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**Monitoring of shipbuilding restructuring programmes in Germany and Spain  
Third Commission Report to the Council, February 1999**

# Monitoring of the restructuring of the public shipyards in Spain

## Third Commission Report, February 1999

### I. Introduction

By letter 6715 dated 6 August 1997, the Commission informed the Spanish Government of its decision (State Aid case C 56/95, Official Journal C354 of 21 November 1997, page 2) to approve state aids totalling PTA 229.008 billion in support of the restructuring of the publicly owned yards in Spain.

The aid was made up as follows:

- interest payments of up to 62.028 billion pesetas in 1988 to 1994 on loans taken to cover unpaid previously approved aid;
- social aids of up to 80 billion pesetas (plus a further 3.98 billion pesetas that had been paid in 1991 and 1993 to cover costs arising from previous restructuring);
- investment aids of up to 10 billion pesetas;
- tax credits in the period 1995- 1998 of up to 58 billion pesetas;
- a capital injection of up to 15 billion pesetas.

Of these aids a sum of 135.028 billion pesetas (comprising the 1988 to 1994 interest payments of 62.028 billion pesetas, tax credits in 1995 to 1999 of 58 billion pesetas, and the 1997 capital injection of 15 billion pesetas) were approved exceptionally pursuant to Council Regulation 1013/97 of 2 June 1997. The balance of the aids approved were authorised as being compatible with the rules of the shipbuilding aid directive.

In addition to the aids approved in August 1997, a sum of up to 89.104 billion pesetas had previously been approved by Commission letter dated 22 January 1996(OJ C 75 of 15 March 1996, page 2) to cover unpaid, previously authorised loss compensation aid plus interest. The total package of aids approved thus amounted to 318.112 billion pesetas.

Under the terms of the Commission's decision, the aids were approved subject to various conditions, particularly as regards capacity reductions and production limitations.

In accordance with the provisions of Article 1.4 of Council Regulation 1013/97, Spain was required to carry out a genuine and irreversible reduction of capacity of 30,000 cgrt in the public yards. Annual production shall not exceed the remaining level of capacity (210.000 cgrt) for a period of 10 years.

Furthermore, the Astano yard shall not re-open to shipbuilding (although it will continue its FPSO activities, but without receiving contract-related aid); and Astander shall, in addition to ceasing newbuilding, not engage in ship conversions while it remains in public ownership.

In approving the aid, the Commission stressed the finality and exceptional nature of the aid package, taking note of the undertakings made by the Spanish government in that regard. Should any public yard, each of which is to be a separate profit centre on full cost basis, not achieve viability by the end of 1998, no more restructuring aid (including loss compensation, guarantees and rescue aid) will be possible for the yards or their legal successors (eg if privatised).

## II. The monitoring report

This latest Commission report essentially reflects the position as at the end of 1998. It is based on information provided by the Spanish authorities in quarterly reports submitted on 15 September and 29 December 1998 together with supplementary information provided during monitoring visits by the Commission services and their consultants in September/October 1998 and January 1999. These monitoring visits included meetings in Madrid as well as on-site visits to the yards at Barreras, Cadiz and Puerto Real. The Commission acknowledges the full co-operation provided by the yards and the Spanish authorities.

Since Barreras has been privatised (as reported in the Commission's second monitoring report), monitoring in relation to this yard at is limited to its levels of production in order to ensure that the overall annual limitation of 210,000 cgrt for the beneficiary yards is respected.

### Use of Aid

In total the overall package of aid approved by the Commission amounted to 318.112 billion pesetas. Of this amount, 66.008 related to aids already paid prior to implementation of the current restructuring plan (62.028 billion pesetas to cover interest payments made in the period 1998 - 1994; and 3.98 billion pesetas in social aids paid in 1991 and 1993). The Commission's monitoring therefore focuses on the balance of the package, amounting to a total of 252.104 billion pesetas, directly linked to the restructuring plan.

It will be recalled that of the above sum aids totalling 215.969 billion pesetas had been paid as at 31 December 1997, as can be seen from the following table:

bn PTAs

Aid	approved	paid up to end 1997	Outstanding
loss compensation	89.104	87.37	1.734
social aids	80	79.05	0.95
investment aids	10	10	0
tax credits	58	39.549	18.451
capital injection	15	0	15
Total	252.104	215.969	36.133

The balance of 36.133 billion pesetas outstanding was paid to the public yards during 1998. No more aids are due.

On 20 January 1999 (C3/99(ex NN145/98), decision not yet published) the Commission decided to initiate proceedings under Article 93.2 of the EC Treaty in order to investigate the tax credits of 18.451 billion pesetas paid in 1998. The Commission took this decision in the light of doubts about the compatibility of this aid payment given that the yards have since 1997 also been receiving tax credits under general measures.

The yards have not obtained any new loans or state guarantees since the last report.

### **Investments**

As at 30 September 1998 actual and forecast expenditure were as follows:

Million PTAs						
<u>YARD</u>	<u>1996</u>	<u>1997</u>	<u>30/9/1998</u>	<u>1998</u>	<u>1999</u>	<u>TOTAL</u>
Puerto Real	167	409	230	527	647	1750
Cadiz	54	133	109	140	23	350
Sevilla	2	158	112	142	48	350
Sestao	37	364	150	419	2480	3300
Astander	43	54	104	153	-	250
Astano	303	1141	221	271	135	1850
Juliana	39	146	34	165	-	350
Corporate Services	670	553	140	277	-	1500
<u>TOTAL</u>	<u>1314</u>	<u>2958</u>	<u>1100</u>	<u>2095</u>	<u>3333</u>	<u>9700</u>

This represents a slippage in scheduling compared with the original plan and is mainly due to delays in investment at Sestao because of problems in obtaining the necessary planning approvals from the local authorities.

Apart from the slippages in timing, there have been no major changes in the original investment plan. During the yard visits, the nature and status of projects have been appraised. No discrepancies have been identified.

### **Productivity performance**

It will be recalled that under the restructuring plan, the objective was to improve productivity expressed in cgt/man year by 35%. On the basis of actual production and average level of workforce in 1998 (see below), overall productivity exceeded this target. Overall performance compared with 1994 improved by over 39% although there were variations as between individual yards with smaller yards registering greater improvements. It remains difficult to draw definitive conclusions about relative performance at the level of individual yards/ships given the variety of shiptypes under construction. Where yards are engaged in series building the trend is generally positive, although levels of improvements based on hours/cgt and steel hours/net steel tons are variable.

### **Capacity reductions and production limitations**

In the previous reports it was noted that on-site inspections had confirmed that the required capacity reductions had been achieved.

As regards production, the overall level attained in 1998 was 209,263 cgt, broken down as follows:

	Cgt
Puerto Real	64616
Sestao	72985
Sevilla	27538
Juliana	16603
Barreras	27521

This level of production is just within the annual production limitation of 210,000 cgt. Nevertheless the situation will continue to be kept under very close review and will be covered further in the next monitoring report. On current forecasts, production in 1999 is expected to be around 202,000cgt. On the basis of the present orderbook, production the following year is expected to be about 88,000cgt.

### **Employment reductions**

By the end of 1998 all the workforce reductions under the plan (which, including Barreras, foresaw a reduction from 10017 in 1994 to 6100 at the end of 1998) had been achieved. Indeed the total reduction was greater than foreseen. The total workforce in the public yards at the end of the year was 5690, compared with a target of 5845 under the restructuring plan. The following table shows the evolution against the final target broken down by yard:

	1994	31/12/98 - plan	End 1998 - actual
Puerto Real	2031	1390	1344
Sestao	2458	1230	1216
Sevilla	679	364	360
Juliana	720	450	434

Astano	1971	1180	1155
Cadiz	615	390	416
Astander	433	292	292
Corporate Services*	656	449	473
<b>Total</b>	<b>9563</b>	<b>5745</b>	<b>5690</b>

\* includes Manises diesel

### **Financial Viability**

On the basis of performance in the first three quarters of the year, up to 30 september 1998, ordinary results for 1998 were forecast to show a loss before tax of 21.923 billion pesetas on a turnover of 140.601 billion pesetas. This compares with a loss of 23.996 billion pesetas in 1997.

The yards will therefore have failed to achieve their target of breaking even by the end of 1998. The breakdown by yard was expected to be as follows:

	Bn PTA	
	Turnover	Result
Puerto Real	37.490	(9.742)
Sestao	36.927	(0.771)
Sevilla	8.820	(2.164)
Cadiz	21.013	(3.630)
Juliana	14.557	(1.206)
Astander	3.514	(0.530)
Astano	19.578	(4.100)

At the time of drafting this report, the results for 1998 had not yet been finalised. However provisional figures indicated that the overall loss would be slightly higher than forecast. This will be reported on further in the next monitoring report.

### **III. Conclusions**

It appears that to date the conditions laid down in the Commission's decision are being respected, apart from the apparent possible breach of the conditions attached to the volume of aid approved (in relation to tax credits).

There are two key aspects that will continue to need close attention. These are compliance with the limitations on production in 1999 and subsequent years; and fulfilment of the undertakings of the Spanish government that no more aids will be granted to the yards.

## **Monitoring of the restructuring of MTW-Schiffswerft and Volkswerft Stralsund Germany (Land Mecklenburg-Vorpommern)**

### **Third Commission Report, February 1999**

#### **Introduction**

MTW-Schiffswerft and Volkswerft Stralsund belonged to Bremer Vulkan Verbund AG until early 1996. Due to a massive misuse of restructuring aid by their mother company Bremer Vulkan they had to be taken over by Bundesanstalt für vereinigungsbedingte Sonderaufgaben (BvS) and the Land Mecklenburg-Vorpommern when Bremer Vulkan collapsed in order to rescue their restructuring. With Council Regulation 1013/97 of 02 June 1997 a new legal base was provided for the assessment of the aid necessary for the completion of the restructuring of these yards. Article 1 of this Regulation stipulates that for the period from 1 March 1996 until 31 December 1998 operating aid may be considered compatible with the common market up to DEM 333 million for MTW-Schiffswerft and up to DEM 395 million for Volkswerft. The additional investment aid is to be assessed under Article 6 of the prolonged Seventh Directive on aid to shipbuilding.

The first Commission report informed in detail about the first tranche of aid to the yards, which was approved by the Commission end of July 1997.

As described in the previous second report the two shipyards were sold and reprivated in early 1998. In both cases the privatisation was arranged in form of an "asset deal" as the new owners, Odense Steelshipyard in the case Volkswerft and a subsidiary of Aker RGI ASA in the case of MTW-Schiffswerft, were not prepared to take over the risks and liabilities related primarily to vessels contracted in the Bremer Vulkan period. Due to this contractual construction, there is now for each of the yards a new operating company (Aker MTW-Werft GmbH and Volkswerft GmbH Stralsund) and a residual company (MTW-Schiffswerft GmbH and Ostsee Beteiligungs- und Verwaltungsgesellschaft mbH (OBVG)). The finalisation of the restructuring programmes and the completion of the ships under the orderbook existing at the time of privatisation is financed by the residual companies. The privatisation in form of an asset deal changed therefore the aid programmes as presented in the Commission document COM (97) 132 of 14 March 1997. The restructuring aid is channeled through the residual companies. It is now to be made sure by the monitoring that the condition that no aid must be given for the restructuring and privatisation in addition to the amounts foreseen, is not circumvented by the "asset deal", in which all liabilities and risks from guarantees remain with the old companies.

With the approval of the privatisations, the Commission released a second tranche of aid for Volkswerft (via OBVG) in February 1998 and for MTW-Schiffswerft in July 1998.

The present report essentially covers the time between July 1998 and end of December 1998. The Commission approved the privatisation of MTW-Schiffswerft GmbH in Wismar end of July 1998. As most the restructuring of the yards has been completed in the meantime, the Commission's monitoring activities focused on the examination of the use of aid, the financial position of the residual companies and on the respect of the capacity limitations.

## Monitoring reports and site visits

Pursuant to Article 2 of Council Regulation quarterly monitoring reports shall be submitted by the German Government to the Commission. The Commission received two further monitoring reports for each of the yards covering the period until end of September 1998. Additional extensive information was provided by the draft annual reports of the auditors for 1997 and the financial planning of the residual companies as of end of 1998. The Commission and their consultants undertook further monitoring visits to both yards in the period. The fifth monitoring visit to both yards took place beginning of July 1998, the sixth in early October focussed on MTW, the seventh in December 1998 to Volkswerft and the eighth in January 1999 again to MTW. Further, the Commission had preliminary discussions on the potential further use of the capacity of the former Elbwerft. This yard ceased production end of 1997 and was definitely closed end of 1998.

This third Commission report is based on the above mentioned information in the various reports and information collected during the site visits. As the developments in the two yards are no longer fully parallel, the rest of this report discusses the developments in Volkswerft and MTW separately.

### **Volkswerft**

#### **1. Investments and investment aid**

A major part of the, the residual panel lines will be commissioned in April 1999 and the conservation halls in September 1999. Hence, the works for the physical restructuring of the yard will be completed in autumn 1999, essentially as scheduled. Costs are expected to remain in the budget, with the possibility of very minor savings. By mid December 1998 orders had been placed for a total DEM 665.5 million under the total budget of DEM 687.7 million (including contingencies). All contracts and payments are linked directly to the investments. BvS continues to have all payments supervised by auditors. It is expected that the residual contracts will be placed in the next few weeks.

Under the new restructuring programme the Commission approved until now two tranches of investment aid on a total amount of DEM 380.7 million. On 23 December 1998 Germany sent to the Commission a request for the release of the final tranche of DEM 34.2 million investment aid, which is currently under examination.

#### **2. Financial status of the residual company OBVG and use of the operating aid**

Six of the originally eight ships under the orderbook of the residual company OBVG were delivered by end of 1998, the residual two container vessels will be delivered as planned in April and June 1999. OBVG will have to bear part of the penalties and claims for late delivery of two special ships in 1998. The financial results of OBVG will be somewhat worse than expected by Germany at the time of privatisation, but according to the revised risk analysis the own income of OBVG and the residual operating aid will be just sufficient to meet all remaining risks from placement and charter guarantees. The main reason that most of the perceived risks led to actual payments in 1998 is the sharp deterioration on the charter



market for container ships. OBVG had to not only to pay on charter guarantees given but it faced also a reduction of the market value of its ship participations, which are to be sold.

The German government submitted in December 1998 a request for a third tranche of DEM 19.3 million operating aid of which a part is to finance contract related aid under the general "Wettbewerbshilfe" scheme and the residual part to increase risk provision for the residual company. This request is currently examined by the Commission.

On basis of the information received it can be concluded that the operating aid has been used as set out in the Commission decisions on the first two tranches of aid. Minor deviations in actual payments (related to the financing of vessels) have been caused by operative changes and delays. These were handled in line with standard commercial practice in the sector.

### **3. Productivity, production and respect of the capacity limitation**

Volkswerft achieved in 1998 a substantial improvement in productivity. As regards the construction of container ships productivity is now somewhat better than envisaged, further improvements can be expected from the commissioning of the residual facilities under construction. The yard faced however considerable difficulties in the production of two specialised ships contracted before privatisation. The new company managed to overcome the difficulties in marketing and organisation, which had influenced the performance in 1997. Audited results for 1998 are not yet available. Volkswerft announced a small positive result for the year. Preparation of the final figures may take some time in view of the pending claims on the ships delivered late as mentioned above.

Production increased from 76,257 cgt in 1997 to about 84,700 cgt (provisional) in 1998. As usual the final production figures for 1998 will only be available once the vessels under construction will have been delivered and the tonnage certificates for these ships are established. However, there are no indications of an excess of the capacity limit at present. It is expected for 1999 that the production of Volkswerft will be again close to the capacity limit.

Volkswerft reduced its staff from 1372 on 1 January 1998 to 1273 on 1 October 1998 (both figures include apprentices). A further reduction is foreseen but has not yet been decided.

### **4. Conclusions and outlook**

From the information received the Commission can conclude that the aid received by the yard was used as specified and that the conditions set in Article 2 of Council Regulation 1013/97 have been respected. The Commission is examining the notified third tranche of restructuring aid and expects to take an early decision on this.

Further monitoring will focus on the financial situation of the residual company OBVG and on compliance with the production limit in 1999 and thereafter.

## **MTW-Schiffswerft (now Aker-MTW Werft)**

### **1. Investments and investment aid**

In July 1998 the Commission released the second and final tranche of DEM 116.9 million investment aid. The total investment aid approved under the new programme is DEM 312.2 million, DEM 13.2 million less than budgeted. The investments are finalized since late autumn 1998.

### **2. Financial status of the residual company MTW-Schiffswerft GmbH and use of the operating aid**

The orderbook of the residual company at the time of privatisation stood at 14 vessels. By end of 1998, it has been gone down to 4 vessels to be delivered until September 1999. Six vessels were delivered in 1998 and four orders were cancelled in agreement with the shipowner.

The cancellation of the four orders had already foreseen at the time of the Commission's examination of the privatisation programme and the expected profits had been deducted. Due to the cautious line taken at the time, the deviations in the expected balance of the residual company are minor. They are mainly caused by the reduced market value of loans to shipowners in view of the difficulties on the market for container ships.

In July 1998 the Commission had decided to approve a second and final tranche of DEM 151.8 million operating aid to MTW. The total operating aid approved amounts hence to DEM 332.3 million, which is the maximum amount foreseen under Article 1 of Council Regulation 1013/97 reduced by DEM 720 000 in view of a capacity excess in 1997.

As it stands now, it can be expected that the operating aid and the own income of the residual company will be sufficient to meet all residual obligations.

From the information received, the Commission can conclude that the operating aid disbursed was used in line with the Commission decisions. The amount earmarked to cover risks of the residual company will only be disbursed after the respective payments have been effected and are confirmed by the auditors of BvS.

### **3. Productivity, production and respect of the capacity limitation**

MTW achieved in 1998 further strong improvements in productivity, which exceed substantially the values expected in 1996 when the rescue concept was drafted. The yard managed to deliver all vessels in time.

Production was 98153 cgt in 1997 and 100.030 cgt in 1998. The figure for 1998 is provisional and the Commission will decide depending on the final value if and which action needs to be taken. From the detailed information available it can be concluded that the margin of error should be less than 0.5 % so that a substantial excess can be excluded. The planned production in 1999 will be again at the capacity limitation. While in this year the employment situation in shipbuilding is again positive, the orderbook situation is weak for the year 2000.

The deeply depressed market situation in the off-shore sector might well add to the difficulties. The privatisation concept for MTW was partly based on the expectation that free capacity of the yard could be used for off-shore equipment.

The number of staff was almost stable at about 1415 in 1998. The reduction of personnel has therefore been slower than planned, although the yard expects that employment in the shipbuilding wing of Aker-MTW will go down to 1150 staff by end of 1999, as foreseen in the feasibility study of 1996. Due to the lower reduction of personnel, it is expected that some DEM 8 million of the DEM 25.1 million social aid will not be spent.

Audited results for 1998 of the new company Aker-MTW have not yet been available at the time of drafting this report. As all ships were delivered as planned and productivity was higher than envisaged the yard expects a positive result for this year.

Aker revoked its offer to buy the bankrupt Elbwerft and to operate this yard together with MTW.

#### **4. Conclusions and outlook**

From the information received the Commission can conclude that the aid received by the yard was used as specified and that the conditions set in Article 2 of Council Regulation 1013/97 have been respected. The restructuring of the MTW yard is virtually completed. Further monitoring will focus on compliance with the production limit in 1999 and thereafter. In addition, the Commission will continue to monitor the correct use of the residual aid.

#### **Other issues:**

##### **Excess of the capacity limitation by Kvaerner Warnow Werft GmbH (KWW)**

KWW is a former GDR shipyard located in Rostock-Warnemünde. After privatisation the Commission had authorised restructuring aid on a total amount of DEM 1247 million by means of several decisions in 1993-95. The approval of the aid had been made subject to an annual capacity limitation of 85.000 cgt. per year. This capacity limitation needs to be respected until end of 2005 unless the Commission authorises an earlier termination.

The regular monitoring report of the yard of 30.6.98 indicated that production would reach 106.945 cgt. in 1998 and considerably exceed the limit in 1999 again. The Commission and its technical advisor undertook an on-site monitoring of the situation in October 1998, which confirmed that a substantial excess was to be expected.

On 25 November 1998 the Commission decided to open the Article 93(2) procedure in view of the non respect of the conditions of the decisions authorising the restructuring aid. According to the preliminary findings of a further monitoring mission on 14 January 1999 actual production in 1998 may have even higher than announced. In this case, production of the east German shipyards would have exceeded the joint limitation of 327.000 cgt set in Council Directive 92/68 EEC. The Commission asked the German government to provide complete information about the production of the yards without any further delay.

After analysing the response the Commission might decide on an extension of the Article 93(2) procedure.