

**DECISION No. 337
Of 31.12.2004**

**Concerning the State aid granted to S.C. COST S.A. Targoviste
According to the conditions laid down in Protocol 2 on European Coal and Steel
Community, Annex to the European Agreement establishing an association between
the European Communities and their Member States, on the one hand, and
Romania, on the other hand**

THE COMPETITION COUNCIL,

Having in regard the provisions of the Competition Law no.21/1996, published in the Official Gazette, Part I, no. 88 of April 30, 1996, amended and completed by GEO no. 121/2003 approved by Law no. 184/2004,

Having in regard the provisions of the Law on State Aid no. 143/1999, published in the Official Gazette, Part I, no. 370 of 03.08.1999, amended and completed by Law no. 603/2003,

Having in regard the provisions of the Europe Agreement establishing an association between Romania, on one hand, and the European Communities and their Member States, on the other hand, ratified by Law no. 20/1993, published in the in Official Gazette, Part I, no. 73 of 12.04.1993,

Based on the following:

I. PROCEDURE OF NOTIFICATION

(1) Under Note no. 17183/27.12.2004, registered at the Competition Council as no. RS-AS/111/29.12.2004, the Authority for State Assets Recovery (AVAS) notified, on the basis of article 6 of the Law no. 143/1999 on State aid with subsequent amendments and completions, the modification of the restructuring plan and of the existing aid, authorized by the Competition Council by Decision no. 114/06.04.2004, granted to S.C. COST S.A. Targoviste. The notification became effective at 29.12.2004.

II. The Legal basis for granting the aid

- Law no. 137/2002 regarding some measures for accelerating privatization, with the subsequent modifications and completions;
- E.G.O. no 50/2004 for establishing some measures regarding the finalization of privatization of firms in difficulty;
- G.O. no. 94/2004 regarding some financial measures, approved by Law no. 507/17.11.2004;
- G.D no. 577/2002 regarding the approval of the methodological norms for applying the E.G.O. no OUG nr. 88/1997 on the privatization of comercial companies, with the subsequent amendments and completions;
- Protocol 2 on ECSC products, annex to the Europe Agreement

III. Description of the measures

III.1 Description of S.C. COST S.A. Targoviste

(2) The company has been set-up by the Decision of the Ministers Council no. 1101/1969 and it was called Alloy Steel Enterprise. The first capacities – the manufacture and forging of steel – have been put into function in the period 1973-1975. In 1975, by the Decision of the Ministers Council no. 300/01.04.1975, the Alloy Steel Enterprise becomes the Special Steel Combined. By the Government Decision no. 29/1991 and according to the Law no. 15/1990 S.C. COST S.A. has been set-up by taking over the patrimony of the former COS Targoviste.

(3) The company S.C. COST S.A. Targoviste is registered in the Commercial Register with the number J 15/284/1991, the Unique Registration code 1522894, and have had, on the date of concluding the Selling-Purchasing Shares Contract a share capital of ROL 1,005,679,350,000 divided into 40,227,174 shares with a rated value of ROL 25,000/stock.

(4) The shareholder's structure after the transfer of ownership to Mechel Trading AG is as follows:

Table no. 1 The shareholder's structure before the privatisation of SC COST SA

Shareholders	CAPITAL	
	Shares number	Equity capital (%)
APAPS	33,788,927	83.995
SIF Oltenia	6,140,967	15.266
Other shareholders (Law no. 66/1993)	297,280	0.739
	40,227,174	100.000

Source: 2004 State aid notification to the Competition Council

(5) After the transfer of ownership, the Company obtained from the Ministry of Economy and Commerce the owner title for the land of 1,486,951.3 sm. After refreshing the registered capital with the land value, respectively 53,873,850,000 ROL, the shareholders structure is modified as follows:

Table no.2 The shareholder structure after the privatisation of SC COST SA

No.	Shareholder	No. of shares	Value	Percent
1.	MECHEL (CONARES Trading AG)	33,788,927	844,723,175,000	79.724%
2.	SIF Oltenia	6,140,967	153,524,175,000	14.489%
3.	APAPS	2,154,954	53,873,850,000	5.085%
4.	Others	297,280	7,432,000,000	0.702%
5.	TOTAL	42,382,128	1,059,553,200,000	100.000%

Source: 2004 the State aid notification to the Competition Council

(6) Mechel Trading AG firmly undertakes to maintain, for a period of 5 years from the closing data, a number of 5,630 employees, as existing in the company upon the closing data, save/except for the following events: retirements, termination of individual work employment contract for reason of discipline or for professional inadequacy, resignations or other natural causes.

(7) The activity of the Company is the manufacture and marketing of the special steel (alloy steel) for instruments, bars, blocks, semi-finished forged products, sections and drawn bars, bands and iron plates for electro-technical industry and other researching, projecting and supplying services activities.

(8) Currently, the productive equipment of S.C. COST S.A. Targoviste is:

Section	Type and number of installations	Annual Capacity - tones/year	
Electric steelwork no. 1	2 electric furnaces of 10 t (1973), 2 electric furnaces of 10 t (1983-1994), 3 induction furnaces of 2,5 t, vacuum de-carburetion installation (VOD), electrical re-smelting installation	39,000 liquor steel	
Drop shop of blocks and bars	2 pre-heating ingots furnaces of 1 t, 1 portative furnace, 3 pre-heating furnaces for forging ingot of 1.000 tf; 2 pre-heating furnaces SLX 40, 3 heating furnaces for radial forging machines, 5 heating furnaces for pres of 1600 tf, 5 heating furnaces for forging hammer and cooling conducted furnaces, final hot treatment furnaces	37,400	
Electric steelwork no. 2	9 electric furnaces, installation DH type import Germany, VAD-VOD vacuum installation for steel processing, blooms continuous casting 250 x 360 mm (un-finished), billets continuous casting 140 x 140 mm	1,004,000	liquor steel
Break down mill of half-finished products	10 deep furnaces, duo-reversible stands Ø 950, a break down stand Ø 850, 4 stands Ø 750, 14 slow cooling curbs of 100 t, 8 cooling curbs of 120 t	780,000	
Rolling mill of medium and small sections	Preparing train with 6 HV stands, intermediary train with 5 HV stands, final train 1 with 4 HV stands, 2 final train with 1 stand	250,000	
Rolling mill of small sections	furnace for billets, preparing train with 6 HV stands, intermediary train with 12 OV stands, final train with 6 OV stands	250,000	
Bars drawing mill	Bindings cleaning and barking installation, chemical cleaning installation for bindings, chemical cleaning installation for bars, bull blocks VO, continuous cutting installation Danielli, hot treatment furnace, polishing and cutting installation, control installations	67,000	
Rolling mill of electro-technical bands	preparing installation of bindings, normalizing installation – stapling – cleaning , polycylinder rolling mill Sendzimir, quarto –reversible rolling mill, preparing installation for cold bindings, hot treatment installation, covering installation, tunnel and vacuum hot treatment furnace, cutting installation	108,000	

Source: 2004 the State aid notification to the Competition Council

(9) The plant has all the required licenses issued by authorized institutions.

III.2 S.C. COST S.A. Targoviste Privatization

(10) The selling method of SC COST SA was the negotiation based on the final tender, improved and irrevocable.

(11) The privatization process of SC COST SA Targoviste, has been launched by publishing an announcement in the newspaper *Adevarul* on 20.03.2002, in the local newspaper *Monitorul de Prahova* and in *Financial Times* on 21.03.2002.

(12) The announcement underlined that only the interested bidders could be selected that could prove the fulfillment of pre-qualifying criteria: 5-years of minimum activity in the main field of SC COST SA or in complementary activities. The following two firms have acquired the tender book: ERDEMIR ROMANIA SRL on behalf of EREGLI DEMIR VE CELIK FABRIKALARI TAS Turkey and CONARES Holding. Further to the publishing of the Law no. 137/2002 regarding certain measures for the acceleration of privatization and of a potential buyer request, APAPS has prolonged with two times the date of the submitting the offer: on 19.04.2002 and 28.05.2002.

(13) After analyzing the documentation of potential buyers according to the legal provisions and to the requirements included in the selling announcement, the Negotiation Commission has decided that the Company Conares Trading AG Suisse, now called Mechel Trading AG, will participate to the negotiation with final offer, improved and irrevocable, within the privatization process of SC COST SA Targoviste.

(14) [...] ¹

(15) The information submitted by the Authority for Privatization and Management of State's Participations (APAPS) (currently, the Authority for the State's Assets Recovery (AVAS) leads to the conclusion that the privatization was carried out in a transparent and open way.

III.3 The Privatization Contract

(16) [...] ¹

IV. Measures Granted to Restructure S.C. COST S.A. Targoviste

(17) In the period 1998-2004, S.C. COST S.A. benefited from the following measures in the context of its restructuring and return to viability:

a) loan granted in 1998 by the Ministry of Public Finance on the base of GD no 525/1998 for the payment of electricity and natural gas in value of ROL 66 billion;

b) annulment of the debts accumulated as accessories to the credit for the payment of electricity granted in 1998 by the Ministry of Public Finance in value of ROL 59,651 billion, State aid authorized by the Competition Council through Decision no. 480/29.10.2001;

¹ Confidential data

c) exemption from the payment of delay increases for the tax on buildings unpaid in due time in the period January 2000 – July 2001, granted in 2001, in value of ROL 1,186 billion (Decree of Local Council no. 169/31.07.2001);

(18) The State aid on the basis of the Law no. 137/2002 when the Company was privatised, in total amount of ROL 2,229,968 million for the historic cumulated debts:

- Exemption from the payment of certain own debts and budgetary debts administrated by AVAS (the Authority for the Recovery of the State Assets), inclusively their accessories, in amount of ROL 144,041 million, representing :

- Restructuring funds granted to the company in the period 1993 -1997 that were not reimbursed by the Company, in amount of ROL 26,234 million;
- Residual dividends in value of ROL 667 million;
- Delay interests and penalties in amount of ROL 93,832 million;
- Delay penalties related to the restructuring fund, respectively ROL 7,548 million;
- Conversion into shares of Company's debts, respectively ROL 15,760 million.

- Exemption from the payment of interests, penalties and delay increases related to the residual debit due to the National Fund of Social Health Insurances in value of ROL 841,909 million;

- Exemption from the payment of some contributions due to the state budget, in value of ROL 192,223 million;

- Exemption from the payment of certain debts owed to the local budget of Targoviste, in amount of ROL 3,279 million, representing:

- Debts due to the local budget in amount of ROL 2,492 million and
- Delay increases and penalties in amount of ROL 787 million.

- Exemption from the payment of the debts owed to FDFEE ELECTRICA MUNTENIA NORD and SC DISTRIGAZ SUD, in total amount of ROL 1,064,274 million consisting in:

- penalties and tariff increases on electricity consumption, in amount of ROL 812,534 million and
- penalties for not paying in time the natural gas invoices in value of ROL 251,739 million.

(19) In the period 1998-2004 SC COST SA benefited of a gross state aid in amount of ROL 2,372,787 million (USD 77,225,355).

V. The Relevant Market Description

V.1 The competitive position of SC COST SA. The main competitors

(20)The measures granted to S.C. COST S.A. may affect the market of long steel products, steel bars and forged blooming.

(21) During the last years, most of the part of the Company's production was delivered on the domestic market. The main groups of products were middle and light profiles and concrete steel. The sales of heavy profiles had a decreasing trend, while the sales of drawn bars, blocks and forged bars were almost constant, but in reduced quantities.

(22) The share market of S.C. COST S.A. for products made and traded on the Romanian market:

Table no.4 The Romanian share market of SC COST SA

No.	Product	2000	2001	2002	2003
1	Heavy profiles forged and half-finished products for forge	8.0%	8.5%	8.1%	8.5%
2	Middle and light rolled products	26.6%	27.7%	27.4%	27.7%
3	Calibrated steel	49.5%	48.8%	46.5%	48.2%

Source: 2004 the State aid Notification to the Competition Council

(23) Although the entire assortment of products is available to export markets, during the last years, the Company sold significant quantities of concrete steel. Because in the last year, the weight of the concrete steel in total exports reached 80%, the sales of other products decreased to only a few thousands tonnes/year. The heavy profiles and steel bars almost disappeared from the Company's portfolio for export. Until 2002, the main export markets of the Company were USA, West-Europe (Germany, Italy, Great Britain and Portugal), Bulgaria and the former Yugoslavia.

VI.2. Product Sale Programme

(24) COST Targoviste plans to reassert its leading position in the field of special steels on the domestic market. The Sales Plan developed for the following years and the investment plan foreseen are conceived to meet that target. According to the Sales Plan submitted, the deliveries of reinforcing bars will be drastically reduced, to a little bit more than 10% of the total output (i.e., just as required from a material flow / production planning point of view). The production of mainly alloyed medium and light sections is forecasted to increase to almost five-times compared to 2002, reaching 323 K tones by 2005. As well, the increase of production of forged bars and blocks as well as the one of drawn bars is expected to account for approximately 15% of the total output.

Table no 5: The Production Programme structure of CS Targoviste 2003 – 2008²

Products	(thousand tones)					
	2003	2004	2005	2006	2007	2008
Heavy sections	[...]	[...]	[...]	[...]	[...]	[...]
Medium and light sections	[...]	[...]	[...]	[...]	[...]	[...]
Reinforcing bars	[...]	[...]	[...]	[...]	[...]	[...]
Drawn bars	[...]	[...]	[...]	[...]	[...]	[...]

² Confidential data

Heavy forgings	[...]	[...]	[...]	[...]	[...]	[...]
Total	[...]	[...]	[...]	[...]	[...]	[...]

(25) S.C. COST S.A. aims to achieve domestic sales of 437 K tones by 2005, increasing the share of domestic deliveries to 85% of the total sales, driven by the strong increase of the medium and light sections output.

Table no. 6 The Production Programme structure of CS Targoviste on domestic market 2003 – 2008
(thousand tones)

Products	2003	2004	2005	2006	2007	2008
Heavy sections	27	43	42	42	42	42
Medium and light sections	92	201	293	293	293	293
Reinforcing bars	112	50	48	48	48	48
Drawn bars	29	30	33	33	33	33
Heavy forgings	7	15	22	22	22	22
Total	266	339	438	438	438	438

(26) [...]²

Table no. 7 The Production Programme structure of CS Targoviste on external market 2003 – 2008²
(thousand tones)

Products	2003	2004	2005	2006	2007	2008
Heavy sections	[...]	[...]	[...]	[...]	[...]	[...]
Medium and light sections	[...]	[...]	[...]	[...]	[...]	[...]
Reinforcing bars	[...]	[...]	[...]	[...]	[...]	[...]
Drawn bars	[...]	[...]	[...]	[...]	[...]	[...]
Heavy forgings	[...]	[...]	[...]	[...]	[...]	[...]
Total	[...]	[...]	[...]	[...]	[...]	[...]

Source: S.C. COST S.A. Targoviste Business Plan

(27)After privatization, COST Targoviste gained access to the strong international sales and marketing network of Mechel Trading. Moreover, as Mechel already owns other special steel plants, too, Targoviste will benefit of the special steels trading capabilities of Mechel, crucial for Targoviste in its effort to reinstall itself on the export markets.

VII. The Restructuring Plan

(28) Following the negotiations with the Romanian State on the Sale-Purchase of the majority share-package, Mechel Trading AG has committed to perform development investments in amount of USD 13,772,000 except any other investments from its own sources, consisting in cash amounts transferred to the company by the purchaser, in its name and on its account. The Purchaser undertakes also to make available to the Company, upon the closing date, a working capital of USD 4,500,000, out of which USD 3,500,000 until the end of the first investment year and USD 1,000,000 in the second investment year. Mechel Trading AG has committed to invest USD 7,300,000 for the environment protection over a period of five years.

(32) The modernization of the continuous caster will improve the metal output and will determine the costs reduction for the middle and light profiles (these were obtained from ingots steel) and for drawn bars (presently obtained during the casting flow in ingots – rolling process).

(33) Other projects having as purpose the reduction of costs and of energy consumption, are:

- new burners added to the EBT from the steel shop no. 2, which will increase the productivity through reducing tap-to-tap time;
- the modernization of the vacuum degassing station from the steel shop no. 2 which will reduce to maximum the downgrades and it will increase the quality of the steel;
- the installation of an intermediate quality control equipment for billets, which will determine a lower energy consumption at the rolling mills and it will also help to detect flaws and to decrease the rejection rates.

VII.3 The Environment Protection Programme

(34) [...] ⁴

Table no. 9 The Environment Protection Investment Plan of SC COST SA Targoviste 2003 – 2007⁴

No.	Measure	Deadline	The assessment of implementation costs (USD million)
1.	[...]	[...]	[...]
2.	[...]	[...]	[...]
3.	[...]	[...]	[...]
4.	[...]	[...]	[...]
5.	[...]	[...]	[...]
6.	[...]	[...]	[...]
7.	[...]	[...]	[...]
8.	[...]	[...]	[...]
9.	[...]	[...]	[...]
10.	[...]	[...]	[...]
	TOTAL		[...]

Source: 2004 The State Aid Notification to the Competition Council

(35) Thus, the measures for environment protection will aim to the following:

- Fumes gathering and cleaning from OE2 and mixed rolling mill;
- Warehousing and manipulating dangerous substances;
- Mill scale and slime briquette, resulting from the rolling plant and from the continuous caster.

VII.4. Financial Restructuring

⁴ Confidential data

(36) The financial restructuring comprises a series of measures concerning the historical debts of S.C. COST S.A. Targoviste, mainly the erase of penalties and other fees for payment delay or for the failure to pay the debts in due time to the State budget. An important part of the accrued penalties correspond to the production capacities which were closed between 1991 and 1999.

(37) The debts corresponding to the production capacities which were closed are reflected in the balance sheets of the Company between 1993 and 2002 and led to the increase of the debts of the Company. The Romanian Company had not initiated an immediate financial restructuring, which led to the difficult economic-financial situation in 2002. The penalties and other fees for late payment have continued to rise up to the moment of the transfer of ownership to Mechel Trading AG, when they were written-off.

(38) The financial restructuring has involved the following measures:

- the granting of a loan for the payment of electricity and natural gas;
- the annulment of the debts cumulated as accessories to the credit for the payment of electricity;
- exemption from the payment of delay increases calculated for the tax on buildings;
- State aids granted in the moment of privatisation in the form of:
- exemption from the payment of certain contributions to the State budget;
- exemption from the payment of delay increases and penalties related to the obligations owed to the National Single Fund of Social Health Insurances;
- exemption from the payment of certain own debts and budgetary credits administrated by the Authority for State Assets Recovery, including their accessories;
- exemption from the payment of certain debts owed to the local budget;
- exemption from the payment of residual debits owed to S.C. FDFEE ELECTRICA MUNTENIA NORD S.A. and S.C. DISTRIGAZ SUD S.A.

VII.5 The reduction of capacities

(39) In 1989, in Romania, the production capacities reached about 18 million tonnes per year. Beginning with 1990, the steel production began to decline, due to the low domestic demand of metal. In 1993, the Romanian steel industry had a capacity of 17.4 million tonnes of steel/year. In 2003, the capacity was about 9.4 tonnes of steel/year.

(40) For S.C. COST S.A. the level of the steel production capacities is presented as follows:

Table no 10. The evolution of the steel production capacities UM = thousands tones

Steel shop	1993 – projected capacity	2008- projected capacity	1993-2008 Modifications
Electric steel shop no. 1	60	54	- 6
Electric steel shop no. 2	1,000	575	-425
Total	1,060	629	-431

Source: Annex to the Strategy of Restructuring the Romanian Steel Industry for the period 2004 – 2008

(41) The period when these capacities were closed and the dismembering is presented in Table no. 11.

Table no. 11 The period of closing/dismembering the capacities

Capacity/installation	Closed capacity (thousand tonnes/year)	Year (period)	
		closures	dismembering
Steel shop no. 1	-6	1998	1999
Steel shop no. 2	-425	1991-1999	2000-2005

Source: Annex to the Strategy of Restructuring the Romanian Steel Industry for the period 2004 – 2008

VII.6. Restructuring costs, financing sources and the envisaged financial situation

(42) The restructuring costs include the technological investment cost, the environment protection investment cost, the employment restructuring cost and the financial restructuring cost and they are presented in Table no. 12.

Table no. 12 Restructuring costs **USD million**

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Total	Financing sources
Technological restructuring costs						-	1.0	4.0	4.0	4.8	13.8	Mechel Trading AG
Environment restructuring costs						-	1.0	2.0	2.0	2.3	7.3	Mechel Trading AG
Social restructuring	0.014	0.012	0.01	0.011	0.013		0.013				0,073	The company and Mechel
Working capital						3.5	1.0				4.5	Mechel Trading
Financial restructuring, of which: - historical debts write-off; - payments of debts	7.4	-	-	2.1	-	32.1	33.5 4.9	-	-	-	77.1 4.9	-State aid -Mechel Trading AG
Total	7.414	0.012	0.010	4.111	0.013	35.6	41.41	6.0	6.0	7.1	107.67 3	

Source: The Authority for State Assets Recovery

(43) The total gross cost of the restructuring made from the technological investment cost, environment protection investment cost and financial restructuring cost is in amount of USD 107.673 million, out of which the Company's contribution is of USD 30.6 million.

VIII. Assessment of the Measures

(44) Under the EA, Romania has undertaken to respect certain rules as regards the granting of the State Aid to undertakings operating in Romania. The Competition Council

must assess the aid granted in the light of national law, and Romania's obligations under the EA, which entitle Romania to grant State aid to the steel industry for restructuring purposes up to the date of accession, provided certain conditions are met. It is useful for the Competition Council to consider the *acquis communautaire* applicable to the State aid under consideration, bearing in mind the particular situation of the steel industry.

VIII.1 The State aid character of the facilities granted to SC COST SA

(45) According to Article 2 of the State aid law no. 143/1999, with the subsequent amendments and completions any measure of support granted by the state or the local administrative authorities, from state resources or local administrative authorities' resources, regardless of its form, that distorts or threatens to distort competition, by favoring certain undertakings, the production of certain goods, the provision of some services or affects the commerce between Romania and the EU Member States, being considered incompatible with a normal competitive environment.

(46) The facilities granted to SC COST SA meet the criteria stipulated in Article 2 of the Law no. 143/1999 on State aid, amended and completed by the Law no 603/2003 (hereinafter called Law), and of Article 87 (1) of the EC Treaty, having in view that:

- they are granted from State resources (State budget and local budget);
- they constitute measures in the support of an undertaking, respectively SC COST SA to which it is offered an advantage compared to the other undertakings;
- they may affect the trade between Romania and the Member States of the European Union as the products manufactured by the Company are marketed both in the country and on the external market, thus competing with the products of the European undertakings acting on the same relevant market.

VIII.2 Compatibility assessment

(47) In assessing the compatibility of the State aid, the Competition Council has to evaluate whether the measures are compatible with a normal competitive environment in accordance with the provisions of Article 2 paragraphs (2) and (3) of the Law and with the applicable *Acquis* as agreed upon in the Europe Agreement. It must therefore assess whether the measures are covered by one of the exemptions to the general prohibition of State aid.

(48) The criteria applicable to the State aid for the steel sector are laid down in Protocol 2 on ECSC products, Annex to the Europe Agreement establishing an association between the European Communities and their Member States on one hand, and Romania on the other hand.

(49) The State aid granted to S.C. COST S.A Targoviste aims to facilitate the restructuring of Company. According to Article 9 of Protocol 2, the Restructuring aid may be approved if it strictly fulfils the criteria and if it is certain that the advantages that

result out of the survival of the undertaking will compensate for any distortion of the competition, especially if the net effect of collective redundancies, as a consequence of the companies' bankruptcy, combined with the effects that it can have upon the suppliers, would exacerbate the unemployment problems on national level.

(50) In accordance with the provisions of Protocol 2 on ECSC products, Romania can grant a Restructuring aid to Steel companies if it leads to the viability of the benefiting firms under normal market conditions at the end of the restructuring period and the amount and intensity of such aid are strictly limited to what is absolutely necessary in order to restore such viability and are progressively reduced. Moreover, the restructuring programme must be linked to a rational globalization and a reduction of the production capacity in Romania.

VIII.2.1 Firm in Difficulty

(51) According to the Commission's Guidelines on the restructuring aid, a firm is in difficulty where it is unable to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to go out of business on short or medium term. The usual signs of a firm being in difficulty are increasing losses, diminishing turnover, increasing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value. In acute cases, the Company may already have become insolvent or may be the subject of collective insolvency proceedings brought under its domestic law.

(52) The difficult problems that S.C. COST S.A. Targoviste is facing at the moment of privatization should be analyzed in the context of the crisis through which the steel industry of Romania passes. Its decline began in 1990. The difficult economic situation is generated, on one hand, by the decrease of the demand on the internal market and the costs imposed by a significant technological gap, compared to the external market competitors, and, on the other hand, by the difficulties in respecting the rules imposed by its presence on the free and global market.

(53) In the same time, the economic – financial situation of S.C. COST S.A. Targoviste was negatively influenced by the increase of the purchase price of the raw materials (iron cast), utilities (methane gas, energy) over the inflation index and over the selling price increase index, imposed by the metallurgic products market.

(54) On the privatization moment, the situation of S.C. COST S.A. Targoviste was extremely severe. The Company had accumulated debts in value of over ROL 2,156 billion compared to the share capital of ROL 1,105 billion S.C. COST S.A. Targoviste is facing a lack of capital, having net assets in value of only ROL 19.8 billion. Only the commercial debts of S.C. COST S.A. Targoviste were in value of ROL 1,005 billion on 31.03.2002, being a bit lesser than the share capital.

(55) The historical debts of the Company, that permanently generated new penalties and supplementary charges, could not be paid by the Company taking into consideration

the accentuate increase of the current purchase prices for the raw materials and utilities and the necessity to develop certain programmes for investing and modernizing the equipment from the productive sector in which the future activity of the Company was compromised. Besides all these aspects, the tougher and tougher competition on the steel market, manifested even on the internal market, would have lead only to the aggravation of the situation of S.C. COST S.A. Targoviste.

(56) The immediate consequences would have been the entering of the company in payment incapacity, because of the accumulated debts. This measure would have lead, on one hand, to the lay-off a large part of the 5,400 employees, and on the other hand to the disappearance of a most important metallurgic center for the machine building industry, being known the fact that this Company is the only Romanian Company capable to produce, by its own technical endowments, high alloyed steels, stainless tools.

(57) Considering the evolution of the main economic-financial indicators the following can be observed:

a) Diminishing of the own capitals:

- thousand ROL-

	2000	2001	2002
Own capitals	1,082,526,481	158,399,817	16,599,470
Profit/Loss	+18,529,090	-909,870,086	-406,413,730
Loss/Own capitals (%)	-	574	2448

Source: 2004 The State Aid Notification to the Competition Council

b) Evolution of Turnover

- thousand ROL -

	2000	2001	2002
Turnover	2,080,059,680	3,058,228,673	2,957,287,813
Turnover expressed in 2000 comparable prices	2,080,059,680	2,347,067,286	1,919,931,328

Source: 2004 The State Aid Notification to the Competition Council

c) *The increase of the degree of indebtedness* calculated as a ratio between the total debts and the total liability

- thousand ROL -

	2000	2001	2002
Total debts	1,100,741,934	2,210,437,944	1,654,404,668
Total liability	2,257,978,237	2,372,252,832	1,671,421,327
Total debts/total liability	49%	93%	99%

Source: 2004 The State Aid Notification to the Competition Council

d) *The decrease of the patrimony solvability* calculated as ratio between its own capital and the total liability

- thousand ROL -

	2000	2001	2002
Own capital	1,082,526,481	158,399,817	16,599,470
Total liability	2,257,978,237	2,372,252,832	1,671,421,327
Solvability (%)	48	7	1

Source: 2004 The State Aid Notification to the Competition Council

e) *The negative economic accountability* calculated as operating profit/turnover
- thousand ROL -

	2000	2001	2002
Gross operating Profit	53,668,757	-925,618,136	-392,431,164
Turnover	2,080,059,680	3,058,228,673	2,957,287,813
Economic accountability (%)	2,6	-30	-13

Source: 2004 The State Aid Notification to the Competition Council

f) *Increase of losses*

From the balance sheets, it results the fact that during 2001-2002 the Company registered a cumulated loss of ROL 1,316,283,816 thousand, of around 1.2 times the registered capital.

g) *The increase of the stocks volume*

Year	2000	2001	2002
Stocks	694,962,461	804,790,175	795,648,255

Source: 2004 The State Aid Notification to the Competition Council

i) *The diminishing of the net assets*

(58) Beginning with 2000, the net assets decreased from ROL 1,157,236,303 thousand, to ROL 161,814,888 thousand in 2001 and to ROL 17,016,659 thousand in 2002, recording a decrease of 68 times, in a period of 3 years.

(59) From the analysis of the balance sheets it results that, in 2001 the debts were doubled compared to the previous year (from ROL 1,100,741,934 thousand to ROL 2,210,437,944 thousand), and in 2002 it is recorded a slight decrease of these, down to the value of ROL 1,654,404,668 thousand.

(60) The increase of the losses, the increase of the stocks volume, the debts accumulation, the diminishing of the value of the net assets, the diminishing of its own capital, the increase of the degree of indebtedness and the inexistence of an over-capacity of production, as they were reflected in the upper economic analysis, prove that it is a firm in difficulty.

VIII.2.2 Restoration of viability

(61) As provided by Article 9(4) in Protocol 2 on ECSC products, as well as by Article 12 paragraph (3) from the Regulation on state aid for rescuing and restructuring firms in difficulty, the implementation of the measures contained by the restructuring plan must assure to the firm the long-term viability and the functioning on its own resources. The fulfilment of viability criteria represents an essential element in the assessment of the Competition Council on the compatibility of the State aid with a normal competitive environment.

(62) Considering that the steel sector represents a sensitive sector within the European economy and taking into account the experience of EU in restructuring the steel sector, the analysis on the restructuring of the undertaking's viability of the Competition Council was based on the viability test of the European Commission.

(63) The main viability indicators (criteria) are the following:

V_1 – gross operating margin;

V_2 – gross profit ratio.

(64) At the end of the restructuring period, the viability indicators for S.C. COST S.A. Targoviste must reach the following values:

- V_1 must represent 10% times more out of the revenue obtained from selling steel products;
- V_2 must be 1.5% times more out of the revenue obtained from selling steel products.

(65) In order to analyze the viability indicators in the European Commission Test, the Company made a 5-year forecast of the evolution of the Income Statement, the Balance Sheet and the cash flow, based on the current prices. This meant:

- Forecast of revenues based on the selling price and the production volume estimated in the context of potential development of the steel international market;
- Estimation of operational costs by applying different inflation rates for materials, energy and fixed costs.

(66) In the first set of financial forecasts, the application of the viability test is based on the revenues and costs of the undertaking. The costs and revenues taken into account are those afferent to the metallurgic production. The turnover is the one resulted from the revenues collected from the steel product sale.

Table no. 13 The Forecast of the Income Statement for a 5 year period based on current prices⁵
USD Thousand

	2003	2004	2005	2006	2007	2008
Revenues from steel sales	[...]	[...]	[...]	[...]	[...]	[...]
COGS (Costs of Goods Sold)	[...]	[...]	[...]	[...]	[...]	[...]
Gross profit	[...]	[...]	[...]	[...]	[...]	[...]
Selling, General, Administrative	[...]	[...]	[...]	[...]	[...]	[...]

⁵ Confidential data

EBITDA	[...]	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]	[...]
Operating profit	[...]	[...]	[...]	[...]	[...]	[...]
For. exchange expense	[...]	[...]	[...]	[...]	[...]	[...]
Other income / expense	[...]	[...]	[...]	[...]	[...]	[...]
EBIT	[...]	[...]	[...]	[...]	[...]	[...]
Interest expense	[...]	[...]	[...]	[...]	[...]	[...]
EBT	[...]	[...]	[...]	[...]	[...]	[...]
Income tax	[...]	[...]	[...]	[...]	[...]	[...]
Net income	[...]	[...]	[...]	[...]	[...]	[...]

Source: S.C. COST S.A. Targoviste Business Plan

(67) The application of the Viability Test of the European Commission implies the checking of the following indicators:

- the level of depreciation/amortization (which has to represent minimum 5% out of steel sales revenue);
- the level of financial charges (which has to represent minimum 3.5% out of the steel sales revenue).

(68) The data presented hereinbefore led to the following situations, in matters regarding the depreciation and the level of financial charges:

Table no. 14 The Situation of the depreciation/amortization level ⁵
USD Thousand

USD thousand	2003	2004	2005	2006	2007	2008
Turnover	[...]	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]	[...]
% of turnover before adjustment	[...]	[...]	[...]	[...]	[...]	[...]
% of turnover (minimum necessary)	[...]	[...]	[...]	[...]	[...]	[...]

Source: Competition Council calculation based on the S.C. COST S.A. Targoviste Business Plan

Table no. 15 Situation of the level of financial charges⁶

	USD Thousand					
Mii USD	2003	2004	2005	2006	2007	2008
Turnover	[...]	[...]	[...]	[...]	[...]	[...]
Forecasted financial charges	[...]	[...]	[...]	[...]	[...]	[...]
% of turnover	[...]	[...]	[...]	[...]	[...]	[...]

⁶ Confidential data

before adjustment						
% of turnover (minimum necessary)	[...]	[...]	[...]	[...]	[...]	[...]

Source: Competition Council calculation based on the S.C. COST S.A. Targoviste Business Plan

(69) The data presented in the Tables no. 12 and 13, following the forecasts for 5 years, led to the conclusion that the undertaking does not fulfil the criterion of the financial charges absolutely necessary for the application of the Viability Test. So, it is necessary a second set of financial estimations by applying the special accounting conditions to the first set of financial forecasts

Table no. 16 The Forecast of the Income Statement for a 5 year period based on current prices after adjustments for financial expenses⁶

	2003	2004	2005	2006	2007	2008
Revenues from steel sales	[...]	[...]	[...]	[...]	[...]	[...]
COGS (Costs of Goods Sold)	[...]	[...]	[...]	[...]	[...]	[...]
Gross profit	[...]	[...]	[...]	[...]	[...]	[...]
Selling, General, Administrative	[...]	[...]	[...]	[...]	[...]	[...]
EBITDA	[...]	[...]	[...]	[...]	[...]	[...]
Depreciation	[...]	[...]	[...]	[...]	[...]	[...]
Operating profit	[...]	[...]	[...]	[...]	[...]	[...]
For. exchange expense	[...]	[...]	[...]	[...]	[...]	[...]
Other income / expense	[...]	[...]	[...]	[...]	[...]	[...]
EBIT	[...]	[...]	[...]	[...]	[...]	[...]
Interest expense	[...]	[...]	[...]	[...]	[...]	[...]
EBT	[...]	[...]	[...]	[...]	[...]	[...]
Income tax	[...]	[...]	[...]	[...]	[...]	[...]
Net income	[...]	[...]	[...]	[...]	[...]	[...]

Table no. 17 The Forecast of the Income Statement for a 5 year period based on current prices after adjustments for financial expenses, incomes and costs⁶

	%	2003	2004	2005	2006	2007	2008
Revenues from steel sales	98.75	[...]	[...]	[...]	[...]	[...]	[...]
COGS (Costs of Goods Sold)	101.25	[...]	[...]	[...]	[...]	[...]	[...]
Gross profit		[...]	[...]	[...]	[...]	[...]	[...]
Selling, General, Administrative		[...]	[...]	[...]	[...]	[...]	[...]
EBITDA		[...]	[...]	[...]	[...]	[...]	[...]
Depreciation	101.25	[...]	[...]	[...]	[...]	[...]	[...]
Operating profit		[...]	[...]	[...]	[...]	[...]	[...]
For. exchange expense	101.25	[...]	[...]	[...]	[...]	[...]	[...]
Other income / expense		[...]	[...]	[...]	[...]	[...]	[...]
EBIT		[...]	[...]	[...]	[...]	[...]	[...]
Interest expense	101.25	[...]	[...]	[...]	[...]	[...]	[...]
EBT		[...]	[...]	[...]	[...]	[...]	[...]
Income tax		[...]	[...]	[...]	[...]	[...]	[...]
Net income		[...]	[...]	[...]	[...]	[...]	[...]

(70) After the application of the Viability Test, the two viability indicators can be determined:

V_1 (gross operating margin) = EBITDA / (steel sale revenue)

V_2 (gross profit ratio) = EBIT / (steel sale revenue)

Table no. 18 Viability indicators

	2003	2004	2005	2006	2007	2008
EBITDA/SALES>10%	5.62%	3.7%	12.7%	10.9%	8.4%	12.7%
EBIT/SALES >1,5%	-4.35%	-4.9%	4.1%	2.3%	-0.2%	4.1%

(71) The Competition Council notes that at the end of the assessed period – 2008, SC COST SA will fulfil the Viability Criteria set by the European Commission.

VIII.2.3. The value and intensity of the Aid limited to the minimum necessary

Minimum value of the aid

(72) According to the provisions of Protocol 2 on ECSC products the State aid should be limited to the minimum necessary in order to allow the restructuring according to the financial resources of the undertaking or of the shareholders. The level of the State aid should be strictly limited up to a level of fulfilling the objectives of the Restructuring Plan.

(73) Because of the difficult financial situation which the company was facing, in order to stay on the market, it was necessary its privatization and the granting of a state aid for restructuring. Thus, in August 2002, the majority shares of S.C. COST S.A Targoviste were bought Mechel Trading A.G.

(74) The analysis of the economic – financial situation of the company reflected the fact, in order S.C. COST S.A. to pass over the difficult situation it is facing and to remain in the economic circuit, it was necessary a substantial financial restructuring by write-off historical debts.

(75) The Romanian authorities granted to S.C. COST S.A. in the period 1998-2004 a state aid as write-off debts and penalties in value of ROL 2,372 billion (USD 77,2 million). During the period 1993-1997, SC COST SA benefited de of State aid in amount of ROL 26.4 billion.

(76) The investor assumes by the Share Purchase Agreement to pay by its own sourced budgetary debts of the company which are rescheduled, in amount of USD 1.558 million and commercial debts to DISTRIGAZ SUD in amount of USD 3.345 million. Also, the investor assume to oblige COST to pay ROL 21 billion, representing credits granted by AVAS for paying the bills to energy and natural gas suppliers, as well as ROL 5.4 billion, representing funds for restructuring granted to COST.

(77) The investor assumes technological and environment investments and working capital with a value of USD 25.572 million, the own contribution representing 27.0% from the restructuring costs.

(78) The Competition Council concludes that the State aid granted is limited to the minimum necessary because the Company is relieved from the paying of historical debts. The state aid allows Company to be eligible for credits. It results that by granting this aid there had not been granting new supplementary liquidities, so it is necessary that the Company and the new investor have to develop a minimum investment programme in order to reach the viability parameters.

VIII.2.4. Intensity of the aid

(79) The amount of the aid has to be strictly limited until the level of accomplishing the restructuring programme's objectives (the accomplishment of viability).

(80) The criterion of the intensity of the aid requires an examination of whether the minimum necessary aid is still too high, i.e. the State' participation is too large to be considered proportional and therefore cannot be justified, even if this means that the company concerned may not be restructured at all.

(81) The intensity of the restructuring aid is 73.0% (USD 82.8 million restructuring state aid divided by USD 113.4 million which represents the value of the restructuring costs. The Competition Council takes the view that in the special circumstances of this restructuring case, this is an appropriate level of State aid intensity.

VIII.2.5. No undue distortion of Competition – compensatory measures

(82) The compulsory limitation or reduction of the Company's presence on the relevant market represents a compensatory factor in favour of its competitors. It should be in proportion with the distortive effects of the aid and, in particular, to the relative importance of the firm on its market or markets.

(83) The Competition Council assessed the closing and the dismember of capacities in S.C. COST S.A. Targoviste case and concludes that by closing 431 thousand tonnes/year of Electric Steel Shop, out of which 425 thousand tonnes/year had been dismembered in the year 2000-2005, the negative effects which arise from the granting of the aid have been compensated.

VIII.2.5 The evolution of the State aid

Table no. 15 The evolution of the state aid

Table no. 15 The evolution of the state aid										USD million	
Year	1993-1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005-2008
Granted State aid	-	3.4	2.2	7.4	-	-	2.1	-	32.1	33.5	-

(84) As shown in the Table no. 15, the State aid will not be any longer granted after 2004.

(85) S.C COST S.A. Targoviste benefited of State aids for restructuring for the period 1993 – 1997, in amount of ROL 26,460 million (USD 5.6 million).

IX. Annual monitoring and reporting

(86) The Competition Council continuously monitors the implementation manner for the Restructuring Plan, so that it would not divagate from the accomplishment of the Restructuring Plan's objectives. Any modification of the Restructuring Plan or of the State aid's quantum must be notified for re-assessing the granting conditions for the State aid.

(87) The Competition Council continuously monitors the implementation manner till the end of the restructuring period in order to ensure there will be no increases of the production capacities, major deviations from achieving the restructuring measures, and that the state aid will not create additional liquidities which will be used for activities other than the ones listed in the Restructuring Plan.

IX .Conclusions

(88) Taking into account the above presented, the Competition Council concludes that the State aids meet the criteria for authorization under Protocol 2 on ECSC products, attached to the European Agreement setting the association with Romania, on one hand, and the European Communities and the Member States, on the other hand, and they are compatible with a normal competitive environment.

DECIDES

Art. 1. According to paragraph (1) and (2) of Article 12 of Law No. 143/1999 on the State Aid, with the subsequent modifications and completions, authorizes the modification of the State aid authorized by the Competition Council by Decision no. 480/29.10.2001, Decision no. 559/27.12.2001 and Decision no. 114/2004, granted to SC COST SA Targoviste. Also, by this decision it is authorized the State aid granted to SC COST SA Targoviste during the period 1993-1997, in amount of ROL 26,460 million (USD 5.6 million).

Art. 2. The total amount of State aid authorized by this decision in benefit of SC COST SA Targoviste during the period 1993-2004 is of ROL 2,399,027 million (USD 82.8 million).

Art. 3. This Decision shall be applicable as of the date it is communicated.

Art. 4. According to the provisions of Article 29 of Law No. 143/1999 on the State aid, as amended, this Decision may be challenged by the interested parties at the Court of

Appeal Bucharest, Administrative Litigation Section, within thirty days of the date of its communication.

Art. 5. This Decision shall be notified by the Secretariat General of the Competition Council to:

- Authority for State Assets Recovery, str. Cpt. Av. Alexandru Serbanescu, nr. 50 sector 1;
- SC COST SA Targoviste, str. Soseaua Gaesti, nr. 11, Judetul Dambovita.

Art. 6. The General Secretariate and the Direction for State aid Authorization will follow the enforcement of this decision.

PRESIDENT

MIHAI BERINDE