (32) [OJ L 83, 27.3.1999, p. 1.](#)
- (33) Case C-256/97 *DM Transports* [1999] ECR I-3913, paragraph 30; Case T-36/99 *Lenzing v Commission* [2004] ECR II-3597, paragraphs 137 and 139.
- (34) Case C-256/97 *DM Transports* [1999] ECR I-3913, paragraph 30.
- (35) Case C-342/96 *Spain v Commission* [1999] ECR I-2459, paragraph 46; Case C-256/97 *DMT* [1999] ECR I-3913, paragraph 24. Case T-152/99 *HAMSA v Commission* [2002] ECR II-3049, paragraph 167. Case T-198/01 *Technische Glaswerke Ilmenau v Commission* [2004] ECR II-2717, paragraph 99; Case T-68/03 *Olympic Airways v Commission* [2007] ECR II-2911, paragraph 283.
- (36) Case C-256/97 *DMT* [1999] ECR I-3913, paragraph 30. Case T-152/99 *HAMSA v Commission* [2002] ECR II-3049, paragraph 168. Case T-46/97 *SIC v Commission* [2000] ECR II-2125, paragraph 95. Case T-68/03 *Olympic Airways v Commission* [2007] ECR II-2911, paragraph 283.
- (37) The use of the IAS is mandatory in the EU pursuant to Commission Regulation (EC) No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council ([OJ L 261, 13.10.2003, p. 1.](#))
- (38) Case T-16/96 *Cityflyer v Commission* [1998] ECR II-575, paragraph 52.
- (39) Case T-228 and 233/99 *Westdeutsche Landesbank v Commission* [2003] ECR II-435, paragraph 314.

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