COMMISSION DECISION

of 21 October 2003

on the research and development aid to the site at Zamudio (Basque Country) which Spain is planning to implement for the company 'Industria de Turbo Propulsores, SA' (ITP)

(notified under document number C(2003) 3525)

(Only the Spanish text is authentic)

(Text with EEA relevance)

(2004/170/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

Having regard to Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [1], and in particular Article 7 thereof,

Having called on interested parties to submit their comments pursuant to those provisions [2], [3] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter of 15 December 2000, registered on 18 December, the Spanish authorities, acting in accordance with Article 88(3) of the Treaty, notified a plan to grant research and development aid to the site at Zamudio (Basque Country). Further information was sent by letter of 17 April 2001, registered on 19 April.

(2) By letter of 20 June 2001, the Commission informed Spain that it had decided to initiate the procedure laid down in Article 88(2) of the Treaty in respect of the planned aid.

(3) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* [4]. The Commission called on interested parties to submit their comments on the aid.

(4) By letter of 21 August 2001, registered on 24 August, the Spanish authorities submitted their comments to the Commission.

(5) By letter of 17 October 2001, registered on 18 October, the Federation of Turbine and Heavy Energy Plant Manufacturers (Sytemel) submitted comments on the planned aid to the Commission.

(6) By letter of 29 October 2001, registered on 30 October, the Pratt & Whitney company submitted its comments to the Commission.

(7) By letter of 15 November 2001, the Commission forwarded to the Spanish authorities a copy of the comments submitted by Sytemel and Pratt & Whitney.

(8) By letter of 27 November 2001, registered on 28 November, the Spanish authorities requested the Commission to provide a Spanish translation of those comments. The Commission satisfied that request by letter of 21 December 2001.

(9) By letter of 28 January 2002, the Spanish authorities sent the Commission their response to the comments submitted by Sytemel and Pratt & Whitney.

(10) By letter of 13 December 2002, the Commission asked the Spanish authorities for further information. The Spanish authorities provided that information by letters of 16 January 2003, registered on 20 January, of 27 January 2003, registered on 29 January, and of 5 February 2003, registered on 6 February.

(11) By letter of 23 April 2003, the Commission informed Spain that it had decided to extend the procedure laid down in Article 88(2) of the Treaty in respect of the planned aid.

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[1] OJ L 83, 27.3.1999, p. 1.
[2] OJ C 274, 29.9.2001, p. 2.
[3] OJ C 147, 24.6.2003, p. 6.
[4] See footnote 2.

(12) By letter of 16 June 2003, registered on 16 June, the Spanish authorities submitted their comments to the Commission on the extension of the procedure.

(13) The Commission decision to extend the procedure was published in the *Official Journal of the European Union* ([5]). The Commission called on interested parties to submit their comments.

(14) By letter of 24 June 2003, registered on 26 June, the Spanish authorities forwarded to the Commission the comments submitted by the aid recipient.

2. **DESCRIPTION**

(15) The case concerns aid which the Basque Government plans to grant to the company Industria de Turbo Propulsores SA (ITP).

(16) ITP specialises in the design, development, manufacture and maintenance of gas turbines. It is owned by Rolls-Royce (46,7 %) and by the consortium Turbo 2000 (53,3 %), the latter being itself owned 50/50 by Sener and SEPI. The number of employees and the company's turnover exceed the thresholds laid down in Annex I to Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to state aid to small and medium-sized enterprises ([6]) for a company to be considered an SME.

(17) The aid concerns:

— a research and development (R & D) project to be carried out on the site at Zamudio (Basque Country), involving the development of two new types of low-pressure turbines,

— a tangible investment project for the Zamudio site which would increase ITP's production capacities and enable it to become Rolls-Royce's main supplier of low-pressure turbines for the engine models in service.

(18) The administration granting the aid is the Basque Government (regional administration).

(A) **The R & D project**

(19) The R & D project concerns the development of two new low-pressure turbines, of high and low thrust respectively.

— the high-thrust turbine is to be incorporated into the Rolls-Royce Trent 500 engine, which powers the Airbus A340-500 and A340-600 aircraft,

the project comprises the whole cycle of development of the turbine. This involves four stages: preparation of the project, preliminary design, conceptual design and realisation of the concept. The last stage is divided into seven steps: detailed design, component trials, engine trials, aerodynamic validation trials, manufacture of prototypes, certification and post-certification activities,

— the low-thrust turbine is to be incorporated into the Allied Signal Aero Engines ([7]) AS900 engine which powers the Bombardier Continental and the BAE Systems 146 RJX regional jet.

The project comprises seven main tasks: general activities, design of the low-pressure turbine, manufacturing support, manufacture of development components, manufacture of tools, component trials and improvement of the aeromechanic parameters of the turbine. The programme also includes three additional tasks: integrated logistic support activities, design of axial compressors, and activities linked to the study of the external behaviour of the engine.

(20) According to the Spanish authorities, all the activities covered by the aid constitute 'precompetitive development activities' within the meaning of Annex I to the Community framework for state aid for research and development ([8]) (hereinafter referred to as the R & D framework).

(21) The duration of the project is four years, from 1999 to 2002.

(22) The aid is provided by the Basque Government in the form of an interest-free loan totalling ESP 4 000 million (EUR 24,04 million) out of total eligible costs amounting to ESP 10 422 million (EUR 62,64 million). The loan is to be paid and reimbursed according to the arrangements set out in the following table:

(ESP million)

Year	Costs	Payment	Reimbursement
1999	1 935	0	
2000	4 064	2 000	
2001	2 762	1 000	
2002	1 661	1 000	

([5]) See footnote 3.
([6]) OJ L 10, 13.1.2001, p. 33.
([7]) This company recently merged with the Honeywell group.
([8]) OJ C 45, 17.2.1996, p. 5.

(ESP million)

Year	Costs	Payment	Reimbursement
2003			0
2004			0
2005			0
2006			0
2007			100
2008			100
2009			200
2010			200
2011			200
2012			750
2013			2 450
Total	10 422	4 000	4 000

(B) **The investment project**

(23) According to information provided by the Spanish authorities, the project is not part of any current regional aid scheme approved by the Commission. It is ad hoc regional aid.

(24) The project should allow the Zamudio site to become competitive in a high-technology market where the indirect costs are high. ITP plans to manufacture various components on the Zamudio site for the following engine models: EJ-200, Trent 700 and 800, Allison 601 K, Atar 9K50 Plus, BR715, TF50 A, LM 2500, F414, M138(FLA), MTR390 (attack helicopter), Trent 900, Trent Industrial, Trent 500 and AS900.

(25) The Spanish authorities consider that this project will have positive effects on the whole of the Basque economy, such as industrial diversification, economic impetus, creation of jobs and added value, access to advanced technologies and their incorporation into the technological and industrial fabric, workforce skilling, and a multiplier effect on industry as a whole. They also refer in particular to the creation of some 1 000 indirect jobs in the Basque Country, and a subcontracting ratio which could reach 30 % in 2002.

(26) The duration of the project is three years (2000 to 2002).

(27) The total amount of the investment is ESP 8 852 million (EUR 53,2 million), broken down as follows:

(ESP million)

	Years			
	2000	2001	2002	Total
Buildings	1 070	880		1 950
Tools	275	467	320	1 062
Machines	1 420	1 500	2 920	5 840
Total	2 765	2 847	3 240	8 852

With a reference and discount rate of 5,7 %, the total amount of the investment, discounted to 31 December 2000, is ESP 8 358 million (EUR 50,23 million).

(28) The aid is in the form of a non-repayable grant. According to the Spanish authorities, the aid is conditional on net job creation by ITP ([9]), and maintenance of the investments over a minimum period of five years. The overall amount of the grant is ESP 1 170 million (EUR 7,03 million), to be paid according to the following timetable:

(ESP million)

Year	2000	2001	2002	Total
Grant	343	369	458	1 170

With a reference and discount rate of 5,7 %, and a tax rate of 32,5 %, this gives a total amount discounted to 31 December 2000 of ESP 1 102 million, i.e. an aid intensity of 13,18 % gge (gross grant equivalent) and 9,80 % nge (net grant equivalent).

(C) **Background**

(29) In addition, in reply to a question from the Commission, the Spanish authorities indicated that the recipient firm had, on 27 January 1998, received investment aid in the form of a tax credit amounting to ESP 737 272 004 (EUR 4 431 094). The investment project, which covered the period 1997-2001, involved the following costs: buildings (ESP 1 150 million), machinery (ESP 5 400 million), technical installations (ESP 600 million), other installations (ESP 173 million) and IT systems (ESP 675 million), i.e. a total of ESP 7 998 million. The aid, with an intensity of 9,22 %, was granted by the Vizcaya Provincial Council under Provincial Law (Norma Foral) No 7/1996 of 26 December 1996. However, by Decision 2003/27/EC of

([9]) ITP plans to create 272 new jobs between 2000 and 2003.

11 July 2001 on the State aid scheme implemented by Spain for firms in Vizcaya in the form of a tax credit amounting to 45 % of investments ([10]), the Commission found that the aid provided for by the Provincial Law (45 % tax credit for investment in firms in Vizcaya) was unlawful and incompatible with the common market and had to be repaid.

(30) By letter of 5 February 2003, registered on 6 February, the Spanish authorities indicated that this aid to ITP had not yet been repaid.

3. DESCRIPTION OF THE GROUNDS FOR INITIATING THE PROCEDURE

(31) In its decision of 20 June 2001, the Commission raised a number of doubts concerning the following aspects of the aid under examination:

— the classification of certain R & D tasks as precompetitive development activities. For the low-pressure high-thrust turbine project, the doubts concerned in particular the engine testing, certification and post-certification activities. For the low-pressure low-thrust turbine project, the doubts concerned in particular manufacturing support, tools manufacturing and integrated logistic support activities,

— the admissibility of additional overheads and other operating expenses as eligible R & D costs,

— the incentive effect of the R & D component of the aid,

— the justification of the project in terms of regional development, in view of the fact that it was an ad hoc aid measure,

— the justification for including the expenditure on tools among the eligible costs of the investment project.

4. DESCRIPTION OF THE GROUNDS FOR EXTENDING THE PROCEDURE

(32) The Commission took the view that the circumstance referred to in recital 29 above, of which it was informed after its decision of 20 June 2001, was a new fact in that the information was not known to it when it adopted that decision.

(33) The Commission deemed that information to be of key importance if it was to be able to reach a decision on all the other issues already mentioned.

(34) In accordance with the principle established by the Court of Justice of the European Communities in its judgment of 15 May 1997 in Case C-355/95 P Textilwerke Deggendorf GmbH v Commission and Federal Republic of Germany ([11]), the fact that old aid that was unlawful and incompatible had not been repaid by the recipient firm could affect the compatibility of the new aid on account of the cumulative affect of the aid measures in question.

(35) Since the Spanish authorities had informed the Commission that the recipient of the aid examined under the present procedure had not reimbursed the aid in the form of a tax credit amounting to ESP 737 272 004 granted by the Vizcaya Provincial Council, which had been declared unlawful and incompatible by Decision 2003/27/EC, the Commission had doubts as to the compatibility of the new R & D and investment aid.

(36) In view of those doubts, the Commission extended the procedure in order to examine this question, which was not covered by its decision of 20 June 2001.

5. COMMENTS BY THE SPANISH AUTHORITIES

Classification of certain R & D tasks as precompetitive development activities

(37) With regard to the high-thrust turbine project, the Commission did not rule out the possibility that the engine testing, certification and post-certification activities could relate to marketable products and might therefore not constitute precompetitive development activities. The Spanish authorities pointed out that the engine trials for this project comprised the following tests: extensometry, measurement of the metal temperatures, measurement of the air temperatures, thermal paints, efficiency tests, cycle tests, type tests and fan blade off tests. Only the last two were certification tests. According to the Spanish authorities, they were also crucial to the objective of developing the capacity of ITP's R & D department for designing complete models. The fan blade off test was not carried out earlier during the development phase in view of its high cost. It therefore provided the first opportunity (not without risk) for calibrating non-linear calculation tools developed for this loading case. The other activities formed part of the development process and constituted

([10]) OJ L 17, 22.1.2003, p. 1.

([11]) [1997] ECR I-2549.

the initial verification and calibration of the design tools developed by ITP. The Spanish authorities furthermore took the view that components subjected to the tests could not be used commercially, given the ageing that accumulated during the resistance test (type test) and the destructive nature of the fan blade off test. Be that as it may, the Spanish authorities stated that this aspect could be checked by the monitoring committee provided for under the programme.

(38) The certification and post-certification activities for the high-thrust turbine project involved analysis of the data and documents generated by prior tests, a task that should not be confused with a drafting activity aimed at fulfilling conditions laid down by the certification authority. The Spanish authorities took the view that the certification process imposed technical constraints which in this case were more stringent than those demanded by the customer. Those constraints were imposed from the beginning of the design and determined it. According to the Spanish authorities, they could not therefore be regarded as a mere administrative requirement without innovative value. In any event, the Spanish authorities drew the Commission's attention to the fact that ITP's involvement in this activity was an excellent learning opportunity for the company, which it could put to good use with a view to launching other competitive projects in the near future. These activities contributed to the development of a new business area for the firm, which took the form of the creation of an airworthiness department and the submission to the JAA (Joint Aviation Authority) of an application for DOA (Design Organisation Approval).

(39) In the case of the low-thrust turbine project, the Commission's doubts concerned in particular manufacturing support, tools manufacturing and integrated logistic support activities. With regard to tools manufacturing, the Spanish authorities stressed that the first objective of the project was to produce an engine that was significantly cheaper than any other existing option, which made it necessary to modify aerodynamic criteria, mechanical criteria, qualification conditions, etc. The activities corresponding to this task constituted the engineering design and manufacturing engineering departments' contribution to the review of the design and manufacturing concepts. Those activities involved, in particular, a high degree of innovation with regard to design and manufacturing methods and high-level technical discussions on the quality and capacity conditions of the process.

(40) With regard to the tools manufacturing activities, the Commission did not rule out the possibility that at least part of the tooling might be used for the series production of engines. The Spanish authorities acknowledged that one of the usual principles in a development programme was indeed to recover as many of the tools as possible for the production programme. However, in the present case, they claimed, the approach was different in that the project was based on extremely low purchase prices, which introduced huge risks with regard to the possibility of future manufacture. The time to market was furthermore reduced in order to be able to capture the three possible customers before competing projects. Lastly, the reduction of costs required from the outset made it necessary to introduce concepts that were unusual in this type of small engine, such as the reduction of the number of vanes, and therefore had to be verified at a very early stage in the project. It was therefore necessary to finalise the tooling very early on, even before the concepts had been demonstrated. The Spanish authorities also pointed out that, as a result of regional policy commitments, the cast components, which used to be produced in the United States, were to be transferred to Vizcaya, which meant that ITP had in any event to bear the cost of a new set of tools.

(41) As regards integrated logistic support activities for the AS900 project, the Commission took the view that these corresponded to marketable versions, to which they contributed no new feature, modification or improvement, and therefore did not form part of precompetitive development. The Spanish authorities explained that these activities related to the following aspects: (a) the illustration of technical manuals; (b) the drafting of technical manuals; and (c) reliability, maintenance, etc. The last-named activities, although carried out by the logistic support group, were design/development tasks, carried out at the same time as development of the turbine, which determined the product design itself. They did therefore constitute precompetitive development activities. As far as activities (a) and (b) were concerned, the Spanish authorities argued that the Commission's view could be justified if ITP were habitually engaged in activities of this type. However, in the present case, these were new activities for the company which introduced an innovation in the development of its methods, involving the development of tools necessary for the establishment of a new department. In particular, this included the development of systems and tools for producing and illustrating technical publications, which had to be drawn up in a manner that was compatible with those used for the aircraft as a whole and incorporate the latest available technological advances. A far from negligible share of the work therefore consisted in developing the successive prototypes and the final version of the systems for producing technical publications, a task which, according to the Spanish authorities, formed part of precompetitive development.

Admissibility of additional overheads and other operating expenses as eligible costs

(42) The Spanish authorities understood that the Commission's doubts related to the costs under the heading 'contribution to development of the programme'. They could not understand why the Commission had classed these costs as additional overheads, since, in their view, they were in fact direct costs arising from the research activity. The Spanish authorities stressed that ITP was not an original engine manufacturer (OEM) and therefore could not, even if it so wished, assume responsibility for the engines as a whole and, in particular, for the process of incorporating its turbines into those engines. Consequently, the tasks involved in incorporating the turbine into the engine, and especially the tests on the turbine, had to be carried out under the responsibility of the OEM, with ITP's participation. The Spanish authorities also stressed that the intensity of the aid towards these eligible costs was 8 % and that the repayable advance requested for these costs accounted for 30 % of the total amount of the repayable advances requested for the entire project, which was in line with the conditions for intangible technology transfer costs associated with investment projects.

Incentive effect of the R & D component of the aid

(43) The Spanish authorities pointed out that ITP was active in two areas: engine maintenance and the development and production of engine components. At the time when it applied for the aid, the company was specialised above all in the static components, which are simpler and less integrated. Its production infrastructure was therefore tailored to the production of parts of this type. After analysing its position in this market, ITP had decided to change its strategy in order to become a supplier of complete modules. Such a decision entailed an obvious risk, not only on account of the scale of the necessary investments but also because the company had to penetrate two different sectors (both high- and low-thrust low-pressure turbines) with two different partners (Rolls Royce and Allied Signal). The Spanish authorities also stressed that contacts between the company and the Basque Government dated back to August 1998 and that the latter's willingness to support the project was a factor in the decisions taken by ITP.

(44) The Spanish authorities also pointed to a further three factors that made such a change of strategy particularly risky: first, the risk of having to invest a very large proportion of the resources generated ([12]); second, the fact that, without the aid, the production of parts for the Trent 500 project would have been located at Rolls Royce's existing plant in Derby and not on the Zamudio site; and, third, the fact that the AS900 programme was in competition with the range of engines produced by Rolls Royce North America (formerly Allison), which logically caused some of the shareholders to be reluctant to take risks under a competing project.

(45) The Spanish authorities then provided certain indicators which, in their view, demonstrated that the aid did have an incentive effect. ITP enjoyed significant growth over the period 1997-1999, the time when it framed its strategy for involvement in low-pressure turbines. This growth, which was in the region of 0,60 %, was similar to that enjoyed by the US firm General Electric. Furthermore, ITP accounted for only 1,46 % of turnover in the engine subsector and 0,25 % in the European aerospace sector, whereas its participation in the Fifth Framework Programme was in the region of 6 % for the engine subsector and 1,80 % for the aerospace sector, or 4.1 times greater than what could normally be expected on the basis of its turnover.

(46) The company's R & D expenditure increased substantially in relation to its turnover from 1999 (the first year of the project) onwards, as shown by the following table:

(ESP million)

	1993	1994	1995	1996	1997	1998	1999	2000
Turnover	14 108	14 145	16 051	14 702	19 263	25 333	31 493	36 952
R & D	238	914	1 850	3 705	4 373	4 750	8 061	12 438
R & D/turnover	0,02	0,06	0,12	0,25	0,23	0,19	0,26	0,34

([12]) The resources generated in 1997 and 1998 (prior to the project) were ESP 4 534 million and ESP 6 566 million respectively, while the necessary investments amounted to ESP 1 935 million in 1999 and ESP 6 829 million in 2000, or ESP 19 274 million over the four years of the project's duration.

The workforce also increased significantly, since the company employed 300 technicians after 12 years of activity.

(47) On the assessment of the technological risk inherent in the project, account had to be taken, according to the Spanish authorities, of the fact that it was usual for OEMs to publish incomplete information concealing possible delays or development problems in order to preserve their image, which could lead the Commission to believe that this project did not involve any risks.

(48) Concerning the technological barriers which the project had to overcome, the Spanish authorities referred to the information they had already provided in their letter of 17 April 2001. The value of the project's technological objectives should not be underrated, they claimed, since a good number of them had not yet been achieved. As regards the TRENT 500 engine, they pointed out that what was certified in December 2000 was a basic version of the engine, using technology that imposed heavy loads. A new version of the engine was therefore developed which improved efficiency by 1 %, and the company was currently working on a version that was to achieve a 2 % improvement in efficiency. Certification of the AS900 engine was delayed by one year as a result of technical problems.

(49) Lastly, the Spanish authorities pointed out that OEMs frequently created major barriers to the transfer of technology to the companies to which they subcontracted, given the risk the latter could introduce into the programme. This limited, in practice, the number of firms that could receive subcontracts for low-pressure turbine modules or take part in risk-sharing programmes. It was therefore unlikely that any other company in Spain would have sufficient prior know-how to be able to enter this sector. Consequently, it was difficult to imagine other firms in Spain or Europe that could receive similar aid. The Spanish authorities also stressed that it was usual for the aircraft industry to receive state aid; they claimed, however, that the intensity of the aid planned for this project was lower than the average levels of aid in Europe and the United States.

Justification of the project in terms of regional development

(50) The Spanish authorities pointed out, firstly, that although the project did not form part of a Commission-approved aid scheme, that did not mean that there was no overall system for examining, analysing and evaluating projects of this nature. The project was classed as a strategic programme and had been evaluated by the Basque Government under the Interinstitutional Economic Development Plan 2000 to 2004 and the Interinstitutional Agreement on the introduction of the Plan concluded between the Basque Government and the Vizcaya, Guipúzcoa and Álava Provincial Councils. The Plan provided the framework for the economic development activities of all the Basque institutions. The Spanish authorities explained that they had decided at the time not to notify the Commission of the Plan as such but to make individual notifications.

(51) As regards the effects of the project on regional development, the Spanish authorities explained that industry in the region had traditionally been concentrated in sectors such as mining, steelmaking, shipbuilding and capital goods. The successive crises in those sectors had deeply affected the region and prompted it to adopt an industrial policy aimed at facilitating structural change. The Economic Development Plan 2000 to 2004 therefore put forward a model of competitiveness geared to the creation of businesses in the region with higher demand potential in order to serve as an engine for development, promote economic activity in what were regarded as strategic, priority sectors, develop the innovative capacity of businesses and facilitate the internationalisation of firms in the region. The policy was not based on a sectoral approach but had a regional development focus. The Interinstitutional Agreement provided for the possibility of supporting specific projects pursuing these objectives in accordance with a number of qualitative and quantitative criteria enabling their potential contribution to regional development to be gauged irrespective of the sector concerned. The Spanish authorities took the view that the project presented by ITP was fully in line with those objectives.

(52) The Spanish authorities also took the view that the project presented by ITP could give a major boost to the development of the region: using a mathematical model developed by the University of Deusto (Faculty of Economics and Business Studies) on the basis of input-output tables, they claimed that the project could have a total economic impact of ESP 101 792 million for a level of activity of ESP 39 096 million. In terms of gross value added, the impact would be ESP 52 100 million for a gross value added by activity of ESP 28 400 million and an additional activity of ESP 16 821 million. As far as employment was concerned, the total effect would be 5 239 jobs overall for a workforce of 1 424 in the company.

(53) Lastly, the project would according to the Spanish authorities involve a volume of investment to be

subcontracted in the region amounting to ESP 1 450 million and a level of subcontracting in the region amounting to 30 %. It was also hoped to increase the number of local suppliers by 40 %. The Spanish authorities also stated that the project would help to consolidate an industrial group that was specialising in products with high value added and substantial technological content, develop the competitiveness of firms operating as subcontractors in the aircraft industry and boost aerospace research in the Basque Country. There was also a long-standing tradition of cooperation between ITP and the Bilbao Engineering School or the Mondragón Polytechnic University with a view to developing a skills base capable of meeting the needs of the sector. Lastly, the Spanish authorities hoped that the Zamudio site would become a centre of attraction for advanced industries.

Justification for including the expenditure on tools among the eligible costs of the investment project

(54) The Spanish authorities explained that expenditure under the heading 'tools' related to production tooling associated with the manufacturing process at the Zamudio site and comprised mechanical apparatus (clamps, jigs, templates, stiffeners, i.e. components for handling parts and for the interaction between parts and tools), sheetmetal working and welding tools (cutting and finishing tools, tools for assembling welded components, etc. These were extremely costly, given the number of adjustments and mechanisms involved) and inspection and verification tools (standard components, templates and gauges for facilitating the inspection of the first and series-produced components). The tooling was to be designed for the machinery to be installed at Zamudio and related to new investments. The relevant expenditure was broken down as shown in the following table:

(ESP million)

	2000	2001	2002	Total
Mechanical apparatus	150	327	215	692
Sheetmetal working and welding	85	97	93	275
Verification	25	43	27	95
Total tools	260	467	335	1 062

Issue raised in the decision to extend the procedure

(55) The Spanish authorities provided proof that the aid described in recital 29 had been reimbursed in full by the recipient since the decision to extend the procedure, including compound interest calculated using the interest rates recommended by the Commission.

6. COMMENTS BY INTERESTED PARTIES

Comments submitted by Sytemel

(56) The Federation of Turbine and Heavy Energy Plant Manufacturers (Sytemel), a French trade association, wished to draw the Commission's attention to the following regional issue: since the French department of Pyrénées-Atlantiques was already home to a number of industrial manufacturing or subcontracting centres for the Turbomeca group (which produced combustion turbines for aircraft applications and also naval or terrestrial uses), the distortion of competition caused by possible support from the Basque Government would aggravate the already adverse effect of geographic proximity of the sites on the mobility of researchers and technicians. Publicly assisting a new R & D centre for combustion turbines and abnormally affecting the natural conditions of competition between manufacturers were both unfavourable factors for trans-Pyrenean attractiveness and proper regional planning in Europe.

Comments submitted by Pratt & Whitney

(57) First, Pratt & Whitney argued that the intensity of the aid for this project should be considered in conjunction with state aid previously granted to Rolls-Royce for the Trent 500 engine and related development activities, since Rolls-Royce was the only private industrial partner in ITP. Account had to be taken in this connection of the fact that the Trent 500 was a derivative rather than a new engine and incorporated technologies taken from the Trent 700, Trent 800 and Trent 8104 engines, which meant that the costs and technological risks involved were reduced. Pratt & Whitney therefore took the view that the cost of developing the Trent 500 should be only 30 to 40 % of the cost of a completely new engine, a fact that should be taken into account when determining the eligible costs. The Trent 500 had furthermore already received state aid granted by the United Kingdom in 1998, which, according to Pratt & Whitney, must have been based on the assumption that Rolls-Royce would bear all the development costs. Transferring a share of the risks to other partners, such as ITP, would result in an effective increase in the intensity of the aid already granted and a 'double-dipping' of state aid since those partners would obtain further state aid for themselves. There could even be 'triple-dipping' of aid in that the request for additional aid presented by Rolls-Royce in 2001 for the Trent 600 and Trent 900 engines included, according to Pratt & Whitney, engine programmes and technologies that were already assisted by the 1997 aid grant. Pratt &

Whitney also pointed out that Rolls-Royce's contribution to R & D activities from its own funds was unusually low compared with the levels of company-funded R & D by Pratt & Whitney and other competitors.

(58) Pratt & Whitney considered that the aid for the high-thrust turbine had no incentive effect since the request for aid was retroactive as the precompetitive development costs had already been incurred. The Trent 500 programme was long past the launch phase and the engine had already been certified by the competent authorities. Pratt & Whitney shared the doubts raised by the Commission based on the fact that the project had already reached a high level of maturity. The company pointed out that the period for which the aid was requested (1999—2002) postdated the formal announcement by Airbus in June 1997 that it had selected the Trent 500 as the sole engine for the A340-500/600. The engine was first tested in May 1999 and certified in December 2000. Orders for A340-500/600 powered by the Trent 500 engine had so far totalled 88 aircraft, most of which had been placed before 1999.

(59) Pratt & Whitney shared the doubts raised by the Commission as to whether engine testing, certification and post-certification activities could be classed as precompetitive development activities within the meaning of the R & D framework. The company explained that, according to its own experience, large aero-engine development projects had four distinct phases:

— the concept phase, during which market requirements, business strategy and technology readiness were continuously re-evaluated. Conceptual design studies were conducted with airframe manufacturers to determine the requirements for thrust, performance, weight, noise, emissions, installation constraints and so on. Technologies were proven through analysis and rig or engine testing in order to minimise technical risk. This phase could continue for long periods of time. It could be regarded as 'precompetitive', but the costs were relatively low, about 4 % of the total programme cost,

— the launch phase, during which the production design of a specific new engine model or derivative was developed. Some rig and component testing could be carried out, and long lead-time tooling and parts were ordered using the expected production configuration. By the end of this phase, the engine configuration and technology were largely fixed. The engine manufacturer entered into business agreements with customers, specifying the certification and delivery schedule, price, performance and technical requirements for the engine. This phase lasted around one year and accounted for some 9 % of the total programme development cost. Pratt & Whitney considered that this phase too could be regarded as precompetitive development within the meaning of the R & D framework, since it was uncertain until the end of the phase whether the engine would ever be manufactured and sold. However, by the end of the launch phase, if the programme was to proceed, it was because the engine manufacturer had obtained a sufficient number of orders, and subsequent phases could not therefore be deemed to constitute precompetitive activities,

— the engine validation and certification phase, which was intended to establish that the product met specifications and was sufficiently safe and reliable for entry into service. New and unproven technologies were generally not added to the engine design during this phase since this would prove difficult, risky and costly. The phase could itself be divided into two parts: before and after production of the first engine to test (FETT), the initial prototype of the commercial production engine. During the production of the FETT, detailed design drawings of all engine components were completed. The FETT was typically fabricated by hand, using non-production processes and temporary tooling. The engine validation and certification phase prior to FETT lasted about one year after the end of the launch phase and accounted for around 9 % of the total programme cost. Once the FETT had been produced it had to successfully undergo all the tests required to ensure that the engine met all the minimum standards for safety and performance. All the engines used for these tests were produced in accordance with the design of the model to be certified. This period lasted about two years and accounted for around 55 % of total costs. A large proportion of these costs were incurred in producing the engines used for the tests. Five such engines could be enough for certifying a derivative engine, while as many as ten or more engines were normally necessary for a new engine design. These engines were usually manufactured using commercial production methods. They were tested under extreme conditions, which meant that it was practically impossible to refurbish and sell them to the airlines. They were therefore generally used for other development activities or in post-certification engine improvement programmes. Pratt & Whitney consequently shared the Commission's view that the costs incurred during this certification phase related

to a product that could be used commercially — and which indeed was already sold commercially after the end of the launch phase,

— the flight test and airframe certification phase, the final phase in which the engines were installed in the aircraft in accordance with the certified configuration. The aircraft had to successfully undergo a set of flight tests with the certified engines in order to demonstrate that the engine and airframe combination met the prescribed airworthiness, performance and operability requirements. After completing the flight test programme, flight test engines were typically refurbished and sold commercially. Along with the Commission, Pratt & Whitney took the view that the activities carried out during this phase could not be regarded as precompetitive development activities within the meaning of the R & D framework.

(60) Lastly, with regard to the eligibility of costs, Pratt & Whitney shared the Commission's doubts in the case of the low-thrust turbine project as to whether manufacturing support, tools manufacturing and integrated logistic support activities could be regarded as precompetitive development activities within the meaning of the R & D framework: manufacturing support formed part of the firm's commercial policy and did not constitute a research and development activity; tools manufacturing was aimed at building the machines necessary to make prototypes, which could at least in part be subsequently re-used to manufacture standard engines; and integrated logistic support consisted in producing manufacturing instructions, manuals and technical procedures for engine maintenance that related to the commercial versions of the engines, to which they brought no innovation, modification or improvement. The same doubts applied also to the high-thrust turbine project.

Comments submitted by the recipient

(61) The aid recipient submitted comments only on the decision to extend the procedure. These comments concurred with those made in that connection by the Spanish authorities, which demonstrated that the unlawful and incompatible aid mentioned in recital 29 had been reimbursed in full by ITP since the decision to extend the procedure, including compound interest calculated using the interest rates recommended by the Commission.

7. RESPONSE BY THE SPANISH AUTHORITIES TO THE COMMENTS SUBMITTED BY INTERESTED PARTIES

Response to the comments submitted by Sytemel

(62) According to the Spanish authorities, and contrary to what was claimed by Sytemel, the project would not affect the network of plants and subcontractors that usually worked for Turbomeca or trigger any movement of researchers towards the Basque Country. ITP, as a supplier of subsystems and a risk partner in engine programmes, was not in competition with small or medium-sized workshops. On the contrary, it created work for manufacturers of this type since it did not have the facilities for producing all the components that went to make up a turbine. ITP planned to continue subcontracting 15 % of production. In these circumstances, the geographic proximity of the manufacturers represented by Sytemel constituted an advantage in comparison with other potential suppliers located in the United Kingdom, Germany or central or southern Spain. It could thus be argued that suppliers of subsystems created work rather than taking it away, and this was confirmed by certain facts: ITP had not received a single subcontracting order from industries in that region, but had placed increasing volumes of manufacturing orders in the south of France. For example, ITP had in a single year ordered turbine discs worth EUR 17,2 million from a French company, while the hoped-for grant amounted to EUR 7 million. Furthermore, this type of component was traditionally supplied by a Japanese company.

(63) Unlike Sytemel, the Spanish authorities considered that geographic proximity was an advantage and that the mobility of researchers and technicians should be encouraged, as indeed the European Union had done in the Sixth Framework Programme, in order to develop European industry. In this connection, ITP and the Basque Government were taking part in the Interreg initiative with a view to developing technological and commercial links between the Basque Country and the Aquitaine region.

Response to the comments submitted by Pratt & Whitney

(64) The Spanish authorities considered that Pratt & Whitney's arguments concerning the aid intensity, in other words the link with aid received by Rolls-Royce for the Trent 500 project, were based on the incorrect assumption that Rolls-Royce was the only private shareholder in ITP and that the remaining shares belonged to the State or to regional or local authorities. But ITP was mainly privately owned, its only public shareholder being SEPI, which held 26,65 % of the capital. The remainder was split between the private companies Sener (26,65 %) and Rolls-Royce (46,7 %). Given its private company status, the state aid received by ITP in Spain was therefore separate from the aid granted by the United Kingdom to a British firm. The planned R & D aid to ITP corresponded to investments in capital, engineering and actual development equipment, for which no other state aid had been received. The conditions for ITP's entry into the project as a risk partner were furthermore market conditions,

without any premium or special treatment by Rolls-Royce. There was no duplication of work or any overlap with aid granted in the United Kingdom. With regard to Pratt & Whitney's opinion that the Trent 500 was a derivative engine, the Spanish authorities pointed out that even a new engine was based on additional knowledge in relation to previous ones. That principle, which applied to all manufacturers, enabled each of them to reduce development costs significantly. In any event, the aid had to be assessed in relation to the actual development costs and not the costs that would have been incurred if the engine had been completely new. The Spanish authorities stressed that the aid was an incentive aimed at enabling ITP to enter a new area of activity and that ITP therefore did not have the experience acquired by other firms. As regards the level of innovation incorporated into the turbine, the Spanish authorities claimed that the design and the technology used were completely new in comparison with other low-pressure turbines produced by Rolls-Royce or any other manufacturer. They repeated that the aid to ITP was designed to cover costs that the company had genuinely incurred and had not been reduced in any way by state aid granted in the United Kingdom. Lastly, they took the view that it was not for them to comment on the accounting criteria used by Rolls-Royce and stressed that Rolls-Royce and ITP were two completely different companies.

(65) Concerning the incentive effect of the aid, the Spanish authorities considered that Pratt & Whitney had arrived at the conclusion that there was no technical or commercial risk on the ground that the Trent 500 engine was certified in December 2000 and that the R & D activities had therefore been completed before certification of the engine was first announced. The Spanish authorities took the view, on the other hand, that many of those activities overlapped, particularly if account was taken of the different levels: engine, system and subsystem. Many announcements were furthermore made artificially in order to protect the customer's programme and preserve the commercial image of the project. The Spanish authorities stated that the turbine standard certified in December 2000 did not fulfil the requisite conditions and that the engine was in fact certified with a basic low-pressure turbine standard in order to avoid delaying the development programme for the aircraft it was to power. Between that standard and the subsequent one, modifications were developed and tested that were in advance of the state of the art. Those modifications were partly the result of parallel R & D plans and showed the extent to which the technological risk existed and could have an economic impact on a small firm like ITP. The Spanish authorities stressed that the time-lag with respect to the established schedule due to the design of the second configuration caused the precompetitive development activities to be delayed and that, although the project was already at an advanced stage when it was notified to the Commission, it should not be deduced therefrom that the aid was any less necessary. Lastly, they argued that the existence of orders or declarations of intent to purchase engines did not relieve the manufacturer of the risk of failing to meet the technical specifications, since orders not only did not provide any advance funding but always included heavy penalties in the event of non-compliance.

(66) As regards the precompetitive development activities, the Spanish authorities took the view that the model for engine design projects put forward by Pratt & Whitney was not necessarily the only one possible and that other OEMs were perfectly capable of adopting other models that might not coincide with the one described. In any event, according to the Spanish authorities, some major differences could be observed between the methods adopted by an OEM such as Pratt & Whitney and those of a firm like ITP. The proportion of precompetitive development tasks was, for one thing, much larger in the case of a supplier of subsystems than in that of an OEM since the former was involved not in engine marketing, certification or sales but in technical activities. The availability of existing technology (precedents) also differed as between a firm traditionally present in the market, like Pratt & Whitney, and a medium-sized firm that had been in the market for only 12 years, like ITP. For example, an OEM could regard a low-pressure turbine as a by-product of the high-pressure turbine, whereas ITP, a supplier of low-pressure turbines, could not refer to high-pressure turbine or any other previous turbine technology, and the net technological content of these activities was therefore proportionately higher in the case of ITP than for an OEM. Lastly, the Spanish authorities were convinced that the activities in respect of which the Commission had raised doubts did constitute precompetitive development activities for ITP, since they corresponded to the initial development of certain methodologies and processes.

(67) Lastly, as far as the eligibility of costs was concerned, the Spanish authorities took the view that the Commission had all the information it needed in order to reach a decision on this issue and, in particular, on the specific content of each of the tasks. Since such information was not available to Pratt & Whitney when it submitted its comments on the certification and post-certification activities, those comments were groundless.

8. **ASSESSMENT**

(68) The measures planned by the Spanish authorities confer an advantage on the recipient firm by relieving it of some of the costs incurred through the investments and research activities which it should normally bear itself. This advantage is also selective with respect to other firms that might wish to carry out such investments or similar research projects. It could also affect intra-Community trade if only because the projects in question are aimed at developing and manufacturing products to be supplied to Rolls-Royce and therefore exported to the United Kingdom, and also because ITP subcontracts for a number of European firms. Lastly, the interest-free loans are granted direct by the Basque Government, and consequently the advantages must be deemed to be conferred by means of state resources. The measures in question therefore constitute state aid within the meaning of Article 87(1) of the Treaty.

(69) As stated in recital 26 of this Decision, the Commission raised doubts concerning this project. The questions arising will be examined below, the planned aid for research and development and the planned aid for investment being dealt with separately.

A. **Aid for research and development**

Classification of the R & D tasks as precompetitive development activities

(70) The Commission notes firstly that the assessment of state aid for research and development in the light of the Community rules is based on the analysis of eligible costs relating to specific investments. The fact that other investments, even linked to the same project, have received state aid cannot therefore make the project in question incompatible with the Treaty. This principle therefore applies all the more in the case of investments under a different project. The Commission therefore has to dismiss the arguments put forward by Pratt & Whitney concerning the aid received by Rolls-Royce in the context of the latter's investments linked to the Trent 500 project and the Trent 600 and Trent 900 projects.

(71) In its Decision on State aid to Rolls-Royce for the development of the Trent 600 and Trent 900 engines ([13]), the Commission classified the different phases of aero-engine development in line with the stages of R & D defined in Annex I to the R & D framework.

(72) According to that classification, activities prior to engine certification constitute R & D activities in line with the R & D framework, as they are situated at least as far away from the market as precompetitive development activities.

(73) On the other hand, the Commission found in that Decision that engine certification, let alone activities subsequent to such certification, were too close to the market for them to constitute R & D activities in line with the R & D framework.

(74) The Commission considers that it must adopt the same approach towards the project under examination in the present Decision as it took when it assessed the abovementioned United Kingdom project. It cannot follow the approach advocated by Pratt & Whitney, since that would mean restricting the scope of research and development exclusively to very early work carried out even before an initial prototype, albeit commercially unusable, was built. Such an approach would clearly run counter to the logic of the R & D framework, which expressly provides for the construction of such prototypes to be included among research and development activities.

(75) Account should also be taken in this particular case of the fact that the work undertaken by ITP is aimed at developing engine subassemblies and not the entire engine. The certification activities to be taken into account in order to draw the line between ITP's work corresponding to R & D within the meaning of the R & D framework and work falling outside that definition should therefore be the activities aimed at certifying the engine with the turbines developed by ITP as part of the present project and not any previous certifications of the engine with other turbines. This distinction is particularly important in the case of the Trent 500 engine, which, owing to the schedule imposed by the aircraft manufacturer, was the subject of an initial certification by Rolls-Royce that was completed in December 2000, but using a different turbine that did not display the same set of characteristics as the one developed by ITP under the present project. That initial certification, which had nothing to do with this project, could not therefore be used to draw the conclusion, put forward by Pratt & Whitney, that any activity carried out under the present project after December 2000 does not constitute R & D within the meaning of the R & D framework.

([13]) Commission Decision of 30 October 2001 on State aid case No 120/01, OJ C 67, 16.3.2002, p. 33.

(76) In view of the foregoing, the Commission takes the view that the costs linked to the certification and post-certification activities for the high-thrust turbine cannot be regarded as R & D within the meaning of the R & D framework. The amount of those costs, namely ESP 682 560 989 (EUR 4 102 274), should therefore be deducted from the total eligible costs notified by the Spanish authorities.

(77) With regard to the engine testing costs linked to the high-thrust turbine, the Commission takes note of the Spanish authorities' statement that only some of those tests (the fan blade off tests and type tests) formed part of the certification process. For the reasons already mentioned, these certification tests do not constitute R & D activities within the meaning of the R & D framework. On the other hand, the Commission takes the view that the other testing activities should be regarded as preceding the engine certification with ITP's new turbine, even where they took place after the engine was certified in December 2000 with another, less powerful, turbine. These last-named activities are therefore included in the precompetitive development phase.

(78) The Spanish authorities pointed out that the above-mentioned certification tests accounted for 15,6 % of the total engine testing costs linked to the high-thrust turbine. The Commission therefore considers that 15,6 % of the total cost of the task should be deducted from the amount of the costs eligible for aid. An amount of ESP 29 577 643 (EUR 177 765) should therefore be deducted from the total eligible costs notified by the Spanish authorities.

(79) In the case of the low-thrust turbine project, the Commission raised doubts concerning the inclusion among eligible costs of the costs relating to manufacturing support, tools manufacturing and integrated logistic support. It considered that these activities were aimed at manufacturing or maintaining engines in their final, marketable state.

(80) As regards manufacturing support, the Spanish authorities claimed that this activity involved a high degree of innovation in terms of design and manufacture and important technical discussions concerning the quality and capacity requirements of the production process. The Commission does not call these considerations into question, but takes the view that they do not enable it to withdraw its reservations as to whether or not such activities qualify as R & D.

(81) First, the fact that the activities involve a high degree of innovation is not sufficient for them to be classified as R & D activities within the meaning of the R & D framework. Point 2.3 of the framework makes it very clear that although certain activities may be regarded as innovative they do not fall within the scope of the framework.

(82) Second, the existence of important technical discussions as part of this task does not in any way alter the fact that the task corresponds to the production process for the commercial engine, as demonstrated precisely by the fact that the quality aspects of the process are taken into account. The definition of precompetitive development activities given in the third indent of Annex I to the R & D framework explicitly excludes activities whose results may be converted or used for industrial applications or commercial exploitation.

(83) The Commission therefore takes the view that the manufacturing support activities relating to the low-thrust turbine do not constitute research and development activities within the meaning of the R & D framework and that the costs associated with those activities cannot be included in the costs eligible for aid in line with the framework. The amount of those costs, namely ESP 58 795 002 (EUR 353 365), should accordingly be deducted from the total eligible costs notified by the Spanish authorities.

(84) With regard to the tools manufacturing activities, the Commission takes note of the Spanish authorities' statement that, unlike usual practice in projects of this type, the tooling for the development activities would not be able to be re-used for the industrialisation of the final product. Neither could it be converted for that purpose given the need to keep the cost of the final production process low, which precludes the use of the type of tooling used in a research and development context.

(85) The Commission therefore concludes that the tool manufacturing activities for the low-thrust turbine may be regarded as precompetitive development activities within the meaning of the R & D framework and that the corresponding costs may be included in the eligible costs of the project under that heading.

(86) As regards integrated logistic support activities, the Spanish authorities stated that the drafting of technical manuals was a new activity for the company which therefore required it to engage in a substantial process of innovation and methods and tools development; they claimed that the other activities in this task, which related to engine reliability and maintenance, constituted design/development activities that were carried out at the same time as the engine design work.

(87) The Commission takes the view that the fact that the company is drawing up technical manuals of this type for the first time and has to develop a set of tools for the purpose does not make it possible to conclude that the drafting of those manuals constitutes an R & D activity within the meaning of the R & D framework. In particular, the purpose of such technical manuals can clearly be only to describe the final version of the engine. Whatever the degree of refinement and innovation incorporated into such manuals, they will have a direct commercial application since they will be used by the buyers of the engines.

(88) As for the activities relating to engine reliability and maintenance, the Commission considers that the fact that they are carried out partly in parallel with engine development and use the results of that development as input data makes it possible to conclude only that they relate to that engine in particular, and not that they form part of the research process. In any event, the Commission points out that these again are activities which by definition are either entirely, in the case of maintenance, or to a very considerable extent, in the case of reliability, directed towards the final stage of the product as placed on the market.

(89) Since all the integrated logistic support activities are to a considerable extent directed towards the final product placed on the market, the Commission therefore takes the view that the costs associated with those activities cannot be included in the costs eligible for aid in line with the R & D framework. The amount of those costs, namely ESP 60 285 198 (EUR 362 321), should accordingly be deducted from the total eligible costs notified by the Spanish authorities.

(90) In view of the foregoing, the total amount of eligible costs should be reduced to ESP 9 590 857 185, i.e. EUR 57 642 213.

Admissibility of additional overheads and other operating expenses as eligible costs

(91) The Commission notes that the costs described in the notification as a 'contribution to development of the programmes' should not be included as additional overheads and other operating expenses in line with the fourth and fifth indents of Annex II to the R & D framework.

(92) These costs in fact correspond to ITP's participation as a subcontractor in the integration of the components it manufactures into complete engines. It is common practice for subcontractors to contribute in this way to the costs of integrating their components into the overall system during the research and development phase. Their contribution often takes the form of cooperation through a risk partnership in which the subcontractor must, in addition to paying an entry fee for joining the programme, take responsibility for part of the development and industrialisation of the engine (usually its own subassembly and the integration of that subassembly into the system).

(93) In the case in point, ITP's participation includes costs, such as the assistance provided by the company in the tests for integrating its subassemblies into the complete engines, which the Commission deems eligible in line with Annex II to the R & D framework where they relate to activities carried out either directly by the aid recipient itself or by subcontractors.

(94) The Commission takes the view that the fact that the aircraft industry adopts specific methods for cooperation between companies, such as risk partnership, cannot have any bearing on the nature of eligible costs in line with Annex II to the R & D framework.

(95) Accordingly, the Commission finds that its doubts concerning the admissibility of additional overheads and other operating expenses as eligible costs can be withdrawn.

Incentive effect of the R & D component of the aid

(96) The Commission notes, firstly, that the technological risk associated with the project is relatively limited, at least in comparison with the high average level of technological risk in the aircraft industry. In particular, examination of the information supplied by the Spanish authorities reveals that ITP's engineers received substantial technical assistance from the United Kingdom company Rolls-Royce, the industry leader in Europe, which is itself involved in very high-technology engine development projects.

(97) The Spanish authorities have nevertheless provided data demonstrating that the aid had a significant quantitative effect on the company's R & D activities. In particular, between 1998 (before the project began) and 2000 (at the peak of its implementation), the firm's R & D spending grew from EUR 152 million to EUR 222 million. In relative terms, the proportion of its total turnover allocated to R & D thus rose from 19 % to 34 % during that period. Furthermore, between 1998 and 2001, the company hired some 50 engineers and technicians.

(98) The Commission cannot take account in its analysis of the data supplied by Pratt & Whitney on this topic,

since they relate to Rolls-Royce and not to the company receiving the aid.

(99) Neither can the figures for Trent 500 engine sales and orders submitted by Pratt & Whitney be taken into consideration in assessing the incentive effect, since they do not distinguish between engines incorporating different types of low-thrust turbine and consequently do not specify whether any of those sales incorporate the new high-thrust turbine developed by ITP under the project covered by this Decision.

(100) The Commission also notes, as mentioned earlier, that the aid enabled significant cross-border cooperation to take place between the recipient and the United Kingdom company Rolls-Royce, with special reference to the latter's Trent 500 engine, in the development of which ITP took part as a risk partner.

(101) The Commission notes, finally, that the company submitted an application for aid to the regional authorities before it launched the programme.

(102) In view of the foregoing, the Commission finds that, in this case and particularly in view of the sector concerned, the aid can be deemed to have an incentive effect in line with section 6 of the R & D framework.

Conclusion on the R & D component of the aid

(103) In view of the foregoing, the Commission finds that some of the activities notified by the Spanish authorities may receive aid that is compatible with the R & D framework. Those activities give rise to eligible costs amounting to ESP 9 590 857 185, or EUR 57 642 213, corresponding to precompetitive development activities in line with Annex I to the framework.

(104) The maximum allowable intensity of the aid is 25 %, pursuant to point 5.5 of the R & D framework, to which an extra five percentage points may be added pursuant to the second paragraph of point 5.10.2 of the framework since the Zamudio site is located in an area eligible for regional aid under Article 87(3)(c) of the Treaty.

(105) The Commission therefore considers that the R & D component of the aid may be authorised under the R & D framework, provided that its gross grant equivalent does not exceed 30 % of EUR 57 642 213, i.e. EUR 17 292 664. The Spanish authorities have furthermore expressed their agreement on this point.

(106) The Commission notes that the gross grant equivalent of the aid must be calculated using the reference and discount rate published by it, plus a premium of 400 basis points, since the loan granted by the State is not backed by any security ([14]). For the calculation of the gross grant equivalent of the aid, the Spanish authorities may refer to Annex I to the guidelines on national regional aid ([15]).

(107) Lastly, as regards the claim made by Sytemel that the distortion of competition caused by possible support from the Basque Government would aggravate the already adverse effect of geographic proximity of the sites on the mobility of researchers and technicians, the Commission considers that increased mobility of researchers is, on the contrary, a positive development that should be encouraged in the Community.

B. **Aid for investment**

Justification of the project in terms of regional development

(108) As the Commission noted in the decision to initiate the formal investigation procedure, the planned investment aid does not form part of an approved aid scheme and must therefore be regarded as ad hoc aid. The Spanish authorities have not disputed that conclusion. The Commission accordingly has to verify, in accordance with the second paragraph of section 2 of the guidelines on national regional aid, whether the benefits for the region outweigh the distortion of competition that can result from the ad hoc aid. The Commission notes, furthermore, that the whole of the Basque Country is eligible for regional aid under Article 87(3)(c) of the Treaty and that, in accordance with Spain's regional aid map, the ceiling for regional aid in the Basque Country is 20 % nge.

(109) The Commission takes note of the fact that, although the aid is not to be granted under a Commission-approved aid scheme, it is in line with the Interinstitutional Economic Development Plan

([14]) See, in this connection, the Commission notice on the method for setting the reference and discount rates, OJ C 273, 9.9.1997, p. 3, and in particular the first indent of the sixth paragraph thereof.

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

2000—2004 and the Interinstitutional Agreement on the introduction of the Plan concluded between the Basque Government and the Vizcaya, Guipúzcoa and Álava Provincial Councils, which, as explained by the Spanish authorities, provides the framework for the economic development activities of all the Basque institutions. The Plan comprises a programme on the basis of which the project in question was selected. The Commission has established that the aid to be granted under that programme is the subject of annual competitive tendering procedures and is granted after publication of a call for applications and selection in accordance with objective criteria. This investment aid must therefore be regarded as an individual aid measure benefiting a specific company but granted in a given overall legislative context of regional development.

(110) The Commission also takes the view that this investment aid can effectively contribute to the economic development of the region. According to the data supplied by the Spanish authorities, the project will have a significant effect in terms of gross value added and job creation; in particular, it involves a relatively high level of subcontracting in the region (30 % in 2002).

(111) The Commission considers, furthermore, that the aid may be regarded as proportionate, since its intensity is well below the relevant regional aid ceiling. It also notes that the aid recipient is to contribute more than 25 % to the financing of the project, that the application for aid was submitted before work started on the project and that the aid is conditional on maintenance of the investments for a minimum period of five years. The conditions laid down in the first and third paragraphs of point 4.2 and in point 4.10 of the regional aid guidelines are therefore met. The aid is also conditional on net job creation by ITP ([16]).

(112) Lastly, as regards the comments submitted by Sytemel in the course of the procedure, the Commission takes the view that the aim of regional aid is precisely to offset the handicaps or development lags from which the regions concerned are suffering, and that it already takes account of the scale of these handicaps when drawing up the national regional aid maps. In the case of the project under consideration, account has to be taken of the fact that the aid intensity is much lower than the ceiling allowed by Spain's regional aid map and that the fears expressed by Sytemel concerning the effects of the project on the operations of companies located in France are unfounded since, as pointed out by the Spanish authorities, ITP has increased its orders from French firms. The Commission accordingly finds that the investment aid to ITP does not affect trading conditions to an extent that is contrary to the common interest.

(113) The Commission therefore concludes that the doubts it raised in its decision to initiate the formal investigation procedure concerning the justification of the project in terms of regional development can be withdrawn.

Justification for including the expenditure on tools among the eligible costs of the investment project

(114) The Commission notes, in the light of the explanations provided by the Spanish authorities, that expenditure on tools for this project relates to ancillary items associated with the production process, to be designed for the machinery to be installed at the Zamudio site. The Spanish authorities also pointed out that these items form part of the company's fixed assets and are entered as such in its balance sheet. These items may therefore be regarded as belonging to the category of 'plant/machinery' referred to in point 4.5 of the regional aid guidelines.

(115) The Commission accordingly concludes that the doubts it raised in its decision to initiate the formal investigation procedure concerning the justification for including the expenditure on tools among the eligible costs of the investment project can be withdrawn.

Conclusion on the investment component of the aid

(116) In view of the foregoing, the Commission finds that the investment project complies with the guidelines on national regional aid.

C. **Issue raised in the decision to extend the procedure**

(117) The Commission notes that the Spanish authorities have provided proof that the unlawful and incompatible aid referred to in the decision to extend the procedure has been reimbursed in full since that decision.

([16]) ITP plans to create 272 new jobs between 2000 and 2003. See decision of 20 June 2001.

(118) The amount repaid includes compound interest calculated using the interest rates recommended by the Commission in accordance with the Commission communication on the interest rates to be applied when aid granted unlawfully is being recovered ([17]).

(119) The Commission accordingly finds that the extension of the procedure no longer serves any purpose.

9. **CONCLUSION**

(120) In view of the foregoing, the Commission concludes that the investment aid planned by the Basque Government may be granted unconditionally. The aid for research and development planned by the Basque Government may be granted provided that certain conditions are fulfilled,

HAS ADOPTED THIS DECISION:

Article 1

The state aid which Spain is planning to implement for the company Industria de Turbo Propulsores SA (ITP), in the form of a grant of EUR 7 030 000, is compatible with the common market within the meaning of Article 87(3)(c) of the EC Treaty.

Implementation of the aid is accordingly authorised.

Article 2

The state aid which Spain is planning to implement for ITP, in the form of an interest-free loan totalling EUR 24 040 000, is compatible with the common market within the meaning of Article 87(3)(c) of the Treaty subject to the conditions set out in Article 3.

Article 3

The gross grant equivalent of the aid, calculated using the reference and discount rate published by the Commission, plus 400 basis points, shall not exceed EUR 17 292 664.

Article 4

Spain shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with Article 3.

Article 5

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 21 October 2003.

For the Commission

Mario MONTI

Member of the Commission

([17]) OJ C 110, 8.5.2003, p. 21.