II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 24 February 1999

concerning State aid granted by Spain to Daewoo Electronics Manufacturing España SA (Demesa)

(notified under document number C(1999) 498)

(Only the Spanish text is authentic)

(Text with EEA relevance)

(1999/718/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93(2) thereof,

Having given notice [1] to interested parties, in accordance with the above provisions, to submit their comments, and having taken account of those comments,

Whereas:

I. PROCEDURE

By letter of 11 June 1996, the Commission received a complaint from Asociación Nacional de Fabricantes de Electrodomésticos de Línea Blanca, the Spanish federation of manufacturers of household appliances (referred to below as 'ANFEL'), stating that Spain had granted aid to Daewoo Electronics Manufacturing España SA (referred to below as 'Demesa'), a company established at Vitoria-Gasteiz [2] in the Autonomous Community of the Basque Country (referred to below as 'the Basque Country'), in the form of grants and tax exemptions exceeding the ceilings allowed for regional aid in the Basque Country. The Commission received further complaints concerning the same aid from a competitor of Demesa, from the European Committee of Manufacturers of Electrical Domestic Equipment (referred to below as 'CECED') and from Associazione Nazionale Industria Elettrotecniche ed Elettroniche, the Italian federation of manufacturers of household appliances (referred to below as 'ANIE').

By letter dated 26 June 1996, the Commission asked the Spanish authorities for information.

After receiving a reminder sent on 11 September 1996, Spain provided some information by letter dated 16 September 1996. By letter of 11 February 1997, the Basque regional authorities forwarded additional information to the Commission.

Following further correspondence, the Commission informed Spain by letter of 16 December 1997 that it had decided to initiate proceedings under Article 93(2) of the Treaty in respect of possible aid received by Demesa, and urged the Spanish Government to provide a number of items of information.

The Commission's decision to initiate proceedings was the subject of a notice [3] published in the *Official Journal of the European Communities*, in which the Commission invited interested parties to submit their comments on the measures concerned. Spain submitted its comments by letters dated 23 January 1998 and 6 March 1998.

The Commission forwarded the comments it received from interested parties to Spain, offering it an opportunity to respond, which it did by letter of 20 October 1998.

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[1] OJ C 103, 4.4.1998, p. 3.

[2] Vitoria-Gasteiz is a municipality located in Álava, one of the three provinces forming the Autonomous Community of the Basque Country.

[3] See footnote 1.

By letter of 4 June 1998, the Commission informed Spain that it had decided to extend the proceedings.

The Commission's decision to extend the proceedings was published in a notice in the *Official Journal of the European Communities* ([4]). Spain submitted its comments by letters of 22 and 24 July 1998. In the notice, the Commission invited interested parties to submit their comments; it forwarded the comments received to Spain, offering it an opportunity to respond, which it did by letter received on 3 December 1998.

Two meetings were held in Brussels (29 October 1998) and Vitoria-Gasteiz (15 December 1998) between Commission staff and representatives of the Basque regional authorities, during which the latter reaffirmed their position.

II. DESCRIPTION OF THE AID

II.1. *The measures concerned*

The measures in respect of which proceedings under Article 93(2) of the Treaty were initiated and subsequently extended are the following:

— Demesa's use, free of charge, of a 500 000 m^2 plot in the Júndiz industrial estate at Vitoria-Gasteiz since 1996 and its subsequent purchase of the land at less than the market price,

— aid granted to Demesa in connection with the Ekimen programme ([5]), in so far as it is not covered by the general rule laid down in that scheme, which allows an aid intensity equal to 10% of the eligible costs corresponding to the amounts actually ([6]) invested by Demesa, given that the project is not strategic and does not involve job creation,

— a tax credit applied in the form of a 45% reduction in Demesa's corporation tax liability ([7]) and other tax concessions also granted to Demesa under the corporation tax arrangements of the Province of Álava ([8]).

II.2. *The beneficiary*

The beneficiary of the measures is Demesa, established in the Júndiz industrial estate at Vitoria-Gasteiz and a wholly owned subsidiary of Daewoo Electronics Co. Ltd (referred to below as 'Daewoo Electronics'), one of the companies belonging to the South Korean multinational group Daewoo.

Daewoo Electronics was created in 1971 and has a global network of 92 plants ([9]). It manufactures consumer electronics products and household electrical appliances (white goods) for the Korean and world markets. In 1997 its sales totalled USD 2 725 million ([10]).

II.3. *The Cooperation Agreement between Demesa and the Basque regional authorities*

On 13 March 1996 the Basque regional authorities and Daewoo Electronics concluded a Cooperation Agreement in which Daewoo Electronics undertook to establish a refrigerator manufacturing plant in the Basque Country and the Basque regional authorities undertook in return to support the investment by providing a number of grants. The Agreement entered into force on the date of its signature.

Point 3 of the Cooperation Agreement made reference to the grants and other advantages that the project could receive from the regional authorities, namely a non-refundable grant

([4]) OJ C 266, 25.8.1998, p. 6.

([5]) Scheme approved by the Commission by letter SG (96) D/11028 of 13 December 1996 (State aid N 529/96). The Decree of the Basque Regional Government establishing the scheme (Decree No 289/1996 of 17 December 1996) was published in *Official Gazette of the Basque Country* No 246, 23.12.1996, p. 20138).

([6]) In the light of information submitted by the complainants (who presented a study conducted by an engineering company specialised in the design of refrigerator manufacturing plants), the Commission decided also to examine whether the cost of Demesa's investments had not been artificially increased in order to obtain a larger grant.

([7]) Sixth additional provision of Provincial Law (*Norma Foral*) 22/1994 of 20 December 1994 (*Official Journal of the Province of Álava* (BOTHA) No 5, 13.1.1995), whose validity was extended for 1996 by the fifth additional provision of Provincial Law 33/1995 of 20 December 1995 (BOTHA No 4, 10.1.1996) and for 1997 by point 2.11 of the single-derogating provision of Provincial Law 24/1996 of 5 July 1996 (BOTHA No 90, 9.8.1996) in conjunction with the seventh additional provision of Provincial Law 31/1996 of 18 December 1996 (BOTHA No 148, 30.12.1996). The tax credit may be granted for 1998 pursuant to the 11th additional provision of Provincial Law 33/1997 of 19 December 1997 (BOTHA No 150, 31.12.1997) and for 1999 pursuant to the seventh additional Provision of Provincial Law 36/1998 of 17 December 1998 (BOTHA No 149, 30.12.1998).

([8]) Provincial Law 24/1996 on corporation tax.

([9]) 33 production centres, 33 commercial subsidiaries and 19 branches.

([10]) EUR 2 388 million (EUR 1 = USD 1,1410, Inf€uro exchange rate, February 1999).

of up to 25% of investments in fixed assets and of start-up costs, as well as any other public aid generally available to operators making investments in the Basque Country in environmental protection, R&D and energy saving projects.

The maximum aid intensity allowed in the Basque Country is 25% nge (net grant equivalent) ([11]) (35% for SMEs).

Under the Agreement, Daewoo Electronics was to set up a company with its seat in the Basque Country (Demesa). The new company was immediately to draw up a business plan whose approval by the regional authorities was an indispensable condition for implementation of the Agreement. The business plan, which covered the period 1996 to 2001 and was presented to the regional authorities in September 1996, provided for an investment of ESP 11 835 600 000 ([12]) and the creation of 745 jobs. Sales were planned to begin in 1997, mainly on the Spanish market and in France and Italy, and were to spread to Germany and the United Kingdom in 1998. At the outset, most of the turnover was to be generated on the domestic market, but exports were to grow each year, reaching 60% of the total in three to four years.

II.4. ***The Ekimen scheme and the non-refundable grant awarded to Demesa***

The non-refundable grant equivalent to 25% of the investment in tangible fixed assets was negotiated in the framework of the abovementioned Cooperation Agreement of 13 March 1996 and granted on 24 December 1996 by decision of the Basque Government under the Ekimen regional aid scheme approved by the Commission on 13 December 1996.

The scheme covers the period 1996 to 1998. Its aims are regional development and job creation. Aid granted under the scheme takes the form of non-refundable grants or soft loans ([13]) for the creation of new production facilities or the extension or modernisation of existing infrastructure. The eligible costs include land, buildings and plant.

The beneficiaries are, *inter alia*, industrial companies or firms engaged in extractive activities. In order to qualify for aid under the Ekimen scheme, investments have to comply with the following conditions:

— the investment project has to be technically, economically and financially viable and has to be implemented within a period of three years from the date when the aid is granted,

— the amount of the investment has to exceed ESP 360 million,

— it must entail the creation of at least 30 jobs,

— any fixed assets transferred to third parties or produced by another company in the same group are not eligible,

— at least 30% of the investment has to be financed from the beneficiary's own resources.

As regards the conditions in which non-refundable grants are awarded and, in particular, their variation in intensity in accordance with specific criteria, the Commission stated the following in its letter SG(96) D/11029 of 13 December 1996 approving the Ekimen scheme.

'The Commission notes that non-refundable grants, which must not exceed the ceiling of 25% gge ([14]), will be awarded in accordance with the following conditions: (a) 10% as the general rule; (b) an extra 5% for strategic projects or projects which create jobs; (c) and extra 5% for projects located within priority areas; and (d) an extra 5% for projects which make a significant contribution to regional development or job creation'

The grant awarded on 24 December 1996 represents an aid intensity of 25% gge of the investment and amounts to a total of ESP 2 958,9 million ([15]), to be paid in instalments over a four-year period in accordance with the following schedule (ESP million):

1996	30 500
1997	1 557 600
1998	759 900
1999	610 900

The grant represented an aid intensity of 18,76% nge, which falls below the ceiling of 25% nge laid down for the Basque Country.

Contrary to the forecasts set out in Demesa's business plan, the total investment of ESP 11 835,6 million justifying the grant of the aid was to be carried out during that same period 1996 to 1999 and not over the period from 1996 to 2001. The Commission expressed doubts, which were subsequently dispelled, as to whether the condition that the project was to be completed within three years, one of the qualifying

([11]) The maximum limit for regional aid in the Basque Country, in accordance with the Spanish regional aid map (OJ C 25, 31.1.1996, p. 3).
([12]) EUR 71 133 388,63.
([13]) The interest rate applied can be between two and five points lower than the nominal interest rate.
([14]) Gross grant equivalent.
([15]) EUR 17 783 347,16.

conditions for the grant, would be fulfilled. The regional authorities confirmed that payment of the aid was to be made over a period of three years, although given the date on which the grant was awarded (24 December 1996) it would be split into four budget allocations. The regional authorities also confirmed that Demesa's investment would involve the creation of 412 jobs during the period 1996 to 1999.

According to information provided by the regional authorities, updated to June 1998, Demesa has declared investments corresponding to 44% of the total amount; 201 jobs had been created up to that date ([16]).

II.5. *Tax concessions available in the Province of Álava*

The tax arrangements in force in the Basque Country are governed by the Economic Agreement established by Law 12/1981 of 13 May 1981, as last amended by Law 38/1997 of 4 August 1997. Under the Economic Agreement, the Álava Provincial Council may, under certain conditions, maintain, establish and regulate the tax system within its territory ([17]).

Using the powers conferred on it by the Economic Agreement, the Álava Provincial Council has established the following tax aid measures:

(a) a tax credit corresponding to 45% of the cost of investments, provided that these exceed ESP 2 500 million. The credit is applied to the amount payable by way of corporation tax. It was originally valid only for investments made between 1 January 1995 and 31 December 1995, but the period was subsequently extended until 31 December 1997 by successive budgetary provisions. Any tax credit not used up because it exceeds the amount of definitive tax liability may be carried forward and applied in subsequent years. Decisions granting the credit also lay down the time limits, ceilings and any other restrictions applicable in each case. Investments made in the preparatory phase of a project may be deemed eligible if so decided by the Álava Provincial Council. Demesa was granted the benefit of the tax credit by Decision 737/97 adopted by the Álava Provincial Council on 21 October 1997;

(b) a reduction ([18]) of 99%, 75%, 50% and 25% in the basis of assessment for corporation tax, applicable, respectively, for four consecutive years running from the first year in which the basis of assessment is positive. These reductions are available to companies newly established in the Province of Álava provided that they invest at least ESP 80 million and create at least 10 jobs;

(c) various reductions in the amount of tax payable ([19]), which may not total more than 40% of the tax liability.

III. REQUEST FOR INFORMATION AND INITIATION OF PROCEEDINGS

In the decision which it notified to Spain by letter dated 16 December 1997, the Commission:

— urged the Spanish Government to provide it with the information necessary for determining whether the non-refundable grant was awarded in accordance with the Ekimen aid scheme, and whether the investment costs covered were equivalent to the amounts actually invested,

— initiated proceedings under Article 93(2) of the Treaty in respect of certain tax measures and with regard to the free-of-charge use of a plot of land and the subsequent sale of the land at less than the market price.

III.1. *Spain's reply to the request for information: the grant awarded under the Ekimen scheme*

Spain transmitted the information set out below, which was provided by the Basque Regional Government.

In so far as the grant amounting to 25% gge of the investments made during the period 1996 to 1999 was awarded under a regional aid scheme approved by the Commission, the regional authorities took the view that there was no obligation to notify it. Following the request for information made by the Commission (which itself was acting in response to the complaints mentioned above), the Basque regional authorities nevertheless informed it of the award of the grant. The regional authorities also stressed that the plan submitted by Demesa fulfilled all the eligibility conditions laid down in the Ekimen scheme and that its economic and financial viability was ensured.

([16]) According to an article in the Spanish press (*El País*, 11. November 1998), reporting on trade union action, Demesa employed 170 workers, 90% of whom did not have open-ended employment contracts.

([17]) See Article 6 of the Economic Agreement, as amended by Law 38/1997 of 4 August 1997. The Provincial Councils of the other two provinces of the Basque Country (Vizcaya and Guipúzcoa) also have powers in the tax field.

([18]) See Article 26 of Provincial Law 24/1996.

([19]) 15% of the amount invested in new tangible fixed assets; 10% of the accounting result set aside in a reserve for investments; 30 % of R & D Expenditure; 15% of investments in environmental protection; 25 % of investments made with a view to developing exports. See Articles 37, 39, 41, 42 and 43 of Provincial Law 24/1996.

As far as fulfilment of the conditions for the award of the grant is concerned in particular, the regional authorities made the points summarised below:

— the household-appliances sector is of strategic importance for the Basque Country. The regional authorities base their arguments concerning the strategic nature of the sector on the theory of competitive advantage and clusters ([20]). They claim that the household appliances cluster accounts for 6% of GDP in the region and can consequently be regarded as strategic; the project is furthermore strategic in its own right since Demesa's establishment in the Basque Country will lead to keener competition between companies in a sector in which there is no strong group of local competitors in the region,

— a multinational company was investing in a region severely affected by economic recession,

— the grant awarded to Demesa does not exceed the ceiling of 25% gge laid down in the Ekimen aid scheme, which in turn represents only around 20% nge. This is less than the maximum allowed in the Basque Country (25% nge),

— the fact that the investment is not located in a preferential interest area for the purposes of the Ekimen scheme does not mean that Demesa cannot be awarded aid up to the prescribed maximum of 25% gge: the regional authorities enjoy wide discretionary powers allowing them to award grants up to that limit,

— there is no objective factual basis for the complainant's claim that the real cost of Demesa's investment is only half the declared value. The regional authorities nevertheless decided to carry out an audit on the investments made,

— the Ekimen scheme comprises a procedure for checking and monitoring investments which makes it possible at all times to verify that the investments actually made correspond to the amount of aid disbursed.

([20]) The regional authorities refer in particular to the 'theory of competitive advantage developed by Prof. Michael Porter'. Among works published by this author, see for example *The Competitive Advantage of Nations*, The Free Press, New York, 1990 or, more recently, 'Clusters and New Economics of Competition', in *Harvard Business Review*, Vol. 76, Issue 6, November/December 1998, pp. 79 to 90. In that article, clusters are defined as 'geographic concentrations of interconnected companies and institutions in a particular field' (p. 78). 'They include, for example, suppliers of specialised inputs such as components, machinery, and services, and providers of specialised infrastructure. Clusters also often extend downstream to channels and customers and laterally to manufacturers of complementary products […]. Finally, many clusters include governmental and other institutions […] that provide specialised training, education, information, research, and technical support.' The characteristic feature of this definition is summed up by the words 'geographic concentration'. The author also states in the article that 'government policies in developing economies often unwittingly work against cluster formation. Restrictions on industrial location and subsidies to invest in distressed areas, for example, can disperse companies artificially'.

III.2. ***Observations submitted by Spain***

III.2.1. **Free-of-charge use of a 500 000 m² plot of land and subsequent sale of the land at less than the market price**

The regional authorities claim that Demesa has never used a 500 000 m² plot of land free of charge. With the aid of documentary evidence, they point out that the company occupied and subsequently purchased a plot of only 100 000 m². In line with specific requirements of property law, the sale was formalised only after successive divisions and amalgamations of the different pre-existing plots had been completed. The regional authorities have also supplied aerial photographs demonstrating that Demesa has indeed occupied only the 100 000 m² of land it purchased.

A complication nevertheless arose in the course of the sale transaction owing to the presence on the land of tenant farmers who claimed compensation for crops ploughed up as a result of the construction work. It was only after enforcement proceedings had been initiated, and subsequently settled out of court, that the deed of sale was formalised on 30 December 1997. According to the regional authorities, the transfer of ownership could not take place until the dispute over tenure of the land had been resolved, since Gazteiko Industria Lurra SA, the company selling it, felt bound to act in good faith towards the purchaser. In any event, the regional authorities stress that the sale took place in accordance with Spanish law and therefore that there can be no question of aid as far as the conditions of sale are concerned.

As regards the price at which the land was sold, the average prices communicated by the complainant (between ESP 6 000 and ESP 7 000 per square metre) are for plots of land (between 1 000 and 10 000 m²) much smaller than that purchased by Demesa (100 000 m²). It is reasonable to assume that a lower price per square metre would be charged for a plot of land 10 times larger. In support of this, the regional authorities have submitted two reports drawn up after the sale by two independent experts, according to which the purchase price of a 100 000 m² plot of serviced land varies between ESP 4 000 and ESP 5 000 per square metre. The regional authorities consequently take the view that the price of ESP 4 125 per square metre of serviced land paid by Demesa is in line with market conditions.

The documentation submitted also includes a 'supplementary accounting report on available plots of land' drawn up, according to the regional authorities, by the auditors Price

Waterhouse for 1997. That report gives a unit cost of ESP 4 481 per square metre of serviced land for 50 000 m^2 plots located in the same area as the land occupied by Demesa.

Lastly, the regional authorities take the view that the Commission communication of 10 July 1997 on State aid elements in sales of land and buildings by public authorities ([21]) does not apply to the case in point since the purchase of the land was decided before the communication was adopted.

III.2.2. **Tax aid**

Spain has communicated an extremely detailed report, drawn up by the Basque regional authorities, on the basis and workings of the tax arrangements applicable in the Province of Álava. The report claims that, when it decided to initiate proceedings, the Commission did not take sufficient account of the historical, constitutional and legislative bases of the Province's specific legal arrangements.

In the taxation field in particular, the reference framework for these special arrangements is the Economic Agreement referred to in point II.5.

Using these legislative powers in the tax field, the Álava Provincial Council adopts, among other things, legal provisions relating to corporation tax.

The regional authorities consider that these corporation tax provisions are general measures which should not be examined in the light of Article 92 of the Treaty since they lay down the general corporation tax arrangements applicable in the Province of Álava. According to the Basque regional authorities, in taking the view that these arrangements could involve aid, in so far as the tax concessions they provide for are restricted to companies established in or maintaining economic links with part of the territory of a Member State, the Commission is failing to take into consideration the specific structure of taxation powers under Spanish law.

Neither is the tax credit in particular granted on a discretionary basis by the Álava Provincial Council. The tax credit is governed by law and granted automatically to eligible firms. The regional authorities stress that it is not possible under Spanish law to apply differentiated tax treatment, except in cases expressly provided for by law. Indeed, individual tax measures are prohibited. In the case of the tax credit, the Basque authorities do not enjoy any discretionary powers whatsoever. The decision to grant the tax credit (Decision 737/97) referred to in the legislation concerned merely involves a prior check that the eligibility conditions are fulfilled and is adopted for reasons of legal certainty and sound financial management. A company merely has to demonstrate that there is a causal link between the investments made during the preparatory phase of the project and the materialisation of those investments in order to qualify for the tax credit.

Decision 737/97 granted Demesa a tax credit of this nature amounting to 45% of the value of the investments. The tax credit cannot be combined with any other tax concession granted in respect of the same investments.

The regional authorities have submitted a report stating that the tax burden is heavier in the Basque Country than in the rest of Spain, despite a tax rate which is 2,5 percentage points lower and the tax concessions available only in that region ([22]).

III.3. ***Observations submitted by interested parties***

A number of observations were received from the complainants concerning the initiation of proceedings. These can be summarised as follows:

— the Spanish authorities were deliberately slow in answering the Commission's successive letters, pursuing a policy of *fait accompli*. The complainants point out that the first substantial answer to the Commission's first request for information, which dated from June 1996 (when it was still possible to take action to prevent disbursement of the aid) was not received until 11 February 1997,

— the household appliances sector, and particularly the refrigerators/freezers segment, continues to suffer from surplus capacity. Three of the leading European manufacturers (Electrolux, Whirlpool and Fagor) have announced plant closures and job cuts or restructuring operations. The complainants stress in this connection that the Court of Justice of the European Communities confirmed in *Pyrsa* (judgment of 14 January 1997 in Case C-169/95 *Spain v Commission*) ([23]) that regional aid should not give rise to a sectoral overcapacity,

— the conditions for the award of the grant have not been fulfilled, since:

(i) the project will not be completed within three years,

([21]) OJ C 209, 10.7.1997, p. 3.

([22]) 'Los principios y normas de armonización fiscal en el concierto económico' (tax harmonisation principles and rules in the economic agreement), Fundación Banco Bilbao Vizcaya, 1997.

([23]) [1997] ECR I-135.

(ii) the project is not 'strategic', nor will it entail the 'creation of jobs'. Only a grant of 10 % gge would be justified in accordance with the criteria laid down for the Ekimen scheme,

— the tax credit is illegal since it was not notified to the Commission before it was put into effect,

— Demesa is occupying a 500 000 m^2 plot of land without legal title and without paying rent. Free-of-charge use of the land is worth ESP 100 million per year, and the price of land in the same area is around ESP 6 000 per square metre,

— the cost of the plant and machinery has been overvalued, with the result that the amount of the grant corresponds to 51 % of the real cost of the investments,

— Demesa has not complied with the obligation, laid down by the Ekimen scheme, to finance 30 % of total net assets from its own resources during its second year in business.

III.4. ***Comments made by Spain in response to observations submitted by interested parties***

These comments can be summarised as follows:

— the regional authorities consider that sufficient information has been provided to enable the Commission to establish that the conditions for applying the Ekimen scheme are complied with. However, as regards the claim that Demesa has not complied with the obligation to finance 30 % of total net assets from its own resources during its second year in business, they point out that, for the purposes of applying the Ekimen scheme to Demesa's investment, the three years should be counted from January 1997, and not 24 December 1996, the date on which the grant was awarded. Compliance with this condition should therefore be checked at the end of 1998 and not at the end of 1997,

— the case-law quoted by the complainants (the Court's judgment in *Pyrsa*) cannot be applied to the case in point: unlike Pyrsa, Demesa's investment project is not a high-risk venture, and Demesa is not a firm in difficulty,

— the complainants have not provided any proof in support of their claim that the cost of the plant and machinery has been overvalued.

IV. EXTENSION OF THE PROCEEDINGS

After receiving Spain's reply to the request that it provide the information necessary for examining whether the grant of 25 % gge awarded to Demesa fulfilled the conditions of the Ekimen scheme, the Commission informed Spain by letter of 4 June 1998 that it had decided to extend the proceedings in order to examine the part of the grant awarded to Demesa not covered by the general rule of the Ekimen scheme allowing an aid intensity of 10 % of the effective eligible costs.

IV.1. ***Observations submitted by Spain***

The regional authorities have reiterated that the conditions for the award of a grant under the Ekimen scheme to cover 25 % of the costs of Demesa's investment at Vitoria-Gasteiz have been scrupulously observed.

They point out that, when it approved the Ekimen scheme (in December 1996), the Commission not only agreed to the definitions of 'strategic' projects and 'creation of jobs' to be used for the purposes of implementing the scheme, but also refrained from formulating any reservations of a sectoral nature, with the exception of a general reference to the sectors for which specific guidelines exist, which is not the case of the household appliances sector.

The Ekimen scheme draws a distinction between 'strategic projects' and 'strategic sectors', fulfilment of each of which criteria entitles the company concerned to an extra 5 % for the purposes of Article 10 of the Decree approving the Ekimen scheme.

Any project that fulfils the purely quantitative criteria, which the Commission accepted when it approved the scheme, constitutes a 'strategic' project. The Commission is not entitled to modify these criteria without at the same time infringing the principles of legitimate expectations and legal certainty.

The regional authorities also argue that it is right to regard the household appliances sector as 'strategic' since it accounts for 6 % of GDP in the region. The Competitiveness Programme for the Basque Country classifies the 'large household appliances' cluster among the clusters whose development is given priority. This definition is based on the nature and extent of the competitive advantage and the contribution which the companies concerned make to value added and job creation in the Basque Country.

The regional authorities stress that, for the purposes of implementing the scheme, job creation is to be checked on the basis of objective data and not, as the Commission suggested when it extended the proceedings, in terms of the sectoral impact of Demesa's investment. This is confirmed, according to the regional authorities, by the guidelines on national regional aid, which state that 'job creation' must be checked solely on the basis of the net number of jobs created in a particular establishment.

As far as the sector is concerned, the Commission has not provided precise figures making it possible to determine which specific sector is affected by surplus capacity. The statement that 95% of sales of appliances are based on replacements does not indicate either the product or the period of time concerned. Neither does the claim that the European market has shrunk by 5% over the last two years specify the individual sector concerned, nor is any specific period of time assigned to the figure quoted of a surplus production capacity of more than 4 million units in the cold range.

The regional authorities have submitted figures taken partly from information supplied by ANFEL, CECED, the complainants in these proceedings, and Master Cadena, the leading distributor on the Spanish market. The latter claims that turnover in household appliances grew by 3% in 1997; as far as refrigerators are concerned, the growth was 4,4%. According to CECED's figures, the number of units sold on the Spanish market rose from 1 000 066 in 1996 to 1 133 350 in 1997. The number of units sold has also grown in the other Member States, with the exception of Austria and Germany. The number of refrigerators manufactured in Spain rose from 1 308 844 units in 1996 to 1 456 019 in 1997. According to the regional authorities, forecasts by 'Consumer Europe' point to a 10% increase in refrigerator sales (measured in units) on the European market over the period 1996 to 2001.

The regional authorities also refer to statements made in April 1998 by the chairman of Electrolux, the leading European manufacturer of household appliances, to the effect that sales of these products will increase by 4% in 1997 and continue to improve in 1998.

On the question of the artificial overvaluation of the investment costs incurred by Demesa, the regional authorities have provided detailed information on the procedures for checking that the investments have actually been carried out. They have also confirmed that payment of the grant is conditional on actual implementation of the investment. In this connection, they have submitted detailed information on checks carried out during the period from June 1997 to September 1997.

On the doubts raised as to the real cost of Demesa's investment, an audit report drawn up by a consultant who regularly works for the Commission has been presented, which makes, *inter alia*, the following points:

— The price of non-serviced land in the Júndiz industrial estate (Vitoria-Gasteiz) is ESP 5000 per square metre; the final price of ESP 4125 per square metre paid by Demesa for serviced land is a market price with a normal discount given the size of the plot. The report's findings examine the differences between the estimates made by the consultant and the regional authorities (the column 'Consultant's estimate' gives a price for the land of ESP 500 million (or ESP 5 000 per square metre), whereas the column 'Demesa' shows a price of ESP 413 million ([24]) (or ESP 4 125 per square metre)),

— the cost of the buildings and construction work is in line with prices prevailing in the construction industry,

— the total estimated cost of plant and machinery currently installed therefore amounts to ESP 2 449 000 000 (EUR 14 718 786,44), as against the ESP 2 500 771 550 (EUR 15 029 939,72) calculated by Demesa. The cost estimated by the consultant is broken down as follows:

Machinery	ESP 1 565 million ([25])
Plant	ESP 819 million ([26])
Auxiliary machinery	ESP 65 million ([27])

— there is no justification for claiming ESP 525 million in installation costs and costs prior to start-up.

The report also states that current production capacity is 140 000 refrigerator units of between 310 and 370 litres. There are plans for raising capacity to 600 000 units in future. To reach that level of output, it would be necessary, according to the auditor, to add an extra production line and create two shifts or to build a new factory with the same capacity.

IV.2. ***Observations submitted by interested parties***

The new points made by interested parties in the observations they submitted can be summarised as follows:

— the argument put forward by the Basque regional authorities, according to which, in order to boost competition in the sector, it is necessary to subsidise a competitor, is incoherent, contrary to common sense and

([24]) This amount differs slightly from the figure of ESP 412,5 million obtained by multiplying the surface area of 100 000 m^2 by the price per square metre.

([25]) Cost according to information supplied by European manufacturers. The cost declared by Demesa is not given.

([26]) Cost according to information supplied by European manufacturers. The plant was purchased from Daewoo Electronics (Demesa's sole shareholder) for ESP 718 565 011. Some of this plant (worth ESP 300 million) is installed on the premises of third parties.

([27]) Cost according to information supplied by European manufacturers.

does not make the project at all strategic. Competition does exist on the Spanish market. This argument would make sense only if the relevant geographic market were the market of the Basque Country, and if that market were protected; however, the relevant geographic market is the European market,

— the jobs created are insecure and extremely low-paid ([28]),

— if the forecasts are fulfilled, Demesa will place an extra 600 000 units on the European market, thereby contributing to an aggravation of the surplus capacity estimated at 5 million units.

For these reasons, and in view of the seriousness of the situation, the interested parties requested the Commission to order the provisional recovery of the aid paid to Demesa, pending adoption of the final decision.

IV.3. ***Comments made by Spain in response to observations submitted by interested parties***

In the comments it made on the observations submitted by interested parties, Spain reiterated the arguments it had already put forward in the course of the proceedings and claimed that there were no grounds for the Commission to order recovery of the aid already disbursed.

V. ASSESSMENT OF THE AID

Article 92(1) of the Treaty establishes the principle that, save as otherwise provided in the Treaty, any aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market.

V.1. ***The refrigerator sector in Europe***

According to Demesa's business plan, the Álava plant should, by 1999 at the latest, have an annual production capacity of 600 000 units, of which 30% are to be sold on the Spanish market and 70% elsewhere (mainly France and the United Kingdom). The plant is to produce combined refrigerator-freezers equipped with the no-frost system.

This investment forms part of the overall strategy ([29]) pursued by Daewoo Electronics, whose goal is to become, by 2002, the world's leading refrigerator manufacturer, holding a share of around 12% of the world market in that product, with an annual production target of 7 million units, of which 5 million are to be produced at 12 centres located outside South Korea. The company plans to invest around USD 1 000 million in the construction of eight new factories with a view to gaining a share of around 12% of the world refrigerator market. Up to 2002, the production capacity of the four European plants will be 1,5 million units ([30]), i.e. 13% of total European production capacity forcast for 2001.

According to the data and information in the Commission's possession, demand and production vary according to the country concerned ([31]):

([28]) See footnote 16.

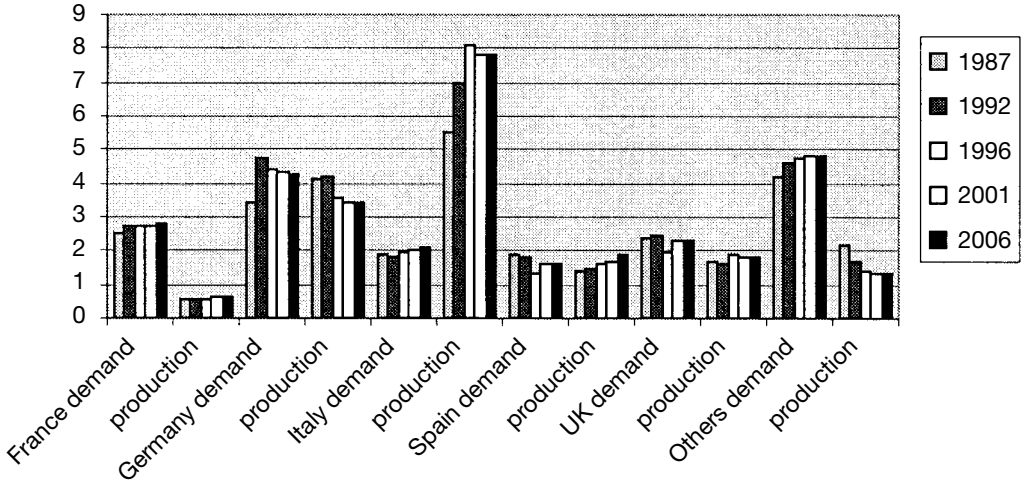
([29]) Daewoo Electronics had also considered setting up a plant creating 300 new jobs at Verdun, France. CECED likewise lodged a complaint against the aid that the French authorities were intending to grant in connection with that investment. In December 1997 the Commission requested information from the French authorities, which replied that Daewoo Electronics had suspended the project.

([30]) 'Aims To Lead Global Refrigerator Market', June 1997, http://www.dwe.daewoo.co.kr/news.

([31]) Report entitled 'World Major Household Appliances to 2001', The Freedonia Group Inc., March 1998. See also the article published in the *Financial Times* on 2 July 1997, p. 13: 'Rough and tumble industry. Domestic appliance groups are adopting varied tactics to boost market share in Europe's stagnant market', which reports that the market in refrigerators and ovens has reached saturation point.

Refrigerator and freezer demand and production

(million units), 1987 to 2006



France: Demand for refrigerators and freezers will remain relatively stagnant at around 2,7 million units per year. France is not a major producer and some 75% of demand is covered by appliances from Germany and Italy. The leading brands on the French market are Brandt, Electrolux, Whirlpool and Bosch-Siemens.

Germany: Demand for refrigerators and freezers will fall slightly, from 4,4 million units in 1996 to 4,3 million units in 2001. Output declined from 4,2 million units in 1992 to 3,55 million units in 1996 and is forecast to stand at 4 million units in 2001. A total of 2,8 million refrigerators were manufactured in 1996, 40% of which by Bosch-Siemens.

Italy: The market is dominated by combined refrigerator-freezers owing to lack of space in the average home. The overall market in domestic refrigeration equipment will grow by 0,7% per year up to 2001. Italy is one of the main manufacturers of refrigerators and freezers. Output was 8 million units in 1996, 75% of which were for export. Electrolux is the market leader, with over 30% of the 6,1 million units produced in 1996. Whirlpool is also one of the main manufacturers and holds a 25% share of sales.

Spain: Demand for refrigerators declined from 1,84 million units in 1992 to 1,36 million units in 1996. Demand is forecast to grow by 3,3% per year between 1996 and 2001, reaching 1,60 million units in that year. This growth points to a market trend whereby replacement sales are again supplementing the installed base. Output will increase from 1,58 million units in 1996 to 1,7 million units in 2001. Fagor is one of the leading producers, with 700 000 units, representing around 40% of total output ([32]).

United Kingdom: Demand for refrigerators and freezers declined from 2,46 million units in 1992 to 1,935 million units in 1996. Sales will nevertheless grow by around 3,4% per year to reach 2,3 million units in 2001. Output will level out as the popularity of imported goods increases.

Other west European countries: In the rest of western Europe the market is mature and static. Demand will keep up at around 4,8 million units, 75% of which will be covered by imports. Output has been on a downward slope since 1992 and will stabilise at around 1,4 million units.

The market in refrigerators and freezers is saturated in western Europe, where most homes are equipped with a refrigerator and separate freezer. There is a growing preference among consumers for combined refrigerator-freezers, but the market

([32]) See http://www.fagorelectrodomesticos/mcc.es. Fagor is a company belonging to the Mondragón Corporación Cooperativa (MCC) group http://mondragon.mcc.es/spanish(indice.html) headquartered at Mondragón (Guipúzcoa, Basque Country). With more than 100 subsidiaries and branches and 29% of its turnover generated outside Spain, MCC is the largest industrial group in the Basque Country and one of the five leading industrial groups in Spain. In 1997 it generated a turnover of ESP 726 706 million (EUR 4 367 591 023,28), of which ESP 86 000 million (EUR 516 870 409,77) was from sales of household appliances, as compared with a total turnover of ESP 354 247 million in 1992. The MCC group employs 34 397 people and has assets valued at ESP 1 541 621 million (EUR 9 265 328 813,72). It has four plants in Asia, four in Latin America and two in Africa (including two factories producing refrigerators in Argentina and Morocco).

is not expected to show signs of growth as households tend to replace refrigerators and separate freezers with combined refrigerator-freezers. Demand is therefore expected to grow by only 0,6% per year to 2001 (up to 18 million units), with replacements accounting for approximately 94% of sales ([33]).

Electrolux (Sweden) is the largest manufacturer of refrigerators and freezers in western Europe, followed by Bosch-Siemens (Germany). Whirlpool (United States) and Merloni (Italy) are also major producers. Fagor Electrodomésticos is the market leader in Spain ([34]).

Surplus refrigerator production capacity has been estimated at some 5 million units in 1997 ([35]). Spain has not supplied any figures concerning excess capacity. The state of the market has caused the sector to undergo extensive restructuring which has given rise to capacity reductions or relocations of production with heavy job losses. These trends are confirmed by the information mentioned earlier and illustrated, *inter alia*, by the closure of several of Electrolux's production facilities in Europe: refrigerator production at Spennymoor (County Durham, United Kingdom), which has a capacity of 320 000 units, is to be abandoned in the summer of 1999, with the loss of 650 jobs; Electrolux has also announced the closure of its plant at Luton (United Kingdom), with the loss of a further 650 jobs; production of refrigerators at Pori (Finland) is to be transferred to other plants in Europe, resulting in 200 job losses; and a plant producing chest-type freezers has been closed in Hungary, with the loss of 200 jobs ([36]) ([37]). In its 1995 annual report, Whirlpool also announced severe job losses in western Europe, amounting to around 15% of its workforce; in September 1997, it announced 4 700 job cuts, most of which are in western Europe ([38]). Whirlpool employs 11 000 people in Europe (mid-1997 figures) at 11 plants, of which those located at Cassinetta (Italy) ([39]), Calw (Germany) and Trento (Italy) produce refrigerators. The MCC group, which owns Fagor, abandoned refrigerator production at Basauri (Basque Country) in 1998, with the loss of 180 jobs. Merloni also indicates in its 1997 annual report ([40]) that the recovery of the household appliances market has not led to firmer prices, since the industry has employed unused capacity.

The above analysis also shows that there is extensive intra-Community trade in the sector, a fact confirmed by Eurostat data ([41]). Consequently, any aid measure will necessarily affect intra-Community trade and competition.

V.2. ***Aid elements established***

The procedure provided for in Article 93(2) of the Treaty has enabled the Commission to establish the existence of the following aid measures within the meaning of Article 92(1).

V.2.1. **Free-of-charge use of a 100 000 m^2 plot of land**

The Commission has taken note of the explanations given by the Basque regional authorities concerning the difficulties due to the presence of farmers on the land where Daewoo Electronics intended to build its plant and the fact that the sale could not be formalised until the divisions and amalgamations of the different pre-existing plots had been completed on the land register.

Nevertheless, no proof has been given that Demesa incurred any cost during the period in which it occupied the land for the purpose of building the plant, from the time the purchase agreement was signed (in October 1996) until the purchase price was actually paid. Neither has the precise date on which Demesa paid for the land been communicated.

According to the information provided, construction works began in January 1997. On 13 January 1997 the farmers, via their lawyer, addressed a complaint to the property company selling the land, Gasteizko Industria Lurra SA ([42]), on account of the destruction of their crops by the construction works for Demesa's plant.

Furthermore, the land was not paid for before September 1997. A document issued by the regional authorities concerning the investments made by Demesa and following an inspection covering a period ending on 10 September 1997

([33]) See footnote 31.
([34]) See footnote 32.
([35]) Information provided by CECED in the context of these proceedings.
([36]) 'Electrolux to phase out production at two UK factories', 14 October 1997, http://www.electrolux.se/corporate/pressnotes.
([37]) 'Electrolux intends to move production from refrigerator factory in Finland', 27 October 1997, http://www.electrolux.se/corporate/pressnotes.
([38]) See http://www2.whirlpool.com/htm/corp/investor.
([39]) The Whirlpool group's largest factory in western Europe.
([40]) See http://www.merloni.it/fr_azi.htm.

([41]) Intra-Community trade in household refrigerators (CN codes 8418 21, 8418 22 and 8418 29) amounted to EUR 677 692 000 in 1996 and EUR 732 189 000 in 1997; 6,91% (1996) and 7,67% (1997) of these sales involved products originating in Spain, while 8,23% (1996) and 7,41% (1997) corresponded to goods introduced into the Spanish market from other Member States. Intra-Community trade in combined refrigerator-freezers and refrigerator-freezers fitted with separate external doors (other than for use in civil aircraft) (CN codes 8418 10 91 and 8418 10 99) amounted to EUR 484 470 000 in 1996 and EUR 555 665 000 in 1997; 19,41% (1996) and 17,72% (1997) of these sales involved products originating in Spain, while 10% (1996) and 9,42% (1997) corresponded to goods introduced into the Spanish market from other Member States.
([42]) According to information provided by the regional authorities, the shareholders in Gasteizko Industria Lurra SA are the Municipal Council of Vitoria-Gasteiz (58,22%) and Sprilur SA (41,78%). Sprilur SA is in turn controlled by the Basque Government, which holds 95,52% of its capital.

makes it clear that only the building, and not the land, was considered to be a completed investment qualifying for payment of the aid. Another document mentions the payment of ESP 413 million for the land in a column relating to November to December 1997 (see Annex III to the letter of 24 July 1998).

In view of the above, and in the light of the information provided by the regional authorities, there are grounds for concluding that Demesa occupied, at least between February 1997 and October 1997, a plot of land with the aim of building or commissioning the construction of a plant on it, without paying the purchase price of the land or incurring any cost whatsoever in connection with its use.

The regional authorities argue that the sale of the land could not be formalised until 30 December 1997 as a result of a dispute concerning tenure of the land. They refer to the rights enjoyed by the tenants under Spanish law and the principle of good faith, which rule out the possibility of transferring ownership of land where there is a dispute concerning tenure. These were the reasons why formalisation of the sale was delayed until the dispute was resolved. Since these requirements result from application of the principles and rules of civil law, the regional authorities conclude that they must be regarded as a general measure which falls outside the scope of Article 92(1) of the Treaty.

The Commission notes, in any event, that neither the principles of good faith alluded to nor the presence of the tenant farmers on the land prevented Demesa from beginning, continuing and completing construction of the plant throughout the whole of 1997. During the same period, Demesa made payments for the works carried out and did not refrain from requesting payment of the grant corresponding to 25% of the cost of the buildings erected. The absence of a formal deed of sale in no way detracts from the fact that Demesa used the land without having to pay the consideration that the company selling it was entitled to demand.

If, despite the precautions taken by the regional authorities, Demesa had not occupied the land and had not begun building the plant in accordance with the timetable laid down in the investment plan approved by those authorities, payment of the grant would have been seriously jeopardised. Demesa therefore had an obvious interest in beginning the construction work without delay.

The Commission accordingly takes the view that Demesa enjoyed an advantage equivalent to postponement of payment of the price of the land for a period of nine months, running from the time it first occupied the land for the purpose of carrying out the construction work (February 1997) until the date on which it paid the price (not before November 1997). In the absence of other comparative or calculation data, that advantage can be estimated as being equivalent to the interest that could be gained from investing for nine months an amount equivalent to the price of the land, corrected as indicated at the end of point V.2.2. The interest rate to be applied is the reference rate for 1997 ([43]). The economic advantage calculated in this manner amounts to EUR 184 075,79 ([44]) (ESP 30 627 635) and constitutes state aid within the meaning of Article 92(1) of the Treaty.

V.2.2. **Sale of a plot of land at less than the market price**

The regional authorities argue that the communication of 10 July 1997 ([45]) cannot be applied in this case. The Commission would point out that the communication does not impose any obligation on the Member States and is restricted to defining, on the basis of established administrative practice, the circumstances in which it may be presumed that no aid is present.

The Commission notes, as it stated when it initiated the proceedings, that the criteria which it set out in its communication of 10 July 1997 were not fulfilled when the land was sold to Demesa. The sale of the land to Demesa consequently does not qualify for a presumption that no aid, as provided for in that communication, was in evidence.

The Commission therefore has to examine, on the basis of the information in its possession, whether the price paid by Demesa corresponds to a market price, bearing in mind that two valuations and an audit report carried out after the event cannot carry the same weight as a valuation carried out before the sale.

The two valuations carried out on 13 January 1998 and 6 February 1998 by two different real estate valuers (see Annex IX to the letter of 6 March 1998) quote a unit price for serviced land of approximately ESP 6 120 per square metre.

However, the first valuation stated that the selling price of a serviced plot of over 10 000 m^2 should be between ESP 4 000 and ESP 4 500 per square metre. The second valuation, based on real data — that is to say the selling prices of serviced plots with similar characteristics sold in previous months — established a price of ESP 5 000 per square metre for two much larger plots of approximately 33 000 m^2; and 50 000 m^2, and concluded that there were no price indicators on the market for serviced plots of 100 000 m^2; however, a price of

([43]) The reference rate is 10,56% for the period 1 January to 31 July 1997 and 6,22% for the period 1 August to 31 December 1997.

([44]) This is the sum of the two amounts obtained by applying on a pro rata basis the reference rates established for the two periods in 1997 (January to July and August to December) to the respective number of months (six and three) during which the land was used in each of those two periods).

([45]) See footnote 21.

between ESP 4 000 and ESP 4 800 per square metre appeared justified in the circumstances, given the costs that could be incurred in servicing large plots. It stressed at the same time the political dimension of sales of this type, which were bound to be influenced by non-economic considerations.

The audit report drawn up in July 1998 (see Annex IV to the letter of 24 July 1998) quoted the price of a non-serviced plot in the same area at around ESP 5 000 per square metre. It stated that the price paid by Demesa could be justified by a discount offered on account of the size of the plot. Nevertheless, in his conclusions, the auditor maintains a price of ESP 5 000 per square metre and points to the difference between his estimate and the price of ESP 4 125 per square metre set by the regional authorities.

The Commission notes that the average of these estimates does not differ substantially from the average unit price of ESP 4 481 per square metre of serviced land calculated in January 1997 by Price Waterhouse, which includes development costs.

In the light of the foregoing, the Commission considers that this price of ESP 4 481 per square metre is the market price for the sale of plots similar to the one occupied by Demesa in the Júndiz industrial estate. Given that Demesa paid only ESP *4 125* per square metre for the land, it enjoyed an advantage that must be calculated as the difference between the two figures, namely ESP 356 per square metre, making a total of EUR 213 960,31 (ESP 35 600 000). This price difference constitutes state aid within the meaning of Article 92(1) of the Treaty.

V.2.3. **Aid elements not covered by the Ekimen scheme**

Amount of the grant

The information provided by Spain in accordance with the procedure under Article 93(2) of the Treaty has enabled the Commission to examine whether the regional authorities complied with the conditions of the Ekimen scheme when they awarded a non-refundable grant corresponding to 25% of the cost of Demesa's investments in tangible fixed assets at Vitoria-Gasteiz.

The examination also established that some of the investments in respect of which the grant was awarded are covered by Ekimen, while the remainder fall outside the scope of that scheme.

The Commission takes the view that, in the case in point, a proper application of the rules governing the Ekimen scheme should have led to the award of a maximum non-refundable grant amounting to 20% gge of the total eligible costs.

Under Article 10 of Basque Government Decree No 289/1996, a non-refundable grant of up to 25% gge is to be awarded in accordance with the following conditions:

'1. A grant of 10% of investment costs deemed eligible shall be awarded as a general measure.

2. Furthermore, in the case of strategic projects [46] and investment projects involving significant job creation which create at least 50 jobs and entail investments worth at least ESP 750 million, the above percentage shall be increased by five points.

3. Similarly, businesses whose project is carried out in a preferential interest area as provided for in Article 4 of this Decree shall receive an additional grant of 5% of the investment costs deemed eligible.

4. Lastly, the percentage may be further increased by up to five points according to the following criteria:

— the extent to which the project is integrated into the Basque Country's industrial base;

— whether the investment is in one of the Basque Country's strategic sectors;

— the number of jobs created by the project.'

As was mentioned in point II. 4, the Commission stated the following in its decision to approve the Ekimen scheme, notified by letter dated 13 December 1996:

'The Commission notes that non-refundable grants, which must not exceed the ceiling of 25% gge, will be awarded in accordance with the following conditions: (a) 10% as the general rule; (b) an extra 5% for strategic projects or projects which create jobs; (c) an extra 5% for projects located within priority areas; and (d) an extra 5% for projects which make a significant contribution to regional development or job creation.'

Consequently, if an investment project is to benefit from a non-refundable grant under Ekimen and within the scope of that scheme, the grant must be awarded in accordance with

[46] Article 6(1)(a) of the Decree defines strategic projects as projects which involve an investment of not less than ESP 10 000 million or the creation of at least 300 jobs. Certain projects 'with complex financing arrangements' may also be deemed strategic.

the detailed conditions and criteria governing the scheme as approved by the Commission.

The Basque regional authorities made the following statement on page 8 of their letter of 23 January 1998:

'In accordance with the former (criteria determining the level of the grant), all projects have to receive a grant equivalent to at least 10% of the eligible investment costs (see criterion (a), i.e. Article 10(1) of Decree No 289/1996; in addition, where the project fulfils the conditions laid down in the second and third paragraphs of the Article (criteria (b) and (c), i.e. those set out in Article 10(2) and (3) of the Decree), that percentage is to be increased by an extra five percentage points respectively. Therefore, a project which fulfils all those conditions must receive a grant amounting to 20% gross.'

The Commission considers that Demesa's investment project fulfils the criteria laid down in Article 10(1) of the Decree (the 10% awarded to all eligible projects) and in Article 10(4) (an extra 5%).

As far as the criterion laid down in Article 10(3) is concerned, Vitoria-Gasteiz, the municipality in which Demesa's investment is located, is not a 'preferential interest area' in accordance with the provisions governing the Ekimen scheme ([47]). The argument put forward by the regional authorities at the meeting of 15 December 1998, to the effect that the beneficial effects of 'strategic' projects which were not located in 'preferential interest areas' extended to the latter, is not sufficient to justify awarding an extra 5% under Article 10(3) to Demesa's investment.

As regards the criterion laid down in Article 10(2) of the Decree, the Commission considers that the award of two 5% supplements under that provision constitutes an incorrect application of the rules governing the Ekimen scheme as approved by the Commission in its letter of 13 December 1996, in view of the fact that each of paragraphs 2, 3 and 4 of Article 10 of the Decree (or each of items (b), (c) and (d) in the above paragraph of the Commission's letter of 13 December 1996) makes it possible to award a 5% supplement up to the maximum of 25% gge laid down for grants falling outside the scope of the Ekimen scheme. Furthermore, the 'preferential interest area' criterion was introduced for the purpose, which was expressly recognised in the preamble to and laid down in Article 4 of the Decree, of practising positive geographical discrimination in favour of specific areas of the Basque Country that suffer from particularly serious economic or development problems, an objective which is in line with the principle — confirmed by the Guidelines on national regional aid ([48]) — of varying the intensity of regional aid (within the maximum ceilings permitted) according to the seriousness of the regional problems to be tackled.

The regional authorities argued, at the meetings of 29 October 1998 and 15 December 1998, that the Commission's decisions to initiate and to extend the proceedings were not based on such an interpretation of that aspect of the Ekimen scheme. The Commission considers that the wording of those two decisions cannot be construed in such a way as to enable the regional authorities to evade compliance with the conditions for implementing the scheme as laid down in its letter of 13 December 1996. In their letter of 23 January 1998, the Basque regional authorities moreover confirmed that an investment fulfilling the criteria set out in items (b) and (c) qualified for two 5% supplements respectively, in addition to the general rate of 10%.

When it initiated and subsequently extended the proceedings, the Commission already raised serious doubts as to the strategic nature of Demesa's investment project and as to the effective creation of jobs. Those doubts have not been dispelled. The Commission maintains the view that the existence of surplus capacity in the sector, as described in point V.1., and the presence in the Basque Country of Spain's leading refrigerator manufacturer, Fagor ([49]) (a member of the MCC group), which holds a 25% share of a domestic market that is not protected by trade or other barriers, makes the alleged strategic nature of the project more than doubtful. The MCC industrial group is constantly building up its presence on the Community and world markets ([50]). The Commission also continues to believe that there is a very real risk that the aided investment will result in capacity reductions in Spain, particularly in the Basque Country, and in other areas of the Community, as can be seen from the current restructuring operations decided by Electrolux and Whirlpool.

However, as regards classification of the investment project as 'strategic' because it fulfils certain quantitative criteria (investment exceeding ESP 10 000 million, creation of more than 300 jobs), when the Commission approved the Ekimen scheme it did not express any reservations on the grounds of possible sectoral problems, either in the household appliances sector or elsewhere, except for the usual reservations with regard to sectors covered by specific state aid guidelines or rules. It would therefore be contrary to the principles of legal certainty and legitimate expectations to modify that overall approval where the Basque regional authorities have observed the criteria for deeming a project to be strategic.

In view of the foregoing, the amount of the grant may not exceed 20% of the eligible costs. The remaining 5%, which was granted under the 'preferential interest area' criterion, is not covered by the scheme and therefore constitutes state aid within the meaning of Article 92(1) of the Treaty and, since it is not covered by a previously approved scheme, must be deemed to be new aid whose compatibility must be assessed directly in the light of the Treaty provisions, as the Commission had already stated in its letter of 4 June 1998.

([47]) The list of 'preferential interest areas' is set out in Annex I to the Decree.

([48]) OJ C 74, 10.3.1998, p. 9.

([49]) See footnote 32.

([50]) MCC has carried out an extensive internationalisation programme affecting both its industrial plants and its commercial presence.

Costs eligible under the Ekimen scheme

The report submitted by the complainants, which was drawn up by a subsidiary of one of CECED's members, alleges that the investment costs were artificially overvalued. The Commission notes that the report is not based on the same assumptions regarding production capacity and product type as Demesa's investment.

The audit report submitted by the Basque Government, which was drawn up by an independent expert, furthermore confirms the reality and conformity of the costs actually incurred by Demesa, with the exception of ESP 525 million in installation costs prior to start-up. The regional authorities also rejected these costs in the course of their checks on implementation of the project.

As far as the eligible costs are concerned, the regional authorities have provided sufficient proof that internal auditing procedures prevent the payment of a grant under the Ekimen scheme if there is no tangible evidence that the investment has been carried out. The same procedures enable the regional authorities to check compliance with the obligation on the company to finance 30% of total net assets from its own resources during its second year in business (Article 5(b) of the Decree). As indicated in point II.4, the Commission considers that, for the purposes of that requirement, the second year is 1998 and not 1997.

However, the fact that the costs have been genuinely incurred and are in line with market prices does not necessarily mean that they are eligible.

The Commission points out in this connection that, in accordance with Article 7 of the Decree governing the Ekimen scheme, fixed assets that have been transferred to third parties are not eligible. According to the audit report, some of the production plant acquired by Demesa (at a cost of ESP 300 000 000, or EUR 1 803 036,31) has been installed on the premises of other companies. This plant is consequently not eligible for aid under the Ekimen scheme, and its financing also constitutes aid within the meaning of Article 92(1) of the Treaty.

V.2.4. **Tax credit equivalent to 45% of the cost of investments and reduction in the tax base for newly created businesses**

In this Decision, the Commission has restricted itself to examining in the light of Article 92 of the Treaty the 45% tax credit and the reduction in the tax base for newly created businesses, and not the other tax concessions.

V.2.4.1. *The 45% tax credit*

The tax credit is governed by the Sixth Additional Provision of Provincial Law 22/1994 on the implementation of the budget of the Province of Álava for 1995, which reads as follows:

'Investments in new tangible fixed assets carried out between 1 January 1995 and 31 December 1995 and exceeding ESP 2 500 million shall, by decision of the Álava Provincial Council, qualify for a tax credit equivalent to 45% of the amount of the investment, as determined by the Álava Provincial Council, to be offset against the amount of personal tax liability.

Any tax credit not used up because it exceeds the amount of tax liability may be carried forward and used for up to nine years following that in which the decision of the Álava Provincial Council is taken.

The decision of the Álava Provincial Council shall lay down the time-limits and restrictions applicable in each individual case.

Benefits granted under this provision shall be incompatible with any other tax concessions for which the same investments may be eligible.

The Álava Provincial Council shall also decide on the duration of the investment process, which may include investments made during the preparatory phase of the project which generates the investments.'

This measure was kept in force in 1996 by the finance act for that year (Provincial Law 33/1995), as amended by the new corporation tax act (Provincial Law 24/1996, which deleted the reference to the period of nine years in the second paragraph) and in 1997 by the finance act for that year (Provincial Law 31/1996). The tax credit equivalent to 45% of the amount of investments was maintained, with amendments to the wording of the provisions, in 1998 and 1999 by Provincial Laws 33/1997 and 36/1998 respectively.

The principle that state aid is incompatible with the common market and the exceptions provided for by the Treaty apply to aid 'in any form whatsoever' and, in particular, to certain tax measures.

If it is to be classed as aid, a measure has to satisfy each of the four criteria mentioned in Article 92 and spelled out below.

First, the measure must afford the beneficiaries an advantage that reduces the costs they normally have to bear in the course of their business. The advantage may be granted through different types of reduction in the company's tax burden and, in particular, through an exemption from or reduction in tax liability.

The 45% tax credit in question undoubtedly fulfils this criterion since, thanks to the credit, Demesa enjoys a reduction in its tax burden equivalent to 45% of the amount of the investment as determined by the Álava Provincial Council. The tax credit can, however, be used without any time-limit, starting in the first year in which the company makes a profit. The Spanish authorities have furthermore confirmed ([51]) that Demesa will be able to choose, in respect of each tax year, the most favourable methods of deduction or reduction, which makes it impossible in practice to determine the intensity of the aid over the whole period in which it is being received.

Second, the advantage must be granted by the State or through State resources. A loss of tax revenue is equivalent to the use of state resources in the form of tax expenditure. This criterion also applies to aid granted by regional or local bodies in the Member States (judgment of the Court of Justice of 14 October 1987 in Case 248/84 *Germany v Commission* ([52])). The State aid may furthermore be granted by way of tax measures laid down by law, regulation or administrative practice or by way of decisions taken by the tax administration.

The tax credit granted to Demesa derives from the combined effect of a budgetary measure and an individual decision (Decision 737/97), both taken by a public authority.

Third, the measure must affect competition and trade between Member States. This criterion presupposes that the beneficiary of the measure carries on an economic activity, irrespective of its legal status or method of financing. The Court of Justice has repeatedly ruled, for the purposes of interpreting this condition, that intra-Community trade is to be deemed to be affected from the moment the beneficiary firm carries on an economic activity which is the subject of trade between Member States.

It has already been demonstrated that Demesa carries on an economic activity which is the subject of trade between member States, in a sector that is highly competitive.

Fourth, the measure must be specific or selective in the sense that it favours 'certain undertakings or the production of certain goods'. The advantage may be selective because it is granted either as an exception to general tax arrangements established by law, regulation or administrative practice, or at the discretion of the tax administration. In the present case, the advantage is selective chiefly on account of the discretion enjoyed by the administration in granting it.

With regard to this condition, the Court of Justice held in *Kimberly Clark Sopalin* (judgment of 26 September 1996 in Case C-241/94 *France v Commission* ([53])) that, where the entity granting an advantage enjoys a degree of latitude which enables it to vary its financial assistance having regard to a number of considerations such as, in particular, the choice of beneficiaries, the amount of the financial assistance and the time-limits and other conditions under which it is provided, as well as to decide on whether or not to renew the measures concerned from one year to the next according to criteria unknown to the Commission, the conditions in which such assistance is granted are liable to place certain firms in a more favourable situation than others and thus to meet the conditions for classification as aid within the meaning of Article 92(1) of the Treaty.

When it adopted Decision 737/97, the Álava Provincial Council enjoyed, pursuant to the abovementioned provisions, discretionary powers for determining which investments in tangible fixed assets amounting to more than ESP 2 500 million qualified for the tax credit, deciding to which part of the investments the 45% reduction could be applied, and establishing the time-limits and maximum ceilings applicable in each case.

The Spanish authorities have not communicated the text of Decision 737/97 granting the tax credit to Demesa. The Commission consequently does not know the precise amount of the tax credit ([54]). However, it must be between ESP 1 125 000 000 and ESP 5 326 020 000, which correspond respectively to 45% of ESP 2 500 000 000 (the minimum investment qualifying for the credit) and 45% of ESP 11 835 600 000 (the amount officially invested by Demesa). Given that there is no time-limit on the use of the tax credit, it is impossible to calculate precisely its intensity. The intensity may be up to 45% nge. On the basis of the profit forecasts set out in Demesa's business plan, the aid intensity of the tax credit is 34% nge.

Secondly, although the discretionary nature of the tax credit is sufficient for it to be classed as a specific measure, and therefore as state aid, the Commission considers that the minimum investment required (ESP 2 500 million) to qualify for the credit is high enough to restrict its application in practice to investments which involve the raising of large amounts of capital, and that it is not justified by the nature or overall structure of the tax system to which an exception is made. The fact that only large investors can qualify for the tax credit makes it a specific measure, which in turn classifies it as state aid within the meaning of Article 92(1) of the Treaty.

Thirdly, the Commission takes the view that the temporary (annual) nature of the measure in fact allows the authorities

([51]) See p. 42 of the letter of 6 March 1998.

([52]) [1987] ECR 4013.

([53]) [1996] ECR I-4551.

([54]) In their reply to the Commission's notification of its decision to initiate proceedings, the Spanish authorities merely stated that 'Demesa was granted, by means of Decision 737/97 of 21 October 1997, the tax concessions provided for in the Sixth Additional Provision of Provincial Law 22/1994 (tax credit equivalent to 45% of investments) for its investment project'.

discretion to grant the tax credit to certain firms only, namely those initiating their investment processes during the period covered by the measure. The Commission notes that the measure does not appear in general tax legislation, only in the annual finance acts, which confirms its temporary nature and enables it to be used for specific projects.

Fourthly, the Commission underlines the close similarities between this measure and the Ekimen scheme, both in terms of the objectives pursued (the financing of new investments in both cases) and as regards their geographical scope (regional in the case of Ekimen, provincial in the case of the tax credit); Ekimen was, however, regarded as a regional aid scheme by the Spanish authorities and was notified as such. The only difference between the two, which is that the Ekimen scheme supports only industrial investments, is more of a formal distinction, since the minimum investment (ESP 2 500 million) required to qualify for the tax credit effectively limits the possible beneficiaries to industrial firms.

Consequently, the tax credit granted to Demesa, corresponding to 45% of the amount of the investment as determined by the Álava Provincial Council, constitutes state aid within the meaning of Article 92(1) of the Treaty.

In its letter to Member States SG(89)D/5521 of 29 April 1989 the Commission stated that it 'considers that a Member State has failed to fulfil its obligation to notify it where the process of putting aid into effect has been initiated. By "putting into effect" it means not the action of granting aid to the recipient but rather the prior action of instituting or implementing the aid at a legislative level according to the constitutional rules of the Member State concerned. Aid is therefore deemed to have been put into effect as soon as the legislative machinery enabling it to be granted without further formality has been set up' ([55]). This is undoubtedly the case with this measure, which has been carried out unlawfully in breach of the provisions of Article 93(3) of the Treaty.

V.2.4.2. *Reduction in the tax base for newly created businesses*

The reduction in the tax base for newly created businesses is laid down in Article 26 of Provincial Law 24/1996, which reads as follows: ([56])

'Article 26 — Reductions in the tax base: Newly created businesses

1. Companies starting their business activity shall be entitled to a reduction of 99%, 75%, 50% and 25% respectively in the positive basis of assessment deriving from their economic activity, before this is offset by any negative bases of assessment arising in previous periods, for the four consecutive tax periods running from the first period in which, within four years of starting their business activity, they generate a positive basis of assessment.

[…].

2. To qualify for this reduction, businesses shall fulfil the following conditions:

(a) They shall start their business activity with a minimum paid-up capital of ESP 20 million.

(b) […].

(c) […].

(d) The new activity shall not have been carried on previously, either directly or indirectly, under different ownership.

(e) The new business activity shall be performed on premises or in an establishment where no other activity is carried on by any natural or legal person.

(f) They shall during the first two years of their activity invest at least ESP 80 million in tangible fixed assets, all of which assets shall be assigned to the activity and shall not be hired out or transferred for use by third parties. For the purposes of this requirement, goods acquired by leasing shall also be deemed to be investments in tangible fixed assets, provided that the business undertakes to exercise the purchase option.

(g) They shall create at least 10 jobs within six months of starting their business activity and shall maintain the annual average workforce at that level from that point and until the year in which their entitlement to the reduction in the basis of assessment expires.

(h) […].

(i) They shall have a business plan covering a period of at least five years.

3. […].

4. The minimum amount of investment referred to in subparagraph (f) and the minimum number of jobs created

([55]) See *Competition law in the European Communities, Volume IIA: Rules applicable to state aid*, Office for Official Publications of the European Communities, Luxembourg, 1995, p. 62.

([56]) Only the provisions which are relevant for the purposes of assessing the state aid elements are quoted here.

referred to in subparagraph (g) of paragraph 2 above shall be incompatible with any other tax concession established for the same investment or job creation.

5. The reduction provided for in this Article shall be requested by means of an application lodged with the tax administration, which, after checking that the initial requirements are satisfied, shall where appropriate notify the applicant company of its provisional authorisation, to be formally adopted by decision of the Álava Provincial Council.

[…].'

In their letter of 6 March 1998, the regional authorities maintain that the benefit of this measure cannot be combined with that of the tax credit.

Before examining whether the reduction in the tax base provided for by Article 26 of Provincial Law 24/1996 contains elements of state aid within the meaning of Article 92(1) of the Treaty, the Commission has to determine whether, as was claimed by the regional authorities, the tax credit cannot be used where the company concerned decides to apply the reduction in the tax base for which it qualifies under the above provision. The wording of Article 24(6) and the overall structure of the system do not confirm such an interpretation.

The Commission notes in the first place that the qualifying conditions for each of the tax concessions are different.

In the case of the tax credit (see point V.2.4.1), the qualifying condition is investment in new tangible fixed assets exceeding ESP 2 500 million.

For the reduction in the tax base, the qualifying condition is, on the other hand, the creation of a new business.

Consequently, a newly created business could be entitled to the reduction in the tax base without investing ESP 2 500 million and, conversely, an existing company investing more than ESP 2 500 million could qualify for the tax credit without being entitled to the reduction in the tax base. In this case, however, Demesa is a newly created business and has invested more than ESP 2 500 million in the Province of Álava.

According to the provision governing the tax credit (see point V.2.4.1), the advantages granted under that provision cannot be combined with any other tax concessions available by virtue of the same investments. The reduction in the tax base is granted by virtue, not of investments but of the creation of a new business. The reduction in the tax base consequently does not fall within the scope of the ban on combination with other tax concessions.

This is confirmed by the wording of Article 26(4) of Provincial Law 24/1996, which provides that the minimum amount of investment (ESP 80 million) referred to in subparagraph (f) and the minimum number of jobs created (10) referred to in subparagraph (g) of Article 26(2) are incompatible with any other tax concession established for the same investment or job creation. In reality, only tax concessions granted by reason of an investment of ESP 80 million (or the creation of 10 jobs) cannot be combined with the reduction in the tax base. In accordance with this principle, ESP 80 million of the ESP 11 835 600 000 invested by Demesa should not be taken into consideration in calculating the 45% of investments eligible for the tax credit.

Neither is the combination of tax concessions ruled out in the administration of the tax, in so far as the tax credit is applied to the amount of personal tax payable (that is, after all deductions and reductions in the tax base have been made), whereas the reduction in the tax base takes place at an earlier stage in the calculation of the tax. Consequently, once there is a positive basis of assessment, the business will apply the reduction in the tax base provided that it has the corresponding authorisation. Once the reduction has been made, the amount of tax payable will be calculated. To the latter, Demesa will apply the 45% tax credit that has been previously calculated on the basis of the total amount of the investments minus ESP 80 million.

Having established that the two measures (the reduction in the tax base and the tax credit granted to Demesa) are liable to be combined, the Commission has to examine whether the reduction in the tax base constitutes state aid within the meaning of Article 92(1) of the Treaty.

If it is to be classed as aid, the reduction in the tax base has to satisfy each of the four criteria mentioned in Article 92 and examined below.

Firstly, the reduction in the tax base affords Demesa an advantage that reduces the costs it would normally have to bear in the course of its business.

Secondly, the reduction in the tax base involves a loss of tax revenue equivalent to the use of state resources in the form of tax expenditure.

Thirdly, the reduction in the tax base affects competition and trade between Member States since Demesa carries on an

economic activity which is the subject of trade between the Member States, in a sector that is highly competitive.

Lastly, the measure must be specific or selective in the sense that it favours 'certain undertakings or the production of certain goods'. In this case, the reduction in the tax base is selective chiefly because only newly created businesses can qualify for it. Article 26 of Provincial Law 24/1996 makes it possible to afford newly created businesses more favourable tax treatment than that applied to other businesses already present on the market. This circumstance is sufficient to demonstrate the specific nature of the measure, on the basis of which the Commission classifies the reduction in the tax base granted to Demesa as State aid within the meaning of Article 92(1) of the Treaty. The specific nature of the measure is strengthened by the fact that only businesses investing ESP 80 million and creating 10 jobs qualify for the reduction in the tax base.

The specific nature of the measure is also strengthened by its purpose, as set out in Provincial Law 24/1996 establishing it. After listing the general objectives of the tax system, the preamble to that instrument enumerates another set of objectives that have more to do with industrial policy, among which it specifically mentions the aim of 'stimulating the creation of new business initiatives', an objective pursued in the instrument by measures aimed at the specific category of newly created businesses (see point (g) of the preamble), which are granted a reduction in the tax base during the first four years of operation in which they make a profit. This stated objective, which confirms that the measure constitutes start-up aid for newly created businesses, does not enable it to be considered compatible with the nature or general scheme of the tax system in question. Neither did the regional authorities indicate or demonstrate in their response to the decision to initiate proceedings that the selective nature of the measure is justified by the 'nature or general scheme' of the tax system concerned (see the judgment of the Court of Justice of 2 July 1974 in Case 173/73 *Italy v Commission* ([57])).

The measure in question clearly constitutes operating aid. Since any profits will be generated in the future and are essentially uncertain, it is not possible to calculate precisely the aid intensity involved in the reduction in the tax base.

In its letter to Member States SG(89) D/5521 of 29 April 1989 the Commission stated that it 'considers that a Member State has failed to fulfil its obligation to notify it where the process of putting aid into effect has been initiated. By "putting into effect" it means not the action of granting aid to the recipient but rather the prior action of instituting or implementing the aid at a legislative level according to the constitutional rules of the Member State concerned. Aid is therefore deemed to have been put into effect as soon as the legislative machinery enabling it to be granted without further formality has been set up' ([58]). This is undoubtedly the case with this measure, which has been carried out unlawfully in breach of the provisions of Article 93(3) of the Treaty.

As regards the nature of the aid granted to Demesa in the light of Community law, with the exception of that granted by the Basque authorities in accordance with the criteria of the Ekimen scheme, the aid was not granted under schemes approved by the Commission but pursuant to national measures that had not been approved by the Commission and should have been notified to it at the planning stage in accordance with Article 93(3) of the Treaty. This aid is consequently illegal under Community law.

Article 92(1) of the Treaty provides that aid meeting the criteria laid down therein shall normally be incompatible with the common market.

In this particular case the exceptions provided for in Article 92(2) of the Treaty are not applicable since the aid does not pursue the objectives listed in that paragraph. Nor indeed have the Spanish authorities attempted to rely on those exceptions.

Compatibility of the investment aid (points V.2.1, V.2.2, V.2.3 and V.2.4.1)

Article 92(3) of the Treaty lists the types of aid that may be considered to be compatible with the common market. Compatibility must be determined with reference to the Community as a whole, and not with reference to one Member State — or region thereof — taken individually. To ensure that the common market functions normally and given the principle established in Article 3(g) of the Treaty, the exceptions listed in Article 92(3) should be construed strictly when it comes to examining any aid scheme or individual aid measure. In particular, the exceptions may be relied on only where it can be demonstrated that, without the aid, market forces would not be sufficient on their own to induce the beneficiaries to act in such way as to enable one of the objectives mentioned in the exceptions to be achieved.

Under Article 92(3)(a), an exception may be made in the case of aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. The municipality of Vitoria-Gasteiz is not located in an area qualifying for regional aid under Article 92(3)(a) of the Treaty.

([57]) [1974] ECR 709.

([58]) See footnote 55.

As regards the exceptions provided for in Article 92(3)(b) and (d), the aid in question is not intended to promote the execution of an important project of common European interest or to remedy a serious disturbance in the Spanish economy, nor does it display the features of projects of that kind. Nor is it intended to promote culture or heritage conservation.

As far as the exception provided for in Article 92(3)(c) of the Treaty is concerned, Vitoria-Gasteiz is located in an area which qualifies for regional aid in accordance with that provision. The maximum aid intensity allowed in the Basque Country is 25% nge ([59]) (35% in the case of SMEs). Given the difference between this and the intensity of aid granted to Demesa in accordance with the Ekimen scheme (20% gross), the Commission has to check whether the aid granted within that limit can be considered compatible by way of regional aid within the meaning of that exception.

The aid in question was not awarded under regional aid schemes approved by the Commission, but granted by means of individual decisions taken by the competent authorities. In such cases, the impact of the aid has to be examined in the context of the Community as a whole. The Court of Justice confirmed this interpretation in *Hytasa* (judgment of 14 September 1994 in Joined Cases C-278/92, C-279/92 and C-280/92 *Spain v Commission* ([60]) and *Pyrsa* ([61]). The 'cluster' approach based on the concept of 'geographic concentration', whose appropriateness as part of the industrial policy pursued by the regional authorities is not addressed in this Decision, cannot justify analysing the impact of the aid without taking the Community context into account.

An individual aid measure may be classed as regional aid compatible with the common market where it effectively contributes to the long-term development of the area and does not have effects that are detrimental to the common interest and competitive conditions in the Community. The aid can accordingly be considered to be compatible with the common market where it does not adversely affect trading conditions to an extent contrary to the common interest.

As already stated and according to information obtained by the Commission in the course of the proceedings under Article 93(2) of the Treaty, the company receiving the aid is operating in a sector which is suffering from problems of surplus capacity at Community level, as illustrated by an extensive restructuring process that has given rise to capacity reductions or production relocations involving heavy job losses within the Community. The aid under examination, which was awarded outside the Ekimen scheme and other regional aid schemes approved by the Commission, contributes to a further deterioration in the situation and runs counter to the process embarked on by the company's main competitors.

The award of aid in a highly competitive sector subjected to nearly constant restructuring and on a market which is stagnant will not result in net job creation in the Community, in Spain or even in the Basque Country, nor will it bring other economic benefits. The aid will result in distortion of competition that will force certain competitors to withdraw from the market or will cause production capacities or jobs to be shifted from one competitor to another or from one region to another, something that should be regarded as contrary to the common interest. The fact that some improvement in demand was observed on the Community market in 1998 in no way detracts from the fact that the industry is still adjusting to surplus installed production capacity in the Community by making very heavy job cuts, far in excess of the number of jobs which Demesa expects to create at Vitoria-Gasteiz. This situation is illustrated by the MCC group's decision to discontinue refrigerator production at Basauri, involving a loss of 180 jobs, authorised by the Basque Government, precisely on the grounds of the poor market conditions in the sector. It is difficult not to see a link between the loss of jobs in refrigerator production at Basauri and Demesa's announcement, at around the same time, of the creation of 200 jobs at Vitoria-Gasteiz.

Neither can an assessment of the compatibility of the aid overlook the information and forecasts concerning market prospects available at the time when the decision to grant aid to Demesa was taken, a period when the main European producers were deciding to undertake the adjustments demanded by the state of the sector. The sector was at that time experiencing great difficulties — as is immediately apparent from the annual reports of the main European manufacturers — which prompted the abovementioned restructuring decisions. It is worth stressing here that the speech given by the chairman of Electrolux on 29 April 1998, quoted by the regional authorities in support of their argument that the refrigerators and freezers segment had been experiencing an upturn since 1997, refers in the first place to the major 'restructuring programme' announced in 1996, involving, *inter alia*, the closure of three plants in the Community, with the aim of 'improving capacity utilisation'. The relative improvement observed in 1997 and mentioned by the chairman of Electrolux concerns the household appliances sector in general and not the refrigerators segment, which continues to undergo extensive restructuring.

It must consequently be concluded that the aid under examination adversely affects trading conditions to an extent contrary to the common interest and therefore cannot be deemed compatible with Article 92(3)(c) of the Treaty. The investment aid in question does not qualify for any of the exceptions provided for in the Treaty. The Commission accordingly concludes that it is incompatible with the common market.

([59]) See footnote 11.
([60]) [1994] ECR I-4103.
([61]) See footnote 23.

Operating aid: reduction in the tax base (point V.2.4.2)

Regional aid intended to reduce businesses' running costs (operating aid) is normally prohibited. This type of aid may nevertheless be granted exceptionally in areas qualifying for the derogation provided for in Article 92(3)(a) of the Treaty where it is justified on the grounds of its nature and contribution to regional development and where the amount of the aid is in proportion to the disadvantages which it is intended to mitigate. The Commission notes that the Basque Country is not one of the areas covered by Article 92(3)(a) of the Treaty.

It consequently has to be concluded that, since the operating aid in question does not qualify for any of the exceptions provided for in the Treaty, it is incompatible with the common market.

This Decision relates only to those tax measures explicitly examined herein and does not pass judgment on the other measures provided for by the specific tax arrangements adopted in the Province of Álava. The Commission reserves the right to examine any such measures that might constitute aid, either as general schemes, or in so far as they might be applied to Demesa.

VI. **CONCLUSIONS**

The Commission finds that Spain has acted illegally and in breach of Article 93(3) of the Treaty in granting the following aid:

(a) the advantage equivalent to postponement of payment of the price of a plot of land in the Júndiz industrial estate at Vitoria-Gasteiz for a period of nine months, running from the time at which Demesa first occupied the land for the purpose of carrying out construction work (February 1997) until the date on which it paid the price (no earlier than November 1997), the amount of which is calculated at EUR 184 075,79 (ESP 30 627 635);

(b) the advantage equivalent to the difference between the market price and the price paid by Demesa for a plot of land in the Júndiz industrial estate, the amount of which is calculated at EUR 213 960,31 (ESP 35 600 000);

(c) the amount corresponding to the five percentage points that exceed the maximum permissible grant of 20% of eligible costs under the Ekimen aid scheme, namely the plant valued at EUR 1 803 036,31 in the audit report submitted by the regional authorities as an annex to Spain's letter of 24 July 1998;

(d) the grant of a tax credit corresponding to 45% of the cost of the investment as determined by the Álava Provincial Council in Decision 737/1997 of 21 October 1997;

(e) the reduction in the tax base for newly created businesses provided for by Article 26 of Provincial Law 24/1996.

This aid has to be deemed incompatible with the common market. Consequently, in order to re-establish the economic conditions with which the company would have had to contend if it had not been granted incompatible aid, Spain must take all the necessary steps to recover it from the beneficiary,

HAS ADOPTED THIS DECISION:

Article 1

The State aid granted by Spain to Daewoo Electronics Manufacturing España SA in the form of:

(a) the advantage equivalent to postponement of payment of the price of a plot of land in the Júndiz industrial estate at Vitoria-Gasteiz for a period of nine months, running from the time Daewoo Electronics Manufacturing España SA first occupied the land for the purpose of carrying out construction work until the date on which it paid the price, amounting to EUR 184 075,79;

(b) the advantage equivalent to the difference between the market price and the price paid by Daewoo Electronics Manufacturing España SA for a plot of land in the Júndiz industrial estate, amounting to EUR 213 960,31;

(c) the amount corresponding to the five percentage points that exceed the maximum permissible grant of 20% of eligible costs under the Ekimen aid scheme, i.e. the plant valued at EUR 1 803 036,31 in the audit report submitted by the regional authorities as an annex to Spain's letter of 24 July 1998;

(d) the grant of a tax credit corresponding to 45% of the cost of the investment as determined by the Álava Provincial Council in Decision 737/1997 of 21 October 1997;

(e) the reduction in the tax base for newly created businesses provided for by Article 26 of Provincial Law 24/1996,

is incompatible with the common market.

Article 2

1. Spain shall take the necessary measures to:

(a) recover from the beneficiary company the aid referred to in Article 1(a), (b) and (c), which was granted to it illegally;

(b) withdraw from the beneficiary company the benefits deriving from the aid referred to in Article 1(d) and (e), which was granted to it illegally.

2. The aid shall be recovered in accordance with the procedures and provisions laid down in Spanish law. The sums to be recovered shall include the interest which has accrued between the granting of the aid and the date on which it is actually repaid. The interest shall be calculated on the basis of the reference rate used to calculate the grant equivalent of regional aid in Spain.

Article 3

Spain shall inform the Commission within a period of two months from the date of notification of this Decision of the measures taken to comply therewith.

Article 4

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 24 February 1999.

For the Commission

Karel VAN MIERT

Member of the Commission