

II

(Acts adopted under the EC Treaty/Euratom Treaty whose publication is not obligatory)

DECISIONS

COMMISSION

COMMISSION DECISION

of 21 October 2008

on the State aid C 9/07 (ex N 608/06) which Spain intends to grant to Industria de Turbo Propulsores

(notified under document number C(2008) 6011)

(Only the Spanish version is authentic)

(Text with EEA relevance)

(2009/179/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to those provisions ⁽¹⁾,

Having regard to those comments,

Whereas:

(2) By letter of 21 March 2007, the Commission notified to Spain its decision to initiate proceedings based on Article 88(2) of the EC Treaty on the abovementioned measure.

(3) The decision of the Commission to initiate proceedings was published in the *Official Journal of the European Union* ⁽²⁾. The Commission invited interested parties to submit their observations on the measure.

(4) Spain submitted its observations on 4 June 2007.

(5) By letter of 13 June 2007, the beneficiary of the aid, Industria de Turbo Propulsores (hereinafter ITP), submitted its observations.

(6) By letter of 13 June 2007, Rolls-Royce (hereinafter RR), which in the decision to open proceedings had been indicated as a potential beneficiary of indirect aid, submitted its observations.

1. PROCEDURE

(1) By letter of 11 September 2006, Spain notified to the Commission the measure relating to State aid that it intended to grant to Industria de Turbo Propulsores.

(7) By letter of 19 June 2007 the Commission forwarded these observations to Spain, which submitted its comments on 12 July 2007.

⁽¹⁾ OJ C 108, 12.5.2007, p. 18.

⁽²⁾ See footnote 1.

- (8) The Commission requested supplementary information from the parties in the case in letters dated 19 December 2007 to Spain, ITP and RR. shares are held by Sener Aeronáutica (53,125 %) and Rolls-Royce (46,875 %).
- (9) ITP replied by letter of 25 February 2008.
- (10) Spain replied by letter of 29 February 2008.
- (11) RR replied by letter of 5 March 2008.
- (12) On 12 March 2008, the Commission forwarded to Spain the information received from ITP and RR. Spain submitted its comments on this information on 9 April 2008.
- (13) By letter of 26 June 2008, the Commission has requested further information from Spain.
- (14) Spain replied by letter of 17 July 2008. Spain then submitted a revised version of this letter on 7 August 2008.
- (15) Finally, by letter of 18 September 2008, Spain provided a final calculation of the amount of the aid, together with corrected payment and reimbursement schedules.
- (19) ITP is an engine manufacturer in the aerospace sector. Its activities are the design, R & D, manufacture, assembly and testing of aeronautical engines and gas turbines. It was created in 1991. It has participated in the development of other engines, in the military sector, such as the EJ200 for the Eurofighter Typhoon, and in the civil sector, such as Trent 500 and Trent 900. It has received aids for these last two programmes ⁽³⁾.
- (20) The notified measure concerns support for the research and development (R & D) activities carried out by ITP for the Trent 1000. Besides the Trent 1000, the B787 aircraft will also be powered by another engine, called GenX, which is being developed by General Electric together with a number of partners.
- (21) The Trent 1000 is being developed by RR and a number of risk and revenue sharing partners (RRSP) which include, beyond ITP, the following companies: Mitsubishi Heavy Industries, Kawasaki Heavy Industries, Goodrich, Hamilton Sundstrand and Carlton Forge. The Trent 1000 received airworthiness certification on 7 August 2007. Its entry into service is however delayed because of major delays in the development of the aircraft itself with respect to the initial schedule.
- (22) ITP participates as a RRSP in the Trent 1000 project with a share of 11 %. A Memorandum of Understanding was signed with RR on 28 September 2004. The final risk and revenue sharing agreement (RRSA) was signed by the two companies on 15 July 2005.

2. OBJECTIVE OF THE MEASURE

- (16) The Spanish authorities would like to grant aid to ITP for its participation in the Trent 1000 engine, which is being developed by RR for the Boeing B 787 aircraft. The project started in 2005 and will end in 2009.
- (17) The aid beneficiary — ITP — is an aero engine company located in Spain. Its main site is located in an assisted area in the Basque country. Other facilities around Madrid are also located in an assisted area (Article (87)(3)(c) of the EC Treaty).
- (18) ITP is a large enterprise: its total sales in 2006 amounted to around EUR 439 million. The number of employees of ITP and its subsidiaries is around 2 400 people. Its
- (23) The total investment by ITP in the project amounts at EUR [...] (*), divided as follows: EUR [...] for R & D costs; more than EUR [...] for industrial investments for the production of the turbine; EUR [...] of other costs (IT, certification, transport, etc.).
- (24) ITP is in charge of developing the low pressure turbine for the new engine. The ambitious technological objectives fixed by RR for the development of the low pressure turbine are: reduction of the acquisition cost by [...] %; reduction in the design time by [...] %; reduction in weight by [...] %; reduction of the noise level by [...] dB.

⁽³⁾ Cases C 38/01 and N 165/03, respectively.

(*) Business secret.

(25) To achieve these objectives, the R & D activities carried out by ITP face several challenges:

- new materials and processes: new materials will be used for the first time for some components, thus requiring new processes,
- mechanical technology: ITP will develop a new system of sealing, optimise the embedding and improve the structure,
- aerodynamics: new design of profiles,
- technology and methodology: the time required for the design of this engine is one year less than for previous engines; for RR to achieve this requirement, ITP has to introduce adequate tools for iterative calculations.

3. DOUBTS RAISED IN THE DECISION TO OPEN PROCEEDINGS

(26) The Commission decided to open proceedings in the first place because it did not have at its disposal sufficient information concerning the aid decision (only the second tranche had been notified by Spain). Even after two detailed requests for information had been sent ⁽⁴⁾, factual information on the aid granted was insufficient.

(27) Secondly, the Commission had doubts or lacked information, or both, on various issues:

- the market failure needed to be demonstrated,
- the incentive effect was not proven,
- there were various doubts concerning the classification of the activities under the R & D categories and on the eligibility of the costs,
- there were doubts concerning the aid instrument and on the aid intensity,

— there was a doubt on the application of the regional bonus,

— there was a doubt on the application of the bonus for international collaboration,

— there was a possible indirect aid to RR,

— there was a doubt on the relevant market and on the impact on competition.

(28) Given the factual uncertainties and the number of doubts raised, the decision will in the first place define its scope, in particular concerning the decision-making process (and the two-step approach adopted by the Spanish authorities). Subsequently, the decision will examine the presence of aid and will clarify the rules applied in order to assess the compatibility of the measure. It will then clarify all the doubts raised in the decision to open proceedings.

(29) In order to avoid repetitions and facilitate comprehension, the information gathered during the investigation, including the observations provided by Spain and by the parties, will be presented for each issue.

4. TWO TRANCHES OF A SINGLE AID

(30) Firstly, in the decision to open proceedings the Commission had a doubt concerning the scope of the notified measure, notably whether the aid under assessment was limited to the notified aid, or whether it included also a loan that Spain had already granted to ITP for the same project under an existing aid scheme.

(31) ITP requested the aid in general terms in June 2004 with a first letter to the Ministry of Industry, Tourism and Trade (hereinafter the Ministry). On 29 September 2004, ITP made a formal request for aid for its participation in the Trent 1000, for an estimated amount of EUR 40 million.

(32) The Spanish authorities gave their support to the project in two tranches, allowing the public agency CDTI to grant a loan to ITP.

⁽⁴⁾ Commission's letters of 10 October 2006 and 30 November 2006.

- (33) The decision on the first tranche was taken by the CDTI on 30 November 2005, covering the costs for that year. The first tranche was a zero interest loan, based on an existing scheme ⁽⁵⁾, for an amount of EUR 9 million.
- (34) The decision on the second tranche was taken by the CDTI on 26 June 2006, covering the remainder of the costs. The second tranche was also a zero interest loan, but whose reimbursement seemed to depend on the sales of the engine. This tranche corresponds to the aid notified by Spain to the Commission on 11 September 2006 for an amount initially set at EUR 27,85 million.
- (35) The Spanish authorities explained this two-step approach on the grounds of the changes incurred during that period in the administration regarding the body with competence to process the substantial R & D aid in the aeronautic sector. In fact, as the Spanish authorities have shown, by providing, *inter alia*, minutes of various meetings, these competencies were transferred from the Ministry to the CDTI, and this transfer took place over a fairly long period of time.
- (36) Spain explained thus that in 2005 CDTI was able to grant only a first loan of limited amount. When the transfer of competencies was finally completed, the CDTI took the decision to give the second part of the loan, which was (the measure) notified by Spain.
- (37) There is no internal documentation of the Ministry or of the CDTI prior to the notified measure confirming in a clear and definite way the intention of the Government to support the project. On the other hand, in the documentation provided by Spain it is possible to find numerous references to the project and to its importance for the Spanish economy.
- (38) Also, it should be noted that there is no letter from the Government to ITP confirming the intention to grant the aid, but some indirect references to a scheme in support of aero-engines ⁽⁶⁾, with the B787 explicitly mentioned. This scheme would have been based on the previous cases approved by the Commission ⁽⁷⁾. According to Spain, the 2005 decision by the CDTI has to be seen as the confirmation for ITP of the intention of the Spanish Government to provide support to the entire project.
- (39) Finally, Spain claims that ITP had legitimate expectations of receiving the aid, because aid had been granted in the meantime by the CDTI to ITP, covering the 2005 costs of the project. This aid was not notified to the Commission since it was based on an approved aid scheme and was below the thresholds for individual notification.
- (40) On the basis of the documentation provided and especially taking into account the changes in the administrative competencies, the Commission is able to arrive at the conclusion that the two loans should be considered as being two tranches of the same aid.
- (41) The Commission notes that Spain recognises that it made a mistake in notifying only the second loan and that the total amount of the two loans should be assessed by the Commission in this case.
- (42) Individual aid to R & D projects can be granted on an ad-hoc basis or on the basis of an approved aid scheme. The criteria for the assessment of the cases subject to individual assessment are contained in chapter 7 of the R & D & I Framework.
- (43) On the basis of these criteria, it is not acceptable for a Member State to artificially split aid to large projects into several parts, as this would lead to very easy circumvention of the notification thresholds, and of the rules concerning the detailed assessment of large cases. Allowing Member State to divide up projects would thus mean abandoning the principle of concentrating the control of the Commission on the more distortive cases.
- (44) In any case, the Commission cannot accept that ITP would have had legitimate expectations of receiving the aid. Due to the limited competencies of the CDTI, any support granted by this agency could not be seen as a promise by the State to grant a larger amount of aid. The negotiations between the CDTI and ITP which took place before the definitive grant decision indicate that while the Spanish authorities had expressed a favourable stance towards supporting the project, ITP had no legitimate expectation of receiving any specific amount of aid. Finally, ITP was not entitled to receive the entire aid before the decision on the second tranche was actually taken.
- (45) To conclude on this aspect, taking into account the exceptional situation created by the changes in the Spanish administration during the grant process, the Commission is able to conclude that the two loans are tranches of the same aid and that they should have been notified together by Spain. Accordingly, the decision is taken on the total amount of the two loans.
- ⁽⁵⁾ According to Spain, the scheme managed by the CDTI was in force before the accession of Spain to the European Community in 1986.
- ⁽⁶⁾ It should also be noted that ITP is the sole Spanish producer in the sector.
- ⁽⁷⁾ C 38/01 and N 165/03.

(46) The Commission also notes that the assessment of the grant process would have been made easier if the Spanish authorities had initially confirmed to ITP their intention to grant the aid, without necessarily entering into details concerning the amount and the conditions at the initial stage. Such a letter of intent, with its necessary reference to the suspension clause linked to the obligation to notify the aid to the Commission, would have helped the assessment of the case, particularly with regard to the incentive effect of the aid ⁽⁸⁾.

5. EXISTENCE OF AID

(47) As indicated in the decision to open proceedings, the measure under assessment falls within the scope of Article 87(1) of the Treaty. This conclusion was not disputed by any of the parties.

(48) The Spanish authorities notified the measure as a State aid. The measure consists of state resources, in this case managed by a public agency under an aid scheme. As mentioned in its website ⁽⁹⁾, the CDTI is a Spanish public organisation under the Ministry of Industry, Tourism and Trade, whose objective is to help Spanish companies to enhance their technological profile. The measure has a beneficiary, the ITP group, which receives an advantage. ITP is active in a sector where there is extensive trade among Member States and the project concerns a product which involves the participation of several international partners. The impact on trade is thus confirmed and the measure should be considered as a State aid on the basis of Article 87(1) of the Treaty.

6. COMPATIBILITY

(49) The Commission has assessed the measure under Article 87(3)(c) of the Treaty, in particular on the basis of the provisions concerning aid for R & D, which, since 1 January 2007, has been the Community Framework for State aid to R & D & I ⁽¹⁰⁾ (hereinafter the R & D & I Framework).

(50) As indicated in the decision to open proceedings, the Commission has assessed the aid under the R & D & I Framework, because in its section 10.3 it is clearly indicated that 'the Commission will apply this framework to all aid projects notified in respect of which it is called upon to take a decision after the framework is published in the Official Journal, even where the projects were notified prior to its publication'.

⁽⁸⁾ A similar provision is contained in point 38 of the Guidelines on National Regional Aid (OJ C 54, 4.3.2006, p. 13), which request that the Member State notifies to the beneficiary its intention to grant the aid through a letter of intent.

⁽⁹⁾ www.cdti.es

⁽¹⁰⁾ OJ C 323, 30.12.2006, p. 1.

(51) In its assessment of the notification, the Commission sent two requests for information ⁽¹¹⁾, which raised a number of issues. In those letters the Commission clearly pointed out that the provision on *consecutio legis* in the R & D & I Framework (point 10.3 mentioned above) indicates that the Commission has to assess the case on the basis of the rules in force at the moment of the decision.

(52) Furthermore, in the second letter of 28 November 2006, the Commission indicated that the case might require opening a procedure based on Article 88(2) of the Treaty.

(53) The Spanish authorities requested that the Commission assess the case under the 1996 R & D Framework which was in force at the moment of the notification, since the measure was notified on 11 September 2006 and since the aid was requested by ITP in 2004.

(54) Referring to the *Graphischer Maschinenbau* case ⁽¹²⁾, Spain argues that if it had granted the aid illegally, the 1996 R & D Framework would apply. Since, according to Spain, the R & D & I Framework in application after 1 January 2007 is more restrictive than the 1996 R & D Framework, in applying the new rules the Commission would thus penalise the Member State which has notified the aid.

(55) The Commission notes that in its view the Spanish argument is irrelevant and that this case law does not apply to the present case because point 10.3 of the R & D & I Framework clearly spells out the rules that the Commission would apply when assessing cases.

(56) Furthermore, the Commission considers that the Spanish argument, that the R & D & I Framework is more restrictive, is not correct. The provisions on the assessment of individual cases involving large amounts of aid simply request a more detailed demonstration of the various aspects of the aid, including its positive effects. An increased level of detail cannot be considered as being more restrictive. On the contrary, the Commission considers that the main aspects of the rules have remained constant or have changed only marginally: definition of the R & D activities, eligible costs, aid intensities, etc.

(57) In its observations, Spain also says that, since the Commission indicated in its letter that it might have doubts, it should have opened proceedings immediately.

⁽¹¹⁾ See the first paragraph in the decision to open proceedings.

⁽¹²⁾ Judgment of the Court of First Instance of 14 May 2002 in case T-126/99, *Graphischer Maschinenbau GmbH v Commission* [2002] ECR II-02427.

(58) However, the Commission notes that an earlier decision to open proceedings would not have changed anything in terms of applicable rules for the final decision, since in any event the applicable rules would have been those in force at the time of the final decision.

(59) In any case, Spain has provided all the necessary information requested in chapter 7 of the R & D & I Framework for the assessment of large individual projects. This information allows the Commission to take a complete view of the case.

7. MARKET FAILURE

(60) To assess properly aid for a large R & D project, it is necessary to assess the objectives of the measure, notably which market failures it aims to tackle.

(61) Firstly, in the notification, the Spanish authorities indicated that the measure aims at correcting imperfect and asymmetrical information, notably concerning long-term projects and the unavailability of private finance in a particular sector characterised by high technological risks and returns in the very long term. The Commission has recognised the existence of such a market failure concerning funding of large programmes in the aerospace sector in previous decisions⁽¹³⁾.

(62) Secondly, the Spanish authorities considered that the fact that R & D activities were to be carried out in assisted areas should be taken into account in the assessment of the market failure. R & D activities in less developed areas would be characterised by more positive externalities and knowledge spillover, and by imperfect and asymmetric information.

(63) However, point 7.3.1 of the R & D & I Framework states that the Commission needs to take into account: '(i) disadvantages caused by peripherality and other regional specificities; (ii) specific local economic data, social and/or historic reasons for a low level of R & D & I activity in comparison with the relevant average data and/or situation at national and/or Community level as appropriate; and (iii) any other relevant indicator showing an increased degree of market failure'. Without a demonstration based on these criteria, the Commission was not in a position to confirm the existence of regional disadvantages for the case under assessment.

⁽¹³⁾ See for instance Commission's decisions on cases N 165/03 (Spain, aid to ITP for the Trent 900), N 372/05 (France, aid to Snecma for the engine SaM 146), N 120/01 (United Kingdom, aid to Rolls-Royce for the development of the Trent 600 and Trent 900 engines), and more recently on cases N 195/07 (Germany, aid to Rolls-Royce Deutschland), and N 447/07 (France, aid to Turbomeca).

7.1. Asymmetry of information

(64) Spain provided additional arguments to support the existence of market failures linked to the existence of an asymmetry in the information.

(65) Spain first referred to the specific business model of aero engine development. It showed that since the upfront investment is very important, with returns only over a very long period (the cash-flow of the project becomes positive in a stable way only after [> 10] years; in cumulated terms, it becomes positive after [> 15] years), projects are shared by various partners in order to reduce the overall risks.

(66) Secondly, according to Spain, for companies in the sector on the source of funding is the cash-flow derived from older projects. Since revenues from a project come in only after more than a decade, because they derive more from the sale of spare parts than from the initial sale of the engine, only companies with a long succession of programmes can fund new investments.

(67) According to Spain, ITP is a relatively young company, since it was established only in 1989. Because of its age, ITP would not be able to benefit yet from the positive cash-flow deriving from past investments.

(68) Thirdly, ITP has provided information on the difficulty that it encountered in raising funds to finance its investment in the project. ITP did not produce a specific letter from a bank rejecting such a request for funding but it did submit exchanges of e-mails between financial intermediaries and business organisations⁽¹⁴⁾ which reveal the unavailability of bank financing for this type of project.

(69) As mentioned above in paragraph 61 and footnote 13, the Commission has recognised in several situations that the specific business model of aero engine development is characterised by asymmetry of information. However, this conclusion does not mean that any project in the sector would face a market failure. It is evident that in several occasions, various companies in the sector have been able to fund new projects either through their own means or through the financial market. The Commission must assess the presence of the market failure in the specific case under assessment.

⁽¹⁴⁾ In particular HEGAN, which is the Basque platform in the aeronautic sector.

- (70) In the present case, as already noted in the decision to open proceedings, the arguments provided by Spain on the presence of a market failure were considered to be sufficient and the Commission did not raise a specific doubt.
- (71) Taking into account the new elements, including the information submitted by ITP, the Commission is able to conclude that the present case is characterised by an asymmetry of information. It notes that in the case of ITP the asymmetry is partly linked to the development phase of the company, which is however reaching an age where it will be able to finance new projects with the revenues from older programmes. In other words, ITP is reaching the situation where the business model of an aero engine company can function normally.
- (72) The Commission is therefore able to conclude that in the present case there is a market failure. As indicated in the decision to open proceedings, it has then to assess whether the presence of a regional disadvantage increases the degree of this market failure.
- (77) Further, according to Spain, the project contributes to the development of a scientific (research organisations), technological (test centres) and educational (engineering school) infrastructure in the region.
- (78) Finally, according to Spain, the project contributes to the development of a network of subcontractors able to work in a highly advanced field. Currently, ITP can buy only [< 50] % of its input in Spain; its ambition is to increase this ratio significantly.
- (79) To conclude, Spain argues that the regional disadvantage, and the positive impact of the project at regional level, contribute to the market failure and that this should be recognised by the Commission.
- (80) Spain also adds that if the Commission does not recognise such an advantage, it would contradict the approach contained in the 1996 R & D Framework, which provided for an automatic bonus of 5 % to projects carried out in assisted areas falling within the scope of Article 87(3)(c) of the Treaty (the bonus being of 10 % for areas falling under Article 87(3)(a) of the Treaty).

7.2. Regional disadvantage

- (73) In its submissions, Spain put forward a number of arguments to support the presence of a regional disadvantage that would increase the degree of market failure.
- (74) In the first place, Spain pointed out that R & D contributes to the Lisbon objectives and that in the context of the agreement on the Financial Perspectives 2007-2013 ⁽¹⁵⁾, Spain was allocated an additional EUR 2 billion of structural funds to increase R & D & I. According to Spain this earmarking clearly shows that the country is lagging behind in the field of R & D activities.
- (75) In the second place, Spain pointed out that the R & D activities in the project under assessment will be carried out in assisted areas falling within the scope of Article 87(3)(c) of the Treaty ⁽¹⁶⁾.
- (76) Spain has also stressed that the development of ITP in the Basque Country would contribute to regional development in an area affected by industrial restructuring (closing of heavy industry).
- (81) It is true that in terms of R & D expenditure, the statistics show that Spain is lagging behind with respect to the EU average. However, the Commission notes that this is not *per se* a sufficient argument to justify an individual aid, but rather an argument that would support a more horizontal approach towards the promotion of R & D ⁽¹⁷⁾.
- (82) In the second place, the Commission notes that the R & D project is taking place in assisted areas. The Commission also notes that by not including the regional aid bonus in the R & D & I Framework it has simply contributed to better targeting State aid to those projects which contribute to economic efficiency. The Commission has recognised that State aid can contribute either to equity objectives, such as regional development, or to efficiency objectives, i.e. to respond to market deficiencies ⁽¹⁸⁾. Accordingly, the Commission has revised the various State aid rules in a coherent way, aligning the conditions for compatibility to the objective of the measures adopted by the States ⁽¹⁹⁾.

⁽¹⁵⁾ Point 54bis of document 15931/05 of the European Council on the Financial Perspectives 2007-2013.

⁽¹⁶⁾ See Commission's decision on case N 626/06, on the Spanish Regional Map, adopted on 20 December 2006.

⁽¹⁷⁾ In 2007 and 2008 the Commission approved several aid schemes supporting R & D activities notified by Spain.

⁽¹⁸⁾ See for example the State aid Action Plan — Less and better targeted State aid: a roadmap for State aid reform 2005-2009, COM(2005) 107 final, adopted by the Commission on 7 June 2005.

⁽¹⁹⁾ Accordingly, there is no regional bonus in the recently adopted Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) (OJ L 214, 9.8.2008, p. 3).

- (83) In the third place, the Commission notes the argument put forward by Spain on the need to set up the necessary infrastructure in the fields of research, technology and education. In the case under assessment, however, Spain has not demonstrated that in the present case, the aid granted to an individual company, ITP, is necessary to develop the knowledge infrastructure. Further, the Commission notes that the measure under assessment is an individual aid to a single beneficiary. Its impact on the abovementioned infrastructure can only be very indirect.
- (84) Finally, the Commission notes that the aid is aimed at contributing to the development of a network of subcontractors. While, in terms of regional development, such objectives would indeed be relevant, from a wider European perspective, it is not certain that there would be an increase in infrastructures or a network of subcontractors around each large company, especially in an integrated sector such as the aeronautic sector. In such a technologically specialised and advanced sector, where programmes involve multiple partners from all over Europe and worldwide, while the benefits of developing a network of subcontractors in an assisted area are not obvious, it is also true that relying for [> 50] % of its inputs from outside the country shows a strong dependency on international partners, and therefore a risk factor.
- (85) The Commission therefore considers that the specific situation in the assisted area where the project is carried out shows a very moderately increased degree of market failure, in particular as regards the availability of technologically advanced subcontractors that could be viable risk-sharing partners.
- (89) As also mentioned above in paragraphs 31 *et seq.*, the Spanish authorities have indicated that the aid was requested by ITP before the start of the project, thus respecting the provision contained in the second paragraph of chapter 6 of the R & D & I Framework.
- (90) As also mentioned above, the Commission had concerns regarding the decision-making process and because of the late notification. The information submitted by Spain makes it possible to conclude that the notified measure relates to a single aid measure, which was granted in two tranches. The assessment of the incentive effect must therefore be carried out for the entire aid.
- (91) Concerning the decision-making process, the Commission would stress that the particular conditions in the case — transfer of competencies, two-step approach and transition to new State aid rules — make assessment of these conditions peculiar in the present case.
- (92) The Commission notes, firstly, that it normally has doubts concerning the incentive effect of a measure when several grant decisions are adopted in relation to a single project. It also doubts the incentive effect whenever the formal decision to grant the aid is taken by the State at a point in time when the project is well advanced. In the case of R & D it is essential that the aid has an impact on the behaviour of the company by leading it to make a larger or a speedier investment in a project. Without such an impact, the aid would have no incentive effect and would not be necessary.

7.3. Conclusion on the market failure

- (86) On the basis of these arguments, the Commission is able to conclude that there is a market failure in the case under assessment.

8. INCENTIVE EFFECT

- (87) Taking into account the information available at that stage of the investigation, in the decision to open proceedings the Commission expressed doubts about the incentive effect of the aid.

8.1. Necessity of aid

- (88) According to chapter 6 of the R & D & I Framework the Commission has first to look at whether the request for the aid was submitted by the beneficiary before the start of the R & D project.

- (93) In order to have such an impact, the aid has to be decided by the State, either formally, albeit with a suspensive clause pending the necessary approval by the Commission of the compatibility of the aid on the basis of Article 88(3) of the Treaty, or through a letter of intent ⁽²⁰⁾, which would not give rise to legitimate expectations but would be sufficiently strong to indicate the State's willingness to support a project.

- (94) The Commission also notes that a necessary condition for the compatibility of aid to a R & D project is the prior notification of the aid under Article 88(3) of the Treaty. A notification of aid to a project which is close to completion would mean that the State is not convinced about the aid it intends to grant or not able to give an assurance about such aid. If, in the face of this uncertainty, the company is able to carry out the project, and even to conclude it, it is likely that the aid is not wholly necessary for the company itself.

⁽²⁰⁾ See also paragraph 31 above.

8.2. Basic indicators

- (95) According to chapter 6 of the R & D & I Framework, the Commission has to assess, for all individual measures, a number of criteria indicating the incentive effect of the aid, relating to the increase in size, scope or speed of the project or the increase in the total amount spent by the beneficiary on R & D.
- (96) In its observations Spain has submitted a number of facts to demonstrate that the basic criteria mentioned above were met.
- (97) Firstly, according to Spain, the aid was necessary for ITP to make an investment equivalent to 12 % of the project, involving an increase in size and scope. Without the aid, ITP would not have been able to make such a large investment ⁽²¹⁾.
- (98) Secondly, according to Spain, the aid would have allowed an increase in the speed of the project. Spain argues that the time required for development of the Trent 1000 is much shorter than for previous engines.
- (99) Thirdly, Spain notes that ITP's average R & D personnel costs (24 %) are higher than the average in the sector (19 %). Further, ITP has heavily invested in R & D in recent years, since the ratio between R & D and turnover was 16 % in 2005, 26 % in 2006 and 22 % in 2007. Spain compares these figures with a European average for the sector of 11 % in 2005 and 2006. Spain indicates that without the aid for the Trent 1000, the figures for R & D/turnover would have fallen to [...] % and [...] % in 2006 and 2007 respectively.
- (100) ITP has provided detailed information about its personnel. It indicates that, starting from the hypothesis that without the aid it would have not been able to carry out the project, it would have difficulties in relocating the [...] full-time equivalent jobs of staff who have been working on the project. ITP says that a minimal part could be moved to more upstream work (on research and technology), but that it would have difficulties in retaining the other researchers. According to ITP, the fact that it maintains this high level of R & D spending indicates that the aid has an incentive effect.
- (101) The Commission notes that the assessment of these indicators depends on the alternative scenario which would have materialised without the aid. If the aid has indeed allowed ITP to engage in a larger project, then the aid has

had an incentive effect on the scope and size of the project.

- (102) However, the Commission notes the ambiguity of the figures concerning R & D spending. While it is true that ITP has high levels of R & D spending compared with competitors in the sector, this may depend more on its lack of revenues from older programmes as described above ⁽²²⁾ than from its R & D intensity. Further, the Commission cannot accept that maintaining constant levels of R & D spending and personnel would prove that the aid has an incentive effect. On the contrary, in normal circumstances, it would seem that if the aid has no effect on R & D spending or on R & D personnel, it would mean that the effect of the aid is rather to support a project that replaces older projects which have been finished rather than to support brand-new efforts by the beneficiary.
- (103) In any case, in the assessment of an individual aid measure, the Commission has to undertake a detailed assessment of the information submitted by the Member State and by the beneficiary, in addition to the basic indicators mentioned above.

8.3. Alternative scenarios

- (104) In its detailed assessment of the incentive effect, the Commission has based itself on point 7.3.3 of the R & D & I Framework.
- (105) ITP has submitted the presentation made to its Board when it took the decision to invest in the project. The documentation shows that the company had looked at several alternatives before negotiating with RR, with the business plans for each alternative, both with and without the aid:
- [...] % of engine (whole Low Pressure Turbine),
 - [...] % (Low Pressure Turbine less Nozzle Guide Vanes),
 - [...] % (Low Pressure Turbine less Nozzle Guide Vanes and Seals),
 - [...] % (Tail Bearing Housing and Disc); in this case ITP would have been merely a sub-contractor.

⁽²¹⁾ This argument is discussed in more detail in the next section (see the next section in the decision, paragraphs 104 *et seq.*).

⁽²²⁾ Trent 500 and Trent 900, the subjects of cases C 38/01 and N 165/03, respectively.

- (106) It should be remembered that the project is the final result of a negotiation between ITP and RR. It is very difficult to guess what the outcome of such negotiation would have been in the absence of the aid.
- (107) As a matter of fact, while there were alternative possibilities for ITP, these were not really counterfactual projects, in the sense that they depend also on the other party in the negotiation. Also, on the basis of the arguments submitted by RR, it would seem that they were not interested in a limited participation by ITP (e.g. around [...] %), as it would have forced RR to take more risks, to carry out some of the work directly or to find other partners.
- (108) Further, even if financial calculations for the project with and without the aid were also presented to ITP's Board, it would seem that the availability of the aid was taken into account in the decision by ITP to engage in the project ⁽²³⁾.
- (109) Finally, on the basis of the analysis carried out by ITP of the various alternative participations, it would seem that the decision was based mainly on a number of fairly qualitative factors (summarised in some SWOT diagrams), rather than on the quantitative ones (such as the expected internal rate of return (IRR), for instance), which were also made available to the Board. It should be noted that the IRR is not at all high compared with the average cost of capital of [...] %. The IRR calculated at 25 and 50 years probably shows that without aid, the project would not be sufficiently profitable for the company to invest in it. The low level of the final IRR, even with aid, also confirms that ITP's real objective in agreeing to invest with expected low return, is to strengthen its position in the market.
- (110) Therefore the Commission notes that the aid undoubtedly triggered an investment by ITP in a larger project with a more ambitious scope.
- (111) The Commission also notes that it is difficult to establish an exact counterfactual project, since there were various initial alternatives, which had in any case to be subsequently negotiated with the leader of the project, RR.
- (112) The Commission notes that the project is profitable, as it is normal for projects concerning aero engines, since it would be against any business logic to invest in a project with negative returns. The Commission notes that in this type of project the main indicator used by the company in its investment decision is the IRR, which is positively impacted by the aid, since it enables it to go beyond the average cost of capital for the sector.
- (113) The Commission notes that, as in aero engine projects, the amount of initial investment is particularly important and that the time path of cash flows is characterised by a negative cumulated cash flow, in the present case for the first 19 years.
- (114) Finally, the Commission has assessed the level of risk involved in the research project. ITP has listed the main risks of the project:
- technical risks involved in achieving the specifications for the first certification, and over a reduced period compared with previous programmes,
 - technical risks of having to redesign in early production phases,
 - commercial risks deriving from the pricing policy (which is outside the control of ITP),
 - the foreign exchange risks (because sales are denominated in dollars), and
 - risks relating to the unit production cost, which was set by Boeing at a level implying a [...] % cost reduction compared with previous engines. This cost is affected mostly by the novelty of the design and the cost of raw materials.
- (115) ITP has produced estimations of the variation of the net present value (NPV) of the project on the basis of changes in some of these parameters. These estimations show that the NPV may easily become substantially negative either if sales are below expectations, the exchange rate is less favourable or the cost of raw material becomes higher.
- ⁽²³⁾ It should also be noted that in the same presentation, reference is made to potential difficulties in the discussions with the Commission, albeit referring at worst to some adjustments to the amounts and conditions without mentioning the risk of full prohibition of the aid. This reference, however, does not give rise to any legitimate expectation from the company of receiving the aid itself. It simply reflects the experience of the company in two previous State aid cases.

(116) The Commission notes that the risks of the project are significant. It notes that not all the risks indicated by ITP are equally significant in terms of their assessment, such as for instance the foreign exchange risk. The Commission further notes that ITP has been able to provide detailed calculations of the financial aspects of the project, including their sensitivity to risk factors. These calculations show in the first place that the project is modestly profitable compared with the average cost of capital for the company. In the second place they show that the technical and commercial risks are significant, especially compared with the amount of investment and its expected cash-flow.

(117) On the basis of these criteria, the Commission is able to accept that the aid has an incentive effect, since it allows ITP to engage in a project on a scale that it would not be able to afford without aid.

9. PROPORTIONALITY

(118) In order to assess the proportionality of the measure, the Commission first has to assess the eligible costs, notably whether the doubts raised in the decision to open proceedings have been clarified; it then has to examine the aid instrument, again assessing whether any of the doubts raised have been clarified; thirdly, it must examine whether the bonuses for the regional disadvantage and for collaboration are applicable to the project; and finally, it has to define the aid intensity and verifying that it respects the conditions set in the R & D & I Framework.

9.1. Eligible costs

(119) In the decision to open proceedings, the Commission raised four doubts concerning the eligible costs of the project receiving the aid:

(a) the classification of the expenditure according to the research categories was made on the basis of a theoretical model and did not reflect the real costs (and not even the projected costs) of the beneficiary;

(b) in the classification of the expenditure, the level of studies preparatory to experimental development was particularly high compared with the other cost categories, especially considering other engine development projects;

(c) several specific aspects were questionable: the amount allocated to technical management in the first year of the project and the expenditure relating to equipment (in particular where such equipment was used exclusively for the project); and

(d) the inclusion of some costs incurred by ITP in the period 2008 and 2009, after the certification of the engine.

(120) The Commission raised doubts concerning the classification of the activities on the basis of the definition of industrial research and experimental development included in section 2.2(f) and (g) of the R & D & I Framework, as well as on its own practice in the field of R & D ⁽²⁴⁾.

(121) The Commission raised a doubt regarding the eligible costs, notably on the expenditure related to equipment, on the basis of point 5.1.4 of the R & D & I Framework.

(122) In reply to the decision to open proceedings, Spain has provided a new classification of costs which reflected the activities effectively performed or planned, with the resulting classification in terms of R & D categories. The new information provided by Spain allowed the Commission to analyse in detail each work package and to verify that the classification of the R & D activities was correct.

(123) Further, the Spanish authorities have accepted that the upper time limit for considering eligible costs is the certification of the aircraft. Given that the costs that were incurred after certification were minor, this does not affect significantly the total amount or the distribution of costs between the R & D categories.

(124) Spain has also agreed to consider the work carried out between certification of the engine and of the aircraft as Experimental Development instead of Industrial Research, since this work is performed on prototypes of the turbine module.

(125) The Spanish authorities have also agreed to include 100 % of the work performed on tasks relating to the testing of components (EUR [...]) in the category Experimental Development. This is consistent both with the classification used for other tasks and with the definition proposed by ITP itself, according to which tests dedicated to accumulated hours of operation (and fatigue tests belong to this category) are to be considered as Experimental Development.

⁽²⁴⁾ Notably in the projects funded under the Framework Programme for R & D — see Decision No 1982/2006/EC of the European Parliament and of the Council of 18 December 2006 concerning the Seventh Framework Programme of the European Community for research, technological development and demonstration activities (2007 to 2013) (OJ L 412, 30.12.2006, p. 1) — and in its experience in the assessment of State aid cases in the aero engines sector.

- (126) In its observations, beyond its support for the arguments put forward by Spain, ITP also acknowledged that its internal accounting system did not allow separation of R & D costs according to the different categories. This explained why the categorisation was made on what appeared as a theoretical model. ITP also stated that it had started adapting its accounting system in order to allow such categorisation, since it is also required by the IFRS accounting standards ⁽²⁵⁾.
- (127) Spain provided a corrected and final version of the eligible costs, which is presented in the table below. Total eligible costs of the project for the entire period 2005-2008 amount to EUR 73,567 million. Of these the costs relating to activities classified as industrial research amount to EUR 29,296 million (39,8 % of total eligible costs). Experimental development activities costs are EUR 44,212 million (60,1 %). Preparatory studies worth EUR 59 000 are also included in the project.

Table — Eligible costs

(in million EUR)

R & D Category	2005	2006	2007	2008	Total
Industrial research	[...]	[...]	[...]	[...]	29,296
Feasibility studies	[...]	[...]	[...]	[...]	0,059
Experimental development	[...]	[...]	[...]	[...]	44,212
Total	[...]	[...]	[...]	[...]	73,567

- (128) Taking into account the detailed information provided by Spain, its acceptance of the observations on the specific aspects relating to the time limit of the project and the classification of some types of expenditure, the Commission is able to have a complete view of the eligible costs and of their categorisation.
- (129) In conclusion, the eligible costs include only activities eligible for aid under point 5.1.4 of the R & D & I Framework, correctly allocated to the respective categories of industrial research and experimental development, as defined in section 2.2 of the same Framework.

9.2. Aid instrument

- (130) In the original notification the Spanish authorities intended to use an instrument which combined the characteristics of a repayable advance — with reimbur-

sement of the principal of the loan proportional to the success of the project — and of a soft loan — with no interest payable by the beneficiary. The Commission, in its decision to open proceedings, raised doubts regarding this hybrid instrument, which would give a double advantage to the beneficiary, combining the risk-sharing element of an advance with the certainty of an advantage in terms of interest not paid. The combination of these two advantages would have rendered the aid too generous for the beneficiary.

- (131) A repayable advance is defined by section 2.2(h) of the R & D & I Framework. The conditions for its compatibility are defined in point 5.1.5 of the R & D & I Framework.
- (132) A soft loan is a loan with a reduced interest rate (in this case a zero interest rate). The aid element is the amount of interest not paid by the beneficiary, calculated by the difference between the market rate applicable to the loan and the interest actually paid. In the present case the market rate was the reference rate, with no additional basis points added, and the interest paid was zero. The Commission, in its decision to open proceedings, also raised a doubt about the interest rate to be used in the calculation of the aid element of the loan. As described below, this aspect is no longer relevant.
- (133) In their observations, the Spanish authorities recognised, firstly, the existence of such a double advantage and agreed to correct the aid instrument. The authorities indicated that they would propose granting the aid through a soft loan. According to Spain, the reason for using a soft loan is simply that they thought it would be more easily approvable by the Commission.
- (134) The same position was taken by ITP in its observations. However, ITP also added that it could agree to the aid instrument taking the form of a repayable advance ⁽²⁶⁾.
- (135) In its letter of 19 December 2007, the Commission mentioned that repayable advance would probably guarantee greater proportionality in this case.
- (136) The Commission noted that adapting in 2007 the aid instrument as proposed by Spain into a loan with zero interest would have been to the advantage of the beneficiary because in that case commercial risks would have been somewhat reduced, since sales of the engine were increasing.

⁽²⁵⁾ These standards allow for a different classification in the accounts of expenditures relating to industrial research, classified as expense, and experimental development, classified as an asset.

⁽²⁶⁾ In its letter of 25 February 2008, ITP notes that it had applied for a 'reimbursable loan in case of success of the project'.

- (137) In the case at hand, the aid would have played the role of an advance, in that it would have assured ITP that it would have enough cash to make the investments, while at that time it would have spared ITP the interest. ITP would not only have repaid only the principal but would also have avoided paying an extra fee in case of success. The Commission considered this to be an excessive advantage for the firm and asked the Spanish authorities to suggest ways of reducing it, either by changing the instrument or by introducing clauses and conditions which would have linked the instrument to the risk.
- (138) The Commission further pointed out that repayable advances are a risk-sharing instrument which, in case of the success of the projects, allow for a more than proportionate reimbursement from the beneficiary: if sales forecasts are fulfilled, the aid is fully reimbursed, including interests. If sales remain below the forecasts, the reimbursement is reduced proportionally ⁽²⁷⁾. If sales are above forecasts, the reimbursement exceeds the amount of the advance received.
- (139) In the assessment of the case, the Commission and Spain arrived at the conclusion that the appropriate aid instrument for this type of aid is a repayable advance, with the specific characteristics outlined below.
- (140) The aid instrument is structured around the reasoning put forward by the Spanish authorities that the two grant decisions in this case are two tranches of the same aid, with a single request for aid.
- (141) The modified schedule for the aid is based on the following elements.
- (142) The disbursement of the aid follows the schedule foreseen for the two tranches.
- (143) The reimbursement is calculated on the basis of the total aid received by ITP adjusted at the reference rate for 2005 (4,08 %).
- (144) The target date is [...], when full adjusted reimbursement should be deemed complete, based on the forecast below.
- (145) The prudent forecast of engines sold is of [...] engines (based on [...] aircraft), and does not include replacements. This figure is mentioned in the internal business plan of ITP presented to the board in view of its decision to invest in the project.
- (146) Reimbursements have to be considered as amounts of euro per engine sold; the amount per engine will vary as follows: until [...] engines sold (40 % of the final forecast) ITP will pay EUR [...] for each engine; from [...] to [...] engines (up to 85 % of the final forecast), ITP will pay EUR [...] for each engine; from [...] to [...] engines (the final forecast), ITP will pay EUR [...].
- (147) In setting these amounts, Spain has taken into account the fact that the first engines are sold at greater commercial discount. It has also taken into account the cash-flow for the project, which is already negative for the first years since the initial investment is very significant and sales are spread over at least twenty years.
- (148) After the target forecast of [...] engines is reached, ITP will pay an additional success fee of 1 % of the turnover deriving from sale of each engine until the year 2043 ⁽²⁸⁾.

9.3. Regional bonus

- (149) The Spanish authorities recognise that according to the R & D & I Framework in place since 1 January 2007 no regional bonus can be granted for projects carried out in assisted areas. However, they indicated that they would like to give this bonus at least for the eligible costs of the year 2006.
- (150) In its assessment, the Commission can only base itself on the rules it has spelled out, which are contained in the R & D & I Framework. On that basis, considerations regarding the potential disadvantage to the project that would derive from the fact of being carried out in an assisted area have to be demonstrated and taken into account in the assessment of the market failure and of the incentive effect.
- (151) As indicated above, the aid has to be assessed in its entirety under the applicable rules, which is the R & D & I Framework. The R & D & I Framework no longer provides for the possibility of increasing the aid intensity for projects carried out in assisted areas. Therefore the Commission cannot agree that the aid intensity should include such a bonus.

⁽²⁷⁾ And the distortion of competition is less, since the product has not been a success.

⁽²⁸⁾ The R & D & I Framework explicitly foresees that in case of success exceeding the outcome defined as successful, the Member State concerned should be entitled to request payments exceeding repayment of the advance (see the sixth paragraph of section 5.1.5).

9.4. Collaboration bonus

(152) The Spanish authorities have indicated that in their view the notified project should be entitled to receive a bonus for international cooperation. According to their arguments, ITP is participating in an international project for the development of the Trent 1000 engine ⁽²⁹⁾.

(153) The R & D & I Framework in point 5.1.3(b) defines very precise conditions for a project to be entitled to additional bonus for international cooperation: 'The project involves effective collaboration between at least two undertakings which are independent of each other and the following conditions are fulfilled: [...] the project must [...] be cross border, that is to say, the R & D activities are carried out in at least two different Member States'.

(154) In the decision to open proceedings, the Commission raised two doubts: (a) the Commission doubted that ITP and RR can be considered as independent undertakings, since RR is a shareholder of ITP with almost 47 % of the shares; and (b) the R & D activities of the notified project could not be carried out entirely outside Spain.

9.4.1. ITP and RR are not independent enterprises

(155) Spain provided various arguments in support of the independence of the two enterprises.

(156) In their view, ITP is participating in the project as risk-sharing partner, under similar conditions as other partners: the fact that the conditions for the contract are the same as for the other RRSP partners would show that ITP is at the same level as the other RRSP with whom RR has no shareholding link.

(157) Secondly, according to Spain, if ITP was not independent, it could not work for competitors of RR such as General Electric and Honeywell.

(158) Thirdly, RR has only 47 %, which is not a controlling stake, compared with 53 % held by the other shareholder, Sener Aeronautica. The board members nominated by RR are the minority (four out of a total of nine), the remaining being nominated by the largest shareholder.

(159) Finally, according to Spain, independence is also proved by the duration of the negotiation between ITP and RR on the project, which took two years before an agreement could be reached.

(160) These arguments were also put forward by ITP in its observations. In addition, according to ITP, its independence from RR is obvious, since ITP sales to RR are only 25 % of its turnover in 2008, with a tendency to decrease.

(161) In its letter of 19 December 2007, the Commission also sought RR's views on whether ITP and RR could be considered to be independent. Further, according to RR, 'ITP is a legally and financially independent company and [...] is not controlled by RR. [...] Nevertheless, ITP is an important collaborator for RR in certain civil programmes, notably the Trent 500 and 900 engines, and RR maintains its shareholding in ITP partly to protect its interests in those collaborative programmes and also to help develop ITP as an independent player (and partner) in the aeronautical sector'.

(162) RR also writes that 'establishing relationships with long term independent strategic partners who can share risk, provide design capabilities and make resources available is a logical and not unusual step for OEMs involved in the design and manufacture of gas turbines'.

(163) The Commission has assessed in detail the relationship between ITP and RR. RR is a large shareholder (47 %), with several board members. RR members abstain when RR projects are discussed, but on the other hand are present when strategies are decided.

(164) Secondly, the Commission notes that ITP has participated in several other RR projects (the Trent 1000 being the third largest engine in which ITP is involved).

(165) The provision in the R & D & I Framework relating to 'independent' has to be interpreted as being different from 'not controlled'. In other words, it is not enough not to be controlled by another company to be viewed as being independent from it.

⁽²⁹⁾ Spain also argues that such a bonus was allowed for the previous cases concerning ITP.

(166) By analogy with the definition of small and medium-sized enterprises (SME) ⁽³⁰⁾, companies having capital links with one another (in this case a 47 % share) should be considered as linked enterprises. They could still be considered to be independent for the purpose of merger control ⁽³¹⁾ or from the point of view of accounting rules, since ITP is not consolidated in RR's accounts.

(167) The relevant aspect in this case is that two linked enterprises active in the same sector have no difficulty in collaborating. This is confirmed if one looks at the issue from a substantial point of view, that is, if ITP and RR face difficulties in collaborating in R & D projects.

(168) RR's investment in ITP was made precisely in order to develop a stable long term relationship ⁽³²⁾, which is a common feature in the sector between the OEMs and their main partners. For instance, RR refers to the roles of Snecma and MTU as long-term partners of General Electric and Pratt & Whitney, respectively.

(169) In the present case, ITP and RR have an established collaboration in the field of aero engines. The project under assessment is the third large engine developed by RR in which ITP is participating with a significant role (and always for the same component, the low pressure turbine). RR itself recognises that this prior participation does in fact make future collaborations easier and smoother.

(170) In its assessment of the aid to ITP for its participation in the Trent 500 ⁽³³⁾, the Commission noted that the first significant participation of ITP in a RR engine was characterised by an international collaboration, but did not foresee any specific bonus. As is recognised by RR, however, the involvement in successive projects brings an additional mutual knowledge which progressively reduces the difficulties relating to collaboration.

(171) Two linked companies with a stable long-term partnership do not have any difficulty in collaborating. Therefore, the Commission has arrived at the conclusion that ITP and RR cannot be considered independent of each other in the sense required by the collaboration bonus for R & D projects.

⁽³⁰⁾ Commission Recommendation 2003/361/EC (OJ L 124, 20.5.2003, p. 36).

⁽³¹⁾ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (OJ L 24, 29.1.2004, p. 1).

⁽³²⁾ In RR's words: 'RR has developed a productive working relationship with ITP and ITP has gained an in-depth understanding of RR working practices, procedures, tools and methods'.

⁽³³⁾ Case C 38/01 (OJ L 61, 27.2.2004, p. 87).

9.4.2. *The R & D activities of the notified project will be carried out entirely in Spain*

(172) In any case, the second condition concerning the cross-border nature of the project is not met either.

(173) The Spanish authorities argue that the Commission should assess the project for the engine in its entirety and not only the part to be developed by ITP.

(174) The second indent of point 5.1.3(b) of the R & D & I Framework requires that the R & D activities are carried out in at least two different Member States. In the present case, the project under assessment is the low pressure turbine developed by ITP. Most of the R & D activities eligible for the project take place only in Spain, and eligible costs are incurred by ITP in its sites.

(175) In conclusion, the Commission considers that it is not possible to apply the collaboration bonus to the present aid, because ITP and RR cannot be considered independent and the R & D activities take place mostly in Spain.

(176) However, as it did above for the regional bonus ⁽³⁴⁾, the Commission notes that the non-application of the collaboration bonus has no practical implication, since the aid intensity remains below the level set in the R & D & I Framework.

9.5. Aid intensity

(177) According to point 5.1.5 of the R & D & I Framework, the applicable aid intensities for R & D projects funded through repayable advances are 60 % for industrial research and 40 % for experimental development. As indicated above, no bonuses can be added to the project under assessment.

(178) As mentioned above, the project is characterised by around 39,82 % of industrial research and around 60,18 % of experimental development. The overall maximum aid intensity therefore is 47,93 % ⁽³⁵⁾.

(179) Taking into account that the total eligible costs are EUR 73,567 million and the aid amount that the Spanish authorities initially intended to grant was EUR 36,850 million (the sum of the two grant decisions), the resulting aid intensity would have been 50 %, above the maximum allowable intensity.

⁽³⁴⁾ See paragraphs 149 to 151 above.

⁽³⁵⁾ $60,1 \times 40 \% + 39,82 \times 60 \% = 47,93 \%$.

- (180) Therefore, the Spanish authorities acknowledged that, as a consequence of the re-classification of the eligible expenditures, as mentioned above in paragraphs 119 to 129, they had to reduce the amount of aid in order to respect the maximum intensity of aid. In their letter of 18 September 2008, Spain indicated that the final aid amount would be EUR 35,2624 million. Spain also provided a revised payment and reimbursement schedule, along the lines indicated above in paragraphs 141 to 148.
- (181) Therefore the aid remains below the maximum aid intensity set by the R & D & I Framework.

9.6. Conclusion on proportionality

- (182) The Commission is able to conclude that the classification of eligible costs, the modified aid instrument and the adaptation of the amount of aid ensure that the aid remains proportionate and kept to the minimum. Further, these conditions, which are similar to those applied in comparable cases⁽³⁶⁾, also ensure that the aid is fully reimbursed in normal market conditions, including with interest rates, or even beyond, if sales exceed forecasts.

10. IMPACT ON COMPETITION

- (183) In the decision to open proceedings, the Commission proposed that the relevant market for the case was to be considered the market for aero engines, which is a worldwide market. It sought the view of interested parties on this aspect.
- (184) The Commission recalls that the aero engine sector is characterised by the presence of three large Original Equipment Manufacturers (OEMs) — RR, General Electric (GE) and Pratt&Whitney (PW) — which lead the engine programmes. At a second level there are a number of first-tier partners (Snecma, MTU, Avio in Europe, MHI, IHI and KHI in Japan, etc.) which in many cases have long-term relationships with a single OEM (like Snecma with GE) or work on a project basis with various OEMs (like Volvo). ITP is the smallest of the first-tier partners.
- (185) The Spanish authorities indicated that on the world wide market of components for aero engines, ITP is a smaller player than its competitors (in Europe, Rolls Royce, Snecma, Avio, Volvo, MTU, etc.). Thus, the aid would have a very limited impact, given the small market size of ITP, accounting for only [5-10] % of the more limited gas turbine market, which is a small segment of the

larger engine market. As mentioned in the decision to open proceedings, low pressure turbines are an essential component of the engine but cannot be easily considered as a separate sub-market, among other reasons because they can be developed either by the large OEMs or by first-tier partners.

- (186) Besides RR, no other interested party participated in the proceedings. Taking into account the publicity given to the decision to open proceedings, and the small number of actors in the sector and their size (all large enterprises), the Commission infers from this absence of comments that no competitor had concerns that this aid may distort dynamic incentives, create market power or maintain inefficient market structures.

- (187) The Commission is therefore able to conclude that, in the absence of intervention by competitors or other third parties, and taking into account the very limited market share of ITP, the impact on competition is very limited.

11. INDIRECT AID TO RR

- (188) In the decision to open proceedings, the Commission raised a doubt about a potential indirect aid that the notified measure could give to the producer of the engine, RR. The Commission noted that RR may be a potential beneficiary of the aid, since it is the leader of the Trent 1000 and is a large shareholder of ITP. The Commission also noted that this assessment may be influenced by the specific conditions for the collaboration, which may have been impacted by the aid.
- (189) Already in their comments during the notification phase, the Spanish authorities had indicated that in their view there is no indirect aid, as the money paid to RR by ITP as an entry fee⁽³⁷⁾ comes from its own resources and it is not linked to the eligible costs of the project.
- (190) As requested by the Commission in the decision to open proceedings, the Spanish authorities have further provided all the relevant documents concerning the co-operation between ITP and RR, notably the 2003 Memorandum of Understanding and the Risk and Revenue Sharing Agreement.
- (191) Spain and ITP have observed that the contract between the CDTI and ITP clearly indicates that eligible expenditure are only those incurred in the implementation of the project, which would exclude the payment of fees by ITP to RR.

⁽³⁶⁾ Cases Eurocopter N 186/06, Turbomeca N 447/07 or Rolls-Royce Deutschland N 195/07.

⁽³⁷⁾ It is a normal practice in the sector that RRSP pay an entry fee to the OEM.

- (192) Secondly, Spain indicated that the CDTI will monitor strictly the implementation of the contract, and will pay the aid to ITP only after the expenditure has been documented.
- (193) Finally, Spain argued that the prices used in the commercial relationship between RR and ITP are identical to those used in the other RRSP agreements.
- (194) In its observations, RR first described in detail the negotiating processes between the OEMs and potential RRSPs, which involve parallel discussion with various partners, in Europe and abroad. These discussions do not take place on a component-by-component basis, even if there are some key technological areas which the OEMs do not consider for partnering, but involve various levels of discussion and of possible involvement by the partners. RR also indicated that programme contributions by partners — which can comprise cash, engineering work and the provision of services and development parts by the RRSP — are negotiated and fixed at the start of the programme.
- (195) RR stated that negotiations were carried out at arm's length, on fully commercial terms as with other RRSPs. It described the agreement with ITP, which is in line with the agreements reached with the other full RRSPs⁽³⁸⁾ in the Trent 1000. RR demonstrated that ITP's overall contribution does not confer any financial advantage to RR.
- (196) Finally RR stated that it will not benefit from the aid granted by Spain to ITP, since it will be used only in Spain, for ITP's activities for the low pressure turbine. RR would receive a benefit only through the dividends to which it would be entitled as a shareholder.
- (197) The Commission notes, incidentally, that these arguments also confirm the non-applicability of the collaboration bonus (see above paragraphs 172 to 176). Since ITP is the sole beneficiary of the aid, it bears the entirety of the eligible costs. The first indent of point 5.1.3(i)(b) of the R & D & I Framework stipulates that no single company should bear more than 70 % of the eligible costs, which is clearly not the case here.
- (198) In its assessment of these arguments, the Commission notes in the first place that the documents submitted by Spain and the information provided by the parties indicated that the RRSP agreement between ITP and RR had indeed been negotiated on commercial terms.
- (199) Secondly, the Commission notes that eligible expenditure has been incurred only in Spain and that no costs relating to activities by RR or carried out in RR's premises are included in the eligible project.
- (200) Thirdly, the Commission acknowledges that the shareholding position by RR does not give it an advantage from the aid to ITP, other than the one deriving from the establishment of a long-term partnership.
- (201) The Commission also notes that it is possible to say that the OEMs have an advantage if their RRSPs benefit from aid, which allows the RRSPs to invest significantly in major engine programmes and the OEMs themselves to share the risks associated with such programmes.
- (202) On the other hand, however, the Commission notes that such advantage is inevitably limited, if compared with the overall investments by the OEMs in these programmes. The advantage would be even more limited if compared with the overall size of the engine market and with the overall turnover of the OEMs.
- (203) In any case this advantage seems to be impossible to quantify, as its quantification would need to be based on a comparison with alternative scenarios of programme organisations, given the complexity of the negotiations concerning the RRSPs.
- (204) In any case, the Commission notes that this advantage does not entail a transfer of public funds from the State to the OEM, especially in this case where the eligible expenditure was all incurred in Spain.
- (205) In absence of a transfer of State resources, and with a limited and not quantifiable advantage, the Commission is therefore able to conclude that there is no indirect aid to RR as a result of the support granted by Spain to ITP.
- (206) According to point 7.5 of the R & D & I Framework, in the light of the positive and negative elements assessed above the Commission balances the effects of the measure and determines whether the resulting distortions adversely affect trading conditions to an extent contrary to the common interest.

12. BALANCING TEST

⁽³⁸⁾ RR has no shareholding link with these companies.

(207) In the present case, the Commission finds that the aid has positive effects in so far as it addresses a market failure, that it has an incentive effect for the beneficiary and that it is granted through an appropriate instrument which ensures that the aid is proportionate.

(208) The Commission also finds that the negative effects of the measure are limited, since the distortion of competition created by the aid is not significant as it does not crowd out investments by competitors, it does not create a position of market power and it does not maintain an inefficient market structure.

(209) In balancing these elements, the Commission further notes that the Spanish authorities have agreed to reduce the amount of eligible costs, to revise their classification, to adapt the aid instrument and to reduce the overall amount of aid.

(210) The Spanish authorities will provide an annual report on the implementation of the aid, allowing the Commission to monitor the measure.

(211) In conclusion, the Commission is able to say that the balancing test for the aid under assessment is positive.

13. CONCLUSIONS

(212) On the basis of the above, the Commission therefore concludes that it should raise no objections to the aid

of EUR 35,2624 million that Spain intends to grant to ITP for the development of the low pressure turbine of the Trent 1000 engine developed by RR for the Boeing 787.

(213) Finally, the Commission considers that the aid granted by Spain involves no indirect aid to RR,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which Spain is intending to grant to ITP, amounting to EUR 35 262 400, is compatible with the common market.

Implementation of the aid is accordingly authorised.

Article 2

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 21 October 2008.

For the Commission

Neelie KROES

Member of the Commission
