

New Guidelines on Regional Aid – Is the Party Over for Large Investment Projects?

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I. Introduction

The European Commission (“Commission”) has recently completed the review process of its guidelines on how Member States can grant investment aid to companies in order to support the development of disadvantaged regions in Europe (“RAG 2013”).¹ The new guidelines will enter into force on 1 July 2014,² and are part of a broader strategy to modernise State aid control (State aid Modernisation initiative, “SAM”).³

Among the major changes introduced are the new rules concerning investment aid granted to large investment projects (“LIPs”).⁴

Historically, LIPs have long been subject to specific rules, aimed at controlling those aid projects most likely to cause a distortion to competition through the downsizing of the volume of the aid. The process started in 1998, and by 2006 the resulting system was a mix between automatic exemption for those projects falling within the safe harbour of the Block Exemption Regulation, individual assessment of reportable aid projects⁵ based on the criteria laid down in the Regional Guidelines, and in-depth economic assessment of a limited number of cases exceeding certain pre-determined thresholds, conceived to detect the most problematic cases.

These rules have changed again with the last review process: from the entry into force of the RAG 2013, all reportable projects will be subject to an in-depth investigation whose outcome is far from being predictable.

Against this background, the purpose of this article is to describe how the rules on regional aid to large investment projects have changed, and assess the Commission’s practice so far with respect to in-depth investigation of LIPs. This analysis is of interest, since the methodology of the in-depth assessment, particularly with respect to the incentive effect, will not change; hence, it is possible to predict future trends, taking inspiration from the Commission’s recent practice.

The remainder of this article is structured as follows: in Section II we review the applicable rules

on regional aid to large investment projects, and describe how the system has changed with the last review process. In Section III we go through the Commission’s recent practice with regard to in-depth investigations of large investment projects. Last, in Section IV we draw some conclusions.

II. EU Rules on Regional Aid to Large Investment Projects

Large investment projects have long been subject to specific rules aimed at limiting the amount of aid these projects may be awarded. The rationale of such rules was, and still is, to minimise their impact on competition, and ensure a uniform approach in their assessment, as well as to prevent subsidy races between Member States.

In this respect, the first piece of soft legislation was published in the context of the landmark reform of regional aid rules in 1998,⁶ when the Commission adopted, alongside with the first Guidelines on Regional aid, the first Multisectoral Framework for regional aid to large investment projects (“MSF 1998”).⁷ The methodology laid down in the MSF 1998 was innovative for the time, in that it provided three assessment criteria (or adjustment factors) aimed at decreasing the aid intensity with respect to the max-

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1 Guidelines on regional State aid for 2014-2020, OJ 2013 C 209/1 (“RAG 2013”).

2 See RAG 2013, para 186.

3 Communication from the Commission – EU State aid Modernisation, COM (2012) 209 final.

4 By large investment project is meant an initial investment with eligible costs exceeding €50 million

5 I.e., those projects whose aid intensity exceeds the thresholds set forth by the Block Exemption Regulation, for which a notification is due.

6 Guidelines on national regional aid, OJ 1998 C 74/9.

7 Multisectoral framework on regional aid for large investment projects, OJ 1998 C 107/7 (“MSF 1998”).

imum regional ceiling.⁸ In addition, the MSF 1998 established a notification threshold for individual aid.⁹ However, as such, the system rapidly showed a number of weaknesses: rules were not transparent enough, cases required a lot of work and time, and the resulting aid levels were generally too high despite the adjustment factors.¹⁰ This led to a first revision in 2002, and the adoption of the Multisectoral Framework 2002 (“MSF 2002”).

With the latter, the Commission essentially sought to simplify and clarify the applicable rules. The main innovation of the MSF 2002 consisted in the replacement of the three assessment criteria with a brand new system based on a scale of investment expenditure, where the reduction of aid level for large investment projects was obtained through the automatic adjustment of the regional aid ceilings on the basis of a scale consisting of three thresholds of investment expenditures and related adjustments.¹¹ In addition, and most importantly with respect to reportable aid projects, the MSF 2002 limited the discretionary power of the Commission by laying down two specific scenarios in which the granting of aid was subject to a *per se* prohibition, *i. e.*, when: (a) the market share

of the aid beneficiary was above 25 % before or after the investment; and/or (b) the production capacity created by the project accounted for more than 5 % in a market in structural decline.¹² The underlying rationale was that in case either the beneficiary enjoyed some market power, or the market was characterised by overcapacity, the distortive effect of aid granted under such circumstances would be magnified.

Although such rules had been conceived for being applied until 2009, few years later they were again revised in the context of the second reform of regional aid, and ultimately incorporated into the Guidelines on National Regional Aid for 2007-2013 (“RAG 2006”).¹³

While the 2006 review process was mainly focused on other aspects of regional aid rules, the RAG 2006 also innovated with respect to large investment projects. Most notably, in line with principles spelt out in the State aid Action Plan,¹⁴ the RAG 2006 set forth a more flexible and economic-oriented approach towards reportable investment projects,¹⁵ by removing the *per se* prohibition laid down in the MSF 2002 with respect to those projects meeting one of the two thresholds mentioned above.¹⁶

8 Namely: (i) the competition factor, (ii) the capital/labour factor, and (iii) the regional impact factor. The first looked into the competitive situation of the market, and considered whether the latter was characterised by structural overcapacity, or the aid beneficiary had a high market share. The second adjustment factor was meant to capture highly capital intensive projects, which were deemed to have the most distortive effects on competition. Lastly, the third factor took account of the beneficial effects on the economies of the assisted regions, particularly in terms of job creation; it also acknowledged that capital intensive investments may create a significant number of indirect jobs in the assisted region, despite the number of direct jobs being limited. While the first two factors were meant to decrease the aid intensity of the project concerned, the third one was meant to compensate such decrease, within the limits – in terms of global aid ceiling – set forth for each region.

9 In this respect, the MSF 1998 set forth two alternative thresholds above which an investment project had to be notified, *i. e.*, when either (i) the total project cost was above €50 million, where the cumulative aid intensity expressed as a percentage of the eligible investment costs was at least 50% of the relevant regional aid ceiling, and aid per job amounted to at least ECU 40,000; or (ii) the total aid to be granted was at least equal to €50 million.

10 For a comment, see Merola, ‘Regional Aid: Recent Trends and Some Historical Background – with special Focus on large Investment Projects’, (2010) 3 EStAL 589, p. 594.

11 Namely: (i) up to €50 million, 100% of the applicable aid ceiling; (ii) between €50 million and €100 million, 50% of the applicable aid ceiling; and (iii) above €100 million, 34% of the applicable aid ceiling. See MSF 2002, paras. 21 ff.

12 See MSF 2002, para. 24.

13 Guidelines on national regional aid for 2007-2013, OJ C 2006 54/13.

14 State aid Action Plan – Less and better targeted State aid: a roadmap for State aid reform 2005–2009, COM(2005) 107 final. In line with the Lisbon Agenda, the SAAP introduced the principle of “less distortive and better targeted State aid”; and was aimed at fostering a more refined economic approach in the field of State aid.

15 Large investment projects can benefit from the Block Exemption Regulation whenever aid intensity is below the notification threshold, and the relevant criteria laid down by Regulation are met. Currently, regional investment aid awarded in favour of large investment projects is subject to the notification obligation if the total amount of aid from all sources exceeds 75% of the maximum amount of aid (as laid down in the relevant regional aid map) an investment with eligible costs of €100 million could receive. See General Block Exemption Regulation (GBER), Article 6 (2) (OJ 2008 L 214/3). The same notification threshold should continue to apply following the review of the GBER which is currently under way.

16 RAG 2006, para. 68. Below such thresholds, the Commission confined itself at verifying that the standard conditions for the approval of regional investment aid were met, most notably in terms of incentive effect, and contribution to a coherent regional development strategy. Particularly with respect to the incentive effect, the standard test set forth in the RAG 2006 was based on the chronological criterion, *i. e.*, proof that work on the project did not start before the authorities had committed to fund the project (see RAG 2006, para. 38). As to the contribution to regional development, the Commission verified whether the aid produced positive effects, mainly in terms of job creation (number of jobs directly and indirectly created by the invest-

In such cases, the RAG 2006 required the Commission to conduct an in-depth assessment of the aid measure, through the opening of the Article 108(2) procedure, aimed at ascertaining that (i) the aid was necessary to provide an incentive effect; and (ii) the benefits expected outweighed any distortion of competition. Detailed guidance on the criteria to apply for the purpose of this assessment was then adopted in a communication which set forth the methodology of the in-depth assessment, based on the so-called balancing test (“Communication 2009”).¹⁷

In essence, according to the methodology spelt out in the Communication 2009, the Commission had to:

- Assess the appropriateness of the aid instrument;¹⁸
- Analyse the incentive effect of the aid measure;
- Assess the indirect positive effects,¹⁹ as well as the proportionality of the aid;²⁰
- Balance the positive effects of the aid against its negative effects.²¹

In this context, as acknowledged by the Communication 2009, one of the most important steps of the analysis concerned the detailed assessment of incentive effect of the aid. The latter was aimed at determining whether the aid did actually contribute to changing the behaviour of the beneficiary, *i.e.*, to take the decision of investing in the assisted region; or whether – absent the aid – the investment would have been carried out anyway.

In particular, according to the Communication 2009, the incentive effect should be proved based on a comprehensive description of the counterfactual scenario, aimed at ascertaining that (a) either the investment project would not be profitable without the aid, irrespective of the location (scenario 1 or “investment decision”); or (b) the investment project, without the aid granted in that particular region, would prove to be more profitable if carried out in a different location (scenario 2 or “location decision”).

The introduction of such case-by-case assessment, as opposed to the *per se* prohibition, represented a significant improvement, in that – at least in principle²² – it allowed a more targeted and economic assessment of those LIPs subject to an outright prohibition under the old regime. However, given the complexity of the analysis required, the system was designed for being applied only to those few cases that triggered the in-depth assessment; by contrast, the vast majority of reportable aid projects underwent a more “standard” assessment, where the effects of the aid was generally presumed to be positive, provided certain formal requirements were met.²³

Against this background, under the new RAG the Commission has significantly toughened the rules applicable to LIPs by introducing a number of relevant changes.²⁴

- i) The first major innovation has to do with the assessment of reportable LIPs: the market share/

ment), training and knowledge transfer, spillover effects. Over the years, the Commission authorised over thirty reportable LIPs based on the standard criteria set forth in the RAG 2006, hence without carrying out the in-depth assessment. The majority of these cases concerned regional aid in the solar and semiconductor sector (see, *e.g.*, *Sunfilm AG.*, Commission decision of 19 June 2008, case N 453/2008; *Solibro GmbH*, Commission decision of 20 July 2010, case N 641/2009); also, a number of these cases concerned the automotive sector (see, *e.g.*, *Fiat Sicily*, Commission decision of 29 April 2009, case N635/2008; *Ford España*, Commission decision of 17 June 2009, case N473/2008; *Fiat Powertrain Technologies in Verrone*, Commission decision of 9 June 2010, case N27/2010).

17 Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJ 2009 C 223/3 (“Communication 2009”).

18 Communication 2009, para. 18 (“*measures for which the Member State considered other policy options, and for which the advantages of using a selective instrument such as State aid for a specific company are established, are considered to constitute an appropriate instrument*”).

19 Notably in terms of: number and quality of jobs create; knowledge spillovers; clustering effect; duration of the investment and possible future follow-on investments. See Communication 2009, paras. 14-16.

20 Communication 2009, para. 29 (“*the amount and intensity of the aid must be limited to the minimum needed for the investment to take place in the assisted region*”).

21 As to the negative effects of the aid, the Communication distinguishes between (i) effect on competition and (ii) effect on trade. With respect to the effects on competition, two theories of harm are contemplated, namely the creation of market power and the creation or maintenance of inefficient structures. As to the negative effect on trade, the Communication points at possible loss in economic activity, mainly in terms of job cuts, which may happen in principle whenever the aid generates a capacity increase exceeding market growth. See Communication 2009, paras. 37-51.

22 See Section III below.

23 See fn.17 above.

24 Among the other major changes introduced by the RAG 2013 are: (i) an increase in the overall share of regions where regional aid can be granted (notably, from the current level of 46,1 % to 47,2 % of the EU population); (ii) an increase in the aid categories that may benefit from the Block Exemption Regulation, particularly with a view to facilitate the absorption of EU funds in cases where aid measures are co-funded by structural funds; (iii) for assisted regions other than the least developed ones, aid intensities are lowered by 5 percentage points; (iv) strengthening of anti-relocation provisions.

capacity thresholds that triggered the in-depth assessment under the RAG 2006 have been removed; as a result, any individual aid²⁵ above the notification threshold will be subject by default to such in-depth assessment. As to the latter, most criteria set forth in the Communication 2009 are taken over by the RAG 2013, particularly with respect to the analysis of the incentive effect. Hence, the Commission will continue to assess the notified aid by weighting its positive and negative effects; in doing so, it will particularly verify that the aid has an incentive effect on the basis of the counterfactual analysis, either in case of an “investment decision”, or in a “location decision”, as described above.

- ii) The second, major change has to do with the areas in which large enterprises may be awarded regional aid. In order to be eligible for regional aid, areas may either fulfil the conditions of Articles 107(3) (a) or (c) of the TFEU, depending on the level of economic development (so called “a” and “c” areas). While, until the last review process, large enterprises were generally eligible for aid in both areas, under the new RAG large enterprises will not be

eligible for aid in “c” areas unless aid is granted for the set-up of new economic activities, or for the diversification of existing establishments into new products or new process innovations.²⁶ In addition, all investment aid granted to diversify an existing establishment in a “c” area into new products will remain subject to the notification obligation, thus undergoing the in-depth assessment.²⁷

Ostensibly, such changes are the outcome of a rather contentious debate concerning the effectiveness of regional aid granted to large enterprises, in a context where the Commission’s view and that of Member States and other stakeholders were opposite.²⁸

The latter generally shared the view of keeping the rules set forth in the RAG 2006, and disfavoured the option of making rules more restrictive on several aspects, most notably the compatibility assessment. Such restrictions, besides increasing administrative burdens for Member States and aid beneficiaries,²⁹ were deemed to be particularly inappropriate in times of economic crisis.³⁰ In addition, the vast majority of stakeholders strongly opposed the restriction of aid to large enterprises in “c” areas,³¹ for “*modern regional policy tries to support clusters composed of [large enterprises] and SME, and ... any exclusion of [large enterprises] would endanger the efficiency of these policies, and their contribution to regional development*”.³² A further sensible argument put forward was that “*any exclusion of [large enterprises] would give them an incentive to relocate activities to locations outside the EEA*”,³³ so that the collateral damage from banning potentially “good aid” would ultimately outweigh any gains resulting from the prohibition of “bad aid”.

Conversely, according to the Commission, regional aid has a limited incentive effect with respect to large companies, in that it is “*one of the factors, but not the determining one to invest or to locate in a disadvantaged region*”.³⁴

In addition, according to the Commission, aid to large enterprises in “c” areas is more likely to distort competition, since it is often not a necessary condition for a company to invest or to locate an investment in these areas; and its contribution to regional development, as opposed to aid in “a” areas, is “*proportionally less important*”.³⁵

Admittedly, the tightening of the rules for large enterprises must be read in the context of the State aid Modernization (SAM) initiative. At the outset,

25 By individual aid is meant both aid granted under a notified scheme, as well as *ad hoc* aid. Currently, *ad hoc* aid to large enterprises is block-exempted to the extent it is used to supplement aid granted on the basis of regional investment aid schemes (Article 13(1) GBER). This might change following the review of the GBER which is currently under way (see Article 1(4) (d) of Draft GBER, available at http://ec.europa.eu/competition/consultations/2013_gber/gber_draft_regulation_en.pdf).

26 RAG 2013, para. 15.

27 RAG 2013, para. 24.

28 See Commission Staff Working Document, Impact Assessment Report, available at http://ec.europa.eu/competition/state_aid/regional_aid/impact_assessment_report_en.pdf (“Impact Assessment Report”).

29 See Impact Assessment Report, p. 76.

30 *Ibid.*, pp. 10-11.

31 *Ibid.*, p. 66.

32 *Ibid.*, p. 10.

33 *Ibid.*, p. 36.

34 *Ibid.*, p. 12. See further *Combes/van Ypersele*, ‘The Role and Effectiveness of Regional Investment Aid. The Point of View of the Academic Literature’, (2013), available at http://ec.europa.eu/competition/consultations/2013_regional_aid_guidelines/index_en.html.

This view is now fully embodied in the RAG 2013, where it is stated that “*large undertakings tend to be less affected than small and medium enterprises (SMEs) by regional handicaps for investing or maintaining economic activity in a less developed area*”, (RAG 2013, para. 14).

35 Impact Assessment Report, p. 34.

this reform was conceived as something similar to that undertaken a decade before in the antitrust area: the Commission would focus its resources and enforcement powers on the important cases truly capable of distorting competition and cross-border trade within the EU (big cases of operating and rescue aid such as, *e.g.*, Alitalia or Olympic Airways), while good aid (*e.g.*, regional aid to sound investment projects) would benefit from streamlined rules.³⁶

However, with the deepening of the Eurozone crisis, the reform has taken a rather different spin: adapting State aid enforcement policy to the current economic situation has become the priority. In a context of gloomy economic forecasts, the Commission has opted to strengthen its role, and allow less “safety margin” to Member States, by introducing rules which will reduce pressures on public budgets³⁷ and restrict overall aid expenditure.³⁸ This mirrors the Commission’s twofold concern that first, in times of crisis, competition for attracting investments is distorted, since those EU countries having constrained resources may be easily outbid by richer regions; this may result in inefficient outcomes for the EU as a whole, which in turn may jeopardise the internal market.³⁹ Further, in times of severe strains on public budgets, a stricter control on State aid is a sensible approach to preserve collective welfare:

without strict enough rules governing the granting of subsidies, public authorities would end up wasting large sums of taxpayers’ money, which could be better spent.⁴⁰

The decision of widening the scope of cases subject to in-depth scrutiny was also influenced by the Commission’s perception that the thresholds triggering the in-depth investigation were, after all, inadequate to detect the most harmful cases.⁴¹ In this respect, a major role was also played by the General Court’s ruling in the *Smurfit Kappa* case⁴² last year, whereby the Court annulled a Commission’s decision approving regional aid for the construction of a paper mill in the Brandenburg Nordost region in Germany. In that case, the Commission had taken the view that, since the market share of the aid beneficiary (Propapier PM2) did not exceed the 25 % threshold, nor did the aid increase capacity by more than 5 %, it did not have to carry out the detailed verification set forth by the RAG. However, the Court did not share the Commission’s view,⁴³ and annulled the decision on the grounds that the formal investigation procedure may in principle be initiated even where the thresholds are not exceeded.

As a result, despite the criticisms raised by stakeholders in the context of the public consultation on the revision process,⁴⁴ the Commission ultimately

36 In this respect, some authors also put forward the idea that, in line with the principle of subsidiarity, some form of devolution of powers to national authorities and courts would be appropriate in a forward looking perspective. See, *e.g.*, Merola, *fn.* 10 above, p. 615; Merola *et al.*, ‘The Most Appropriate Economic Tool for a Better Targeted State aid Policy’, in *Economic Analysis of State aid Rules – Contributions and Limits*, Merola, Massimo and Derenne, Jacques, (eds.), p. 62.

37 Impact Assessment Report, p. 6.

38 *Ibid.*, p. 7.

39 *Ibid.*, pp. 23-24.

40 Speech by Joaquin Almunia, Commission Press Release of 8 May 2012.

41 See, *e.g.*, Impact Assessment Report, p. 41. Some commentators have criticised this position, arguing that the economic literature in point “does not assess whether State aid results in distortions in competition, and more research would be useful to determine how best to deal with the other potential benefits and inefficiencies of awarding of State aid.” They conclude by saying that “as long as one of the key aspects of regional aid is to prevent aid that would distort competition, a market power or market share screen (within a properly defined geographic market) is both relevant and useful in a streamlined assessment process”. See Langenfeld/Alexander, ‘State aid and Supply-Side Geographic Market Definition’, (2013) 2 EStAL 362, p. 366.

42 Case T-304/08, *Smurfit Kappa Group v Commission* [2012], not yet reported.

43 In particular, according to the General Court, while the Commission has the power not to initiate the formal investigation procedure, it cannot justify the decision by claiming that it is required by the Guidelines *not* to initiate the procedure. Hence, the Court concluded by stating that the Commission had “*misconstrued the scope*” of the thresholds laid down in the RAG 2006. As it has been observed, while the statement that formal compliance with the provisions of the RAG is not evidence in itself of the positive effects of the aid was correct in that context, the ruling had wider implications, in that it clearly questioned the Commission’s discretionary power of selecting the most problematic cases based on the triggering thresholds. See Nicolaidis, ‘Is the General Court Unwittingly Weakening the System of State aid Control? *Smurfit Kappa v European Commission and the Application of the Regional Aid Guidelines*’, (2013) 4 (2) JECLAP 134.

44 Impact Assessment Report, p. 76 (“*Stakeholders generally have a preference for the baseline scenario which is essentially based on per se rules. It is generally accepted that rules and definitions in the RAG should be clear, simple, and unequivocal, to ensure the predictability, transparency, and speediness of Commission decisions. Many stakeholders consider that the enhanced economic approach ... is not compatible with these requirements. Many respondents to the public consultation state that the counterfactual analysis ... is disproportionate and that it would present a heavy burden.... The counterfactual analysis and net extra costs calculations are considered to be complex to perform and require beneficiaries to provide information on their internal management decisions, for which there are no harmonised evaluation criteria*”).

kept its view that the in-depth assessment should be extended to all reportable projects; the sole compromise being reached with respect to the areas in which Member States may award regional aid to large enterprises, in that the approach initially taken in the Draft guidelines (*i. e.*, *per se* prohibition of regional aid to large enterprises in “c” areas) has been softened.⁴⁵

Since all reportable projects will now be subjects to the in-depth assessment, it seems appropriate to look at the Commission’s practice in point so far to gain some insight on what will be the likely fate of reportable LIPs in the future.

III. Commission’s Practice – State of Play

Regrettably enough, the Commission’s practice remains limited so far. In the period of application of the RAG 2006, the Commission opened several formal investigation procedures on the ground that the market share/capacity thresholds were exceeded. However, only one final decision was ultimately adopted in accordance with the criteria of the in-depth investigation. As to all other cases concluded so far, the notifications were ultimately withdrawn, save for one case where the Commission approved the aid without undertaking the in-depth assessment.

1. Dell Poland

The only recorded precedent in which the Commission concluded the in-depth assessment is *Dell Poland*.⁴⁶

⁴⁵ See Impact Assessment Report, p. 35.

⁴⁶ Commission decision of 23 September 2009, case C46/2008 (“Dell”).

⁴⁷ Namely Łódź in Poland, and Nitra in Slovakia.

⁴⁸ Dell, paras. 189-193.

⁴⁹ Dell, paras. 153-161. It has also been observed that attracting capacity-driven industries is an important part of regional development plans. Such industries are “*by definition capital intensive*”, hence require significant financial funds. However, in principle they can generate technological spillovers, and offer well as mid- to long term commitment to a particular region; further, they facilitate the creation of regional industrial clusters by attracting further businesses to the region. See *Friederiszick/Tosini*, ‘Implication of the State aid Modernization for the Assessment of Large Investment Projects’, (2013) 1 EStAL 46, p. 50.

⁵⁰ Dell, paras. 202-204.

The investment project at issue in *Dell* consisted in the setting-up of a new plant for the manufacture of personal computers and servers in Poland.

As it is apparent from the decision, the company had decided to carry out the project “*irrespective of its location*”; hence, the Commission had to consider the effects of the aid in terms of favouring its location in the target region as opposed to another region (Scenario 2, location decision). After having analysed and compared the costs and benefits of several potential locations, Dell retained two potential locations for the investment project,⁴⁷ and conducted a counterfactual analysis to assess the comparative advantages of the two locations; based on the latter, it concluded that, absent the aid, it would have been more advantageous *not* to locate the project in the most disadvantaged region. Hence, the Commission was able to conclude that proof of the incentive effect of the aid had been duly provided. In fact, the Commission endorsed the Polish authorities’ view that “*the only relevant question in order to prove the incentive effect under Scenario 2 is whether the investment would have been located elsewhere had the aid not been granted*”.⁴⁸

Further, moving to the assessment of the effects, the Commission keenly emphasised the positive contribution the Dell project was deemed to have on regional development. Particularly, the Commission endorsed the view of the Polish authorities that aid granted to LIPs impact significantly on regional development, in that they trigger additional investments through the clustering of economic activity and its associated effects; the latter benefit in turn the labour market and promote infrastructure development.⁴⁹

Conversely, as to the negative effects, the Commission dismissed all concerns raised by competitors: since Dell would have carried out the project in any event, an increase in market power would have happened irrespective of the location of the investment and would not have been affected by the granting of the aid. Accordingly, the Commission considered that it was “*not possible to decide that the market power of the beneficiary has increased as a result of the aid*”. A similar conclusion was reached with respect to the risk of creating or maintaining inefficient market structures, since the theory of harm under scenario 2 “*is not whether competitors are likely to be affected by the investment but rather whether the aid has any effect on the choice of location*”.⁵⁰ On the other hand, as to the negative effects on trade, the Commission found that the aid would not result in a substantial loss of jobs in existing locations, in that, according

to the Commission, Dell's decision to close down a similar manufacturing facility in Ireland could not be deemed a direct effect of the aid.⁵¹ Hence, on balance, the positive effects of the aid were considered to be prevailing.

Overall, the approach followed by the Commission is sensible: in principle, in scenario 2 cases, all negative effects in terms of overcapacity and/or market power would in principle materialise regardless of the aid (given that under scenario 2 the project would have been carried out in another location); hence, there is no causal link between the aid measure and the distortion of competition resulting from the project.⁵² Furthermore, the Commission's analysis in *Dell* is also noteworthy in that it shows a certain willingness to avoid an overly formalistic assessment of the incentive effect, and minimise the negative effects on the aid – most notably with respect to the thorny issue of relocation within the EU,⁵³ and overcapacity.⁵⁴

2. The string of in-depth investigations in the automotive sector

After *Dell*, the Commission opened a number of in-depth investigations, mostly concerning the automotive sector. However, as mentioned, most notifications were withdrawn,⁵⁵ and the aid amount was reduced up to the notification threshold.⁵⁶ This

inconclusive outcome was reached several months – and, in at least one case, years⁵⁷ – after the opening of the Commission investigation.

Since these cases have been withdrawn, there is limited information publicly available. Yet, the decisions opening the formal investigation procedure shed some light on the underlying problematic aspects of these cases, and show how the Commission has later become stricter in applying the criteria of the in-depth investigation.

In this respect, a first, contentious, issue concerned the retained market definition – a key notion to establish whether the thresholds triggering the in-depth investigation were exceeded. Particularly, the Commission could not agree with the notifying authorities the exact definition of the relevant market for cars, in that it did not share the view that the product market should be defined based on combined car segments, as opposed to single segments. In the same vein, the Commission questioned that the geographic scope of the market could be defined as wider in scope than the EEA.⁵⁸

More importantly, for those investment projects concerning car engines, the Commission took the view that the downstream final products (*i.e.*, cars) had to be considered the product concerned by the aid; on that basis, it concluded that the market share and capacity thresholds were likely exceeded, which in turn triggered the in-depth investigation.⁵⁹ How-

51 *Dell*, paras. 211-213.

52 In this respect, a parallel can be drawn with the so-called failing firm defence in merger control, according to which a merger capable of significantly reducing competition may nonetheless be approved if it can be demonstrated that – absent the merger – the target company would exit the market, and the acquiring company would acquire its shares anyway. The rationale behind this is that there is no causal link between the merger and the worsening of the competitive landscape.

53 In this respect, some have criticised the Commission's reasoning in point, observing that the policy approach in *Dell* was not entirely consistent with the objective of cohesion (see *Merola*, fn. 10 above). Admittedly, the Communication 2009 failed to address clearly the issue of EU relocation, by stating that “where there is credible evidence that the State aid would result in a substantial loss of jobs in existing locations within the European Union, which would otherwise have been likely to be preserved in the medium term, the social and economic effects on that existing location will have to be taken into account in the balancing exercise” (para. 54). The RAG 2013 has now filled this gap by providing that (i) individual aid granted under a notified scheme remains subject to the notification obligation if, at the moment of aid application, the beneficiary has recently closed down the same/similar activity in the EEA, or has the intention to do so within a period of two years after the investment project is completed (RAG 2013, para. 23); and (ii) whenever it can be established a causal link between granting of aid and relocation,

“this will constitute a negative effect that is unlikely to be compensated by any positive elements” (RAG 2013, para. 122).

54 *Dell*, para. 140.

55 *Audi Hungaria*, case C-31/2009; *Fiat Powertrain Technologies PL*, case SA.30340; *Volkswagen Sachsen GmbH*, case SA.32169; *Linamar Powertrain GmbH*, case SA.33152. Formal investigations are still pending in the following cases concerning the same sector: *BWM Leipzig*, case SA.32009; *Porsche Leipzig*, case SA.34118; *Revoz.*, case SA.33707; *Ford Espana*, case SA.34998.

56 The possibility to grant aid up to the notification threshold is expressly envisaged by the Communication 2009 for those cases where aid is granted on the basis of an existing regional aid scheme.

57 On average, the timespan from the date of notification to that of withdrawal was around 27 months, while the sole in-depth investigation lasted on average around 19 months.

58 According to the RAG 2006, markets are normally defined as EEA-wide in scope for the purpose of the in depth assessment. This approach was strongly opposed by the notifying authorities in the *Audi Hungaria* case; see Commission decision of 6 July 2010, paras. 15 ff.

59 The RAG 2006 (para. 69) provides that when the project concerns an intermediate product and a significant part of the output is not sold on the market, the product concerned may be the downstream product.

ever, if the underlying assumption of the test laid out by the RAG was to identify those companies with market power, this was hardly achieved in those cases: by substituting an intermediate product with a product further down in the chain,⁶⁰ the Commission inevitably obtained a distorted picture of the competitive landscape.

The second, more contentious, issue concerned the proof of the incentive effect through the complex counterfactual analysis, which arguably caused the withdrawal of most cases.⁶¹

In this respect, it may be observed that, of the two possible scenarios, the first is, in our view, unlikely to be considered in real life cases. Indeed, in such cases, the underlying assumption is that profitability of an investment project is conditional upon the granting of the aid. However, it seems rather implausible that a company operating in a market economy, with obligations of accountability towards its shareholders – possibly even listed on a stock exchange – could conceive an industrial investment at loss, save for public subsidies whose granting is far from being

certain until the (rather unpredictable) Commission approval. Furthermore, even assuming that such industrial projects were indeed conceivable, it is likely that the aid amount would need to be substantial, in order to fundamentally change the economics of such project. However, the size of the aid is an aspect scrutinized closely by the Commission, particularly having regard to the ratio aid intensity/ positive effects. Hence, a strong imbalance between size of the aid and number of direct jobs created is likely to be a source of concern.⁶²

Equally complex problems also arise in connection with scenario 2, under which the aid beneficiary is supposed to perform a complex cost comparison between different locations, in order to prove that the aid would cover the additional costs of locating the project in the disadvantaged area. However, in real life cases, if and when such comparisons are carried out, they are unlikely to be conducted with the level of precision required by the Commission.⁶³ Furthermore, it seems unlikely that a company would undertake such a time-consuming and costly exercise,⁶⁴ without being sufficiently certain that the Commission will ultimately approve the aid project. All this is further complicated by the excessive and rather unpredictable length of the in-depth investigation, which is hardly compatible with industrial strategies, and is likely to be an additional deterrent to including aid in the financial planning of a large industrial investment project.⁶⁵

3. Petrogal

Despite the rigorous attitude taken by the Commission in the automotive cases, the last LIP case closed to date where an Article 108(2) procedure was opened to conduct an in-depth assessment of the aid, namely *Petrogal*,⁶⁶ had a – surprisingly enough – positive outcome.

The case regarded an investment project to reconfigure and expand the existing refinery units in Sines and Matosinhos, the only two existing refineries in Portugal, aimed at increasing the production of diesel fuel to the detriment of gasoline.

The formal investigation was opened on the grounds of the Commission's doubts, mainly with respect to the formal incentive effect and contribution to the regional development of the aid; furthermore, the market share/capacity thresholds appeared to be exceeded. However, almost two years after the opening of the formal investigation, the Commission was

60 In particular, by substituting an intermediate product with an end product for market definition purposes, the Commission fails to properly consider the relevant supply side substitutability, which is a pattern typically displayed by intermediate products (see, e.g., the string of merger precedents in cases dealing with automotive components such as batteries or engines). For a comment on market definition in the field of State aid, see also *Friederiszick / Tosini*, fn. 57 above.

61 See, e.g., Impact Assessment Report (p. 33), where it is stated that "the aid beneficiaries were allegedly unable to prove that they would have carried out their investment in an alternative location in the absence of aid".

62 In at least one case the Commission prohibited the aid *inter alia* on the grounds that the ratio aid intensity/jobs created was deemed inadequate. See Commission decision of 15 September 2010, case C8/2009, upheld on appeal (Case T-551/10 *Fri-El Acerra v Commission* [2013] not yet reported)

63 In this respect, it has been observed that the assessment of profitability entails a number of rather complex operations, such as, e.g., the assessment of the right discount rate to be taken into account; or the extent to which relevant tax effects need to be included; and for how many years operational costs should be calculated. See Otter, 'Regional Aid Guidelines 2014-2010 (Draft): Implication for Large Enterprises', presentation to 11th Experts' Forum on New Developments in European State aid Law, Brussels, 7 June 2013.

64 Companies are required to plan their investment decisions by making accurate *ex ante* comparative calculations, based *inter alia* on official board documents, risk assessments, financial reports, internal business plans, expert opinions and other studies related to the investment project under assessment, as well as documents containing information on demand forecasts, cost forecasts, financial forecasts (RAG 2013, para. 72).

65 See statistics fn. 66 above.

66 Commission decision of 3 August 2011, case C-34/2009.

able to authorise the investment aid, and dismissed all initial concerns.

Key to the positive outcome is likely to be the Commission's finding that the market share/capacity thresholds had in fact *not* been exceeded,⁶⁷ hence no proper counterfactual analysis and balancing test was required.

In this respect, it is worth noting that in the opening decision the Commission had raised doubt that the aid was necessary, since it appeared that the investment project had likely been carried out "*also in a counterfactual scenario analysis without aid*". Also, the project seemed *prima facie* not compliant even with the formal chronological requirement laid down by the RAG 2006.⁶⁸ On the latter point, the Commission ultimately showed a more flexible stance than in other cases, accepting that – in substance – the formal requirement to prove the incentive effect had been met.⁶⁹

However, had the in-depth investigation been carried out, it is likely that the notifying authorities would have faced serious issues in proving the incentive effect through a proper counterfactual analysis, as well as passing the balancing test – given the substantial doubts already expressed in the opening decision.⁷⁰

IV. Conclusions

The review of State aid rules on large investment projects conducted by the Commission in the context of the new RAGs marks a notable shift of policy relative to the line taken in the previous guidelines. Extending the in-depth investigation to all reportable LIPs, with a view to assessing the incentive effect of the aid and the prevalence of positive implications, entails in practice a significant toughening of the treatment of such projects. In light of the Commission's recent practice highlighted above, in the future very few reportable LIPs – if any – will likely be able to stand scrutiny.

Admittedly, this shift is in line with the new trend advocated by the Commission under the SAM initiative: in times of economic crisis and constrained public budgets, the recipe for a sound State aid enforcement policy with respect to LIPs is centralisation combined with strict vigilance.

Toughening the scrutiny of all reportable LIPs, "across the board", could have been an acceptable and even sensible development assuming that: (i) the market share and the capacity tests were unfit to

divide "good" LIPs from "bad" ones; (ii) the in-depth assessment consisted of a balanced and predictable scrutiny conducted within a reasonable time frame which could still result in a positive outcome.⁷¹

Regrettably enough, the recent practice in point shows that the counterfactual analysis and the balancing tests are prohibitive hurdles to pass, and, if anything, there is still some opacity and too much discretion in the Commission's hands which create excessive uncertainty. If, on top of that, one adds the excessive – and quite unpredictable – length of the review process within which this assessment is conducted, the end result is that most firms will be discouraged from receiving significant aid in connection with LIPs and will rather fall back on small projects receiving aid amount below the notification threshold.

While this seems to be in line with the Commission's view that regional investment aid is more effective when geared towards SMEs, this may ultimately prove to be detrimental to the EU, given the positive impact of LIPs on local economies in terms of new jobs and spill-over effects and the risk of delocalisation in extra-EU areas offering more competitive conditions.

67 In order to decide whether the market share/capacity thresholds had been exceeded, the Commission adopted a rather conciliatory approach, *inter alia* by conceding that the products concerned by the investment project were exclusively diesel and heavy naphtha, and did not include other refinery-related products. The latter could in principle have been included in the assessment, given the fact that heavy naphtha may be considered an intermediate product within the meaning of paragraph 69 of the RAG 2006. Further, the Commission conceded that the geographical market for diesel was at least region-wide, again adopting a more flexible approach than the default one set forth by the RAG 2006 (see above fn. 68). On this basis, the Commission ultimately found that neither the market share nor the capacity thresholds were exceeded; hence, it was not necessary to conduct the in-depth assessment of the aid. See *Petrogal*, pp. 45-62.

68 See Commission decision of 19 November 2009, opening the formal investigation procedure in the *Petrogal* case, p. 11.

69 The *Fri-El Acerra* case (fn. 72 above) raised similar issues in point; in the latter, however, the Commission required strict compliance with the chronological requirement, and could not accept the argument put forward by the notifying authorities, *i.e.*, that the aid beneficiary had been informally assured that the project was eligible for aid.

70 While in its decision opening the formal investigation procedure (fn. 79 above) the Commission strongly contested the disproportion between amount of aid and number of jobs created, in the final decision the Commission states that "*despite the apparent prima facie disproportional amount of aid per direct job created, the positive indirect effects ... point to a regional contribution ... that cannot be considered negligible*" (fn. 77 above, para. 225).

71 In this respect, reference can be made to merger control rules, under which complex mergers normally undergo an in-depth assessment; however, in such cases the type of analysis is predictable, and the timeframe is set in stone.