

## II

(Acts whose publication is not obligatory)

## COMMISSION

## COMMISSION DECISION

of 27 July 1994

concerning aid granted to the Volkswagen Group for investments in the new German *Länder*

(Only the German text is authentic)

(Text with EEA relevance)

(94/1068/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given the parties concerned the opportunity to submit their comments, in accordance with the abovementioned Articles <sup>(1)</sup>,

Whereas:

- the apparently high aid intensity proposed for a plan involving significant expansion of capacity within the European car market could give rise to an unfair distortion of competition,
- not enough evidence had been presented to justify the combination of a relatively high intensity of regional aid and the granting of indirect investment as well as temporary operating aid by the Treuhandanstalt (THA) in connection with the structural and economic problems in the new *Länder*; indeed, the overall aid intensity might be disproportionately high and incompatible with the criteria of the Community framework on State aid to the motor vehicle industry.

## I

By letter dated 14 January 1992, the Commission informed Germany of its decision of 18 December 1991 to initiate the procedure provided for in Article 93 (2) of the EC Treaty with respect to investment aid measures proposed by the German authorities for the Volkswagen Group in the new *Länder*.

In opening the procedure the Commission expressed serious doubts as to the compatibility of the aid with Article 92 of the EC Treaty for the following reasons:

- the State aid had not been properly notified to the Commission in accordance with the procedure provided for in Article 93 (3) and could not yet be fully quantified,

## II

By letters dated 19 September 1990, 14 December 1990 and 14 March 1991 the Commission requested the notification, in accordance with the Community framework on State aid to the motor vehicle industry, of the aid measures supporting the investments of Volkswagen AG in the new German *Länder* and stressed that such aid could not be granted without prior notification and approval by the Commission.

Germany explained by letter dated 29 May 1991 that, in its view, the Community framework did not apply to the new German *Länder* between 1 January and 31 March 1991 because it had been due to expire by the end of 1990 and its renewal by the Commission in December 1990 could only become legally binding upon formal acceptance of the prolongation by the German Government or upon a formal decision of the

<sup>(1)</sup> OJ No C 68, 17. 3. 1992, p. 14, opening a one-month deadline for comments from third parties.

Commission following an Article 93 (2) procedure. Given that the aid measures in question were approved before 31 March 1991, they could only be scrutinized by the Commission with reference to the approved regional aid schemes for the new *Länder* <sup>(1)</sup>.

The legal position taken by Germany was not accepted by the Commission, on the following grounds:

- Commission Decision 90/381/EEC of 21 February 1990 amending German aid schemes for the motor vehicle industry <sup>(2)</sup>, which was not challenged by Germany, was not limited in time so that the renewal of the Community framework by the Commission in December 1990 did not affect the notification obligation,
- Germany did not challenge or react to the renewal of the Community framework itself so the Commission could legitimately assume it would abide by its provisions,
- when approving the extension of existing regional aid schemes to the new *Länder* (SG(91) D/12002 of 9 January 1991) the Commission stipulated that Community frameworks should be complied with. That extension means that the provisions of the 19th Joint Tasks Framework Programme (published by the German Government in July 1991 and approved by letter SG(90) D/27707 of 2 October 1991) also apply in the new *Länder*. Hence the provision on prior notification of aid to the motor vehicle industry also applies in those *Länder*.

Consequently, the Commission considered the aid as non-notified given that it was approved by the German authorities before prior agreement by the Commission <sup>(3)</sup>.

The decision to initiate the Article 93 (2) procedure was based on a first detailed analysis of the information contained in the German authorities' letters of 16 September and 10 December 1991, and several bilateral contacts between the German authorities and representatives of the Commission.

In its letter of 14 January 1992 the Commission requested Germany not only to comment within one month on the decision to open the Article 93 (2) procedure in the Volkswagen case but also to confirm within 10 working days that all aid payments to Volkswagen for its investments in Mosel, Chemnitz and Eisenach had been suspended. If such confirmation was

not received in due time, the Commission reserved the right to stop payment of all State aid by interim decision (see the Commission's letter to the Member States of 4 March 1992).

### III

By letter dated 29 January 1992, Germany agreed to suspend further aid payments until the Article 93 (2) procedure was terminated. By letter dated 31 March 1992 Germany submitted its observations on the Commission's letter of 14 January 1992.

By its letter dated 24 April 1992, the Commission requested Germany, THA and Volkswagen to provide further information necessary to complete its analysis of the case.

These questions, which were explained and justified at a bilateral meeting on 28 April 1992 and repeated in letters of the Commission dated 14 May, 5 June, 21 August and 17 November 1992, were answered point by point by the German authorities' letters of 20 May, 3 and 12 June, 20 and 29 July, 8 and 25 September, 2, 16 and 21 October, and 4 and 25 November 1992. Volkswagen supplemented this information with letters to the Commission dated 15 June and 30 October 1992, and 12 and 20 January 1993. These replies were further discussed at several meetings between the Commission departments, the German authorities and Volkswagen on 16 June, 9 September, 12 and 16 October and 3 December 1992, and 8 and 11 January 1993.

In early January 1993, at a time when the Commission had completed its analysis of the case and was ready to take a final decision, Volkswagen informed the Commission off the record that it was reviewing its investment plans in the new *Länder* and suggested that the Commission did not take its decision until the review was completed. This view was shared by the German authorities.

On 13 January 1993 Volkswagen decided to postpone substantial parts of its proposed investments by up to three years. As the revised timetable of the project changed a number of parameters used by the Commission in its assessment of the compatibility of the proposed aid measures under the Community framework, the Commission agreed to revise its analysis, taking account of the changes to Volkswagen's investment plans.

Details of the modified project were presented to the Commission at a bilateral meeting on 5 May 1993. Written information on the new investment plan was submitted by the German authorities by letter of 6 June 1993, supplemented by Volkswagen in letters dated 24 June and 6 July 1993 and in a fax message dated 10 November 1993. The new information was further discussed at bilateral meetings on 18 May, 10 June,

<sup>(1)</sup> There is no disagreement as to the applicability of the Community framework after 31 March 1991, as Commission approval of the application of the regional aid scheme to the new *Länder* after 31 March 1991 was subject to compliance with the various Community framework in operation.

<sup>(2)</sup> OJ No L 188, 20. 7. 1990, p. 55 (see Article 1).

<sup>(3)</sup> The proposed aid to the Volkswagen Group was registered on 2 July 1991 as non-notified aid under Nos NN 75/91, NN 77/91, NN 78/91 and NN 79/91.

and 2 and 22 July 1993. New information on the Volkswagen Group's capacity plans was sent by the German Government by letter dated 15 February 1994 and by a fax message dated 25 February 1994.

During a site visit in early April 1994 new evidence on the projects was collected, and this had to be incorporated in the analysis as it pointed to changes in the project. This evidence was discussed at bilateral meetings on 11 May and 2, 7 and 24 June 1994 and supplemented by further written information transmitted at those meetings and sent by the German authorities and Volkswagen on 10 May, 30 June and 4 and 12 July 1994. Furthermore, by a letter to Volkswagen dated 24 May 1994, the German authorities revised the aid contracts for the projects.

Among the issues considered in the various letters and meetings were:

- details of Volkswagen's investment plan for the new *Länder* and their relationship with existing vehicle production,
- the precise amounts of State aid proposed or already paid to Volkswagen or the joint venture (Mosel I),
- the precise scope of the obligations assumed by THA with regard to Volkswagen and the joint venture,
- an analysis of capacity, production, product cost and price structure and financial performance at Mosel I,
- the valuation and calculation of the purchase prices for the THA-owned plants (Mosel I, Motorenwerke Chemnitz (MWC or Chemnitz I) and Eisenach) taken over or to be taken over by Volkswagen,
- capacity, production and cost forecasts for the new plants (Mosel II and Chemnitz II) and the development of annual capacity of all Volkswagen Group plants in Europe until 1997/98,
- an analysis of the proposed expenditure to determine its eligibility for aid according to the criteria applied by the Commission in its implementation of the Community framework on State aid to the motor vehicle industry,
- a detailed analysis of the net additional costs of the new plants at Mosel and Chemnitz compared with equivalent plants in a central non-assisted region of the Community to be chosen by Volkswagen as an 'equivalent plant',
- consideration of any possible adverse effects on the sector as a whole arising from the granting of the proposed aid measures, in particular with respect to capacity development.

On 16 June 1993 the Commission approved rescue aid in the form of bank loan guarantees by THA for Sächsische Automobilbau GmbH (SAB or Mosel I) of up to DM 150 million to secure the interim financing of Mosel I until

the final decision in the present case <sup>(1)</sup>. This had become necessary as the company was facing a shortage of liquidity after the payment stop for aid, which included the loss coverage by THA.

#### IV

With regard to the joint venture SAB, the German Government and Volkswagen argued that:

- Mosel I had been created by THA and Volkswagen in December 1990 as part of the restructuring of the former VEB Sachsenring, the producer of the Trabant car, which had been taken over by THA in 1990. The joint venture had been the least costly option for restructuring that was acceptable from a social point of view. Mosel I and associated efforts in the restructuring of the old Zwickau plants were also a necessary interim step for the planned new project Mosel II as it served to build up a skilled workforce in the area,
- the joint venture had taken over the existing car plant at Mosel, including a paint shop, from VEB Sachsenring with effect from 1 July 1991 at a price determined by independent accountants on the basis of asset replacement values,
- Mosel I had originally been assembling Polo cars and was currently producing Golf cars for its own account. Until the end of 1992, all materials were obtained in 'completely knocked-down' form (CKD) from Volkswagen at prices corresponding to the normal prices applied internally within the Volkswagen Group. The assembled cars were subsequently sold back to Volkswagen at a price equalling the final market sales price less sales and distribution costs. This was common practice for all assembly plants within the Volkswagen Group. The costs of inputs received from Volkswagen were also linked to the development of the end-user price by a 'price corridor' to ensure that the value added at Mosel I remained constant even in the event of falling end-user market-prices. Thus, no advantage as compared to assembly in other plants accrued to Volkswagen by this arrangement,
- the obligation of THA to cover the losses of Mosel I up to DM 430 million did not constitute State aid to Volkswagen. The continuing losses were due to the fact that CKD production was generally uneconomic when compared to 'fully built-up' (FBU) production; the assembly work could be performed more efficiently at other Volkswagen plants. Additional losses were caused by the product changeover to the new Golf A3 in August 1992. Volkswagen was sharing the losses in proportion to its 12,5% equity participation. Moreover, the loss coverage by THA was limited to DM 430 million, which was less than 65% of the total accumulated losses of Mosel I by

<sup>(1)</sup> Aid No N 313/93, OJ No C 214, 7. 8. 1993, p. 9.

the end of 1993, which amounted to DM 673,5 million,

- as the Commission, on opening the procedure, had issued a payment stop on all aid payments to Mosel I, THA's payments of loss compensation to SAB which, according to the contract setting up this company, were to occur quarterly, could not be made either. Volkswagen therefore argued that SAB could charge interest on these arrears against THA, which it calculates at DM 20,5 million. This would be common commercial practice and would not constitute aid,
- the price at which Volkswagen will take over the remaining 87,5 % stake in Mosel I from THA with effect from 1 January 1993 is equal to 87,5 % of the replacement value of net assets, or at least DM 150 million. Consequently, there is no reason to believe that the price would involve an aid element. The actual valuation led to a sales price of DM 180 million, to which a further DM 70 million for the present value of the use of the accumulated loss carryforwards has to be added.

With regard to Motorenwerke Chemnitz GmbH (the former VEB Barkas plant, or Chemnitz I), Germany and Volkswagen argued that:

- VEB Barkas had established a facility for the production of 1,1 and 1,3 litre four-stroke engines based on Volkswagen technology. After German monetary union, Volkswagen remained the sole customer for these engines. Volkswagen was paying the same prices to Barkas — later renamed Motorenwerke Chemnitz GmbH (MWC) — as the internal prices applied to engines built in Volkswagen's plant in Salzgitter. The losses of Barkas/MWC until the take-over of the plant by the Volkswagen Group in January 1992 were due not to product pricing but to the inefficiency and capacity under-utilization of the old plant. The coverage of these losses by THA did not, therefore, amount to indirect State aid to Volkswagen,
- the price of DM 68 million at which Volkswagen has taken over MWC was the higher of two independent valuations, one being based on the asset value of the plant and the other on its profitability prospects. The price thus reflected a fair market value and did not contain any State aid element,
- the construction of a modern engine production facility at the site required decontamination works, to which THA would contribute up to DM 155 million. Since this was necessary to make the premises economically viable, such THA payments did not constitute State aid. The Commission accepts that decontamination expenditure does not constitute State aid <sup>(1)</sup>.

As regards cylinder head production at Eisenach, the German Government and Volkswagen argued that the purchase price of DM 53,8 million for the plant was a

fair market price based on two independent valuations commissioned separately by Volkswagen and THA, and therefore did not contain any aid element.

On opening the procedure the Commission had regarded all Volkswagen's investment plans in Saxony as a single project and therefore intended to decide on all elements of State aid together. Even after its decision in 1993 to postpone investment in the new plants, Volkswagen initially argued that this did not affect the production technology, the labour input and other crucial variables. This year, however, on the basis of information collected during a site visit and through new expert advice, it became obvious that this view could no longer be maintained. Volkswagen also acknowledged to the Commission that their former plans had become obsolete and that they were being reworked. The new plans for the new car and engine plants Mosel II and Chemnitz II will now be closely linked to the development of the Golf A4 that will be put into production at the same time as Mosel II is now planned to come on stream, i.e. in 1997. A final version of the new plans will only be available at the end of 1994. On the basis of current information these new plans will include significant changes in technology and production structure. Under these circumstances it is obvious that the original link between the investment projects in the existing former THA plants and the new greenfield projects has been severed. The Commission has therefore decided to limit its current decision to the restructuring aid for the existing plants, on which it can form a clear opinion on the basis of the available information, and to postpone the decision on the aid to the greenfield projects until Volkswagen and Germany are able to present their definitive investment and aid plans. This Decision thus covers the proposed aid to the Mosel I, Chemnitz I and Eisenach projects.

As to the compatibility of the proposed State aid measures, Germany argued further as follows:

(i) Article 92 (2) (c)

This should be the legal basis for the assessment of the compatibility of the aid measures. Despite the fact that Germany was unified on 3 October 1990, the new *Länder* still suffer from economic disadvantages which result from the division of Germany. The Commission should therefore examine whether such economic disadvantages still justify State aid. If so, all other assessment criteria and in particular those related to the Community framework on State aid to the motor vehicle industry, including sectoral considerations and the possible risk of overcapacity, do not apply.

(ii) Article 92 (3) (a)

With regard to the permitted level of aid, the German authorities claim that the new *Länder* now qualify as least developed areas if the latest statistics are taken into account. They refer to the Delors II package, where these areas are proposed as

<sup>(1)</sup> Letter SG(91) D/17825 of 26 September 1991.

Objective 1 areas, which makes them eligible for regional aid up to 75 % NGE.

(iii) Article 92 (3) (b)

Germany argues that this is a further legal basis for the granting of aid in these cases. In its view the problems of integration and restructuring of the former planned economy into a market economy represent a serious disturbance of the German economy.

(iv) Non-applicability of the Community framework on State aid to the motor vehicle industry between 1 January 1991 and 31 March 1991.

The German authorities insist that the Community framework was renewed and altered (thereby including West Berlin) in a legally incorrect way so that they were able to consider the Commission's letter of 31 December 1990 (renewal) as a non-binding recommendation based on Article 93 (1). They thus consider that the Community framework was no longer applicable to them as from 1 January 1991. It is accepted that the Community framework was binding once again as from 1 April 1991 given that the Commission's letter of 11 April 1991 on regional aid in the new *Länder* stipulates compliance with existing frameworks. The Commission had been orally informed of this position in early 1991 and should not therefore, in accordance with Article 5 of the EC Treaty, have objected to such aid by initiating a procedure.

V

The only comment which the Commission received from other Member States following publication of the opening of the Article 93 (2) procedure in the *Official Journal of the European Communities* was a note from France dated 7 January 1993, in which it pointed out that, in view of the additional car-making capacity created by Volkswagen's investments and other assisted projects in the new *Länder*, it was keeping a close eye on the Commission's handling of the case. The French Government further stressed that:

- the new German *Länder* should not be exempt from Community solidarity with regard to State aid granted pursuant to Article 92 (2) (c),
- the approval of any aid by the Commission should be based on a detailed analysis of the incremental costs attributable to the structural handicaps of the new *Länder* and of any indirect support provided by THA.

Germany replied to the remarks of the French Government by a fax message to the Commission dated 15 October 1993 stressing again its position concerning the applicability of Article 92 (2) (c) and 92 (3) (a).

VI

As explained when the Article 93 (2) procedure was initiated, Volkswagen's investment plans in the new *Länder* originate in its decision to accommodate the additional demand for cars in Eastern Germany and Eastern Europe after the political and economic changes in the region by starting production within this new market itself.

The investment is taking place in several stages. The first stage was the formation in December 1990 of a joint venture with THA, SAB, in which Volkswagen's stake is 12,5 %, although Volkswagen is responsible for its day-to-day management. The joint venture started small-scale assembly of the VW Polo (on a semi knocked-down (SKD) basis) at the existing former Trabant plant at Mosel (Mosel I) in May 1990, and began in 1991 to produce the VW Golf (on a CKD basis). A second phase, originally planned for 1994, involves the building of a new plant in Mosel (Mosel II) under the sole responsibility of Volkswagen Sachsen (VWS), a fully-owned subsidiary of Volkswagen created in December 1990. VWS also took over from Automobilwerke Eisenach cylinder head production in Eisenach in mid-1991, for which it will rent a modern building on the Eisenach-West site until the end of 1996. On 1 January 1992 VWS took over MWC, the owner of an existing engine plant (Chemnitz I), from THA. At this location the second phase involves the construction of a new engine plant (Chemnitz II), also originally planned for 1994.

According to information obtained from Germany in the course of the Article 93 (2) procedure:

1. the timetable for the entire investment project has been substantially revised since the procedure was opened. On 13 January 1993 Volkswagen decided to postpone a large part of the investment relating to the new plants. As a result, the new car plant Mosel II, which had originally been scheduled for 1994, will not become fully operational until 1997. The new engine plant Chemnitz II, also originally planned for 1994, will start production in 1996;
2. Mosel I consists essentially of a paint shop and an assembly facility with, according to Volkswagen, an annual capacity of 92 000 units (400 cars per day) and is currently used to produce the Golf model. Car bodies are received from the body shop of Mosel II, which is already operating at a reduced capacity equal to that of Mosel I. Other inputs amounting to about 25 % of materials are received from local suppliers; it is intended to gradually increase this share over the next few years. The remaining inputs are supplied from other Volkswagen plants in Western Germany. The current production at Mosel I was scheduled to stop by the end of 1993 but will, as a result of the revised timetable for the start of Mosel II, continue until 1997 when the new plant becomes fully operational. At present Volkswagen does not have any specific plans for Mosel I after that date. The plant currently employs some 1 900 people. Total investments in Mosel I until 1997 will be DM 519,3

million, of which DM 492,2 million is considered eligible by the German authorities for investment aid. This includes DM 232,9 million paid by SAB to Sachsenring Zwickau (SAZ) for the purchase of the plant;

3. at the time of the formation of the joint venture between Volkswagen and THA, total operating losses of Mosel I until 1993 were forecast at DM 529,1 million. THA had agreed to cover 87,5 % of the losses, up to a ceiling of DM 430 million. Actual losses have meanwhile risen to an accumulated DM 415 million by the end of 1992 and to DM 673,5 million by the end of 1993. The DM 430 million ceiling for THA loss coverage remained unchanged. Before the payment stop in January 1992, THA had paid DM 145,7 million for loss coverage (DM 140,5 million in cash plus DM 5,2 million as an advance on interest due);
4. the Mosel I plant was purchased from SAZ for a total of DM 232,9 million. This price was determined following a valuation performed by the auditors of Volkswagen on the basis of a methodology developed by THA's auditors. It includes DM 67,8 million for completion of the paint shop. SAZ produced Golf A2 car bodies in 1991 and 1992 for SAB but incurred no losses on such production given that it was paid on a value-added basis;
5. the old engine plant at Chemnitz has so far been used for production of the EA 111 (1,05/1,3 l) Polo short engine (Rumpfmotor). It has an annual capacity of approximately 280 000 units and employs some 540 people. Production of the old EA 111 engines was stopped in June 1994. Until production starts at Chemnitz II in 1996, the plant will be used to produce a modified version of the EA 111 1,05 l short engine. In addition and in order to safeguard employment at Chemnitz, in early 1993 Volkswagen started to use the existing engine completion and testing lines to finish 1,3 and 1,6 l engines for use in Mosel I;
6. Chemnitz I was purchased by Volkswagen from THA with effect from 1 January 1992 for DM 68 million. This price is based on the company's closing balance sheet at the end of 1991, which yielded a higher value than an independent cash-flow valuation resulting in DM 65 million. The latter valuation was based on the assumption that engine production would only run until June 1994. Germany confirmed that THA has spent or earmarked DM 155 million for investment, site clearance or decontamination of the old plant (under Barkas and MWC) until its sale to Volkswagen. Of that amount DM 83,7 million was strictly linked to decontamination works. DM 25,7 million was invested only after the sale in 1992 and 1993. This latter amount will be eligible for investment aid in the form of direct investment grants (Investitionszuschüsse) of DM 5,8 million and tax breaks (Investitionszulagen) of DM 2,0 million,

which will be reimbursed to THA by Volkswagen. THA has also covered losses by Barkas and MWC until the sale of the company to the tune of DM 59 million and DM 18 million;

7. the relatively modern cylinder head production facilities at Eisenach have been sold to Volkswagen for DM 53,8 million. The sale price is based on an independent valuation which has been reduced by DM 5 million to reflect the social costs arising from the planned closure of the plant at the end of 1996. Before the sale, THA spent DM 6 million to clear the building of unnecessary facilities, resulting in a net sales price of DM 47,8 million. Total investment in the project by Volkswagen has been DM 72 million, of which DM 30 million is considered by the German authorities to be eligible for investment aid;
8. the Mosel II car plant will be completed and fully operational in 1997. It will consist of a press shop, which has come on stream — as originally planned — in 1994 (to partly supply Mosel I); a body shop, which is already operational at reduced capacity and will be expanded to full capacity by 1997, a paint shop and a trim and final assembly facility which have yet to be completed. The plant will be used for the production of Golf cars of the next model generation. The new Chemnitz II engine plant will come on stream in 1996 and produce a new EA 111 (1,4/1,6 l) engine starting 1996 and a next-generation engine as from 1997. Final plans as to the investment volume, the capacity and employment levels of these plants will be available later this year;
9. for Mosel I, the German authorities have proposed restructuring aid under the regional aid schemes of up to DM 141,6 million, broken down into direct grants (Investitionszuschüsse) of DM 113,2 million and tax breaks (Investitionszulagen) of DM 28,4 million. In addition, THA has agreed to cover 87,5 % of the operating losses of Mosel I between 1991 and 1993, up to a total of DM 430 million. For Eisenach, the German authorities have proposed regional aid in the form of direct grants, tax breaks and special depreciation of up to DM 10,55 million in total;
10. the former Trabant factories at Mosel and Zwickau, which are replaced by Mosel I, used to have an annual assembly capacity of 200 000 units. The old engine plant at Chemnitz used to have an annual capacity of 280 000 units before Volkswagen's investments;
11. as a result of Volkswagen's efforts to build a base of local suppliers in the region, at the end of last year (1993) there were already 87 newly established enterprises in the new *Länder* supplying the plants at Mosel and Chemnitz with parts and components. Volkswagen intends to increase the number of local suppliers further during the coming few years.

## VII

When the Commission initiated the procedure laid down in Article 93 (2), questions relating to the proposed German aid measures which concerned it most were the following:

- the Commission wanted to ascertain whether the arrangements between THA and Volkswagen relating to the project, in particular as regards taking over of losses of Mosel I, and the sales prices received by THA for the Mosel I, Chemnitz and Eisenach plants, contained elements of State aid. The information provided up to that time by the German authorities was not sufficient to quantify the State aid element in those arrangements,
- furthermore, it was necessary to ascertain whether the restructuring aid provided to these plants by the German Government and THA complied with the requirements for this type of aid and in particular whether it was in proportion to the restructuring effort undertaken.

The information obtained from the German authorities and Volkswagen in the course of the procedure has enabled the Commission to acquire a fuller picture of all aid elements and of the amount of such aid.

With regard to the agreement of THA to cover 87,5 % of the accumulated losses of Mosel I between 1991 and 1993, up to a limit of DM 430 million, the Commission considers that this agreement does not correspond to the normal behaviour of a private investor when participating in a joint venture. This follows from the fact that, although THA holds an 87,5 % stake in Mosel I, the company was to be taken over by Volkswagen with effect from 1 January 1993 at a price based on the company's assets or its earnings value. Thus THA was not in a position to recover any of the joint venture's losses incurred and compensated for by it up to that date. In view of the fact that the total accumulated losses of Mosel I up to 1993 amounted to DM 673,5 million (DM 415 million up to the end of 1992), the Commission concludes that the full DM 430 million constitutes State aid. As regards the claim made by Volkswagen and SAB that THA has to pay DM 20,5 million in interest for its arrears in loss compensation payments to SAB, it must be borne in mind that any aid proposal has to be judged in advance by the Commission and that any claim for aid becomes valid only after Commission approval. Consequently, any interest charged because THA cannot pay aid to SAB before the end of the Commission's investigation would constitute further aid.

As regards the capital injection of DM 245,1 million by THA into SAB in 1991, which was intended to finance investment, it must be concluded on the basis of the provisions of the Grundsatzvereinbarung (Basic Agreement) of 1990 between THA and Volkswagen that THA could reasonably have expected to recover these amounts through the sales price. This capital injection cannot, therefore, be regarded as State aid.

As regards the obligation of Volkswagen to take over the remaining 87,5 % of shares in the joint venture from THA before 1994 at a price equal to 87,5 % of the net replacement value of the assets at the time of the take-over, the Commission was concerned that even excluding the loss compensation this might result in an unreasonably low price.

While the price paid to SAZ by SAB for Mosel I might already have been fixed below its objective value, the Commission considers this to be irrelevant to the present case since this sale was virtually an intra-THA transaction. It is, however, highly important that the price on the sale to Volkswagen is correct, given the substantial investment in Mosel I after its transfer to SAB. On the basis of a valuation by the auditors of Volkswagen and THA, the price amounts to DM 250 million (including DM 70 million for the present value of the accumulated loss carryforwards). The methodology established in the basic agreement of December 1990 and the calculations employed have been verified and accepted by an independent auditing expert at the request of the Commission.

As regards the acquisition of the Chemnitz plant, the Commission notes that THA took over the old Barkas engine plant, which was technologically outdated and thus did not meet Western European standards in quality and productivity, and undertook a slow restructuring effort combined with a gradual reduction in the workforce. Continuation of production in that period mainly served to maintain employment (Beschäftigungsgesellschaft), a path that no rational private investor would have followed and which led to losses of DM 59 million. Their compensation by THA, before the new entity, MWC, was set up, is thus a direct consequence of the belated restructuring efforts of THA. Deducting this amount, which can be regarded as State aid only to Barkas, and the sum of DM 83,7 million spent by THA on decontamination, THA's investment in MWC amounts to DM 71,3 million (1991 to 1993), while loss compensation to MWC was DM 18 million (1991). This loss compensation as well as the investment aid of DM 7,8 million have to be regarded as State aid to MWC. THA could reasonably have expected to recover the remaining investment in MWC through the sales price to Volkswagen.

As regards the sale of MWC to Volkswagen at the beginning of 1992, the Commission was concerned that this might result in an unreasonably low price. The actual sales price amounts to DM 68 million. It corresponds to the asset value as determined by an auditing company hired jointly by THA and Volkswagen, which exceeded an independent cash-flow valuation yielding DM 65 million. The Commission informed the German authorities that this asset valuation could not be regarded as an objective valuation because the valuers were instructed to arbitrarily assess the fixed assets at DM 50 million. It was also concerned that the cash-flow valuation might underestimate the value of the plant as it was based on the assumption that the plant would

terminate its operations in June 1994 and that all the workers would be made redundant at that time, involving high redundancy costs. As the new plant Chemnitz II will begin to operate only 18 months later, this assumption cannot be maintained. If these alleged redundancy costs are excluded, the cash flow- valuations would match the asset-based valuation.

Furthermore, on the assumption that the old plant would stop production of EA 111 engines in June 1994, the Commission was originally satisfied that the price corresponded to a fair value of the plant and did not contain any element of State aid to Volkswagen. In the light of new information provided by Volkswagen and the German Government to the effect that production of the EA 111 1,05 l engine will continue in a slightly modified form at the plant at least until 1996 and that the engine dress-up and testing lines, the use of which was not originally planned by Volkswagen, have been employed since 1993 and will continue to be employed to produce the 1,3/1,6 l engines mainly destined for Mosel I, the Commission questioned whether the earnings valuation of MWC was not based on incomplete information and thus the price would be below a fair market value. It would thus lead to the granting of restructuring aid to the purchaser Volkswagen which would be unjustified, since the company had already been restructured by THA. Volkswagen's claim that this 1,05 l engine, which is to be produced until 1996, is practically a new engine must be rejected in the light of the engine's specifications as presented to the Commission and its automotive expert. These show clearly that the engine is essentially the same as the old version. The very small amount of the investment linked to the changeover (DM 2,7 million) also bears this out. On the basis of the figures in the cash-flow valuation, it was calculated that the average gross contribution to earnings from the continuation of engine production is DM 1 million per month. This calculation was accepted by the German authorities, Volkswagen and THA <sup>(1)</sup>. This amount can, however, be reduced by the normal monthly depreciation of the investment necessary to continue production of the 1,05 l engine in order to obtain the net contribution (according to the information transmitted to the Commission this investment is equal to the abovementioned DM 2,7 million). Unless Volkswagen augments the sales price by the equivalent of this net contribution, the sales price of Chemnitz I would contain State aid.

Volkswagen also decided to anticipate some of the investments earmarked for Chemnitz II in order to be able to build a new EA 111 1,4/1,6 l engine in Chemnitz I as from the end of 1994. This engine is entirely new and cannot be produced at Chemnitz I without considerable investment (DM 48,7 million). If production at Chemnitz were at a certain stage to be limited to this type of engine, a monthly payment would no longer be required. This would also hold true if

production were to be limited to spare parts for engines.

As regards the purchase price for Eisenach cylinder head production, the Commission finds that the price of DM 53,8 million determined by an independent valuation corresponds to a fair market price. Considering that most of the workers at Eisenach will be made redundant in 1996 and in all probability will not find jobs at other distant Volkswagen facilities, the Commission can also accept the reduction of the established asset value by DM 5 million to reflect the social costs for those workers.

The direct aid for the restructuring of Mosel I, Chemnitz I and Eisenach, as quantified above, has been awarded by the German authorities under the aid scheme 'Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur' (Joint Tasks Scheme for the Improvement of Regional Economic Structures), the 'Investitionszulagengesetz' (Law on Investment Tax Breaks) and the 'Fördergebietsgesetz' (Law on Assisted Areas), which have previously been approved by the Commission.

The proposed aid for the three projects consists of the following:

- for Mosel I, restructuring aid in the form of direct grants of DM 113,2 million and tax breaks of DM 28,4 million by the German Government and of loss compensation of DM 430 million by THA,
- for Chemnitz I, restructuring aid in the form of loss compensation by THA to Barkas of DM 59 million and to MWC of DM 18 million and investment aid by the German Government of DM 7,8 million. Further aid would be contained in the sales price, unless the price was augmented in the way described above,
- for Eisenach, restructuring aid in the form of direct grants, tax breaks and special depreciation of DM 10,55 million.

As the aid measures reduce the financial burden borne by Volkswagen for its investments in the new *Länder*, they threaten to distort competition between motor vehicle manufacturers within the Community. As there is a very high level of intra-Community trade in the motor vehicle sector, the proposed measures also affect trade among Member States. They consequently fall within the scope of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement.

## VIII

By not notifying the aid contained in the agreement of THA to cover losses incurred by the joint venture, the German Government has infringed Article 93 (3) of the EC Treaty. The German authorities have also failed to notify, in accordance with Article 93 (3), the payment of

(1) The sales contract for Mosel I contains a clause on the sale of Chemnitz which refers to such a payment of DM 1 million per month in the event of continuation of the 'old' EA 111 engine.



part of the regional and other aid related to the investments in the plants at Mosel, Chemnitz and Eisenach. Since the Federal Government did not notify the aid measures in advance, the Commission was not able to submit its comments on the measures before they were implemented. As part of the aid was thus granted in breach of Article 93 (3), it is unlawful.

Since the procedural provisions of Article 93 (3), which are also of significance from the point of view of public order, are mandatory and since the Court of Justice confirmed their direct effect in its judgment of 19 June 1973 <sup>(1)</sup>, the unlawfulness of the aid cannot be remedied after the event.

After the opening of the procedure the German Government suspended all further aid payments pending closure of the Article 93 (2) procedure.

## IX

As regards the legal basis on which the Commission should assess the compatibility of the proposed measures, the German Government has stressed that the derogations provided for in Article 92 (2) (c) (certain areas of the Federal Republic of Germany affected by the division of Germany), Article 92 (3) (a) (areas where the standard of living is abnormally low or where there is serious underemployment) and Article 92 (3) (b) (serious disturbance in the economy of a Member State) would apply to all the measures which the Commission might consider as constituting aid.

The derogation in Article 92 (3) (b) can certainly not be applied to Germany. It is true that German unification has had negative effects on the German economy, but these alone are not sufficient to apply Article 92 (3) (b) to an aid scheme, let alone to an *ad hoc* case of aid. The last time the Commission considered that an aid scheme remedied a serious disturbance in the economy of a Member State was in 1991, when aid was approved for a privatization programme in Greece <sup>(2)</sup>. In that Decision the Commission noted that the privatization programme was an integral part of the undertakings given under Council Decision 91/306/EC of 4 March 1991 concerning the recovery of the entire national economy. The German situation is clearly different.

The exemption provided for in Article 92 (2) (c) must be interpreted strictly. The Commission considers that the derogations provided for in Article 92 (3) (a) and (c) and the Community framework on State aid to the motor vehicle industry, allow it to deal with the problems which the new *Länder* are facing.

The following section contains more detailed explanation of the aid proposed by the German Government which the Commission, in the light of its analysis, can accept unconditionally. This analysis, as has already been stated,

relates solely to the interim establishments (Mosel I, Chemnitz I and Eisenach), since the aid proposed for the new plants cannot yet be assessed.

## Mosel I

As regards Mosel I, the Commission notes that after the monetary union of Germany in July 1990, the existing Trabant production at Zwickau and Mosel ceased to be viable, as the market for the Trabant car had virtually vanished. In order to safeguard car production at the traditional location, THA arranged with Volkswagen to establish the joint venture Mosel I to restructure the former Trabant plants in Saxony, to transform the Zwickau plants into a component supplier and to set up modern car production at the newest of the existing Trabant plants as an interim solution until the planned future plant would come on stream. From the beginning it was clear that this restructuring would not only entail substantial investments, but also heavy operating losses during the first years of production which no private investor would be willing to absorb alone. The Commission therefore views both the direct investment aid provided by the German authorities and the loss coverage provided by THA as part of a single effort to secure the long-term viability of automobile production at Mosel, and consequently concludes that they must be assessed as restructuring aid.

With regard to such aid, the Community framework stipulates that it must be linked to a satisfactory restructuring plan and granted only where it can be demonstrated that the Community interest is best served by keeping a manufacturer in business. It also requires that the aid does not allow a beneficiary to increase its market share at the expense of its unaided competitors. In cases where certain companies still have excess capacity, it may require reductions in capacity as a contribution to overall recovery of the sector.

The Commission has examined the business plan and financial forecasts of SAB and is satisfied that they reflect a sound approach towards re-establishing the economic viability of the former Trabant plants. It is to be noted that the financial implications of former Trabant factories operating as suppliers to Mosel I fell on SAB. The joint venture has invested or will invest more than DM 414 million in the modernization of the existing facility, in particular to replace equipment not suitable for the production of steel-pressed cars, to complete the construction of the paint shop, and for vendor tooling. It has thereby transformed Mosel I into a State-of-the-art painting and assembly facility.

The Commission appreciates that in the early years of operation, the only possible mode of production at the plant has been the assembly of SKD and CKD kits, which was *a priori* uneconomic when compared with standard FBU production. This certainly applies to the production of Polos and the Golf A2 until July 1992. It therefore led to losses resulting from the uneconomic way in which production was organized from the beginning. For both models the car bodies could not be assembled on site. The Polo bodies were assembled and painted in

<sup>(1)</sup> Case 77/72 *Capolongo v. Maya*, [1973] ECR 611.

<sup>(2)</sup> Aid No NN 11/91, Commission Decision of 31 July 1991.

Wolfsburg and then shipped to Mosel. Golf A 2 bodies were assembled at SAZ in Zwickau and painted first in Ingolstadt, and later in the new paint shop of Mosel I. Since final assembly for all of them took place in Mosel I, the resultant transport and logistics needs rendered this production mode highly inefficient. Body-in-white assembly in the old SAZ plant in Zwickau was done in a very labour-intensive way, while the resultant losses were transferred through pricing arrangements to SAB. On the other hand, the CKD production mode implied the shipping of complete component sets from Wolfsburg to Mosel. This was necessary because of the absence of local suppliers in the new *Länder* that could deliver just-in-time and because of the absence of logistics capabilities in terms of modern warehouse facilities, quality control equipment, hard- and software and a workforce trained for supplier logistics on-site that could handle direct deliveries from suppliers. This shipment involved additional costs at Wolfsburg for packaging, unpacking, quality control, administration and transport. Given these two important cost penalties, no private investor would have undertaken such an arrangement on such a scale and for such a long time, the main reason for which was to safeguard jobs in the region.

As the establishment of local suppliers in the region progressed and the share of local content of materials increased, the cost disadvantage of Mosel I associated with CKD production has been diminishing since 1992. The introduction of the Golf A3 in July 1992, the body of which is being assembled at the adjacent Mosel II factory, has given a further impetus to local suppliers. And yet, the component logistics were only transferred from Wolfsburg to Mosel in January 1993. At the beginning of 1993 a share of local supply of 36,5 % had been reached and productivity as well as value-added in the plant had risen significantly, so that it can be considered to have become a well-established FBU plant by that time. Furthermore, from 1993 onwards, Mosel I has been capable of producing at full capacity. Consequently, a crucial objective of the restructuring plan was achieved by the beginning of 1993, while the restructuring process will have terminated completely by the end of 1993, as originally planned. As a result, it can be expected that production at Mosel I will be economically viable and profitable by the end of 1994, as shown by the financial projections presented to the Commission. The Commission is therefore satisfied that there is a true link between the proposed aid and the restructuring plan, which appears to have a solid basis.

The rationale behind the interim project was to maintain and train a workforce for automobile production at the location until the new plant Mosel II comes on stream, as well as to absorb additional demand for Western-style cars in the East German and Eastern European market. The plant has created 700 jobs and saved another 1 250 in an area suffering from low productivity and high unemployment. With regard to the difficult social consequences that a closure of the plant would entail for the region, and the aim of socio-economic cohesion, the Commission agrees with the German Government that keeping Mosel I in business is in the best interest of the Community.

This assessment takes into account the fact that the modernization has involved a scaling down of the assembly facility from a capacity of 200 000 cars per year (910 cars per day) to 92 000 per year (400 cars per day). The calculation of former capacity takes into account Trabant production capacity at Zwickau since, like Mosel I, it could have been converted to produce other cars. Instead these plants were converted as much as possible into component production. Generally, restructuring aid will be allowed under the Community framework only if it does not contribute to the creation of overcapacity, but rather contributes to the overall recovery of the sector by capacity reductions. The Commission accepts that this condition has been fulfilled.

With regard to the amount of aid, the Community framework provides that aid must be in proportion to the problems it seeks to redress. As regards the investment aid of DM 113,2 million in direct grants (*Investitionszuschüsse*) and of DM 28,4 million in the form of tax breaks (*Investitionszulagen*), the Commission notes that they relate to investments for the transformation of the plant into a modern car assembly facility which forms a necessary element of the restructuring plan. This applies to all investment expenditure up to and including 1993, as this was the original timeframe of the restructuring plan which lasted until the planned sale of THA's participation (1 January 1994). The investment undertaken thereafter until 1997, however, is not linked to the restructuring plan and has to be assessed according to the Community framework on innovation, modernization and rationalization. Since the investments constitute normal modernization and replacement investment, according to the Community framework they cannot be supported by State aid. This concerns an eligible investment volume of DM 77,4 million and an aid amount of DM 21,6 million (DM 17,8 million of direct grants and DM 3,8 million of tax breaks). Therefore, investment aid of DM 95,4 million in direct grants and DM 24,6 million in the form of tax breaks can be accepted as restructuring aid.

The Commission recognizes that even the newest Trabant equipment of the plant was far from the standard required for modern car production. Other equipment was technologically outdated and had to be replaced in its entirety. As a result, THA's and Volkswagen's investments for the restructuring of the plant totalled DM 519,3 million (of which DM 64,9 million constitutes the 12,5 % Volkswagen share). The acquisition costs for the remaining 87,5 % share by Volkswagen are DM 250 million.

As regards the loss coverage by THA, the Commission agrees with the position of the German Government that no private investor would have invested in the small Mosel plant at the time of the formation of the joint venture without the participation of THA and an undertaking by it to cover operating losses arising from the inevitably uneconomic CKD assembly in the early years of production. The undertaking to cover losses must consequently be seen as an integral part of THA's scheme for a socially viable privatization of the plant. In this context, the Commission would point out that it

acknowledges the exceptional nature of THA's task of supporting the transformation of a planned economy into a market economy <sup>(1)</sup>.

However, from the exceptional nature of these measures it follows that they must be strictly limited to the requirements of the individual case. Particular vigilance is necessary where support is granted to a company which is only partially privatized, as in the case SAB (Mosel I). In view of the justification given for THA's undertaking to cover operating losses, this means that such coverage can be approved only up to an amount compensating for losses attributable to the uneconomic CKD production mode or to other regional disadvantages linked to producing in the new *Länder*.

On the basis of material cost data for Mosel I and other information supplied by Volkswagen, the Commission has analysed the operating performance of the joint venture with a view to quantifying the share of losses arising from the cost disadvantage associated with CKD production or other regional disadvantages. It has accepted that all losses incurred by the assembly of Polo cars until 1991 and the production of the Golf A2, which was discontinued in July 1992, are indeed attributable to genuine cost disadvantages. The total amount of those losses is DM 235 million, of which THA carries 87,5 %, i.e. DM 205,6 million. The Commission can therefore accept the compensation of those losses to the amount of DM 205,6 million as restructuring aid.

As explained above, production of the Polo and the Golf A2 at Mosel I took place in *a priori* uneconomic circumstances that no rational private investor would have taken over on its own. With the changeover to Golf A3 production in July 1992, body assembly was transferred to Mosel II, so that one of the abovementioned structural disadvantages ceased to play a role. The additional CKD costs continued, however, until the end of 1992 because of a slow changeover from Wolfsburg suppliers to local suppliers and the delayed transfer from Wolfsburg of the local suppliers' logistics, which only took place in January 1993. As regards the losses arising from the production of the current Golf A3 between August and December 1992, the Commission has found that, while DM 111 million (THA share DM 97,1 million) has been clearly shown by the company to be attributable to continuing CKD costs associated with the production of the new model, Volkswagen has been unable to fully explain the unforeseen increase in Golf A3 material costs during the last quarter of 1992, which amounts to DM 69 million (THA share DM 60,4 million). While the Commission can see the commercial reasons why such a cost increase could have happened, it has doubts whether they can be entirely attributed to the regional disadvantages of CKD production which made the restructuring effort more costly. Nevertheless, in view of the fact that the different regional disadvantages did not stop abruptly at the end of 1992, the Commission is willing to accept the compensation of those losses in order to offset any

remaining regional or structural disadvantages during the third year of production (1993). Accordingly, the compensation of the remaining losses for 1992 by THA in proportion to its shareholding to the amount of DM 157,5 million can be accepted as restructuring aid.

In total, the Commission can authorize DM 481,3 million restructuring aid which is justified by the reduction in capacity from 910 cars per day at the time of the aid award to the current level of 400 cars per day, which constitutes a sufficient contribution to the solution of the structural problems of the sector as a whole. This result is in line with the approach the Commission has taken in other cases of restructuring aid, such as the Renault, Rover and ENASA cases <sup>(2)</sup>, where restructuring aid was considered to be in proportion to the restructuring effort if the share of the aid in the total financial needs of the company during the restructuring plan (DM 806,1 million over the period 1991 to 1993) was approximately equivalent to the share of capacity reduction undertaken as part of this restructuring process. In this case the share of the aid at 59,7 % only slightly exceeds the relative capacity reduction of SAB of 56 %. This slight overcompensation is in the Commission's opinion justified by the particularly difficult economic and social conditions in the new *Länder*, a region which in the meantime has been recognized as an Objective 1 area.

When the Commission approved rescue aid in the form of bank loan guarantees to SAB of up to DM 150 million, it made clear that any loss coverage payments approved in a final decision on the present case would have to be used to help repay the loans, and that THA should to that extent be released from its guarantee obligations. The loss coverage payments approved by this Decision exceed the amount of the guaranteed loans, so the loans will have to be repaid in full by SAB.

#### Chemnitz I

With regard to the old engine plant Chemnitz I, the Commission acknowledges that that plant was technologically outdated and thus did not meet Western European standards of quality and productivity, and that even after substantial investment it could be used for only a limited time. In order to safeguard engine production at the traditional location, THA thus undertook to restructure the plant as an interim solution until the planned future engine plant came on stream. It was clear from the outset that this restructuring would entail substantial investment and involve operating losses during an initial period which no private investor would be willing to absorb. The Commission therefore views the direct investment and the loss compensation by THA in 1991 as part of a single effort to secure the long-term viability of engine production at Chemnitz and consequently concludes that they must be considered as restructuring aid.

Furthermore, as the company was producing short engines (Rumpfmotoren) based on Volkswagen technology, it could be of interest only to Volkswagen. Because of the quality and productivity problems

<sup>(1)</sup> See, for example, Commission Decision NN 108/91 of 26 September 1991, SG(91) D/17825, concerning certain financing and other measures within the area of activities of THA.

<sup>(2)</sup> OJ No L 367, 16. 12. 1989, p. 62, OJ No L 25, 28. 1. 1989, p. 92, and OJ No L 220, 11. 8. 1988, p. 30.

mentioned above, Volkswagen was, however, willing to buy MWC only if THA could ensure its adaptation to Western European standards. Furthermore, as confirmed by the independent valuers, Volkswagen possessed sufficient engine capacity in its Salzgitte plant, so that Chemnitz I was not needed by the company.

The rationale behind the interim project was the need to maintain and train a workforce for engine production at the location until the new plant Chemnitz II was to come on stream. The plant has created or saved 540 jobs in an area suffering from low productivity and high unemployment. In view both of the difficult social consequences that closure of the plant would entail for the region and of the aim of socio-economic cohesion, the Commission agrees with the German Government that keeping Chemnitz I in business is in the best interest of the Community.

Investment aid amounting to DM 7,8 million in the form of direct investment grants and tax breaks for the investments decided on under THA ownership and executed in 1992 and 1993 has been awarded to support the restructuring process. As the company has returned to profitability, the process can be judged a success. However, the aid can be accepted only if the relevant clause of the sales contract, which stipulates that the aid is to be transferred back to THA, which paid for these investments, is complied with.

The investment undertaken by Volkswagen in Chemnitz I after 1993 and hence after the end of the restructuring plan has to be assessed, however, under the Community framework on innovation, modernization and rationalization. Since the investments constitute normal modernization and replacement investment, according to the Community framework they can in principle not be supported by State aid. Consequently, only those investments in Chemnitz I paid for by Volkswagen Sachsen which are transferred to the new plant Chemnitz II may be eligible for regional aid, and this only to the amount of their book value at the time of transfer.

Consequently, the Commission can accept restructuring aid by THA to Barkas in the form of loss compensation of up to DM 59 million and to MWC in the form of loss compensation and investment aid to the amount of DM 18 Million and DM 7,8 million respectively. This amount of restructuring aid to MWC is considered by the Commission as necessary but also as sufficient for the plant restructuring plan executed by THA and Volkswagen in the period from 1991 to 1993. This restructuring was not accompanied by a reduction in capacity. As explained above, Chemnitz I contributed to the temporary overcapacity of engines in Volkswagen, which required a new split of engine production between the Salzgitte and Chemnitz plants, as a result of which both plants worked below capacity. In this case the Commission considers it technically impossible to demand a compensating reduction of capacity, as Chemnitz I had only one production line. Demanding the closure of Chemnitz I would also have run counter to the regional development objective pursued by the plant, as explained above. Finally, the Commission's concern has

always been about car production capacity, which is not affected by this plant.

As the restructuring aid to the plant is considered by the Commission to be sufficient for the restructuring process, it follows that no more aid can be granted through the sales price paid by Volkswagen for Chemnitz I. This requires the inclusion of a clause in the contract which ensures that the sales price will rise by DM 1 million for every month of continued engine production after June 1994, less the monthly depreciation of the investment necessary to continue production of the 1,05 l engine.

#### Eisenach

With regard to the restructuring aid of DM 10,55 million for cylinder head production at Eisenach, the Commission notes that, although the facility was relatively new when taken over by Volkswagen in March 1992, additional investments were necessary for modernization and to enlarge the product range of the facility to achieve an economically viable degree of capacity utilization. In the light of the information available to it, the Commission is satisfied that these investments are linked to a sound restructuring plan. Given that the facility currently employs around 200 people and that it will be in operation only until 1996 (when it will be closed down), and in view of the relatively small magnitude of the aid and the fact that Volkswagen has an existing cylinder head production capacity at its Salzgitte plant, the Commission concludes that maintaining the plant in operation until 1996 is in the best interest of the Community and that the aid does not allow Volkswagen to expand its market share at the expense of its competitors.

#### X

As explained above, the Commission considers the restructuring of Mosel I to have attained its objectives by the end of 1993. Nevertheless, the aid proposal by the German authorities provides for a continuation of the loss compensation to the plant in 1993 and of the investment aid until 1997.

As regards the proposed compensation of SAB's losses to the amount of DM 66,9 million, this would be out of proportion to the restructuring costs and would have no regional justification. Such aid would therefore be in the nature of an operating aid which, under the rules of the Community framework, can under no circumstances be allowed.

As regards the claim made by Volkswagen and SAB that THA has to pay DM 20,5 million in interest on its purported arrears in loss compensation payments to SAB, it was explained above that such payments would constitute additional State aid. As indicated, such payments would also be in excess of the amount of aid that can be accepted for the restructuring of Mosel I. Consequently, these interest payments cannot be allowed.

As regards the proposed investment aid for the period 1994 to 1997 of DM 21,6 million in the form of direct

grants (DM 17,8 million) and tax breaks (DM 3,8 million), this has to be viewed as aid for replacement and modernization investments which, under the rules of the Community framework, can under no circumstances be allowed,

HAS ADOPTED THIS DECISION:

#### Article 1

The following aid to the various investment projects of Volkswagen AG in the new *Länder* awarded by Germany are compatible with Article 92 (3) (c) of the EC Treaty and Article 61 (3) (c) of the EEA Agreement:

- aid granted to Sächsische Automobilbau GmbH (Mosel I) in the form of direct investment grants (Investitionszuschüsse) of up to DM 95,4 million, all of which was granted unlawfully before the payment stop, and tax breaks (Investitionszulagen) of up to DM 24,2 million, of which DM 19,0 million was granted unlawfully before the payment stop,
- further aid in the form of loss coverage for Mosel I to be provided by the Treuhandanstalt up to an amount of DM 363,1 million, of which DM 145,7 million was already paid unlawfully before the payment stop,
- aid in the form of loss coverage to Barkas (Chemnitz I) provided by the Treuhandanstalt up to an amount of DM 59 million, which was granted unlawfully before the payment stop,
- aid in the form of loss coverage by the Treuhandanstalt in Motorenwerke Chemnitz (Chemnitz I) up to an amount of DM 18 million, which was granted unlawfully before the payment stop,
- aid in the form of direct investment grants (Investitionszuschüsse) of up to DM 5,8 million and tax breaks (Investitionszulagen) of up to DM 2 million to Motorenwerke Chemnitz or Volkswagen Sachsen (Chemnitz I),
- aid proposed for Volkswagen Sachsen GmbH for its cylinder head facility at Eisenach in the form of direct grants (Investitionszuschüsse), tax breaks (Investitionszulagen) and special depreciation (Sonderabschreibungen) of up to DM 10,55 million in total.

#### Article 2

The purchase price of DM 68 million to be paid by Volkswagen to the Treuhandanstalt for Motorenwerk Chemnitz (Chemnitz I) under Articles VI and VII of the basic agreement of 18 October 1990 between the Treuhandanstalt and Volkswagen shall be deemed not to contain any State aid provided the basic agreement is amended as follows; the purchase price will be increased by DM 1 million for each month of continued engine production after June 1994, payable monthly in advance; from this increase a deduction may be made for the cost

of the investment made in order to keep the factory operational, taking the form of normal depreciation of the equipment until the end of 1995; the increase in the purchase price shall not be payable if the plant produces only spare parts for engines or the new 1,4/1,6 l engine after 1994.

#### Article 3

Germany shall recover from Sächsische Automobilbau GmbH DM 16 173 000 in direct grants (Investitionszuschüsse), being the difference between the amount of direct grants for Mosel I declared in the first indent of Article 1 to be compatible with the common market and the amount of aid already paid to the company, and shall charge interest on this amount from 28 October 1991 (date of payment of the aid) at the percentage value on that date of the reference rate used for the calculation of the net grant equivalent of the various types of aid in the Federal Republic of Germany.

#### Article 4

The following aid to the various investment projects of Volkswagen AG in the new *Länder* awarded by Germany are incompatible with the common market within the meaning of Article 92 of the EC Treaty and Article 61 (1) of the EEA Agreement and may not be granted:

- the proposed loss coverage for Mosel I in excess of the figure referred to in Article 1, amounting to an additional DM 66,9 million,
- the proposed investment aid for Mosel I in excess of the figure referred to in Article 1, amounting to an additional DM 17,8 million in the form of direct investment grants (Investitionszuschüsse) and DM 3,8 million in the form of tax breaks (Investitionszulagen);
- the proposed aid to Mosel I in the form of interest payments by the Treuhandanstalt for the outstanding loss compensation payments to the amount of DM 20,5 million.

#### Article 5

Germany shall inform the Commission within one month of the date of notification of this Decision of the measures taken to comply therewith.

#### Article 6

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 27 July 1994.

For the Commission

Hans VAN DEN BROEK

Member of the Commission