Capacity limitations for shipyards in the context of the Court of Justice' judgement on Kvaerner Warnow Werft (KWW)

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Introduction

On 28 February 2002, the Court of First Instance annulled two Commission decisions concerning the East German shipyard Kvaerner Warnow Werft (KWW), which ruled that KWW had exceeded its capacity limitation and Germany had to recover parts of the earlier restructuring aid. The Commission filed an appeal, which was finally dismissed by the Court of Justice on 29 April 2004.

Since 1995 the Commission monitored the compliance of East German yards with the capacity limitation as a production limitation, in the meaning of limiting the output. According to the Court, the Commission's decisions were wrong in interpreting the capacity limitation of Eastern German shipyards as a production limitation.

Taking into account the judgment's reasoning, the Commission examined whether further to KWW also to other shipyards, which were subject to such limitation, the Court's interpretation of the notion 'capacity limitation' may apply. This article analyses the consequences of the judgement of the Court of Justice and the Commission's decision on capacity limitations for East German, Spanish and Greek shipyards.

1. Background

Capacity limitations for shipyards in East Germany, Spain and Greece

From 1992 to 1997, based on the Council Directive on aid to shipbuilding and it's various amendments (see footnotes (1), (2), (3), and (4)) the Commission approved state aid for several shipyards in Germany, Spain and Greece. In a countermove these Member States accepted to reduce shipbuilding capacities and promised not to exceed these capacity limitations for a period of up to 10 years. The decisions concerned the following shipyards:

— East Germany: Volkswerft Stralsund, Aker MTW, Kvaerner Warnow Werft (KWW), Peene Werft and Elbewerft Boizenburg
— Spain: Astano, Astander, Puerto Real, Sestao, Sevilla, Barreras, Juliana and Astander and private sector yards
— Greece: Hellenic shipyard

Starting point: Kvaerner Warnow Werft (KWW) in East Germany

From 1992 to 1996, a profound restructuring of the five Eastern German shipyards was carried out. As a counterpart for the exceptionally large amounts of aid Germany reduced the shipbuilding capacity in Eastern Germany by 40% resulting in a total capacity limited to 327 000 cgt. Germany allocated this capacity between individual yards, from which 85 000 cgt were attributed to Kvaerner Warnow Werft (KWW).

The restructuring of all yards was carried out in a similar way: the yards were privatised and totally rebuilt with help of state aid. In total, the aid paid to the Eastern German yards amounted to about DEM 6 billion (ca. EUR 3 billion), from which the aid paid to KWW was DM 1.2 billion (ca. EUR 600 million). From 1993 to 1995, five decisions were taken regarding KWW, authorising the aid by tranches.

Since 1994, the Commission had monitored the compliance with the individual capacity limitations, which were supposed to be in force for up to ten years. From the beginning of the monitoring the Commission considered the capacity limitations as being a limitation of production, of the output of the yards in the meaning of tonnage built. Since this was the understanding between the Commission, Germany, and the yards concerned, the monitoring was always carried out as monitoring of actual production of the yards.


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In summer 1998, during a monitoring visit to KWW it was established that the production of the yard would exceed considerably the annual limit of 85 000 cgt. In summer 1999 a negative decision was taken due to exceeding the capacity limit in 1998 by 37 414 cgt (total production 122 414 cgt). This had repercussions to the previous year, and another negative decision was taken in 2000 concerning 8 862 cgt excess of the capacity limitation in 1997. Due to these decisions, KWW was ordered to pay back a total of DM 95 million (EUR 47.5 million) of incompatible aid. KWW reimbursed the whole amount with interest in April 2000 but appealed at the Court of First Instance.

2. The judgements of the Court

When the Commission implemented its decisions on restructuring aid it considered the capacity limitation as both a technical limitation (‘bottlenecks’) and a limitation of actual production. However, following KWW's appeal against the recovery of aid due to its excess of production the Court of First Instance ruled on 28 February 2002, in joint cases T 227-99 and T 134-00, that the Commission was wrong in interpreting the capacity limitation of KWW as a limitation of actual production.

The capacity limitation, in the light of the Commission decisions adopted between 1993 and 1995 authorising the aid, had to be understood as a technical limitation of the production facilities. As long as the production facilities of the yard as described in the Commission decisions authorising the aid were not changed, the yard could produce more than 85 000 cgt. In order to be able to claim that the capacity limitation was in fact a limitation of the actual production, the Commission should have clearly formulated its decisions in the period of 1993 to 1995 accordingly and should have imposed a production limit.

On 13 May 2002 the Commission appealed at the Court of Justice against this judgment. However, on 29 April 2004 the Court of Justice dismissed the appeal with the following arguments:

— With regard to the above mentioned Directives the Commission had a certain measure of discretion in setting the conditions to which the proposed aid was to be subject in order to ensure that it remained compatible.

— The Court takes note that the actual production of an undertaking is not the same notion as production capacity.

— However, neither Directive 90/684 (1) as amended nor Directive 92/68 (2), on which the authorising decisions for restructuring aid to the East German shipyards are based, include a definition of capacity or capacity restrictions.

— If the authorisation of aid was subject to the condition that not only the technical capacity of the yard but also its actual production should not exceed 85 000 cgt per annum, the Commission should have stated that clearly and unequivocally in its authorising decisions. None of the decisions mentions specifically that the capacity restriction constitutes a yearly ceiling on actual production.

— Neither the wording nor the broad logic of the authorising decisions supports the conclusion that the capacity restriction referred to KWW's actual production. Even if the technical restrictions of capacity proved to be inappropriate to avoid distortion of competition, this does not justify a capacity restriction, which was in reality a limitation on production.

Consequently, according to the judgement of the Court of First Instance of 28 February 2002 in cases Kvaerner Warnow Werft vs. Commission the Commission was wrong in interpreting the capacity limitation as a limitation of actual production. A capacity restriction may relate to production achievable under favourable normal conditions, given the facilities available. However, the figure indicated by the capacity restriction may be exceeded in periods of optimal conditions. Following this, the capacity limitation has to be understood only as a technical limitation of the production facilities. As long as the production facilities of the yard were not changed, shipyards can produce more than the capacity limitation authorised in the Commission decision.

3. Implications of the Court's judgment

East German shipyards

The Court judgement concerned the two Commission decisions on Kvaerner (675/1999 and 336/2000), by which the Commission established that Kvaerner exceeded its production limitation. Since the judgement was limited to a specific yard and to specific years of production the Commission examined whether its basic rulings apply only to Kvaerner or whether it should also be applied to other EU yards subject to a capacity limitation.

(1) See footnote 1.
(2) See footnote 2.
On the one hand, using a narrow interpretation, the Court's ruling could be restricted only to KWW. On the other hand, if wording and sense of the original Commission decisions for further shipyards, which authorised state aid subject to capacity limitations, were rather similar to the one for KWW, the Court's judgment may apply accordingly to other concerned yards.

After the closure of one of the East German shipyards (Elbewerft Boizenburg) four yards were still subject to capacity limitations. The aid was approved by several Commission decisions referring to different measures, which were split up into several tranches. However, the critical wording in the different authorising decisions (Kvaerner Warnow Werft, Aker MTW, Volkswerft Stralsund and Peene Werft) was not identical and varied for different measures and tranches.

On the other hand, since the structure of the different decisions for the East German shipyards, to which the Court referred to, was rather the same it was doubtful that the Commission could apply two different methods of monitoring and differentiate between the limitation of capacity and the limitation of production. All authorising decisions had the same objectives with regard to the capacity limitations and it appeared difficult to justify a different treatment of the shipyards. In particular from an economic and political point of view such different treatment would not have been comprehensible.

The in-depth analysis of the Court's judgement supports this approach. Indeed, the Court did not even clearly state that the Commission could have interpreted the notion of limitation of technical capacity as equivalent to the one of production. Although the Court did not exclude that the Commission could have interpreted the limitations in this way with regard to its margin of discretion in the area of state aid the Court observed that the Commission did not use this interpretation in its decisions.

Consequently, it was doubtful that the Court would uphold the earlier decisions for Aker MTW, Volkswerft Stralsund and Peene Werft as regards their interpretation that technical capacity equals production.

Spanish shipyards

As in the German cases, the decision C 56/95, ex N 941/95 (1), concerning aid to support the restructuring of publicly-owned yards in Spain refers as well to Directive 90/684/EEC (latest amended by Regulation 1013/97, see footnote 4). In its first part the decision stipulates that the reduction of technical capacity will be achieved by both closures of facilities and the reduction of production (‘cessation of a new building’).

With reference to Council Directive 90/684/EEC the decision says that ‘Spanish authorities have undertaken that production at the yards will not exceed the reduced capacity of 210 000 cgrt. The Commission will … undertake a close monitoring of actual production levels to ensure that this level of production is not exceeded.’ Finally, according to the decision's conclusive part ‘the Spanish government shall co-operate … to ensure that the production limitation and other conditions are respected’.

Taking into account that the Commission decision requests both a limitation of the production and a reduction of the technical capacity the wording appears substantially clearer than in the decisions on the German yards. In contrast to Council Directive 90/684, which according to the Court did not determine the form of a limit on the actual production of the yards, the decision precisely sets out the conditions for approving the aid. From the legal point of view, the shipyards had — further to the closure of certain facilities — to respect a limitation of the production. However, taking into account that the decision's legal basis was the same as for the East German shipyards (Council Directive 90/684) and with view to the Court's interpretation of the Commission's decision it appeared possible to apply the same monitoring procedures as for the East German shipyards.

Greece shipyards

In 1997, based on Council Directive 90/684 and Council Regulation 1013/97 covering both shipbuilding and ship repair the Commission approved investment aid for Hellenic Shipyards (N 401/97). The decision recalls that certain installations (slipways, docking facilities) shall be permanently closed. Referring to the Council Directive stipulating a reduction of capacity the decision says that ‘there is a reduction in the yard's repair capacity equivalent to the reduction of the number of employees’ (35% from the 1996 employment level), ‘which cannot be compensated by the envisaged increase in productivity and a reduction of docking capacity for commercial vessels’. It appears that despite the reference to productivity, which may imply a limitation of production, the

(1) Case C 56/95 (ex N 941/95), OJ C 354, 21.11.97, p. 2.
Commission could interpret the capacity reduction as a merely technical restriction based on the Court's judgement.

4. Conclusion for the three Member States and follow-up

It follows from the analysis of the different decisions, that a strict interpretation of the judgement may require to continue the monitoring of production for certain East German shipyards but to end it for others. In Spain, the Commission could continue such monitoring since the conditions imposed were focussed on a limitation of the production. In contrast, the Commission was not authorised to carry out a monitoring of production of the Greek shipyards. Such a differentiated approach is not comprehensible both from an economical and from a political point of view.

The Commission concluded that the decisions authorising state aid for the above mentioned shipyards were taken on the same legal basis and resembled the KWW decisions on which the Court of Justice had ruled. With regard to the differences of the decision's wording and their interpretation the Commission decided to clarify the way how it intended to carry out the monitoring of capacities for all the above mentioned decisions on state aid.

For reasons of coherence and equal treatment the Commission decided (NN 56/2003) to consider the capacity limitations of these decisions for East German, Spanish and Greek shipyards as merely technical limitations in so far as the decisions were based on Council Directive 90/684 as amended. However, the monitoring of technical capacity limitations will continue in the sense of the provisions set out in the concerned individual cases of state aid until the date foreseen by each of these decisions. The interpretation and monitoring of capacity limitations for further shipyards based on rules different from those mentioned above were not modified or replaced by the Commission's decision.