



EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

OF 3 DECEMBER 1998

REGARDING THE NORWEGIAN GOVERNMENT'S FINANCING OF
THE ARCUS GROUP OF COMPANIES
(AID NO. 95-021 (NORWAY))

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area¹, in particular to Protocol 26, to Articles 61 to 63 and to the Act referred to in point 1 of Annex XV on the transparency of financial relations between Member States and public undertakings,

HAVING REGARD TO the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. Background and correspondence

When the EEA Agreement entered into force on 1 January 1994 the State owned Norwegian alcohol monopoly, A/S Vinmonopolet, had the exclusive right to import wines and spirits, the sole right to export spirits and the exclusive right to production or redistillation of spirits for industrial purposes, spirits for consumption, and isopropanol. As regards wholesale, producers of wine and spirits were required to sell their products only to A/S Vinmonopolet. Retail trade, *i.e.* sale of spirits, wine, and beer containing more than 4.75 % alcohol (strong beer) by volume to the consumer could only be carried out by A/S Vinmonopolet.

Having examined the Norwegian legislation and marketing arrangements for alcoholic beverages, the Authority concluded in its Reasoned Opinion of 30 December 1994 (Decision No. 335/94 COL), that Norway by maintaining in force exclusive rights as regards imports, exports and wholesale of alcoholic beverages as well as by maintaining the institutional link between the retail monopoly and the production of alcoholic beverages had failed to fulfil its obligations under Articles 11, 12 and 16 of the EEA Agreement.

¹ Hereinafter referred to as the EEA Agreement.

² Hereinafter referred to as the Surveillance and Court Agreement.

Following the Reasoned Opinion, the Norwegian authorities decided in 1995 to split A/S Vinmonopolet in two groups³. Retail activities were to be maintained as a monopoly under the same name as before, A/S Vinmonopolet. Activities related to exports, imports, wholesale and production were to be carried out by a separate group of undertakings, the Arcus Group (hereinafter referred to as Arcus). The Arcus Group was to be established with a holding company, Arcus AS, 100 per cent owned by the State, and two fully owned subsidiary companies, Arcus Produksjon AS and Arcus Distribusjon AS. Parts of the assets and liabilities belonging to the old A/S Vinmonopolet were to be transferred to the Arcus Group. The measures were to take effect from the beginning of 1996.

By letter of 23 November 1995 (ref. 95-6773 D) the Authority requested the Norwegian Government to submit full information on legislative matters and administrative changes related to the market organization for alcoholic beverages in Norway. The letter expressed concerns about the corrective actions to the infringements addressed in the Authority's Reasoned Opinion of 30 December 1994, *i.e.* actions which were required to be completed by the end of 1995. The Authority drew in particular the Norwegian authorities' attention to the rules on competition set out in Articles 53 to 64 of the EEA Agreement.

By letter of 6 December 1995 (ref. 95-6989 D) the Authority informed the Norwegian Government that it had received information indicating that Arcus might be in the process of receiving public assistance, mainly by undervaluation of the assets transferred to the company. Referring to Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, the Norwegian Government was reminded of the EFTA States' obligation to inform the Authority in sufficient time to enable it to submit its comments of any plans to grant or alter aid. It was also informed that failing this, any aid would be deemed unlawful, which might then necessitate the Authority demanding its recovery.

The Norwegian authorities replied by letter dated 4 January 1996 (ref. 96-11 A) that they did not consider the assets transferred to Arcus to be undervalued, and that they therefore were not under any obligation to notify the Authority. The Norwegian authorities committed themselves, nevertheless, to provide the Authority with more detailed information on the valuation and financing of Arcus. Such information including a copy of a report prepared by a consultant, Deloitte & Touche, on the valuation and establishment of opening balances in relation to the splitting up of A/S Vinmonopolet (the D&T report⁴) was submitted to the Authority by letter dated 11 March 1996 (ref. 96-1362 A).

By letter dated 22 December 1995 (ref. 95-7344 A), the Authority received a formal complaint on the valuation of assets transferred from A/S Vinmonopolet to Arcus considering that State aid in the meaning of Article 61(1) EEA was involved. The complainant estimated that the assets transferred to Arcus were likely to have been undervalued by NOK 1.5 billion, implying that Arcus unlike its competitors, would not be required to obtain a normal return on the real value of the assets employed. The complainant also expressed concerns that Arcus' alleged financial advantage could be used to undercut prices and that this would lead to a situation precluding fair competition and equal access to the Norwegian market for distribution of alcoholic beverages.

³ Propositions to Parliament, St prp nr 49 (1994-95), and St prp nr 11 (1995-96)

⁴ 'Verdsettelse og fastsettelse av åpningsbalanser ved deling av A/S Vinmonopolet', carried out by Deloitte & Touche, for the Ministry of Health and Social Affairs, Oslo 25 September 1995.

The Authority informed the Norwegian authorities of the complaint by letter of 1 April 1996 (ref. 96-1374 D) inviting them to comment on the complainant's allegations. By the same letter, the Norwegian Authorities were also requested to provide certain additional information *i.a.* concerning possible plans to sell off fixed assets or to use excess capacity which might be used in other fields of activity than those related to production and trade in alcoholic beverages. A reply from the Norwegian authorities maintaining that no form of State aid had been granted in connection with the re-organisation of A/S Vinmonopolet was submitted by letter dated 7 May 1996 (ref. 96-2662 A). In the same letter it was stated that there were for the time being no plans to sell off important fixed assets. Concerning other possible activities, a reference was made to a contract with a pharmaceutical company concerning letting of storage space and provision of distribution services. It was also mentioned that the estimated value of income from activities based on this contract was incorporated in the opening balance of Arcus.

On 30 October 1996 the Authority decided to open a formal investigation procedure as provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement (Decision No. 246/97/COL). The Norwegian Government was informed by means of a copy of the decision on the same date, whereby it was invited to submit its comments to the decision. The decision to open the investigation procedure was taken without prejudice to the outcome of a final decision.

The gist of the decision was published in the form of a notice in the EEA Section of the *Official Journal of the European Communities* and the *EEA Supplement* thereto⁵. Other EFTA States parties to the EEA Agreement, EU Member States, and other interested parties were thereby informed and invited to submit comments within one month from the date of publication. The European Commission was informed, in accordance with Protocol 27 of the EEA Agreement, by means of a copy of the decision.

The Authority expressed in its decision to open the investigation procedure *i.a.* that the opening balance of Arcus was based on a sub-optimal structure for the group. In this context, the Authority noted that the opening balance was based on the presumption that production facilities in Bergen and Trondheim would be retained in addition to those in Oslo. It was also noted that the D&T report showed that economic gains were to be expected if production activities were centralized in Oslo. The Authority was therefore not convinced that the value used by the Norwegian Government represented what a knowledgeable willing buyer would consider as the real value and willing to pay for the assets transferred to Arcus. It found therefore that a further examination was needed to establish the correct value of the assets transferred from A/S Vinmonopolet. The Authority submitted also that it had not received any information showing that the Norwegian authorities had imposed any specific restrictions on Arcus' use of a provision to cover restructuring costs provided by A/S Vinmonopolet. The Authority concluded therefore at that stage, that the restructuring provision, which amounted to NOK 226 million, must be regarded as State aid in the meaning of Article 61(1) EEA.

By letter dated 13 December 1996 (ref. 96-7409 A), the Norwegian authorities gave in response to the Authority's decision to open the investigation procedure further explanations on why they considered there not to be any State aid involved in the financing of Arcus. It

⁵ OJ C 45, 13 February 1997, page 5, and the EEA Supplement thereto

was *i.a.* pointed out that Arcus would need the warehouse and transport capacity in Bergen and Trondheim. It was also maintained that when the assessment of necessary capacity for Arcus was made, the new bottling and warehouse facilities in Oslo were still under construction, giving another reason for the importance of retaining facilities in Bergen and Trondheim. Referring to the restructuring costs the Norwegian authorities explained that the provision had been made on the basis of estimates of the costs of the necessary reorganisation and the decision of A/S Vinmonopolet to reduce personnel. The Norwegian authorities concluded that they did *"not consider that any form of aid was granted in the form of transfer of assets or financial assistance in connection with the reorganisation of A/S Vinmonopolet."*

The Norwegian Association of Breweries and Mineral Water Producers (Norsk Bryggeri- og Mineralvannindustri Forening) responded to the Authority's invitation to submit comments on possible State aid to Arcus by telefax of 12 March 1997, *i.e.* within the specified period of one month (ref. 97-1656 A). The association expressed general support to the views expressed by the complainant and by the Authority. The association referred amongst other things to the alleged fact that the value of tangible assets appeared to have been set exceptionally low. The association also referred to Arcus' plans to convert part of its production facilities to production of beer and expressed concerns that such production would be based on using facilities taken over at a low price and on financing provided to cover restructuring costs. The association expressed otherwise concerns regarding Arcus' potential for economies of scale and synergies with regard to production, distribution and sales as Arcus was a monopoly producer of spirits. Such advantages were described as not available to other producers of beverages. The association also considered that there was a danger of cross-subsidies in Arcus' distribution activities, *i.e.* between different product categories of spirits, wine and beer. The comments from the association were forwarded to the Norwegian authorities by letter of 8 September 1997 (ref. 97-5809 D).

The Norwegian authorities replied (ref. 97-6979 A) by letter of 3 November 1997 that Arcus, in agreements from April 1997, had transferred bottling facilities in Bergen to a local brewery Hardanger Bryggeri A/S, and at the same time acquired shares in the brewery. The Norwegian authorities maintained that the involvement by Arcus in Hardanger Bryggeri A/S was a normal business transaction, and that the money involved in the transaction could be related neither to financing of restructuring costs, nor to the valuation of Arcus' assets. It was also explained that Arcus had bought shares in an existing brewery on a commercial basis, and thereby engaged itself in normal business practice with which it must be free to proceed, irrespective of the fact that Arcus was a monopoly producer of spirits. Regarding the alleged danger of cross-subsidies, the Norwegian authorities noted that complaints, previously filed with the EFTA Surveillance Authority and the Norwegian Competition Authority, had been closed without any form of intervention from either of those authorities.

On this latter matter and as far as the Authority is concerned, it can be noted that in 1996/97 it investigated complaints in the competition field concerning rebates offered by Arcus Distribusjon AS to importers of and agents for wine and spirits in Norway. The complaints in question did however not concern issues related to cross-subsidies. The cases were closed after Arcus undertook to bring its behaviour into compliance with the EEA competition rules. The same action enabled the Norwegian Competition Authority to close similar cases as well.

Outside the formal investigation procedure, the Authority has received correspondence from parties with economic interests in wholesale distribution and in activities related to the distribution and production of alcoholic beverages. The correspondence originates from parties located both in Norway and in other EEA countries and it voices, without exception, serious concerns regarding the Norwegian Government's financing of Arcus.

A further examination by the Authority of the Norwegian Government's financing of Arcus showed that certain issues which were likely to have a bearing on the outcome of the investigation needed further clarification. The Authority requested therefore additional information by letter of 11 May 1998 (ref. 98-3094 D). It invited in the same letter the Norwegian authorities to submit their comments on some preliminary observations of the Authority. In addition to requesting further information and observations concerning the restructuring provision and what the Authority had phrased the sub-optimal structure of Arcus, some other issues were raised. The Authority questioned amongst other things the justification for using what it considered comparatively high discount rates in the D&T report when calculating the value of Arcus⁶. The Authority also asked for information related to an environmental obligation attached to Arcus' property in Trondheim. To cover this obligation NOK 30 million were provided from A/S Vinmonopolet to Arcus when the company took up its activities.

The Norwegian authorities replied by letters of 9 June 1998 (ref. 98-3978 A) and 30 July 1998 (ref. 98-5053 A). Concerning the Authority's claim of a sub-optimal structure, it was emphasized that the possibilities for strikes and unrest among employees were a factor that had to be taken into account when assessing the possibilities for closing production in Bergen and Trondheim, and that the initial decision of not selling was rational. More details were provided on the actual use of the restructuring means. It was pointed out that manning reductions had been delayed compared to the initial plan, particularly in Bergen because of failure of the project involving Hardanger Bryggeri A/S. The discount factor that had been applied when the opening balance was established, was defended. It was explained, furthermore, that a preliminary sales agreement had been reached for the site in Trondheim.

In addressing issues related to the opening balance of Arcus, the Authority decided to consult external expertise and entered into a service contract with KPMG Management Consulting AS, Oslo, which presented a report on the valuation of Arcus⁷. The report was forwarded to the Norwegian authorities in a letter of 3 November 1998 (ref. 98-7466 D). The Norwegian authorities commented upon the report in a letter dated 17 November 1998 (ref. 98-7850 A).

On 6 November 1998, the Authority received a telefax (ref. 98-7556 A) from the Norwegian authorities with an attached copy of a letter from the Ministry of Trade and Industry to the board of Arcus. In the letter Arcus was informed that the State foresaw dividend payments for the year 1998 of some NOK 150 million. In arriving at this figure the Ministry referred to restructuring means which have been recorded as extra-ordinary incomes and that values would materialize through sale of fixed assets.

⁶ The discounted cash flow method which was used for assessing the value of Arcus, implies that an increase in the discount rate results in a lower value of the company. For more explanation, see Section II 2.1.3 below

⁷ KPMG Management Consulting AS: Review of valuation - Arcus Group of Companies, Oslo 2 May 1997

2. The Arcus Group

2.1 Establishment and organization

The Norwegian Government decided to establish Arcus AS as a holding company with limited liabilities, 100 per cent owned by the State.⁸ It was also decided to establish two wholly owned subsidiaries of Arcus AS, Arcus Produkter AS and Arcus Distribusjon AS. To prepare for the splitting up of A/S Vinmonopolet, the Arcus Group of companies was established in September 1995 with an initial equity of NOK 50 000, owned by A/S Vinmonopolet.

The fission of A/S Vinmonopolet implied that assets and liabilities related to production and distribution were transferred to Arcus AS which in turn made a further distribution to the two daughter companies. Assets and liabilities related to the retail monopoly remained in A/S Vinmonopolet. Share capital and other equity capital in A/S Vinmonopolet were split in relation to the estimated values that remained in the retail monopoly and those transferred to Arcus. It was decided that the ownership of Arcus should be transferred from A/S Vinmonopolet to the Ministry of Industry and Energy as of 1 January 1996. With effect as of the same date, A/S Vinmonopolet transferred assets and liabilities to Arcus which took up its production and distribution activities. As compensation for the values transferred to Arcus, the State, by the new owner, the Ministry of Industry and Energy, received shares in the holding company.

The main activities of the Arcus companies are as follows:

Arcus Produkter AS holds the exclusive right (previously held by A/S Vinmonopolet) to produce spirits in Norway. The company's production activities cover, in addition to fabrication of spirits, also bottling of wine and spirits of domestic and foreign origin. The company sells its products to the retail monopoly, to hotels and restaurants and to tax free shops. In addition, it produces for exports and sells spirits for technical and medicinal use.

The activities of Arcus Distribusjon AS, which in January 1998 changed name to Vectura AS, are imports, storage and distribution of alcoholic beverages. The company sells its services to producers, other wholesalers, and importers of such produces and delivers goods to the retail monopoly and to hotels and restaurants.

Arcus AS is the holding company which, in addition to exercising its ownership functions, also takes care of common services on behalf of the group like finance/accounting, information technology and human resource management. Two new subsidiaries have been established since Arcus started its activities. Arcus Eiendom ANS was established 9 September 1996 to take care of the administration of Arcus' properties. Exar AS was established 13 January 1998 to be in charge of Arcus' production facilities in Bergen. Exar AS is reported⁹ not to be carrying out any activities.

The Arcus group of companies was established with three plants and storage facilities in Oslo, Bergen and Trondheim, respectively, and a plant for rectification of spirits in Hamar.

⁸ Propositions to Parliament, St prp nr. 49 (1994-95), and St prp nr. 11 (1995-96)

⁹ Arcus Annual report 1997

2.2 Opening balance

Preparing for the fission of A/S Vinmonopolet, the owner, the Ministry of Health and Social Affairs, requested a consultant, Deloitte and Touche (D&T), to prepare a report with proposals for an opening balance for the activities that were to be separated from A/S Vinmonopolet. The D&T report¹⁰, dated 25 September 1995, formed the basis for the Norwegian Government's proposal to Parliament¹¹ concerning the establishment of an opening balance for Arcus. Figures in the opening balance, as presented to Parliament, were identical to corresponding figures in the D&T report. Specifications of the opening balance are reproduced in Table 1. The proposal which was presented in November 1995, referred to an opening balance which should be established as of 1 January 1996. A final opening balance could not be established until the final accounts for A/S Vinmonopolet for 1995 were established. Figures from the final opening balance are also reproduced in Table 1. In the opening balance details were specified for each of the three companies within the Arcus Group, Arcus Produksjon A/S, Arcus Distribusjon A/S, and the holding company, Arcus A/S. For the purpose of this Decision, figures are presented only for the consolidated Arcus Group.

Table 1. Opening balances for the Arcus Group (in million NOK)

	<i>As proposed/estimated*</i>	<i>Final**</i>
<i>Assets:</i>		
Cash and deposits	410	343
Other short-term claims and stocks	230	249
Sum current assets	640	592
Long-term claims	0	1
Property, plant and equipment	175	175
Fixed assets	175	176
Total assets	815	768
<i>Liabilities:</i>		
Short-term debt	175	132
Long-term debt	27	23
Restructuring costs	226	226
Environmental obligation	30	30
Sum liabilities	458	411
<i>Equity:</i>		
Share capital	203	203
Other equity	154	154
Total equity	357	357
Total liabilities and equity	815	768

*) Sources: St. prp nr. 11 (1995-96), D&T report

***) Source: Arcus, Annual Report 1996

The establishment of the opening balance was based on the following principles and assumptions:

Deloitte and Touche made its valuation of the Arcus Group based on the discounted cash flow method. In short, this method implies that a future flow of incomes and expenditures is estimated based on assumptions on market developments, operating costs, etc. The value of the activities is set equal to the sum of expected future net revenues discounted to their present value. The discount factor represents a required rate of return. Calculations were

¹⁰ Op. cit.

¹¹ Proposition to Parliament, St prp nr. 11 (1995-96)

based on the assumption that the existing plant structure with facilities in Oslo/Hamar, Bergen and Trondheim should be maintained.

Deloitte and Touche calculated the present value of the operating activities of Arcus (Arcus Produkter AS and Arcus Distribusjon AS) to NOK 203 million. This value determined the estimated value of the fixed assets of Arcus, which was gauged to be NOK 175 million when other assets and liabilities were taken into account. Share capital was set equal to the calculated present value of NOK 203 million.

Splitting up of working capital in the former A/S Vinmonopolet implied that Arcus was to be provided with an amount of NOK 154 million, reflected as part of "Cash and deposits", and entered as "Other equity", implying a total equity of NOK 357 million (203 + 154). In accordance with the principles of the demerger, NOK 230 million was entered as "Other short-term claims and stocks". Regular debt (short-term and long-term) was recorded at NOK 202 million (175 + 27).

Restructuring costs following the break-up of the former monopoly were estimated at NOK 236.7 million. For more details, see Section II 2.2 below. This sum was discounted and set to NOK 226 million which was entered as a liability in the proposed opening balance. To cover these costs the same amount was assumed to be transferred to Arcus from A/S Vinmomopolet. NOK 226 million were therefore entered under "Cash and deposits" in the proposed opening balance. The costs of restructuring were in this way separated from the assessment of the present value of the Group.

An environmental obligation at Arcus' property in Trondheim was estimated to the amount of NOK 30 million, see also Section II 2.3 below. To cover these costs a similar amount was also assumed to be transferred from A/S Vinmonopolet. In the proposed opening balance NOK 30 million were therefore added to "Cash and deposits". The environmental obligation was furthermore, like the restructuring costs, entered as a liability.

As a result of these operations, the proposed opening balance was established with total liabilities amounting to NOK 458 million. Equity was set at NOK 357 million. With estimated current assets at NOK 640 million, fixed assets were determined to be NOK 175 million. This value represented the estimated value of Arcus' various properties, production facilities and equipment.

The proposed opening balance was the basis for the decisions that actually were taken. Arcus was set up with an equity of NOK 357 million of which NOK 203 million were share capital. The value of fixed assets in the form of properties, plants and equipment was set at NOK 175 million. NOK 256 million were transferred from A/S Vinmonopolet to cover restructuring costs and environmental obligations. As can be seen from Table 1, the only difference of some magnitude between the proposed opening balance and the final one was a reduction in regular debt (mostly short-term) and, for practical purposes, a corresponding reduction in current assets.

In its proposition to Parliament¹², the Norwegian Government stated that Arcus was expected to give a satisfactory return on equity, expressed as minimum 10-12% after taxes.

¹² Proposition to Parliament, St prp nr. 11 (1995-96)

2.3 Costs for A/S Vinmonopolet

The estimated value of Arcus implied that its projected future cash flow could not suffice to earn a return on the capital in A/S Vinmonopolet's accounts as recorded before the demerger. It was therefore decided to write down the capital of A/S Vinmonopolet in the accounts for 1995. The value of fixed capital was written down with NOK 476 million from an original value of NOK 791 million to NOK 315 million¹³. The latter remaining capital value was in turn split between fixed assets recorded in Arcus' opening balance and fixed assets remaining in the retail monopoly. The extra-ordinary depreciation costs of NOK 476 million were recorded in the accounts of A/S Vinmonopolet in 1995 in addition to the transfers of NOK 256 million to cover restructuring and environmental obligations. Hence, as a result of the demerger, extra-ordinary costs of NOK 732 million were entered in the books of A/S Vinmonopolet in 1995, see table 2.

Table 2. Extra-ordinary costs for A/S Vinmonopolet 1995

	<i>NOK million</i>
<i>Appropriations for restructuring</i>	226
<i>Appropriations for environmental obligations</i>	30
<i>Depreciation of fixed assets</i>	476
<i>Sum</i>	732

Source: A/S Vinmonopolet, Annual Report 1995

2.4 Liquidation value

Upon request from the Authority, the Norwegian authorities presented an estimated liquidation value of the assets being transferred to Arcus. The estimate is reproduced in Table 3.

Table 3. Liquidation value of Arcus (in million NOK)

<i>Current assets</i>	640
<i>Properties</i>	355
<i>Net sales value production equipment</i>	70
<i>Fixed assets</i>	425
<i>Total assets</i>	1065
<i>Short-term debt</i>	175
<i>Long-term debt</i>	27
<i>Environmental obligation</i>	30
<i>Dismissals, etc.</i>	406
<i>Other close-down costs</i>	40
<i>Total obligations</i>	678
<i>Liquidation value</i>	387

Source: Letter from the Ministry of Industry and Energy, 7 May 1996 (ref. 96-2662 A)

The value of properties was estimated by a recognised appraiser. Net sales value of production equipment was estimated by Arcus. Costs related to dismissals were estimated on the basis of the D&T report and previous agreements between A/S Vinmonopolet and its employees. Other close-down costs were estimated by Arcus.

¹³ A/S Vinmonopolet, Annual Report 1995

2.5 Market presence, trade and economic results

According to the new regime for trade in alcoholic beverages in Norway which was implemented from the beginning of 1996, licenses for distribution, exportation and importation of alcoholic beverages were to be issued by Norwegian authorities.¹⁴ No licenses had yet been issued by 1 January 1996. Therefore, Arcus Distribusjon AS started its activities in 1996 in a *de facto* monopoly situation for an interim period. Other operators obtained later in 1996 rights to carry out importation, exportation and distribution of alcoholic beverages. In 1997 Arcus Distribusjon AS had a market share of 65 % of total deliveries of alcoholic beverages to the retail monopoly and the hotel and restaurant sector¹⁵.

Arcus Produkter AS' share of total sales of wine and liquor in Norway declined in 1996 and 1997 compared to the corresponding shares held by the former A/S Vinmonopolet. The decline in market shares concerned to a lesser extent Arcus' own brands, compared with its supply of other brands imported in bulk and bottled by the company. In 1997 more than 33 per cent of combined sales of wine and spirits to final consumers in Norway were produced or bottled by Arcus Produkter AS¹⁶. Exports were for 1996 reported to amount to 5 per cent of total sales¹⁷ with Germany as the main market.

As there is practically no wine production in Norway and as Arcus Produkter AS has a monopoly on production of spirits, it follows that all spirits and practically all wine purchased by the Arcus companies in bulk or in bottles are imported. Countries within the European Economic Area are among the major countries of origin for the products in question.

Arcus Annual report for 1996 shows that Arcus' total revenues after deductions for excise duties amounted to NOK 1296 million. Operating result amounted to NOK 26.6 million. Net income from financial operations was NOK 13.7 million. NOK 62.1 million from the restructuring provision was recorded as extra-ordinary income, bringing the annual result to NOK 102.4 million. NOK 16.1 million¹⁸ was set off as dividend, see table 4.

In 1997, Arcus reported total revenues net of excises to NOK 1245 million. As current operating costs were higher than current revenues, the operating result turned out with a negative value of NOK 12.8 million. Arcus recorded nevertheless in the same year a positive overall result of NOK 27.8 million. This was achieved by net financial income amounting to NOK 10.7 million and by recording NOK 39.0 million (of which NOK 38.3 million from the restructuring provision) as extra-ordinary income, while extraordinary costs of NOK 9.1 million were deducted. No dividends were paid in 1997.

¹⁴Ot.prp. nr. 51 1994-95, Forslag til lov om endringer i alkoholoven (ny bevillingsordning for engrossalg av alkoholholdig drikk mv) part II

¹⁵ Arcus Annual report 1997

¹⁶ Arcus Annual report 1997

¹⁷ Arcus Annual report 1996

¹⁸ Equal to 4.5 per cent of Arcus equity capital according to the opening balance (NOK 357 million)

Table 4. The Arcus Group: economic results 1996 and 1997 (in million NOK)

	1996	1997
Current revenues	1296.1	1244.6
Current costs	1269.5	1257.4
Operating result	26.6	(12.8)
Net financial income	13.7	10.7
<i>Extra-ordinary items:</i>		
Part of restructuring provision, recorded as income	62.1	38.3
Other income	0.0	0.7
Costs, depreciation daughter companies	0.0	(9.1)
Total result	102.4	7.8
<i>Allocated to:</i>		
Dividends	16.1	0.0
Funds	86.3	27.8

Sources: Arcus Annual Reports 1996 and 1997

II. APPRECIATION

1. Principles

1.1 Product coverage

The Authority notes that Arcus' activities are related to production and trade in goods that fall within the scope of the EEA Agreement (see Article 8, Article 23 (b) and Protocols 3, 8 and 47 EEA). Such goods include amongst others beer and spirituous beverages, as these products are listed in tables I and II to Protocol 3 EEA¹⁹.

Accordingly, the transfer of assets to Arcus from A/S Vinmonopolet falls for consideration under the State aid rules of the EEA Agreement and of the Surveillance and Court Agreement. Moreover, it is recalled that the State aid rules also apply to the services sector.

1.2 Article 61(1)

Article 61(1) of the EEA Agreement reads as follows:

“Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States 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 Contracting Parties, be incompatible with the functioning of this Agreement”

This implies that for a measure to constitute State aid within the meaning of Article 61(1) EEA it must:

1. be granted through State resources in any form whatsoever;
2. favour certain undertakings or the production of certain goods;
3. distort or threaten to distort competition and affect trade between Contracting Parties.

¹⁹ Most wines, on the other hand fall outside the general scope of the EEA Agreement. See the following Advisory Opinions of the EFTA Court in relation to the material scope of the EEA Agreement. *Restamark*, case E-1/94, Report of the EFTA Court 1 January 1994-30 June 1995 (paragraphs 36-43); *Wilhelmsen*, case E-6/96, Report of the EFTA Court 1997 (paragraphs 17-33).

State resources

The measures presently to be examined, all involve the use of State resources as they concern assets, *i.e.* fixed assets and financial resources transferred to Arcus from A/S Vinmonopolet, a wholly State-owned company. It is established case law²⁰ that resources transferred from a State owned company like A/S Vinmonopolet, to the same extent as resources transferred directly from the State, may fall within the notion of aid granted “*through State resources*” in the meaning of Article 61(1) EEA. As resources may be “*in any form whatsoever*” it implies that both financial and fixed assets as well as other advantages are covered by Article 61(1) EEA. The first condition is therefore fulfilled for all the measures considered in the present Decision, in so far as they are found to contain financial advantages.

Measures favouring certain undertakings

As to the second condition, it is obvious that in so far as the measures imply the provision of financial means or fixed assets on favourable terms, the beneficiary would be certain undertakings, namely the undertakings in the Arcus Group.

Effect on competition and trade

Spirits produced by Arcus Produkter AS are in direct competition on the Norwegian market and on export markets with similar beverages produced in other EEA countries. Arcus Produkter AS imports spirits and wine in bulk for bottling and resale. Vectura AS (former Arcus Distribusjon AS) is the main operator on the Norwegian market concerning wholesale and distribution of spirits and wine of foreign or domestic origin. These activities are carried out in competition with other enterprises engaged in importation and trade of such beverages. As regards market presence, trade and economic result, reference is made to Section I.2.5 of this decision.

Any financial advantages involved in the financing of Arcus will therefore distort or threaten to distort competition and affect trade within the territory covered by the EEA Agreement, and thereby constitute State aid in the meaning of Article 61(1) of the EEA Agreement. Provided such advantages are involved, the third condition is fulfilled.

The remaining issue to be addressed in relation to Article 61(1)EEA is thus to determine whether, and to what extent, the measures involved in the Norwegian Government's financing of Arcus imply that Arcus has been ‘favoured’, and thus to identify and quantify possible elements of State aid. The results of the Authority’s examination are presented in section II.2 of this Decision.

1.3 The market economy investor principle

In assessing whether State aid is involved in financial transactions between an EFTA State and a public enterprise, the Authority applies the so-called *market economy investor principle* which is established in Chapters 19 and 20 of the Procedural and Substantive

²⁰ Case 78/76 Steinike und Weinlig v Germany [1977] ECR 595, Case C-305/89 Italy v Commission (Alfa Romeo) [1991] ECR I-1603, Case 303/88, Italy v Commission (ENI-Lanerossi) [1991] ECR I-1433

Rules in the Field of State Aid adopted by the Authority on 19 January 1994²¹ (State Aid Guidelines). This principle intends to ensure that public and private enterprises in similar sectors and in comparable economic and financial situations are treated equally with respect to financial allocations and different forms of public intervention. If public funds to public enterprises are provided on terms more favourable (*i.e.* in economic terms more cheaply) than a private owner would provide them to a private enterprise in a comparable financial and competitive position, then the public enterprise would be receiving an advantage from their proprietors not available to private enterprises. Unless a more favourable provision of public funds is treated as aid, and evaluated with respect to the derogations of the Agreement, then the principle of neutrality of treatment between public and private enterprises is infringed²².

The Authority, in accordance with paragraph 20.3.(2) of the State Aid Guidelines, applies the 'market economy investor principle' "*as a benchmark to determine both whether aid is involved and if so, to quantify it".* (emphasis added)

Based on elaborations by the Court of Justice of the European Communities²³, the test to be applied by the Authority concerns, "*whether in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional policy and sectoral considerations, would have subscribed the capital in question*", ref. State Aid Guidelines paragraph 20.3.(4). (emphasis added)

The Court of Justice of the European Communities, in further elaborating on the market economy investor principle, has stated that "*the conduct of a private investor with which the intervention of a public investor pursuing economic policy aims must be compared need not be the conduct of an ordinary investor laying out capital with a view to realizing a profit in the relatively short term, it must at least be the conduct of a private holding company or a private group of undertakings pursuing a structural policy – whether general or sectoral – and guided by prospects of profitability in the longer term.*"²⁴

2. Assessment of State aid elements

2.1. The value of fixed assets transferred from A/S Vinmonopolet to Arcus

2.1.1. Introductory comments

The Authority considers that the valuation method applied by the Norwegian authorities and as presented in the D&T report, the discounted cash-flow method, is appropriate for evaluating investments where the investor has a long-term interest such as the Norwegian Government in the case under consideration.

The results of a valuation of a company, as the one carried out by the Norwegian authorities in the case at hand, depend on a number of assumptions that are subject to judgement. It is

²¹OJ No L 240, 15.9.1994 and EEA Supplement to the OJ No 34, 15.9.1995

²² Ref. Article 125 of the EEA Agreement

²³ Case 234/84 Belgium v Commission (Meura) [1986] ECR 2263, §14, Case 40/85 Belgium v Commission (Boch II) [1986] ECR 2321, §13

²⁴ Case C-305/89 Italy v Commission (Alfa Romeo) [1991] ECR I-1603, §20

not the Authority's aim to replace the investor's judgement²⁵. Therefore, the Authority has not questioned the numerous detailed assumptions and calculations in the D&T report related to market forecasts, assumed mark-ups, projected costs and liquidity needs. The Authority has, however, noted that Deloitte and Touche in its report expresses the view that the calculation of the value of Arcus is conservative. This is explained both in relation to the Norwegian Companies Act's rules for prudent assessment of fixed assets, but also because of the presumption that the company would not be put up for sale in the market. It is also stated that rather strong measures would be required by the Norwegian Government in its policies to limit consumption of alcohol to the extent consistent with the assumptions on market growth entailed in Deloitte and Touche's calculations, implying that market forecasts are conservative.

Concerning individual items in the opening balance, the Authority has found no reason to object to the recorded values for short-term claims and stocks, nor for short- and long-term regular debt. The same goes for the equity injection of NOK 154 million to cover the need for working capital. These items are assumed to reflect a rational distribution of assets and liabilities as a result of the demerger at hand, and to provide means to meeting current liquidity needs. The Authority has, however, objections to the valuation of fixed assets and the compensation the State received in the form of share capital for the transfer of these assets, see sections II.2.1.2-2.1.4. Transfers to cover liabilities related to restructuring and environmental obligations are dealt with separately below.

When examining the valuation of Arcus and of whether State aid in that context has been awarded, there is no question of the Authority using the benefit of hindsight, ref. State Aid Guidelines point 20.5(2). The Authority has accordingly based its examination on the information available to the Norwegian authorities at the time when the assets were transferred from A/S Vinmonopolet to Arcus.

2.1.2. Sub-optimal structure

The Authority stated in its decision to open the investigation procedure that the estimated value of Arcus' equity capital, NOK 357 million, referred to a calculation based on what must be considered as a sub-optimal structure for the Arcus Group.

The Authority's examination has confirmed the above observation. Information contained notably in the D&T report²⁶ and A/S Vinmonopolet's business plan, shows that the Norwegian authorities based their valuation on a commercially inferior production structure for Arcus, *i.e.* a production structure which would not maximise the present value of Arcus' income from operations. In this context it is recalled that the opening balance was based on an assumption that existing plant structure should be maintained.

A/S Vinmonopolet's business plan was presented in 1995 and showed that bottling of wine and spirits would be much more costly in Bergen and Trondheim than in Arcus' new facilities in Oslo²⁷. It was therefore clear already in the autumn of 1995, that it would not be justifiable on commercial grounds to continue Arcus' production activities in Bergen and Trondheim.

²⁵ State Aid Guidelines, point 20.5.(1)

²⁶ D&T report, page 59 and Annex 1

²⁷ PA Consulting, *op.cit.*

Thus, it is noted in the D&T report that the return on Arcus' production activities would not suffice to cover the estimated market rents in Bergen and Trondheim. It is also made clear in Annex 1 of the D&T report, that Arcus would realise a capital gain if it decided to sell the facilities in Bergen and Trondheim. It must as well be assumed that Arcus alternatively could obtain additional income by letting out these facilities or employing them in new commercial activities on its own account.

Deloitte and Touche presented in their report calculations of economic gains of a centralisation of production activities at the new facilities in Oslo. Applying the discounted cash flow method, an additional present value of such a more economical structure, including the value of sales revenue from properties, was estimated at NOK 202 million. This estimate was not based on an immediate closing down of activities in Bergen and Trondheim. In fact, the estimate was based on the assumption that these production facilities would be sold in 1999. It was furthermore assumed that certain investments in Oslo would have to be undertaken, that some additional restructuring costs would occur and that there would be savings as a resulting of reduced personnel costs.

In addressing the issue of costs related to the demerger of A/S Vinmonopolet, see also Table 2 above, Deloitte and Touche expresses in their report that these costs partly stem from the fact that Arcus was supposed to undertake "softer" restructuring measures, than an independent company operating in the market could afford. This is confirmed in the letter of 9 June 1998, referred to above, where the Norwegian authorities' motivation in opting for a sub-optimal structure is expressed as to avoid possible strikes and unrest among employees.

The Norwegian authorities claimed in their letter dated 13 December 1996 that it was not possible to demonstrate that there would in the future be over-capacity at the plants that could result in additional earnings, nor any likelihood that the company would be in position in the foreseeable future to restructure its activities with the aim to reduce costs. A restructuring of production plants could therefore not be included in the opening balance. However, the Authority has noted with reference to A/S Vinmonopolet's Annual report for 1995 and Arcus' Annual report for 1996, that new automatic warehouse facilities in Oslo were ready and taken into use as early as 1 November 1995. New production facilities in Oslo, including facilities designed for receiving wine and spirits in bulk and three new production lines for bottling were tested and adapted during the autumn of 1995. From 1 January 1996 these various facilities were fully operative.

The Authority considers with reference to the facts referred to above, that the Norwegian authorities' assessment was at variance with how a rational market investor would have acted on the basis of the information available at the time Arcus was established.²⁸ Indeed, it should have appeared as evident that over-capacity would occur relatively soon, which would make the facilities in Bergen and Trondheim available for alternative activities or sale in a foreseeable future. As set out above, the D & T report actually presented alternative calculations in respect of this scenario.

²⁸ It may as well be noted that bottling and production previously carried out in Bergen were transferred to Oslo by 1 July 1997. Similar activities were transferred from Trondheim to Oslo by 30 June 1998.

As referred to above, the Norwegian authorities pointed out in its letter of 9 June 1998 that protests from employees were a factor to take into account, underpinning the rationale for the original decision. However, according to the State Aid Guidelines, as referred to in section II.1.3. above, social considerations alone would not justify maintenance of a sub-optimal production structure. Moreover, a rational investor would not incur costs as in the case at hand, by maintaining an inefficient production structure, if not resulting benefits exceeded the costs. The Norwegian authorities have in no way substantiated that any benefits from avoiding possible unrest among employees would exceed the costs of keeping the inefficient production structure. These costs, which are equal to the gains from a rational production structure, were, as pointed out above, calculated to NOK 202 million by Deloitte and Touche based *i.a.* on an assumption that the actual restructuring would be carried out more than three years after the analysis was made and relevant decisions were taken.

Moreover, and as pointed out in section II.2.2 below, the appropriation of NOK 226 million to cover restructuring costs is a further proof of the undervaluation of fixed assets and equity in the opening balance of Arcus. The estimated present value of the projected flow of future net revenues was set at NOK 203 million. In such a case it does not make economic sense to allocate NOK 226 million to cover restructuring costs, when there are substantial values to be realized in case of liquidation of the undertakings even after obligations to all employees are met, see section I.2.4. above. Only a higher estimated present value could defend such an allocation.

In conclusion, the decision to maintain production activities in Bergen and Trondheim was at variance with the market economy investor principle.

It is stressed in the D&T report that the estimated additional value of NOK 202 million of a more rational production structure was very uncertain. There is, however, nothing in the report stating that the estimate was biased in any direction. The Authority would like to point out that assessments of the kind undertaken in the D&T report, be it calculation of original value or additional value, are based on a number of uncertain assumptions. Uncertainty implies that there is a likelihood both for better and for worse results than forecast. Altogether, the Authority has found no reason to deviate from the forecast of additional value of NOK 202 million as presented in the D&T report, except for a special element related to the environmental obligation at the site in Trondheim.

The additional value of NOK 202 million was arrived at amongst others on an assumption of sale of the property in Trondheim in 1999 at an estimated NOK 45 million. In this amount NOK 4 million were deducted and assumed to reflect environmental liabilities, see section II.2.3. below. As a separate environmental liability of NOK 30 million was entered in the opening balance, NOK 4 million, calculated to NOK 3 million in present value terms, should be added to the estimated additional value of NOK 202 million.

The valuation of Arcus as a going concern should have been based on an economic structure reflecting the most economic use of the assets. The Authority has therefore drawn the conclusion, based on calculations presented in the D&T report and relying on the market economy investor principle, that fixed assets and equity in Arcus' opening balance were set NOK 205 million too low. In this context reference is also made to the stated conservative nature of the assessments which were undertaken when the opening balance was established.

2.1.3. Cost of capital

The cost of capital, *i.e.* the price at which an investor would be willing to provide funds to a company, is the benchmark against which an operation has to be evaluated when assessing whether the return on an equity investment or the interest charged is acceptable to a private investor. The standard methodology used by analysts to calculate the cost of capital is the Capital Asset Pricing Model (CAPM).

Arcus' cost of capital in the D&T report was based on calculations applying standard CAPM methodology. The capital cost (discount rates) were, however, multiplied by a factor of 1.35 to compensate for the poor liquidity of the Arcus shares (a so-called liquidity premium ref. D&T report, page 62). The capital costs were set to respectively 10.3 % p.a. for production of wine and spirits, 12.2 % p.a. for production of technical spirits and 11.9 % p.a. for distribution activities.

Valuations of long-term projects and investments in companies based on the discounted cash-flow method are sensitive to the discount rate. If the cost of capital is set too high, then the value of a project or a company as measured by the present value of its cash flow will be estimated at a too low level. Conversely, the value will be too high if the cost of capital is set too low.

A liquidity premium is normally added to the required rate of return in relation to investment in shares not quoted on the stock exchange. Such a premium can be seen as a compensation for difficulties in selling the shares. For an investor with a long-term horizon in relation to an acquisition and without any plans for sale in the foreseeable future, a liquidity premium would be insignificant. When a transaction, in particular, involves a whole company and not only certain shares, accounting with a liquidity premium is even less relevant.

In its letter to Norway of 11 May 1998, the Authority stated that it is not relevant for investors with a long investment horizon to require compensation for the costs associated with the poor liquidity of asset to be acquired. The Authority referred also to the fact that the reference (and discount) rates of interest for Norway were respectively, 8,19 % in 1995 and 7.00 % in 1996, *i.e.* significantly lower than the ones used in the D&T report.

Referring to the market economy investor principle as elaborated by the Court of Justice of the European Communities as referred to in section II.1.3. above, the Authority has come to the conclusion that the transfer of A/S Vinmonopolet's assets to Arcus should be assessed from the view of an investor having longer-term goals. There is no information in the file to suggest that the Norwegian Government perceived ownership of Arcus to be of a short-term nature or that it was guided by short term profit considerations in its financing of Arcus. It has therefore been found to be inconsistent with the approach of an investor with long-term goals, for the Norwegian Government to require compensation for the poor liquidity of Arcus' shares. The Authority considers that the liquidity premium that was set to 35 % in the D&T report, should be eliminated and that Arcus' cost of capital should be adjusted accordingly. Corrected for this factor and in the light of the various risk factors involved, the Authority can accept the capital cost factors applied in the D&T report.

The required correction of the capital costs implies that the present value of Arcus' net cash flow from assets was under-estimated by NOK 59 million²⁹.

2.1.4. Conclusions

The considerations in points 2.1.2 and 2.1.3 imply that Arcus' opening balance did not reflect the best estimate of the real value of the assets transferred from A/S Vinmonopolet. This refers to the additional value of Arcus' fixed assets according to their best use (NOK 205 million) and the capital cost factor (NOK 59 million), all in all representing an undervaluation amounting to NOK 264 million.

This implies that the Norwegian authorities in effect allowed Arcus at the time of the transaction to acquire the fixed assets in question for less than their real value. The implication of the undervaluation of assets transferred to Arcus is that the value of the shares the State received as compensation for the assets was correspondingly undervalued by NOK 264 million.

The assets transferred from A/S Vinmonopolet were therefore provided to Arcus on terms more favourable than a private owner would provide to an enterprise in a comparable financial and competitive position, ref. State Aid Guidelines point 20.3.(1). This amounts to a transfer of assets from A/S Vinmonopolet, a State-owned enterprise, to Arcus without the State being compensated for the full value. In fact, the transaction implied that A/S Vinmonopolet through the demerger incurred depreciation costs, see Table 2, that were set NOK 264 million too high. In conclusion, the transaction was carried out on terms which involved State aid within the meaning of Article 61(1) of the EEA Agreement amounting to NOK 264 million.

2.2. *Restructuring costs*

In the autumn of 1995 it was clear that Arcus would be facing costs related to organisational changes and that the companies in the Arcus Group would need to undertake certain investments *i.a.* in order to meet the new market situation³⁰. Estimates of Arcus' restructuring costs were presented in chapter 9 of the D&T report, ref. Table 5 below.

²⁹ Estimated by the Authority's services based on the cash-flows presented in chapter 12 of the D&T report and applying discount rates of 7.6%, 9.0% and 8.8% for production of wine and spirits, technical spirits, and distribution, respectively

³⁰ D&T Report, Chapter 9

Table 5 Estimated restructuring costs in NOK million

<i>Cost categories</i>	<i>Year 1996</i>	<i>Year 1997</i>	<i>Total</i>
<i>Reduced manning</i>	75.2	40.5	115.7
<i>Early retirement</i>	29.0	0.0	29.0
<i>Training measures</i> ³¹	10.0	10.0	20.0
<i>Up-grading/profiling of products</i> ³²	19.5	0	19.5
<i>Consultancy help, legal advice</i> ³³	15.0	15.0	30.0
<i>Misc. investments</i> ³⁴	22.5	0.0	22.5
<i>Total</i>	171.2	65.5	236.7 ³⁵

Source: D&T report

A/S Vinmonopolet entered in 1993 and in 1995 into two protocols on personnel management with the local trade unions³⁶. Both protocols expired automatically on 31 December 1997. The protocol from 1993 concerned notably matters related to internal recruitment and transfers of personnel, compensation rules regarding transfers and lay-offs, early retirement, personnel reductions and training measures. The protocol from 1995 was an addendum to the protocol from 1993 and concerned notably measures triggered by the Norwegian Government's decision of 13 February 1995 to abolish A/S Vinmonopolet's exclusive rights regarding importation and wholesale of wine and spirits. The latter protocol contains more detailed provisions concerning compensation in the case of early retirement, training measures to acquire skills regarding activities outside the former alcohol monopoly, unpaid leave, and job related insurance.

The estimated restructuring costs in the D&T report were based on assumptions consistent with the level of manning assumed in the valuation. Rights and obligations following from the two protocols agreed in 1993 and 1995, were also taken into account. The restructuring provision was placed at Arcus' disposal. It was up to the company itself to decide on how to spend the allocated means.

The restructuring measures foreseen in the D&T report implied that Arcus' manning would be reduced by 245 employees, *i.e.* from 621 to 376 persons³⁷. 65 per cent of the planned reductions were foreseen to take place in 1996 and the rest in 1997. During 1996 and 1997 some 150 employees have resigned or been dismissed and replacements with personnel with *e.g.* marketing competence have taken place. Arcus reported to have 685 employees at the end of the 1996 and 716 employees at the end of 1997³⁸. Arcus' manning was therefore at the end of 1997 significantly above the level indicated in the Norwegian Government's

³¹ Training to qualify employees for work outside Arcus or AS Vinmonopolet

³² Costs related to new labels, uniforms, advertisements, respraying of cars, licence fees and re-registration costs and costs related to the registration of the Arcus trademark in other countries.

³³ Costs related to *i.a.* new IT systems, legal advice, upgrading of documentation, logistics and IT management establishment of product, marketing and sales departments

³⁴ Costs related *i.a.* the separation of offices and administration between A/S Vinmonopolet and Arcus.

³⁵ This sum was discounted to arrive at a restructuring provision of NOK 226 million. The latter amount was made available as of 1 January 1996 and was foreseen to earn interest covering the total restructuring needs.

³⁶ "Protokoll - Tiltak ved personaltilpasninger i Vinmonopolet av 11.6.1993" and "Tilleggsprotokoll om tiltak ved personaltilpasninger i Vinmonopolet av 8.6.1995"

³⁷ D&T report, pages 39 and 42

³⁸ Ref. Arcus Annual Report 1997, page 8

proposition³⁹ to the Norwegian Parliament where a reduction in manning was foreseen. By the end of 1997, Arcus' level of manning had in fact increased since the separation from A/S Vinmonopolet.

The Authority has examined the information provided by Norway on how the restructuring provision has been used by Arcus, ref. Table 6 below.

Table 6 Allocation of the restructuring provision in NOK million

<i>Cost categories</i>	<i>Year 1996</i>	<i>Year 1997</i>	<i>Total</i>
<i>Reduced manning</i>	5.7	6.4	12.1
<i>Early retirement</i>	17.2	19.9	37.1
<i>Sum personnel related costs</i>	22.9	26.3	49.2
<i>Training measures</i>	1.2	0.5	1.7
<i>Up-grading/profiling of products</i>	9.5	0	9.5
<i>Consultancy help, legal advice</i>	7.8	0	7.8
<i>Misc. investments</i>	0.7	0	0.7
<i>Sum other restructuring costs</i>	19.2	0.5	19.7
<i>Sum restructuring costs</i>	42.1	26.8	68.9
<i>Balance beginning of year</i>	226.0	121.8	<i>n.a.</i>
<i>- Sum restructuring costs</i>	(42.1)	(26.8)	(68.9)
<i>- Allocations as extraordinary income</i>	(62.1)	(38.3)	100.4
<i>=Balance end of year</i>	121.8	56.7	<i>n.a.</i>

Source: Ministry of Trade and Industry

The Authority accepts that a rational market economy investor guided by prospects of profitability in the longer term might set aside even relatively large sums of money to protect the value of his investments without this constituting aid in the meaning of Article 61(1) of the EEA Agreement.

However, the allocated restructuring means were substantial in relation to the assets involved. This is particularly evident if the restructuring provision is compared to the opening balance and the estimated liquidation value of the company. The liquidation value of Arcus was estimated at NOK 387 million after legal obligations towards employees and other close-down costs had been deducted, see Table 3. Faced with such an amount a rational investor would not have injected NOK 226 million only to observe that the value of the company after that injection was not more than NOK 357 million. Only if the real value of the assets was substantially higher, would a provision of this magnitude make sense from an economic point of view. This underscores what has been pointed out above, namely that the opening balance did not reflect the real value of the company.

As referred to, the undervaluation of NOK 264 million of the assets transferred to Arcus implied a corresponding undervaluation of the shares the state received in compensation. Accordingly, in the view of the Authority, Arcus equity should have been set to NOK 621 million (357 + 264), including the provision of NOK 226 million to cover estimated restructuring needs. Before this provision was made, Arcus' value as a going concern would have been estimated at NOK 395 million (621-226), which would have exceeded the

³⁹ St.prp. nr. 11 1995-96

estimated liquidation value of NOK 387 million. The Authority has therefore not raised any objections in principle to setting up a substantial provision to cover costs related to restructuring.

However, the Authority considers that a rational investor only would have provided such financing under certain conditions that are not fully met in the case at hand. There were, when Arcus was established, significant uncertainties both regarding the amounts of actual restructuring costs that would materialise and when actual payments for restructuring costs might fall due. In such a situation, the Authority considers that it could be rational to set aside a given sum from the start-up, but a rational investor would not accept to cover restructuring costs before they were due and to provide means beyond what was needed for this purpose.

The Authority has not found it established by the Norwegian authorities that there were any specific conditions attached to the restructuring provision. The amount was, as far as the Authority understands, made at Arcus' own disposal and Arcus has even recorded significant amounts of the restructuring provision as extra-ordinary income. In other words, parts of the restructuring provision cannot be seen as anything different from operating aid which normally is incompatible with Article 61 of the EEA Agreement.

The restructuring measures were supposed to be carried out in the first two years of Arcus' operations. It was foreseen (ref. Table 5 above) that more than 70% of the restructuring cost would be recorded in the first year of the planned restructuring period. The Authority has noted that the restructuring period of two years corresponded to the duration of the original protocols agreed between A/S Vinmonopolet and the local trade unions. The Authority has also noted that there were delays in the Government's granting of licences to those that wanted to enter the market as competitors to Arcus. Therefore, Arcus remained in a *de facto* monopoly situation for a substantial part of 1996. As the Authority understands the matter, delays in granting licences were outside Arcus' control. The Authority accepts therefore that Arcus has faced certain unforeseen obstacles regarding the time needed to carry out the planned restructuring and personnel reductions.

The Norwegian authorities reported in their letter dated 9 June 1998 (ref. 98-3978-A) that some of the obligations related to the original protocols with the trade unions were not carried out within their expiry date of 31 December 1997. It was also informed that Arcus had entered into two new agreements amending the original protocols⁴⁰, in respectively 1997 and 1998. Both agreements concern personnel employed by A/S Vinmonopolet before 11 June 1993 and obligations related to the same restructuring process as the original protocols. Obligations following from the agreements would, according to the Norwegian authorities, have to be met in the course of 1998. The Authority considers that it may be justified to use means of the restructuring provision in 1998 to finance personnel related restructuring costs in accordance with the principles of the original protocols between A/S Vinmonopolet and the local trade unions.

Concerning the use of the restructuring provision and in accordance with the market economy investor principle, the Authority makes the following conclusions:

⁴⁰ "Tilleggsavtale 2 - Tilleggsprotokoll Tiltak ved personaltilpasninger i Arcus-selskapene av 12. februar 1997 " and "Avtale om tiltak i forbindelse med personalmessige tilpasninger i Arcus Gruppen, Oslo og Hamar av 11.mai 1998"

- Arcus' use of the provision to cover costs related to reduced manning and early retirement, amounting to NOK 49.2 million for 1996 and 1997, ref. Table 6, does not constitute aid. The costs in question refer to expenses related to costs associated with A/S Vinmonopolet's contractual obligations⁴¹ towards its former employees.
- Arcus' use of the restructuring provision to cover costs related to upgrading/profiling of products, *i.a.* change of name, logo, labels, and initial retraining of personnel have been found to be commercially justified start up costs. Likewise, Arcus' use of the restructuring provision to cover *i.a.* consultancy costs related to the business plan, legal advice, logistics, IT management and organizational changes in Arcus Produkter AS and Arcus Distribusjon AS concern investments needed to adapt Arcus to new market conditions. Arcus use of the provision for the above purposes in 1996 and 1997, amounting to NOK 19.7 million does not constitute State aid.
- Arcus' use of parts of the restructuring provision remaining at the end of 1997, NOK 56.7 million, see Table 6, to cover personnel related restructuring costs in 1998 up to the date of this Decision due to delays in manning reductions, will similarly not constitute aid, insofar as the costs in question refer to obligations that arise from the original protocols between A/S Vinmonopolet and the local trade unions to the benefit of the employees.
- Arcus has allocated in 1996 and 1997 altogether NOK 100.4 million of the restructuring provision as extra-ordinary income. The Norwegian authorities have not presented any economic justification for allowing Arcus to record part of the restructuring provision as extra-ordinary income. The amount of NOK 100.4 million plus accumulated interest on restructuring means (NOK 226 million from the start) not used for restructuring purposes calculated from 1 January 1996 and on the basis of the reference rate of interest which applies to Norway⁴², constitutes aid in the meaning of Article 61(1). The same conclusion must be drawn concerning those parts of the restructuring provision which were remaining at the end of 1997 and which have not in 1998 until the date of this Decision, been recorded to cover personnel related restructuring costs.

2.3. *Environmental obligations*

A/S Vinmonopolet transferred to Arcus together with the restructuring provision an environmental provision of NOK 30 million. The Norwegian authorities have explained the provision of such financing by referring to expected costs related to clean up of pollution in the ground water under parts of the facilities in Trondheim. The pollution stems from old, contaminated industrial waste, and not from Arcus' or A/S Vinmonopolet's activities.

The Authority has noted that at the time of assessment of the opening balance for Arcus, two different estimates of costs related to the environmental obligation existed. An independent

⁴¹ "Protokoll - Tiltak ved personaltilpasninger i Vinmonopolet av 11.6.1993" and "Tilleggsprotokoll om tiltak ved personaltilpasninger i Vinmonopolet av 8.6.1995"

⁴² The type of interest to be applied as the reference rate of interest in Norway is stated in chapter 33.2 (former chapter 27(3)(f)) of the State Aid Guidelines. The actual interest rates to be applied are as follows: For 1996: 7.00%, from 1.1.1997 to 30.5.1997: 6.24%, from 1.6.1997 to 31.12.1997: 5.05%, from 1.1.1998 to 30.5.1998: 5.63%, from 1.6.1998 onwards: 6.75%

appraiser assessing the value of the property in Trondheim, ref. Section II 2.1.2. above, calculated with an obligation amounting to NOK 4 million. The Authority is not aware of any detailed presumptions for this assessment. The other estimate was made by A/S Vinmonopolet. On the basis of a detailed assessment of various cost factors A/S Vinmonopolet estimated the costs to NOK 30 million. This estimate was partly based on previous assessments made by the Norwegian Geological Institute.

Besides rather different estimates of what the costs of cleaning up would amount to, there was at the time of establishment of Arcus, and still is according to the Authority's information, very uncertain when a request from the environmental authorities to clean up the site would possibly materialize. The Authority has noted that certain preventive measures were undertaken at the property in 1992-93 and that the situation is currently surveyed and assessed in co-operation with the environmental authorities⁴³.

The Authority recognizes that there is an environmental obligation attached to Arcus' property in Trondheim. Applying the market economy investor principle the Authority can, however, not see that it was justified to provide Arcus with NOK 30 million to cover such an obligation. Faced with a rather uncertain liability, not knowing when in the future it possibly might materialize, a rational investor would not have provided the allocated means.

In conclusion, the Authority does not object to the fact that an environmental obligation was reflected in the opening balance of Arcus and that it was recorded at NOK 30 million. But the financial advantage of receiving on 1 January 1996 an appropriation of NOK 30.0 million plus accumulated interest on this amount calculated as from the same date on the basis of the reference rate of interest which applies to Norway, constitutes aid in the meaning of Article 61(1).

3. Articles 61(2) and 61(3)

The Authority has not received any information from the Norwegian authorities indicating that they consider any of the exemption clauses under Articles 61(2) or 61(3) of the EEA Agreement to be applicable, the Norwegian position being that no aid was involved in the setting-up of Arcus. Having found that the establishment of Arcus indeed comprised elements of aid in the meaning of Article 61(1) EEA, the Authority has considered these elements for possible exemptions under other paragraphs of Article 61.

The Authority cannot consider the aid to Arcus as compatible with the functioning of the EEA Agreement pursuant to Article 61(2), since the aid does not correspond to any of the cases provided for under those provisions. The same applies to Article 61(3)(b) and (d), as the facts of the case clearly indicate that those provisions are not relevant.

Article 61(3)(a) and (c) EEA provide for exemptions in respect of aid to promote or facilitate the development of certain regions. The aid to Arcus does not qualify for exemptions laid down in those provisions, in so far as they relate to regional aid, nor have the Norwegian authorities put forward any such regional arguments in support of the aid measures. The Authority notes in particular that Arcus' facilities are located in Oslo/Hamar, Bergen and Trondheim, i.e. areas that have not been authorized for regional aid under Article 61(3)(a) and (c).

⁴³ Ref. Arcus Annual Reports 1996 and 1997

With regard to the exemption pursuant to Article 61(3)(c) for "aid to facilitate the development of certain economic activities", the Authority may consider rescue and restructuring aid as compatible with the functioning of the EEA Agreement if it meets a number of conditions, ref. State Aid Guidelines, Chapter 16 on aid for rescuing and restructuring firms in difficulty. However, as Arcus cannot be regarded as having been in difficulty, these Guidelines are not applicable. Even the part of the restructuring provision that has been defined above as State aid, was not used for restructuring purposes. Thus, that aid, too, is found incompatible with Article 61 of the EEA Agreement.

According to Chapter 15 of the State Aid Guidelines, the Authority may subject to specified conditions authorize aid for environmental protection. As no explicit requirement to undertake any clean-up operation has materialized after Arcus was established, there is no ground for exempting the whole or part of the environmental provision described in section II 2.3. above.

4. Breach of procedural obligations

The measures which in parts II 2.1., 2.2. and 2.3. of this Decision have been found to constitute aid, have not been notified to the Authority. The measures have been put into effect without initial approval by the Authority. As unnotified aid, the aid in question is unlawful on procedural grounds by infringing the last sentence of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, ref. State Aid Guidelines Chapters 3 and 6. The aid is also incompatible with the functioning of the EEA Agreement as none of the exemptions provided for in Articles 61(2) and (3) of the Agreement are applicable, ref. point II.3 above.

In negative decisions on cases of unlawful aid the EFTA Surveillance Authority orders for the purpose of restoring the *status quo*, as a rule, the EFTA State concerned to reclaim the aid from the recipient.

5. Recovery

The Authority has concluded that Arcus received fixed assets that were undervalued by NOK 264 million and that the State was compensated with shares undervalued by the same amount. A correct opening balance would have shown fixed assets and share value NOK 264 million above the recorded figures. The aid of NOK 264 million shall be recovered. In the circumstances of the case, with the view of restoring *status quo*, the recovery can be in the form of the State receiving NOK 264 million in increased share capital, recorded in a corrected opening balance as of 1 January 1996.

The estimated figure of a corrected value of Arcus as of 1 January 1996 is largely based on an assumption that measures achieving a rational production structure and property management were to be undertaken in 1999. In view of this and of actual developments no recovery of dividends is called for in the financial years 1996 and 1997.

Appropriation of means to cover restructuring costs, allocated as extra-ordinary income in 1996 and 1997, altogether NOK 100.4 million shall be paid back to the State. Remaining means by 31 December 1997 to cover restructuring costs, not used to cover personnel related restructuring costs in 1998 until the date of this Decision, shall be paid back to the

State. Interest accrued on restructuring means not used for restructuring purposes calculated from 1 January 1996 onwards shall be paid back to the State. The interest rate to be applied is the reference rate of interest for Norway, as referred to above in section II.2.2. (see footnote 42).

The environmental provision of NOK 30 million shall be paid back to the State with accrued interests applying the reference rate of interest for Norway, as from 1 January 1996.

6. Reporting

The Transparency Directive⁴⁴ obliges the EFTA States to ensure that the flow and uses of all public funds to public undertakings whose turnover excluding taxes is ECU 40 million⁴⁵ or higher, are made transparent.

The Authority considers it necessary, for the purpose of monitoring compliance with Article 61 of the EEA Agreement, to request the Norwegian authorities to supply, in respect of Arcus, information of the kind listed in Articles 1 and 3 of the Transparency Directive, and in addition copies of Arcus' annual reports and the protocols from Arcus' annual shareholders' meetings, and a statement on the Norwegian authorities' dividend policies concerning Arcus.

The requested information referred to above, shall be provided within 15 working days of the date of the publication of Arcus' annual report and in any case, not later than six months after the end of the financial year.

HAS ADOPTED THIS DECISION:

1. The public assistance to companies in the Arcus group consisting of;
 - a) assets transferred from A/S Vinmonopolet at an acquisition value NOK 264 million below the commercial value,
 - b) NOK 100.4 million of a restructuring provision of NOK 226 million,
 - c) remaining means of the restructuring provision, NOK 56.7 million, at the end of 1997, in so far as they have not been used to cover personnel related restructuring costs in 1998 up to the date of this Decision,
 - d) an environmental provision of NOK 30 million related to polluted land-fill at Arcus' properties in Trondheim, and
 - e) accrued interests on restructuring means not used for restructuring purposes, referred to in points b) and c), and on the environmental provision referred to in point d),

⁴⁴ The act referred to in point 1 of Annex XV to the EEA Agreement (Commission Directive 80/723 of 25 June 1980) on the transparency of financial relations between Member States and public undertakings

⁴⁵ Some NOK 350 million applying current exchange rates

constitutes State aid within the meaning of Article 61(1) of the EEA Agreement. Moreover, it has been awarded in contravention to the procedural requirements of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, and does not qualify for exemptions according to Articles 61(2) or 61(3) of the same Agreement. Consequently, the assistance is incompatible with the functioning of the Agreement.

2. Norway shall carry out the following corrective measures:
 - a) The aid of NOK 264 million received by an undervaluation of fixed assets transferred to Arcus shall be recovered. This can be done by the State receiving NOK 264 million in increased share capital, recorded in a corrected opening balance as of 1 January 1996.
 - b) The part of the restructuring provision, which has been recorded as extraordinary income in 1996 and 1997, amounting to NOK 100.4 million shall be recovered.
 - c) Remaining means of the restructuring provision, NOK 56.7 million at the end of 1997, in so far as they have not been used to cover personnel related restructuring costs in 1998 up to the date of this Decision, shall be recovered.
 - d) The environmental provision of NOK 30 million shall be recovered.
 - e) Interest accrued on restructuring means of NOK 226 million not used for restructuring purposes calculated from 1 January 1996 onwards shall be recovered. Interest accrued on the environmental provision of NOK 30 million calculated as from 1 January 1996 onwards shall be recovered. The interest rate to be applied shall be the reference rate of interest for Norway (ref. State Aid Guidelines, Chapter 33.2 and the interest rates specified in section II 2.2. of this Decision). Interests shall run until the date of the recovery.
 - f) Compensation and repayment shall be made in accordance with the procedures and provisions of Norwegian law.
3. The Norwegian Government shall keep the Authority informed on a regular annual basis of its financial relations with Arcus by providing the information of the kind referred to in Articles 1 and 3 of the Act referred to in point 1 of Annex XV to the EEA Agreement (Commission Directive 80/723/EEC), and in addition copies of Arcus' annual reports and the protocols from Arcus' annual shareholders' meetings, and a statement on the Government's dividend policies concerning Arcus.

The requested information shall be provided within 15 working days of the date of the publication of Arcus' annual report and in any case, not later than six months after the end of the financial year.

4. The Norwegian Government shall inform the Authority within two months of the date of the notification of this Decision, of the measures taken to comply therewith.

5. This Decision, which shall be authentic in the English language, is addressed to Norway.

Done at Brussels, 3 November 1998.

For the EFTA Surveillance Authority

Knut Almestad
President

Hannes Hafstein
College Member