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**PUBLIC VERSION**

**WORKING LANGUAGE**

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**Subject: State aid N 389/2006 - Temporary Defensive Mechanism to Shipbuilding, Portugal**

Sir, Madam,

The Commission wishes to inform Portugal that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

## **I. Procedure**

1. Portugal notified the measure on 20 June 2006. The Commission, by letter dated 6 July 2006, requested additional information from Portugal and proposed to extend the period within which the Commission would take a decision on the notified measure, in conformity with Article 4(5) of Regulation (EC) N° 659/1999<sup>1</sup>, until such time as the Commission would reach a decision on a previous similar notification by Portugal that was under assessment<sup>2</sup>. Portugal, by letter dated 25 July 2006, accepted this proposal.
2. The Commission, by letter dated 11 May 2007, resumed the assessment of the notification and reminded Portugal that the notification was incomplete. Portugal provided additional information by letters dated 5 July 2007 and 26 July 2007.

## **II. Description of the aid measure**

3. The beneficiary of the aid would be Estaleiros Navais de Viana do Castelo S.A. ("ENVC") a Portuguese shipyard employing about 1000 people.

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<sup>1</sup> Council Regulation(EC) N° 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, of 27.03.1999, p.1.

<sup>2</sup> Case C 26/2006, ex N 110/2006, on which the Commission took a final negative decision on 24 April 2007, not yet published.

Sua Excelência  
**Luís Filipe MARQUES AMADO**  
Ministro dos Negócios Estrangeiros  
Largo do Rilvas  
**P – 1399-030 – Lisboa**

4. Portugal proposes to grant ENVC direct aid amounting to EUR 6,575,558 in relation to seven shipbuilding contracts, signed between 4 February 2005 and 31 March 2005. The details concerning the contracts and the corresponding proposed aid are the following:

<b>Multipurpose heavy lift vessel</b>	<b>Date of signature of the contract</b>	<b>Ship owner</b>	<b>Proposed State aid (EUR)</b>
C 228	24.2.2005	JMS Schiffahrtsgesellschaft mbH &CO KG MS	1,212,766
C 229	24.2.2005	JMS Schiffahrtsgesellschaft mbH &CO KG MS	1,212,766
C 230	4.2.2005	MARE Schiffahrtsgesellschaft	1,212,766
C 231	4.2.2005	MARE Schiffahrtsgesellschaft	661,102
C 232	4.2.2005	MARE Schiffahrtsgesellschaft	630,328
C 233	4.2.2005	MARE Schiffahrtsgesellschaft	433,064
C 210	31.3.2005	Mutualista Açoreana	1,212,766

5. According to the information supplied in the notification, the request for aid in relation to all seven contracts was submitted by the shipyard in July 2005, i.e. after the signature of the contracts. Portugal authorized the aid, on condition of approval by the Commission, by decision of the Ministry of Finance, Public Administration, Economy and Innovation of 7 August 2006.

6. The vessels were delivered, or are expected to be delivered, at the following dates:

<b>Vessel</b>	<b>Delivery date</b>
C 228	30 September 2007
C 229	30 December 2007
C 230	Delivered 28 July 2006
C 231	Delivered 30 October 2006
C 232	Delivered 3 January 2007
C 233	Delivered 24 April 2007
C 210	10 July 2007

7. Portugal proposes to grant the aid on the basis of Council Regulation (EC) N° 1177/2002 concerning a temporary defensive mechanism to shipbuilding<sup>3</sup> as amended by Council Regulation (EC) N° 502/2004<sup>4</sup> (the “TDM-regulation”). The TDM-regulation entered into force on 3 July 2002 and expired on 31 March 2005. This

<sup>3</sup> OJ L 172, of 2.7.2002, p.1

<sup>4</sup> OJ L 8, of 19.3. 2004, p.6

Regulation was, thus, no longer in force at the time when Portugal approved and notified the aid.

8. Portugal argues that the contracts fall within the scope of application of the TDM-regulation because they were signed while this regulation was still in force.

### III. Assessment

#### *Existence of aid*

9. According to Article 87 (1) of the EC 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 common market.
10. The Commission considers that the proposed measures constitute State aid within the meaning of Article 87(1) of the EC Treaty: they take the form of a grant financed by State resources; the measures are selective as they are limited to ENVC; this selective grant is likely to distort competition, by providing ENVC with an advantage over other competitors not receiving the aid. Finally, shipbuilding is an economic activity involving extensive trade between Member States and the measures are thus likely to affect trade between Member States.

#### *Compatibility with the common market*

11. As explained above, Portugal requested the Commission to approve the aid under the TDM-regulation. However, the Commission has doubts that the proposed aid can be considered compatible with the common market. Firstly, the Commission has doubts concerning the incentive effect of the aid, which was only requested by the shipyard after the contracts were concluded. Secondly, the Commission doubts that the TDM-regulation, which has already expired, can still be a valid legal basis for approving the aid.

#### *The incentive effect*

12. As a general principle, State aid may only be considered compatible with the common market if it is necessary to induce the recipient firm to act in a manner which assists attainment of the objectives envisaged by the relevant derogation<sup>5</sup>.
13. The Commission notes in this respect that the objective of the TDM-regulation was to “effectively enable Community shipyards to overcome unfair competition from Korea” (see paragraph 6 of the preamble). Direct aid up to 6% of contract value before aid could thus be authorized provided there had been competition for the same contract from a shipyard in Korea offering a lower price (article 2).
14. Portugal argued in this context that although the shipyard signed the contracts without having guarantees of receiving the aid, it had expectation that it would receive the aid given that the contracts fulfilled the conditions under the TDM-regulation<sup>6</sup>.

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<sup>5</sup> See judgment in Case 730/79 Philip Morris v Commission [1980] ECR 2671, paragraphs 16 and 17.

15. However, the Commission has doubts that this argument is well founded. Generally, the Commission considers that the aid has an incentive effect if an application for aid was submitted before the start of the project<sup>7</sup>. This is not case here. The application for aid was only submitted after the contracts had been signed. Portugal only approved the aid internally (on condition of approval by the Commission) more than a year later. In addition, although Portugal submitted copy of a letter from a ship owner stating that for six of the contracts in question he had received lower offers from Korean shipyards, this letter is dated 9 March 2005, i.e., was only sent to ENVC after the shipyard had already signed the contracts. In any case, Portugal has not provided evidence that at the time ENVC signed the contracts there were any assurances that the shipyard would obtain the aid.
16. On the basis of the information available, the Commission doubts that ENVC was induced in any way by State aid to carry out the projects concerned.

*The legal basis*

17. The TDM-regulation expired on 31 March 2005 and was therefore no longer in force at the time Portugal approved and notified the aid. The Commission, in its decision concerning Case C 26/2006 (ex N 110/2006)<sup>8</sup> explained in detail why it considers that the TDM-regulation can no longer be a valid legal basis for approving new operating aid to shipbuilding. Portugal, in the present case, has not submitted any new information that would modify the Commission's assessment in this respect
18. Thus, the Commission notes that, with regard to notified aid, the Commission's practice is to base its assessment on the laws in force at the time of the assessment<sup>9</sup>, unless otherwise specified in the law in force itself. Portugal only internally approved the aid (conditional on approval by the Commission) and notified it to the Commission long after the TDM-regulation had expired.
19. Portugal sustains, in this respect, that the TDM-regulation is applicable to the present contracts because they were signed during the period of application of this regulation.
20. In this respect, Article 4 of the TDM-regulation states that "*This Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry (...)*". However, the Commission considers that this provision does not define the application in time of the TDM-regulation. Rather, the temporal application of the

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<sup>6</sup> See in this sense paragraph 21 of the Commission decision on case C 26/2006 (ex N 110/2006) not yet published.

<sup>7</sup> See, by analogy, Article 38 of the Guidelines on National Regional Aid 2007-2013 (OJ C 54 of 4.3.2006, p. 13): "aid may only be granted (...) if the beneficiary has submitted an application for aid and the authority responsible for administering the scheme has subsequently confirmed in writing that subject to detailed verification, the project in principle meets the conditions of eligibility (...) before the start of the work on the project".

<sup>8</sup> See footnote 2.

<sup>9</sup> See case N 122/2005 "Unless otherwise specified, the Commission applies to notified projects the rules in force at the time of assessment of their compatibility".

Regulation is defined in Article 5<sup>10</sup> of the Regulation, which states that the regulation "shall expire on 31 March 2005".

21. In contrast, Article 4 establishes additional conditions for the compatibility of the aid. This is also confirmed by the second part of Article 4, which provides that the TDM-regulation shall not apply to "final contracts signed before the Community gives notice in the Official Journal of the European Communities that it has initiated dispute settlement proceedings against Korea (...) and final contracts signed on month or more after the Commission gives notice in the Official Journal of the European Communities that these dispute settlement proceedings are resolved or suspended".
22. From the above, it is clear that the TDM-regulation was only to be applied as long as there was a pending dispute with Korea<sup>11</sup> and in any event, no later than 31 March 2005.
23. This interpretation is supported by the very objective of the TDM-regulation: it was designed "as an exceptional and temporary measure, in order to assist Community shipyards in those segments that have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition (...) [which] should be authorised for limited market segments and for a short period only"<sup>12</sup> (recital 3).
24. The Commission further notes that the interpretation of the TDM-regulation must also be seen in the light of the Community's international obligations. According to the settled case law of the Court of Justice, Community legislation must, so far as possible be interpreted in a manner that is consistent with international law, including the EC's WTO obligations.<sup>13</sup>
25. In this context, the Commission notes that Korea challenged the compatibility of the TDM-regulation with WTO rules. On 22 April 2005, a Panel issued its report concluding that the TDM and several national TDM schemes - existing at the time when Korea initiated the WTO dispute - were in breach of Article 23.1 of the Understanding on rules and procedures governing the settlement of disputes (DSU)<sup>14</sup>. On 20 June 2005, the WTO Dispute Settlement Body (DSB) adopted the Panel report including its recommendation that the Community brings the TDM-regulation and the national TDM schemes into conformity with its obligations under the WTO Agreements<sup>15</sup>. On 20 July 2005, the Community informed the DSB that it had already brought its measures into conformity with the DSB ruling and recommendations since the TDM-regulation had expired on 31 March 2005 and Member States could no longer grant operating aid under this regulation
26. The Community, thus, took a commitment to no longer apply this regulation for allowing the granting of new aid. Accordingly, the Commission does not consider at

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<sup>10</sup> As modified by Council Regulation (EC) N° 502/2004, see footnote 4 above.

<sup>11</sup> Recital 7 confirms this assessment: "the temporary defensive mechanism should only be authorised after the Community initiates dispute settlement proceedings against Korea (...) and may no longer be authorised if these dispute settlement proceedings are resolved or suspended (...).

<sup>12</sup> Emphasis added.

<sup>13</sup> Case C-53/96, *Hermès*, [1998] ECR I-3603, para. 28; Case C-76/00 P, *Petrobrás*, [2003] ECR I-79, para. 57.

<sup>14</sup> See *EC – Measures affecting trade in commercial vessels*, WT/DS301/R, paragraphs 7.184 – 7.222 & 8.1(d).

<sup>15</sup> See WTO document WT/DS301/6.

this stage that the aid could be in conformity with the Community's international obligations.

27. In conclusion, the Commission has doubts that the notified aid can be considered compatible with the common market.

## **Decision**

28. In the light of the foregoing considerations, the Commission has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty and requires Portugal, within one month of receipt of this letter, to provide all documents, information and data needed for the assessment of the compatibility of the aid. It requests Portugal to forward a copy of this letter to the potential recipient of the aid immediately.
29. The Commission wishes to remind Portugal that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.
30. The Commission warns Portugal that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission  
Directorate-General for Competition  
State Aid Greffe  
B-1049 Brussels  
Fax No: +32-2-296 12 42

Yours faithfully,  
For the Commission

Neelie Kroes  
Member of the Commission