


EFTA SURVEILLANCE AUTHORITY

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Dec. No. 52/96/COL
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EFTA SURVEILLANCE AUTHORITY DECISION

OF 8 MAY 1996

ON RESCUE AID IN FAVOUR OF DRIFTSELSESKAPET RENA KARTON AS(NORWAY)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area¹, in particular to Articles 61 to 63,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. The notification

By fax dated 26 April 1996, received by the EFTA Surveillance Authority on the same date (ref. 96-2257 A), the Norwegian Government notified the Authority of plans to award rescue aid to Driftsselskapet Rena Karton AS (DRK).

2. Rescue aid in favour of Driftsselskapet Rena Karton

The planned aid concerns a one-off award of a subordinated risk loan amounting to NOK 2.7 million from the Norwegian Industrial and Regional Development Fund (SND) to DRK. The loan has a duration of 6 months and it will carry an interest rate of 9 % p.a.

¹Hereinafter referred to as the EEA Agreement

²Hereinafter referred to as the Surveillance and Court Agreement

3. Rena Karton

The board of Rena Karton (RK), a Norwegian producer of folding box board, presented a bankruptcy petition on 29 March 1996. The company has therefore according to the Insolvency Act³ been taken over by the administrators of bankruptcy.

RK consisted (prior to the bankruptcy) in addition to the mother company Rena Karton AS of 3 subsidiaries, Rena Emballasje AS, Rena Service AS and Rena Board Sales Ltd. UK., which as a whole had an annual turnover in 1994⁴ of NOK 204 million (ECU 24.6 million⁵) and a balance at the end of the year of NOK 152 million (ECU 18.4 million). The number of persons employed in 1994 was 242.

RK experienced operating losses of respectively NOK 13.7 million and NOK 20.8 million in 1992 and 1993. However, the company went through a reorganization in 1993 which included new owners, new management and a reduction in the number of employees.

After the reorganization in 1993, RK developed an extensive investment plan, "Prosjekt Rena 2000", which aimed at an increase in production capacity from 40,000 to 60,000 tonnes. The first step of the investment programme, which is now finalized, was calculated to involve investment costs of NOK 120 million. However, the second step was carried out earlier than planned and the planned investment costs were exceeded. The implementation of the investments carried out to date amounts to NOK 264 million.

The problems of RK which eventually led to bankruptcy, were mainly caused by the way in which the investment programme was managed. The Norwegian authorities consider the possibilities of establishing viable and profitable production to be good with new owners and new management as the investments carried out at the production plant, including the renewal of production equipment, will contribute to a stable production and less rejected products. Old and run-down machinery are considered to be the main explanations for RK's earlier problems.

4. The rescue operation

In order to continue production at the facilities of former RK, until new owners can take over, a provisional production company, Driftsselskapet Rena Karton AS (DRK), was established. DRK started to run production on 13 April 1996. DRK is foreseen, according to the notification, to be in operation for a period of six to seven weeks.

DRK is a new enterprise and a legal entity separate from the administrator of bankruptcy. The initiative to establish DRK was taken by the municipality authorities of Åmot in co-operation with the local trade union. DRK has an equity capital of NOK 8'754'000. The public share of DRK's equity capital, consisting of respectively NOK 3

³Lov om gjeldsforhandling og konkurs av 8 juni 1984 nr 58

⁴The company has not presented any annual report or accounts for 1995.

⁵ECU 1 = NOK 8.2688

million from the Municipality of Åmot and NOK 0.3 million from the Municipality of Stor-Elvdal, is 38 %.

DRK's objective⁶ is to continue, on a limited scale, trade, agency activities and box board production at Rena until permanent new ownership is established.

DRK has entered into an agreement with commercial banks and the administrator of bankruptcy to recover outstanding accounts from customers and to buy stock of goods on hand. DRK has not taken over RK's production facilities, but rents them from the administrator of bankruptcy. According to the lease agreement, DRK is obliged to cover all costs related to its activities, including maintenance and repair of items covered by the agreement and all of the expenses incurred on the lessor as owner of the assets, such as, but not restricted to, taxes and municipal fees. The ultimate date for a pro and con settlement between the administrator of bankruptcy and DRK is 15 August 1996.

The Norwegian authorities have given the following reasons for maintaining provisional production until new owners can take over:

- Relations with existing customers be maintained
- The existing volume of orders can be delivered
- To prevent fall in value of stocks on hand
- To facilitate the collection of debts from customers
- To keep on key personnel
- To reduce social problems

DRK will produce folding box board, using only one of the former company's two board machines. The production will be based on the old box board machine. The upgraded machine which was renewed through considerable investments in recent years will not be used by DRK. During the foreseen production period of 6-7 weeks, the production will be about 3,000 tonnes, which corresponds to a capacity utilization of 20,000 tonnes per year.

As the Norwegian authorities consider that the prospects for permanent and profitable production of folding box board in Rena are rather good, the period for provisional production indicated above, should give sufficient time to consider the possibilities for further production. In this context, the possibilities of attracting new owners are considered to be far more promising when production is continued without interruption after the bankruptcy.

DRK has 120 employees. Based on the production in the foreseen production period DRK's turnover will be about NOK 19.4 million which corresponds to an estimated annual turnover of NOK 152 million (ECU 18 million). Sales costs have been estimated to NOK 3 million, raw materials are budgeted at NOK 9.2 million, labour costs at NOK 3.3 million, while other costs (including costs related to the lease of premises and production facilities from the bankruptcy administration) are estimated to NOK 3.1 million. The budget estimates therefore foresee DRK obtaining a net result of NOK 0.8 million during its 6-7 weeks in operation.

⁶Prospekt, Driftsselskapet Rena Karton AS

DRK has, according to the notification, a need for liquid financial resources in the provisional production period of NOK 23 million. This will be provided through the notified risk loan of 2.7 million from SND, short-term credit facilities by commercial banks of maximum NOK 12 million (limited to 60 % of DRK's current assets) and DRK's equity capital of NOK 8.7 million referred to above.

The provision of credits from private banks are, according to the Norwegian authorities, dependent on SND's planned provision of liquidity help in the form of the notified risk loan. Taking into account DRK's budget estimates and the financing from other resources, the Norwegian authorities consider that the notified risk loan from SND⁷ does not constitute loan financing in excess of the amount needed to keep DRK in operation through the rescue period.

6. Market conditions and prospects for the future

The market for the products which can be produced in the manufacturing plant at Rena are considered by the Norwegian authorities to be good, as they are to a high degree niche products in a large market which is served by few, but big producers.

The consumption of folding box board in Western Europe is about 1.3 million tonnes per year. RK had a market share in Norway of about 60 % and in Western Europe of about 2 %. DRK will sell to the same groups of customers as RK, i.e. to small- and medium-sized enterprises manufacturing and to wholesale dealers.

There were according to statistics provided by the Norwegian authorities 14 major producers of box board in Europe in 1995 each with a production capacity between 960'000 and 80'000 tonnes per year, i.e. a higher production capacity than former RK. The Norwegian authorities consider therefore that the production activities to be carried out by DRK during the rescue period will have only marginal effects on the market for folding box board.

5. Regional and social aspects

The production facilities of former RK are located at Rena, Municipality of Åmot. Åmot is covered by the Norwegian map of assisted areas⁸, target zone B, where regional investment aid may be granted up to 25 % NGE⁹ plus a top up for small- and medium-sized enterprises (SME) of 5 % (gross).

RK was a 'cornerstone' enterprise in Åmot. This is i.a. reflected in the fact that it was by far the largest private employer in an area with few other employment opportunities. The Norwegian authorities consider that to close down RK permanently would lead to economic and social problems, as the loss of the major employer would

⁷ SND will, in addition, provide soft aid for consultancy help amounting to NOK 0.3 million under the existing aid scheme "Grants for Development of Business and Industry (Aid no 93-153). The grant will cover 50% of the eligible costs of hiring professionals who will assist DRK by providing knowledge and expertise in management and operation activities.

⁸Dec. No 157/94/COL of 16 November on the map of assisted areas (Norway)

⁹Net Grant Equivalent

not only affect the families of the employees directly, but also to a large extent the economy of the municipality and other economic activities in the area. The board factory is also of considerable importance to the forestry industry in the whole county of Hedmark, as it is the major consumer of timber in the area.

According to notification, the number of unemployed in the region has increased in recent years and the unemployment rate in Rena is among the highest in the county of Hedmark. At the end of March 1996, i.e. before the bankruptcy of RK, the unemployment rate in Åmot was 6.4% compared to 4.4% at the national level. In addition 3.1% of the labour force in the municipality was on different employment programmes. The municipality has therefore been involved in programmes with the objective of broadening its economic basis and has received support from the Ministry of Local Government and Labour in accordance with the 'Restructuring and Initiative Grant' scheme (Aid No 95-006, ex Aid No 93-214)¹⁰ for that purpose.

II. APPRECIATION

The Norwegian authorities have by their notification of the loan to Driftsselskapet Rena Karton fulfilled their obligation under Article 1(3) of Protocol 3 to the Surveillance and Court Agreement to notify plans to grant or alter aid.

The notification covers the award of a subordinated (unsecured) loan of NOK 2.7 million in favour of DRK from SND which DRK would not have been able to obtain on similar conditions from a commercial financial institution. As the loan is granted on favourable conditions by SND, which is funded by the State Budget, it constitutes aid granted by the State through State resources. Since DRK will be in direct competition with other producers of folding box board operating in other States participating in the EEA, the aid threatens to distort competition and affect trade within the territory covered by the EEA Agreement. It must therefore be concluded that the loan under consideration constitutes State aid in the meaning of Article 61(1) of the EEA Agreement.

The information supplied with the notification indicates that local municipalities participate in the establishment of DRK by providing share capital. The Authority has found nothing to indicate that this equity capital would contain elements of State aid. This view is supported by the fact that the lion's share (62 %) of the company is privately owned and the budget estimates for DRK indicate a reasonable return on the invested capital. Therefore, the following assessment covers only the notified loan from SND.

According to chapter 16 of the Procedural and Substantive Rules in the Field of State Aid (State Aid Guidelines) as amended on 19 October 1994, State aid for rescuing or restructuring firms in difficulty will, by its very nature, tend to distort competition and affect trade between the Contracting Parties. Therefore, such public interventions as a rule, fall within Article 61(1) of the EEA Agreement and require exemption. The only

¹⁰Dec. No 140/95/COL of 20 December on amendment of an existing aid scheme, 'Restructuring and Initiative Grant' scheme (ex aid 93-214)

basis for exempting aid for rescuing or restructuring firms in difficulty - apart from cases of national disasters and exceptional occurrences which are exempted by Article 61(2)(b) - is Article 61(3)(c). Under this provision, the EFTA Surveillance Authority can authorize "aid to facilitate the development of certain economic activities where such aid does not adversely affect trading conditions to an extent contrary to the common interest." The EFTA Surveillance Authority considers that aid for rescue may contribute to the development of economic activities without adversely affecting trade between the Contracting Parties if certain conditions are met, and will therefore authorize such aid under those conditions. Where a firm to be rescued is located in assisted areas, the EFTA Surveillance Authority takes regional considerations into account.

The Authority has in section 16.2 of the State Aid Guidelines established definitions and the scope of the rules to be applied with respect to rescue aid.

A rescue operation temporarily maintains the position of a firm that is facing a substantial deterioration in its financial position reflected in an acute liquidity crisis or technical insolvency, while an analysis of the circumstances giving rise to the company's difficulties can be performed, and an appropriate plan to remedy the situation devised. In other words, rescue aid provides a brief respite, generally for not more than six months, from a firm's financial problems while a long-term solution can be worked out.

According to the facts provided by the Norwegian authorities, there can be no doubt that the activities to be carried out by DRK are typical for a rescue operation, as DRK is foreseen to be in operation for a limited period of time estimated to 6-7 weeks starting 13 April 1996, and according to the lease agreement between DRK and the administrator of bankruptcy shall not go beyond 15 August 1996. It is also clear that the objective for the administrator of bankruptcy is to seek long-term solutions which include i.a. finding new owners for continued production in the production facilities of former RK.

Conditions for approving rescue aid

- (i) In order to be approved by the EFTA Surveillance Authority rescue aid, as defined above, must continue to satisfy the following basic conditions:
- it must consist of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates;
 - it must be restricted to the amount needed to keep a firm in business (for example, covering wage and salary costs and routine supplies);
 - it must be paid only for the time needed (generally not exceeding six months) to draw up the necessary and feasible recovery plan;
 - it must be warranted on the grounds of serious social difficulties and have no undue adverse effects on the industrial situation in other EFTA States or EC Member States.
- (ii) A further condition is that, in principle, the rescue should be a one-off operation. Rescue aid should therefore normally be a one-off holding operation mounted over a limited period during which the company's future can be assessed.

(iii) In applying the above conditions to SMEs the EFTA Surveillance Authority takes account of the special features of businesses in this size category.

(iv) The approval of rescue aid is without any presumption regarding the subsequent approval of aid under a restructuring plan, which will fall to be assessed on its own merits.

Compliance with the criteria for rescue aid

The information provided by the Norwegian authorities shows that the aid in favour of DRK is granted in the form of a loan bearing an interest rate of 9 % p.a. The interest rate is higher than the current reference rate of interest for Norway, currently 7 % p.a. and approximately at the same level as the interest DRK is foreseen to pay on short-term credits from commercial banks¹¹. Therefore, the interest rate of the loan from SND is deemed to correspond to market terms. The loan has a limited duration of 6 months. The Authority has observed that the loan constitutes only a minor part of DRK's estimated need for liquidity (12%) and DRK's operating costs in the foreseen period of operation (15 %). SND's loan financing of DRK therefore does not go beyond the company's need for liquidity.

The Authority has observed that Rena, where DRK is located, is already experiencing significantly higher unemployment rates than the national average. The area qualifies for regional investment aid i.a. due to low population density. Alternative employment in the region is scarce and the consequences of closing down production are likely to spread to other economic activities. According to regional statistics, gross value added per capita in the Østerdalen area of the County of Hedmark is approximately 34% below the national average.

Furthermore, DRK will have a relatively limited production (3'000 tonnes) while it will be in operation, compared to the total EEA market for folding box board (1.3 million tonnes per year). The aid is therefore not likely to have unjustified adverse effects on competitors within the EEA.

The criteria referred to in point (i) above are therefore fulfilled. The criterion referred to in point (ii) is also fulfilled as the loan under consideration is notified as a one-off award with a duration of 6 months and the lease contract between DRK and the administrator of bankruptcy has a duration of less than 6 months.

The Authority has observed that both DRK and former RK satisfy the definition of a small- and medium-sized enterprise (SME) according to the Commission Recommendation of 3 April 1996¹². Taking into account the general observation that SME's frequently face certain handicaps when compared to established large firms, for example by having greater difficulties in raising finance, the Authority considers in

¹¹Interest rate of 8.25 % p.a. on amounts drawn plus a flat commission of 0.75 %

¹² C (96) 261 Final, *Commission Recommendation of 3 April 1996 concerning the definition of small- and medium-sized enterprises*. According to the recommendation an independent enterprise with fewer than 250 employees, an annual turnover not exceeding ECU 40 million or a balance sheet total not exceeding ECU 27 million is defined as an SME.

accordance with point (iii) above, that the size of the enterprises involved in the economic activities under consideration, provides a further justification for giving the notified aid a favourable treatment.

However, the Authority finds it appropriate to underline in accordance with point (iv) above, that even though the loan of NOK 2.7 million in favour of DRK satisfies the criteria contained in points (i)-(iii) for rescue aid, its favourable assessment is without prejudice to the subsequent approval of any further aid in favour of production at former RK i.a. under an eventual restructuring plan or after a change in ownership of the company.

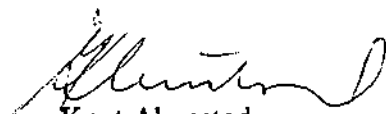
Taking into account the difficulties encountered by former RK over a protracted period and the need to ensure a strict discipline with respect to rescue aid, it is considered necessary for the Authority to be informed *ex post* on the operations of DRK during the rescue period. The Norwegian authorities have in accordance with point 7 of the Annex to the notification committed themselves to submit a report for that purpose.

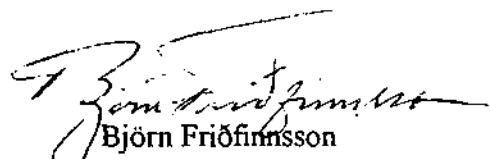
HAS ADOPTED THIS DECISION:

1. The EFTA Surveillance Authority has decided not to raise objections to Norwegian Industrial and Regional Development Fund's planned award of State aid to Driftsselskapet Rena Karton AS as notified by fax of 26 April 1996 from the Norwegian Government.
2. The Norwegian Government is obliged to submit to the EFTA Surveillance Authority a report on the operations of Driftsselskapet Rena Karton AS during the rescue period. The report shall be submitted not later than six months after the aid has been paid out.

Done at Brussels, 8 May 1996,

For the EFTA Surveillance Authority


Knut Almestad
President


Björn Friðfinnsson
College Member