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<p>In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...]</p>	<p>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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Subject: State Aid SA.39877 (2017/NN) – Croatia – Aid to HŽ Cargo d. o. o. – Debt cancellation

Sir, /Madam,

1. PROCEDURE

- (1) By letter dated 1 October 2015, Croatia informed the Commission that it has cancelled liabilities of HŽ Cargo d.o.o. ("HZ Cargo") amounting to HRK 975 million (EUR 129.5 million¹). On the basis of the information provided, the Commission decided to open a case into the measure in favour of HZ Cargo, registered under the State aid case number SA.39877.
- (2) By letters dated 15 October 2015, 28 October 2015 and 21 January 2016, Croatia provided further information. By letters dated April 2016, 28 October 2016 and

¹ Exchange rate used in this decision is EUR 1 = HRK 7.528, OJ C 434, 24.11.2016, p. 2.

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19 December 2016, the Commission requested further information on the measure in favour of HZ Cargo. Croatia responded by letters dated 10 June 2016, 22 November 2016 and 17 January 2017.

2. CONTEXT OF THE MEASURE

2.1. The Beneficiary

- (3) HZ Cargo is a 100% State-owned limited liability company providing rail freight services. Croatia is the sole shareholder of HZ Cargo. In accordance with the Company Statutes its General Assembly consists of one member being represented by the Minister in charge of transport. The General Assembly is held at least once a year. Also in accordance with its Statutes the Supervisory Board is comprised of five members out of whom four are appointed by the General Assembly and one is appointed by the workers' council. The Management Board has one to three members and it is appointed by the General Assembly. HZ Cargo prepares different kind of financial and operational reports, which are subject to approval of the General Assembly. In addition, HZ Cargo is subject to State Audit supervision.
- (4) HZ Cargo provides rail freight transport services of *inter alia* cement, chemical products, grains, oil, wood, salt and metals.
- (5) On 29 December 2006, HZ Cargo was incorporated as a limited liability company, following the reorganisation of HŽ Hrvatske željeznice d.o.o. ("HZ Holding"). HZ Holding, a vertically integrated railway company, which was split into five companies: HZ Holding, HŽ Infrastruktura d.o.o. ("HZ Infrastructure", the infrastructure manager), HŽ Putnički prijevoz d.o.o. ("HZ PP", the rail passenger operator), HŽ Vuča vlakova d.o.o. ("HZ Traction", the traction service provider) and HZ Cargo.² On 1 October 2012 HZ Traction was divided and acquired by HZ Cargo and HZ PP.
- (6) In 2013, HZ Cargo had a 9.6% share in the overall Croatian market for freight transport, whereas the road transport had a share of 60.8%. HZ Cargo's market share in freight transport had decreased to 6.55% in June 2016, whereas the road transport increased its market share to 64.5%.

Table 1: Market share development on the Croatian freight transport market 2012 – June 2016

Market share in % (by volume of goods carried)	2012	2013	2014	2015	Jun-16
Rail	10.1	9.6	10	9.3	7.7
- HZ Cargo	10.1	9.6	10	9.1	6.55
- Other rail freight operators	0	0	0	0.2	0.85
Road	59.7	60.8	63.4	62.4	64.5
Inland waterways	0.6	0.5	0.5	0.5	0.5
Maritime	23.4	22.3	19.5	20.1	19.4
Other	6.2	6.8	6.6	7.7	7.8

² The Act on Division of the HŽ Holding (Croatian OG 153/05).

- (7) At the time of its accession to the European Union (1 July 2013) Croatia granted access to its rail network to foreign rail freight operators. Since 2013 HZ Cargo's rail freight transport market share (measured by volume of goods carried) has decreased from 100% in 2013 to 85.2% in June 2016.

Table 2: HZ Cargo market share in the Croatian rail transport market 2012 – June 2016

Market share in % (by volume of goods carried)	2012	2013	2014	2015	2016
HZ Cargo	100.0	100.0	100.0	97.9	85.2
Other rail freight operators	0.0	0.0	0.0	2.1	14.8

Market share in % (by distance carried)	2012	2013	2014	2015	2016
HZ Cargo	100.0	100.0	100.0	98.6	85.3
Other rail freight operators	0.0	0.0	0.0	1.4	14.7

- (8) In 2016, seven rail freight operators were active on the Croatian market. HZ Cargo's main competitors are PPD Transport d.o.o. ([...]^{*}% market share by volume of goods carried in 2016), Rail Cargo Carrier-Croatia d.o.o. ([...]%), Train Hungary d.o.o. ([...]%), Rail & Sea d.o.o. ([...]%), SŽ Tovorni Promet d.o.o. ([...]%) and Rail Transport Service GmbH.
- (9) In 2013, HZ Cargo had a fleet of 187 locomotives and 5,032 freight wagons, but because of their technical state the company can only use part of the fleet. In 2013, 490 freight wagons and 38 locomotives were either inactive or unavailable. The majority of the freight wagons and locomotives in the fleet are more than thirty years old and require regular maintenance and emergency repairs. In 2013, 586 freight wagons were repaired, generating maintenance costs of HRK 61.8 million (EUR 8.2 million).

2.2. Financial situation of HZ Cargo

- (10) Over the past decade HZ Cargo's business activity was progressively reduced. The cargo volume carried by HZ Cargo decreased by 41% between 2007 and 2015, that is from 17,231 thousand tonnes in 2007 to 10,124 thousand tonnes in 2015.
- (11) With the downsizing of HZ Cargo's business activity also the number of employees was progressively reduced from 2,898 employees 2012 to 1,945 in 2016.
- (12) As presented in Table 3 below, HZ Cargo has been facing financial difficulties for several years.

Table 3: HZ Cargo's financial indicators 2013 – June 2016 (in HRK million)

In HRK million	2013	2014	2015	Jan-June 2016
Turnover				

^{*} Business secret

In HRK million	2013	2014	2015	Jan-June 2016
	687	652	670	244
Operating costs	- 835	-709	-618	-231
EBITDA	- 148	-57	52	13
Interest Expenses	-66	-86	-39	-13
Other costs	-30	-27	-26	-73
Annual result	-244	-170	-13	-73
Total assets	1,827	1,697	1,528	1,465
Total debt (gross)	1,891	1,930	616	626
Provisions	192	136	76	94
Non-current liabilities,	596	432	96	117
Current liabilities	735	1,171	426	329
Accrued expenses and deferred income	368	191	18	86
Equity	-64	-233	912	839
Subscribed share capital	531	531	1,674	1,674
Other equity	-595	-764	-762	-835
- Reserves		4	6	6
- Accumulated profit/loss	-351	-598	-756	-769
- Annual profit/loss	-244	-170	-13	-73
Financial indicators				
Debt-to-Equity Ratio	-29.55	-8.28	0.68	0.75
EBITDA-Interest Coverage Ratio	2.24	0.66	-1.33	- 1.00

- (13) HZ Cargo has been loss making since 2012. The accumulated losses in 2015 amounted to HRK 756 million (EUR 100.4 million), which was the main factor for the decrease in shareholders' equity to a negative value of HRK -233 million (EUR -30.95 million) in 2014. The shareholders' equity shows a positive value of HRK 912 million (EUR 121.1 million) in 2015 and of HRK 839 million (EUR 111.5 million) in June 2016 due to the debt cancellation with a subsequent capital increase amounting to HRK 975 million (EUR 129.5 million),³ which is the measure under assessment.
- (14) As summarised in Table 3 above, in 2014 HZ Cargo reached a significant level of debt (114% of total assets) amounting to HRK 1,930 million (EUR 256.4 million). In 2015, after debt cancellation of HRK 975 million (EUR 129.5 million; see recital (13) above), HZ Cargo's total debts decreased by 68% to HRK 616 million (EUR 81.8 million).

3. DETAILED DESCRIPTION OF THE MEASURE

- (15) On 21 May 2015 the Government of Croatia decided to increase the share capital of HZ Cargo by way of a debt cancellation totalling HRK 975 million (EUR 129.5 million). In other words, Croatia cancelled HZ Cargo's debt (earlier assumed based on issued guarantees) and subsequently converted it to shares in the increased share capital of the company. In effect, Croatia does no longer have any claim with respect to the debt concerned and HZ Cargo does not have any

³ See recital (1) and Section 3 further below.

liability related to it, neither now nor in the future. The cancelled debt related to liabilities incurred by HZ Cargo prior to Croatia accession to the Union (1 July 2013).

Table 4: Overview of HZ Cargo's liabilities cancelled in 2015

Loan granted by (date)	in HRK
Privredna banka Zagreb d.d., Zagreb (2006)	268,619,580.69
Erste & Steiermarkische Bank d.d., Zagreb (2010)	97,542,513.97
Hrvatska poštanska banka d.d., Zagreb (2010)	14,916,963.33
Hrvatska poštanska banka d.d., Zagreb (2010)	122,888,735.84
Hrvatska poštanska banka d.d., Zagreb (2011)	64,251,687.61
Zagrebačka banka d.d., Zagreb (2012)	398,334,897.90
Croatia Banka d.d., Zagreb and Hrvatska poštanska banka d.d., Zagreb (2014)	8,393,573.40 ⁴
Total	974,947,952.75

- (16) HZ Cargo's total liabilities incurred prior to accession of Croatia to the Union amounted to HRK 1,094 million (EUR 145.3 million). HZ Cargo paid back from its own resources HRK 119.4 million (EUR 15.8 million) of the liabilities incurred prior to accession of Croatia to the Union.

Table 5: HZ Cargo's liabilities on 30 June 2013

HZ Cargo's liabilities on 30 June 2013	in HRK
Long-term liabilities towards banks and financial institutions	802,232,804.69
Short-term liabilities towards banks, financial institutions and suppliers	292,087,155.66
TOTAL LIABILITIES (LONG-TERM AND SHORT-TERM)	1,094,319,960.35

4. ASSESSMENT OF THE MEASURE

4.1. Existence of State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union (the "Treaty")

- (17) By virtue of Article 107 (1) of the Treaty *"any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."*
- (18) The criteria in Article 107(1) of the Treaty are cumulative. Therefore, in order to determine whether the measure in question constitutes aid within the meaning of Article 107(1) of the Treaty all of the following conditions need to be fulfilled:

⁴ More precisely, this amount is an interest relating to a loan of HRK 250 million granted to HZ Cargo in April 2014 which was used to settle debts incurred prior to the accession related to railway infrastructure access charges, locomotive maintenance and wagon maintenance. The loan itself was not cancelled.

- (a) the beneficiary is an undertaking within the meaning of Article 107(1) of the Treaty, which implies that it engages in an economic activity;
- (b) the measure is financed by State resources and is imputable to the State;
- (c) it confers an economic advantage;
- (d) this advantage is selective;
- (e) the measures in question distort or threaten to distort competition and affect trade between Member States.

4.1.1. *Economic activity and notion of undertaking within the meaning of Article 107(1) of the Treaty*

- (19) The State aid rules only apply where the beneficiary of a measure is an undertaking. The Court of Justice has consistently defined undertakings as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed.⁵
- (20) The Commission considers that by providing freight transport services, as well as management and coordination of those activities, HZ Cargo is performing an economic activity and therefore constitutes an undertaking for the purposes of Article 107(1) of the Treaty.

4.1.2. *State resources and imputability to the State*

- (21) In order to constitute State aid, the measure in question has to be financed from State resources and the decision to grant the measure must be imputable to the State.⁶
- (22) The cancellation of debt through its conversion to equity was financed from the Croatian State budget (in the form of the State revenue forgone due to non-repayment by HZ Cargo of the debt which prior to the cancellation had been owed to the State) and was granted by the decision of the Government of Croatia adopted on 21 May 2015.
- (23) Therefore, this measure is financed through State resources and it is also imputable to the State.

4.1.3. *Economic advantage*

- (24) An advantage within the meaning of Article 107(1) of the Treaty is any economic benefit which an undertaking would not have obtained under normal market conditions, that is to say, in the absence of State intervention.⁷ Only the effect of

⁵ Judgment of the Court of Justice of 12 September 2000, *Pavlov and Others*, Joined Cases C-180/98 to C-184/98, ECLI:EU:C:2000:428, paragraph 74; Judgment of the Court of Justice of 10 January 2006, *Cassa di Risparmio di Firenze SpA and Others*, C-222/04, ECLI:EU:C:2006:8, paragraph 107.

⁶ Judgment of the Court of Justice of 16 May 2002, *France v Commission ("Stardust Marine")*, C-482/99, ECLI:EU:C:2002:294.

⁷ Judgment of the Court of Justice of 11 July 1996, *Syndicat français de l'Express international (SFEI) and others v La Poste and others*, C-39/94, ECLI:EU:C:1996:285, paragraph 60; judgment of the Court of Justice of 29 April 1999, *Kingdom of Spain v Commission of the European Communities*, C-342/96, ECLI:EU:C:1999:210, paragraph 41; judgment of the Court of Justice of 16 May 2002, *France v Commission ("Stardust Marine")*, C-482/99, ECLI:EU:C:2002:294, paragraph 69

the measure on the undertaking is relevant, not the cause nor the objective of the State intervention.⁸

- (25) The Commission notes that Croatia has decided to cancel HRK 975 million (EUR 129.5 million) of HZ Cargo's debt directly related to railway activities by converting it to equity.
- (26) The Commission considers that the measure has provided HZ Cargo with additional liquidity (by relieving it from the obligation to repay the debt concerned in the future) that it would not have obtained on the market given its difficult financial situation.
- (27) Therefore, the Commission considers that the decision of Croatia to cancel HZ Cargo's liabilities by increasing its capital confers an economic advantage on the company which it would not have obtained under normal market conditions.

4.1.4. *Selectivity*

- (28) Article 107 (1) of the Treaty requires that a measure, in order to be defined as State aid, favours "*certain undertakings or the production of certain goods*".
- (29) The Commission notes that the measure has been granted only to HZ Cargo. Therefore, the measure is selective within the meaning of Article 107 (1) of the Treaty.

4.1.5. *Distortion of competition and effect on trade between Member States*

Distortion of competition

- (30) The Commission has analysed whether the measure distorts or threatens to distort competition. There is an assumption that there is a distortion of competition within the meaning of Article 107(1) of the Treaty whenever the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition.⁹
- (31) In this respect, Croatia has opened the market for rail freight transport to other domestic and foreign operators (i.e. operators established in Croatia and operators established outside Croatia) on 1 July 2013.¹⁰
- (32) The Union rail freight market was first opened to competition on the trans-European rail freight network with the first railway package on 15 March 2003.¹¹ The second railway package liberalised all international freight transport on 1 January 2006, and national rail freight from 1 January 2007.¹² However, several

⁸ Judgment of the Court of 2 July 1974, *Italian Republic v Commission of the European Communities*, C-173/73, ECLI:EU:C:1974:71, paragraph 13.

⁹ Judgment of the General Court of 15 June 2000, *Alzetta and others v Commission*, T-298/97, ECLI:EU:T:2000:151, paragraphs 141 to 147.

¹⁰ See recital (7).

¹¹ *Directive 2001/12/EC of the European Parliament and of the Council of 26 February 2001 amending Council Directive 91/440/EEC on the development of the Community's railways* (OJ L 75, 15.3.2001, p. 1), *Directive 2001/13/EC of the European Parliament and of the Council of 26 February 2001 amending Council Directive 95/18/EC on the licensing of railway undertakings* (OJ L 75, 15.3.2001, p. 26), *Directive 2001/14/EC of the European Parliament and of the Council of 26 February 2001 on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure and safety certification* (OJ L 75, 15.3.2001, p. 29)

¹² *Regulation (EC) No 881/2004 of the European Parliament and of the Council of 29 April 2004 establishing a European Railway Agency* (OJ L 164, 30.4.2004, p. 1), *Directive 2004/49/EC of the*

Member States had unilaterally liberalised their national markets prior to that date.

- (33) HZ Cargo's market share on the Croatian rail freight market amounted to 85.2% in 2016 (see Table 2). HZ Cargo directly competes on this market with six other rail freight operators (see recital (8) further above).
- (34) Furthermore, rail freight transport is in competition with other modes of transport, in particular by road, but on certain routes also by inland waterway and short-sea shipping (see recital (6) and Table 1 further above).
- (35) Therefore, the Commission concludes that the measure distorts or threatens to distort competition in the internal market.

Effect on trade

- (36) When aid granted by a Member State strengthens the position of an undertaking compared to other undertakings competing in intra-Union trade, the latter must be regarded as affected by that aid.¹³ It is sufficient that the recipient of the aid competes with other undertakings on markets open to competition.¹⁴
- (37) In this case, the beneficiary has been in competition with other undertakings providing transport services in the Union, as shown above in recitals (31) to (34). Therefore, the selective economic advantage granted through the increase of HZ Cargo's capital with a subsequent debt cancellation strengthens its economic position, as it relieves the railway freight operator from its debts incurred prior to July 2013. Consequently HZ Cargo will not need to bear all of its financing costs of investment and operating costs inherent in its railway activity.
- (38) Therefore, the Commission considers that the measure is liable to affect EU trade.

4.1.6. Conclusion

- (39) The Commission considers that the State cancelling debt of HZ Cargo by converting it to equity constitutes State aid within the meaning of Article 107(1) of the Treaty.

European Parliament and of the Council of 29 April 2004 on safety on the Community's railways and amending Council Directive 95/18/EC on the licensing of railway undertakings and Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure and safety certification, OJ L 164 of 30.4.2004, p. 44, Directive 2004/50/EC of the European Parliament and of the Council of 29 April 2004 amending Council Directive 96/48/EC on the interoperability of the trans-European high-speed rail system and Directive 2001/16/EC of the European Parliament and of the Council on the interoperability of the trans-European conventional rail system (OJ L 164, 30.4.2004, p. 114) and Directive 2004/51/EC of the European Parliament and of the Council of 29 April 2004 amending Council Directive 91/440/EEC on the development of the Community's railways (OJ L 164, 30.4.2004, p. 164).

¹³ See, in particular, Judgment of the Court of 17 September 1980, *Philip Morris v Commission*, C-730/79, ECLI:EU:C:1980:209, paragraph 11; Judgment of the Court of Justice of 22 November 2001, *Ferring*, C-53/00, ECLI:EU:C:2001:627, paragraph 21; Judgment of the Court of Justice of 29 April 2004, *Italy v Commission*, C-372/97, ECLI:EU:C:2004:234, paragraph 44.

¹⁴ Judgment of the General Court of 30 April 1998, *Het Vlaamse Gewest v Commission*, T-214/95, ECLI:EU:T:1998:77.

4.2. Lawfulness of the aid

- (40) Pursuant to Article 108(3) of the Treaty, Member States must notify any plans to grant or alter aid, and must not put the proposed measures into effect until the notification procedure has resulted in a final decision.
- (41) The Commission notes that the measure in question has been granted on 21 May 2015.¹⁵ Since the aid was not subject to Commission's approval, Croatia has not respected the stand-still obligation of Article 108(3) of the Treaty. Therefore, the measure constitutes unlawful State aid.

4.3. Compatibility of the aid and the legal basis for the assessment

- (42) Since the measure in question constitutes State aid within the meaning of Article 107(1) of the Treaty, the Commission must assess if this aid can be found compatible with the internal market.
- (43) The aid in question can be assessed on the basis of Article 107(3)(c) of the Treaty, which stipulates that: *"aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest"*, may be considered to be compatible with the internal market.
- (44) In this regard, the Section 4 of the Railway Guidelines¹⁶ provides a framework for assessing whether aid to railway undertakings for the cancellation of debts may be declared compatible pursuant to Article 107(3)(c) of the Treaty.
- (45) Croatia asserts that the measure is compatible with the internal market pursuant to Section 4 of the Railway Guidelines.
- (46) The Commission considers that Section 4 of the Railway Guidelines is applicable for assessing compatibility of this measure. Indeed, according to point 54 of the Railway Guidelines, *"In the light of Article 9 of Directive 91/440/EEC, the Commission also considers that, under certain circumstances, it should be possible to authorise [State] aid without financial restructuring if the cancellation concerns old debts incurred prior to the entry into force of Directive 2001/12/EC, which lays down the conditions for opening up the sector to competition."*
- (47) The Commission notes that, according to point 56 of the Railway Guidelines, in the case of Member States which acceded to the Union after the entry into force of the Directive 2001/12/EC, the date of accession should be considered as the relevant date. In this regard, the relevant date in the present decision is the date of Croatia's accession to the EU, which is 1 July 2013.
- (48) The Commission further notes that according to points 55 to 61 of the Railway Guidelines, aid to cancel HZ Cargo's debts incurred prior to Croatia's accession to the EU can be regarded as compatible on the basis of Article 107(3)(c) of the Treaty provided that the following cumulative conditions are met:
 - (a) *"Firstly, the aid must serve to offset clearly determined and individualised debts incurred prior to 15 March 2001, the date on which Directive*

¹⁵ Judgment of the General Court of 14 January 2004, *Fleuren Compost v Commission*, T-109/01, ECLI:EU:T:2004:4.

¹⁶ Community guidelines on State aid for railway undertakings, OJ C184, 22 July 2008, p. 13.

2001/12/EC entered into force. Under no circumstances may the aid exceed the amount of these debts. In cases where the Member States joined the Community after 15 March 2001, the relevant date is that of accession to the Community. The logic of Article 9 of Directive 91/440/EEC, repeated in subsequent Directives, was to address a level of debt accumulated at a time when a decision to open the market at Community level had yet to be taken.

- (b) Secondly, the debts concerned must be directly linked to the activity of rail transport or the activities of management, construction or use of railway infrastructure. [...]*
 - (c) Thirdly, the cancellation of debts must be in favour of undertakings facing an excessive level of indebtedness which is hindering their sound financial management. The aid must be necessary to remedy this situation, insofar as the likely development of competition on the market would not allow them to rectify their financial situation within a foreseeable future.*
 - (d) Fourthly, the aid must not go beyond what is necessary for the purpose. [...]*
 - (e) Fifthly, cancellation of its debts must not give an undertaking a competitive advantage such that it prevents the development of effective competition on the market, for example by deterring outside undertakings or new players from entering certain national or regional markets."*
- (49) Consequently, the Commission has to assess whether the measure complies with those compatibility conditions.
- (a) The aid must serve to offset clearly determined and individualised debts incurred prior to the date of the accession of Croatia to the European Union (i. e. 1 July 2013)*
- (50) As stated in recital (15) and Table 4 Croatia has cancelled liabilities amounting to HRK 975 million (EUR 129.5 million).
- (51) The Commission notes that the amount of HRK 975 million (EUR 129.5 million) subject to cancellation, as described in recital (15) and Table 4 was stemming from individual financial obligations actually incurred prior to the accession of Croatia to the EU.
- (52) The Commission therefore concludes that the measure has served to offset clearly determined and individualised debts incurred prior to the date of the accession of Croatia to the European Union (i. e. 1 July 2013).
- (b) The debts concerned must be directly linked to the activity of rail transport or the activities of management, construction or use of railway infrastructure.*
- (53) Croatia states that HZ Cargo has been performing only services related to rail freight transport or management, construction or use of railway infrastructure.
- (54) The Commission observes, on the basis of the information provided by Croatia and the analysis of the financial statements, that indeed the debts to be cancelled were incurred to finance primarily the purchase of cargo wagons and the renewal and repair of rolling stock. In addition, the debts financed the provision of HZ Cargo's railway activities, such as the outstanding obligations towards HZ Infrastructure. These activities have been the core business of HZ Cargo and are directly linked to the activity of rail transport.

- (55) Therefore, the Commission considers that the debts concerned were directly linked to the activity of rail transport.
- (c) *The cancellation of debts must be in favour of undertakings facing an excessive level of indebtedness which is hindering their sound financial management. The aid must be necessary to remedy this situation, insofar as the likely development of competition on the market would not allow them to rectify their financial situation within a foreseeable future.*

Excessive indebtedness of HZ Cargo, which is hindering its sound financial management

- (56) Croatia asserts that HZ Cargo was over-indebted. Due to the high level of indebtedness the company has not been able to fully meet its financial obligations and finance investments into the modernisation of its rolling stock.
- (57) The Commission considers that HZ Cargo was indeed facing an excessive situation of over-indebtedness. On 30 June 2013, the total debts of HZ Cargo amounted to HRK 1,094 million (EUR 145.3 million; see Table 5 further above). As presented in Table 3 above, since June 2013 the financial situation of HZ Cargo deteriorated even further. On 31 December 2013 HZ Cargo's Debt-to-Equity Ratio reached -29.55. On 31 December 2013 the equity of the company was negative and the book value of the assets of HRK 1,827 million (EUR 242.69 million) was not sufficient to satisfy all of HZ Cargo's outstanding obligations of HRK 1,891 million (EUR 251 million). On 31 December 2014 HZ Cargo's debts increased even further to HRK 1,930 million (EUR 256 million), whereas the book value of its assets diminished to HRK 1,697 million (EUR 225 million).
- (58) The Commission further observes that due to its indebtedness HZ Cargo's interest expenses increased from HRK 12 million (EUR 2 million) on 30 June 2012 to HRK 86 million (EUR 11 million) on 31 December 2016.
- (59) Moreover, the excessive level of indebtedness has hindered the company from investing to improve its operational capacity, mainly through investments into its rolling stock. Due to the backlog in investments into the modernisation of the rolling stock and maintenance, the fleet of the company is outdated and partially obsolete. In this regard, the Commission observes that the majority of the freight wagons and locomotives are older than 30 years and require costly maintenance and emergency repairs. Only part of the rolling stock is actually operational.
- (60) On the basis of the considerations in recitals (57) to (59), the Commission considers that at the time of the debt cancellation HZ Cargo was facing an excessive level of indebtedness which was hindering its sound financial management.

Necessity of the aid

- (61) In addition, the aid must be necessary to remedy the situation of an excessive indebtedness, insofar as the likely development of competition on the market would not allow HZ Cargo to rectify its financial situation within a reasonable period.
- (62) As previously stated in recital (59), due to the excessive level of indebtedness, HZ Cargo was not able to invest into the modernisation of its rolling stock. The majority of its wagons and locomotives are older than 30 years and require costly maintenance and emergency repairs. No other policy measure would be suitable to remedy HZ Cargo's situation and would allow the company to continue its operation.

- (63) The Commission therefore considers that the measure was necessary to remedy HZ Cargo's indebtedness, insofar as the likely development of competition on the market would not allow it to rectify its financial situation within a foreseeable future.
- (d) *The aid must not go beyond what is necessary for the purpose*
- (64) The debt cancellation did not go beyond what is necessary for its purpose.
- (65) The Commission notes that in view of the financial situation of HZ Cargo, the amount of the debt cancellation was the minimum necessary to ensure the financial sustainability of the company. The cancelled liabilities amounting to HRK 975 million have been still outstanding. Therefore, the amount of HRK 975 million was essentially needed for the outstanding payments towards the creditors of HZ Cargo.
- (66) As stated in recital (57), the financial indicators show that the repayment of the liabilities incurred before Croatia's accession could not have been performed from HZ Cargo's own resources. Therefore, the debt cancellation was necessary for the imminent repayment of debts relating to liabilities incurred prior to Croatia's accession and used for the financing of activities directly linked to the activity of rail transport or the activities of management, construction or use of railway infrastructure. The non-payment of the liabilities towards HZ Cargo's creditors would have otherwise led to coercive actions on their part and eventually - to the liquidation of the company.
- (67) After the cancellation, HZ Cargo's debts decreased from HRK 1 930 million to HRK 616 million, an amount corresponding to 40% of the book value of its assets at that time, which is not disproportionate for well-managed undertakings.
- (68) In view of these considerations, the Commission finds that the debt cancellation could not be considered to have put HZ Cargo in a situation more favourable than that of an average well-managed undertaking with the same activity profile.
- (e) *The cancellation of its debts must not give an undertaking a competitive advantage such that it prevents the development of effective competition on the market, for example by deterring outside undertakings or new players from entering certain national or regional markets.*
- (69) It is to be noted that Croatia has cancelled only part of HZ Cargo's debts which were outstanding on the date of the accession, that is to say HRK 975 million. The cancellation of those debts has only allowed HZ Cargo to reduce its over-indebtedness originating from the pre-accession period, but did not provide it with fresh capital or liquidity that could be used to increase its market share or to expand on the new markets to the detriment of existing competitors or potential new market entrants. HZ Cargo has not increased its current capacity or assets, since apart from the imminent need of repayment of the outstanding debts, the funds were not used to improve its market position or allow it to enter new markets. In that sense, the aid has not prevented the development of effective competition on the market.
- (70) The debt cancellation has not affected competitors' market position. The Commission observes that since the debt cancellation five new market players entered the Croatian rail freight market. Hence, they are able to compete with HZ Cargo.

- (71) The Commission also considers that the cancellation of debts did not unduly distort competition and trade between the Member States, because it has only allowed HZ Cargo to stabilise its financial situation, which was hindered by liabilities incurred prior to liberalisation of the market.

Conclusion

- (72) In view of the considerations above, the Commission concludes that the cancellation of debts amounting to HRK 975 million satisfies the compatibility conditions set out by the Railway Guidelines.

5. CONCLUSION

The Commission regrets that Croatia put the cancellation of debts amounting to HRK 975 million into effect, in breach of Article 108(3) of the Treaty on the Functioning of the European Union.

However, it has decided, on the basis of the foregoing assessment, not to raise objections to the aid on the grounds that it is compatible with the internal market on the basis of Article 107(3)(c) of the Treaty on the Functioning of the European Union.

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Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission