COMMISSION DECISION

of 21 September 2005

on State aid No C 5/2004 (ex N 609/2003) which Germany is planning to implement for Kronoply

(notified under document number C(2005) 3497)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/262/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having called on interested parties to submit their comments pursuant to those provisions [1] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter dated 22 December 2003 (A/39031), Germany notified the Commission that it was planning to award an investment grant to Kronoply GmbH, Heiligengrabe (Brandenburg) (hereinafter 'Kronoply') under the multi-sectoral framework on regional aid for large investment projects [2] ('1998 multisectoral aid framework'). The notified aid was registered under No N 609/03.

(2) By letter dated 18 February 2004 (SG/D/200649), the Commission informed Germany of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty.

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

(4) By letter dated 19 March 2004 (A/32003), Germany submitted its comments.

(5) By letter dated 24 May 2004 (A/33878), Luther Menold Rechtsanwaltsgesellschaft mbH submitted comments on behalf of Kronoply. The comments were forwarded to Germany on 19 November 2004 (D/58277).

2. DETAILED DESCRIPTION OF THE AID

2.1. First notification N 813/2000

(6) The present case is related to Case No N 813/2000, in which the Commission approved aid to Kronoply.

(7) On 3 July 2001 (SG/D/289524) the Commission approved a gross aid intensity of 31,5% for Kronopoly under the 1998 multisectoral aid framework in connection with the construction of a production plant for Oriented Strand Board [4] ('OSB') in Heiligengrabe, Brandenburg, an assisted area within the meaning of Article 87(3)(a) of the EC Treaty. The aid intensity was set 3,5 percentage points lower than the maximum because the relevant market was considered to be in decline.

(8) The Commission calculated the three assessment criteria to be applied in determining the maximum allowable aid intensity under the 1998 multisectoral aid framework. Consequently, in order to comply with those criteria, the maximum allowable aid intensity was calculated to be 31,5% (competition factor 0,75, capital-labour factor 0,8 and regional impact factor 1,5). The amount of aid involved was therefore €35,4 million [5].

[1] OJ C 258, 20.10.2004, p. 12.
[2] OJ C 107, 7.4.1998, p. 7.
[3] See footnote 2.

[4] OSB is a wooden panel used in construction and consisting of three layers of 'strands' made primarily of pine. It is used in timber frame construction, in particular for the refurbishment and restoration of old buildings, in the prefabricated building industry and in the packaging industry.

[5] Consisting of investment aid in the form of (i) a non-repayable grant amounting to €19,92 million under the 29th general plan of the joint Federal Government/Länder scheme for improving regional economic structures and (ii) an investment allowance of €15,48 million under the Investment Allowance Law 1999.

(9) Calculation of the competition factor caused some disagreement between the Commission and Germany. Both sides agreed, however, that the relevant market consisted of OSB and plywood products. Germany initially provided studies which showed that this market was not in decline. The Commission had doubts concerning those studies because the results hinged on exceptionally strong demand growth for 2000 as compared with previous years. Information was exchanged on several occasions before Germany reduced the notified aid intensity from 35% to 31,5%:

- By letter dated 22 December 2000 (A/40955), Germany notified its intention to grant aid to Kronoply under the 1998 multisectoral aid framework.

- On 3 January 2001 (D/56400) the Commission requested further information. A meeting was held on 11 January 2001 between representatives of the German Government, the Land of Brandenburg, the company involved and the Commission. The German Government provided the requested information by letters dated 9 February 2001 (A/31359) and 20 February 2001 (A/31463). By letter of 9 April 2001 (D/51511), the Commission sent additional questions to which Germany replied on 21 May 2001 (A/34090).

- By letter dated 19 June 2001 (A/34812), Germany reduced the notified aid intensity from 35% to 31,5%.

- By letter dated 5 July 2001 (SG/D/289525), the Commission informed Germany that it had no objections to the aid.

(10) By letter dated 3 January 2002 (A/30013), Germany requested an amendment to the Commission decision. It provided evidence that the growth in demand estimated for 2000 had been achieved and that the market was therefore not in decline. By letter dated 5 February 2002 (D/50463), the Commission refused to amend its earlier decision because the aid had been assessed on the basis of a correct calculation of all the relevant factors. More specifically, the Commission could not amend its decision for the following reasons: the assessment of the competition factor relied on a comparison between the evolution of the apparent consumption of the product in question and the growth rate in manufacturing as a whole during the period 1994-1999 and on a forecast which, at the time of the decision, was correct.

2.2. **Second notification N 609/2003**

(11) An attempt was made with the second notification to achieve the maximum intensity of 35%, which had been rejected previously, by granting additional aid equivalent to 3,5% (or €3 939 947).

(12) Germany argued that the market definition given in the original notification N 813/2000 had been factually wrong and referred to Article 9 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [6] ('Regulation (EC) No 659/1999'), which allows the revocation of a decision under the following conditions: *'The Commission may revoke a decision taken […] where the decision was based on incorrect information provided during the procedure which was a determining factor for the decision.'*

(13) While the relevant market was defined in the original notification as OSB and plywood, Germany claimed that the newly submitted studies showed that the relevant market was more correctly defined as OSB and only certain segments of plywood. Using this new market definition, the relevant market would not be in decline during the period concerned (see point 3.4 of the 1998 multisectoral aid framework) and so the full aid intensity of 35% would have to be approved.

2.3. **Decision to initiate the procedure**

(14) The Commission did not comply with the request by Germany that, on the basis of a different definition of substitutable products, the relevant market should be limited to OSB and certain segments of plywood.

(15) The Commission did not consider a reassessment of the market to be necessary because two fundamental elements were missing, and this gave rise to serious doubts as to whether the aid was compatible with the common market:

- *Lack of incentive:* The Commission expressed serious doubts about the existence of any incentive effect of the notified aid because the investments had already been made. If the aid does not provide any incentive, the derogations laid down in Article 87(3)(a) and (c) of the EC Treaty concerning regional development do not apply.

- *Lack of necessity:* The Commission seriously doubted that aid for investments already made could still be considered necessary to facilitate the development of certain economic activities or of certain economic areas within the meaning of Article 87(3)(a) and (c). In the case in point, the aid intensity of 31,5% was sufficient to trigger the investment.

[6] OJ L 83, 27.3.1999, p. 1; as amended by the 2004 Acts of Accession.

3. COMMENTS FROM GERMANY

(16) Germany insisted that the Commission had to reassess the market in accordance with Article 9 of Regulation (EC) No 659/1999:

- The aid would be granted under the joint Federal Government/Länder scheme for improving regional economic structures, which the Commission approved as a regional aid scheme. The Commission's duty, therefore, was simply to assess whether the measure notified complied with the requirements set out in the approved aid scheme and was compatible with the 1998 multisectoral aid framework. As the aid concerned by the new notification fulfilled all these requirements, the aid measure was clearly investment aid and not operating aid.

- The European Court of First Instance confirmed in its judgment in *Kronoply* ([7]) that it was possible to notify additional aid or a change to existing aid. The Commission could not, therefore, classify the aid in the second notification as operating aid on the grounds that the project had already been completed. Otherwise, the possibility of notifying further aid measures – as confirmed by the Court - would be meaningless.

4. COMMENTS FROM INTERESTED PARTIES

(17) Kronoply insisted that several notifications were possible for the same investment project and supported its line of argument with rulings from several court cases:

- The European Court of First Instance confirmed in *Kronoply* ([8]) that additional aid or a change to existing aid was possible: '*Furthermore, the national authorities cannot be denied the right to notify a measure with which further aid shall be granted or an existing aid measure shall be amended.*'

- A similar opinion was expressed in *Nuove Industrie Molisane Srl* ([9]): '*…the* [Commission] *Decision does not preclude the possibility for the Italian authorities to notify a project to introduce new aid in favour of the applicant, or to amend the aid already granted it.*'

(18) Kronoply also emphasized that the Commission had to assess the new notification on its own merits and advanced two main arguments for this:

- The Commission could not rely on the earlier market assessment because it had been based on a factually wrong market definition.

- Kronoply had no possibility of having the Court review the Commission's original decision because its interests were not affected ([10]).

(19) Kronoply denied that there was any lack of incentives and supported this view with the following main arguments:

- Point 4.2. of the Guidelines on national regional aid ([11]) ('regional aid guidelines') indicates how to test whether there is an incentive. It reads as follows: '*In addition, aid schemes must lay down that an application for aid must be submitted before work is started on the projects.*' Kronoply fulfilled this requirement by applying to the national authorities for aid before the start of the project. Therefore the aid provided the desired incentive and fulfilled the criterion of necessity with a view to promoting economic development within the meaning of Article 87(3)(a) of the EC Treaty.

- Kronoply had consistently applied for an aid intensity of 35%. The reduction in the intensity of the notified aid did not mean that further aid was no longer necessary. As the formal procedure might take up to eighteen months, it was more advantageous for the recipient to receive immediately the part of the aid the admissibility of which was not challenged by the Commission.

5. ASSESSMENT

(20) Having considered the comments submitted by Germany and Kronoply, the Commission maintains the position it took in the decision instituting the procedure, viz. that a reassessment of the market under the 1998 multisectoral aid framework is not necessary because the two fundamental elements of incentive and necessity are missing in the present case.

5.1. No further eligible investment costs within the meaning of the regional aid guidelines

(21) The Commission takes the view that the present notification N 609/03 (dated 22 December 2003) has to be regarded as a separate and second notification of aid for Kronopoly – albeit aid that does not give rise to any new investment or jobs. Consequently, there are no new additional eligible costs within the meaning of the regional aid guidelines that might justify the granting of additional aid.

([7]) Case T-130/02 *Kronoply* v *Commission* [2003] ECR II-4857.
([8]) See footnote 7, paragraph 50.
([9]) Case T-212/00 *Nuove Industrie Molisane Srl* v *Commission* [2002] ECR II-347, paragraph 47.
([10]) See footnote 9, paragraph 41.
([11]) OJ C 74, 10.3.1998, p. 9.

(22) The Commission approved investment aid for Kronoply amounting to €35.4 million in its decision SG (2001) D/289524 of 3 July 2001, which was based on the information provided by the German authorities at the time. It decided not to raise any objections and approved the aid as finally proposed by Germany. The decision was accepted by Germany and Kronoply. The aid was subsequently granted by the German authorities and Kronoply completed its investment project on 31 January 2003.

(23) Only eighteen months after the Commission's final decision – and almost a year after completion of the investment project - Germany provided a new market definition by notification of 22 December 2003 and explained that, on the basis of new studies, the relevant market was more correctly defined as the market for OSB and only certain segments of plywood. As already stated in its decision to open the formal investigation procedure, the Commission will not, under these circumstances, reconsider its previous decision. It takes the view that the submission of a different market definition by Germany cannot be subsumed under Article 9 of Regulation (EC) No 659/1999.

(24) In line with the judgment of the Court of First Instance in *Kronoply*, the Commission considers that it is indeed possible for a Member State to notify, and for the Commission to approve, additional aid or a change to an approved project, or even different tranches of state aid for a given project, provided that both the incentive effect and the necessity of the aid can be established for each tranche. However, Germany did not notify any additional investment projects planned by Kronoply in addition to the already completed project. Besides, the project to be financed had been completed about one year before the new aid project was notified. The Commission has thus come to the conclusion that this second notification was designed simply to achieve the higher aid intensity of 35% rejected previously and that there were no additional eligible costs for which aid of €3 936 947 could be approved and no incentive effect or necessity.

(25) As the Court of Justice of the European Communities ruled in *Germany* v *Commission* ([12]), the Commission has to consider such aid as operating aid because it is granted without imposing any obligation on the part of recipients and is intended to improve the liquidity situation of their undertakings.

5.2. **Incentive effect**

(26) Even though the Commission considers that the foregoing comments are sufficient to show that granting additional aid will not lead to new investments or to any incentive effect, it would like to expand on the concept of incentive effect in response to the comments submitted by Germany and Kronoply.

5.2.1. *Investment process*

(27) Business investment should be seen as a dynamic process. It is important to differentiate between the *ex ante* and the *ex post* stages:

- Companies decide *ex ante* whether or not to undertake an investment, basing their calculations on the expected revenues and costs of the project. If the expected return on the investment project is higher than the required rate of return, they will embark on the project. Regional aid should be an incentive for companies to change their behaviour and to invest in regions in which they would otherwise not invest.

- Once an investment has been undertaken, it is difficult to reverse *ex post* because a substantial part of it goes into specific assets which cannot easily be redeployed. In selling such assets, the seller would lose some of the investment capital.

5.2.2. Ex ante *assessment of the incentive effect under the regional aid guidelines*

(28) Point 4.2 of the regional aid guidelines applies the following test to determine whether or not the aid has an incentive effect: the beneficiary must apply for aid before the start of the project. If this condition is fulfilled, the Commission assumes that there is an incentive effect.

(29) In their comments, Germany and Kronoply claimed that the test in point 4.2 of the regional aid guidelines was met because Kronoply had submitted its aid application before the start of the project.

(30) The test of point 4.2 is designed to check for the incentive effect without unduly delaying the investment. A full analysis of the economic circumstances of the recipient's investment decision might prove very difficult or time-consuming and might therefore hold up the investment and the economic development of the region.

([12]) Case C-288/96 *Germany* v *Commission* [2000] ECR I-8237, paragraph 48.

(31) In assessing the presence of the incentive effect for the additional aid corresponding to 3,5 %, the key question is whether the difference between 31,5% and 35% changed the incentive effect and influenced Kronoply's investment decision:

- Prior to the investment, Kronoply could not know how much aid it would eventually receive since the assessment of the adjustment factors in the 1998 multisectoral aid framework is at the discretion of the Commission. Kronoply was unsure therefore whether it would be granted an aid intensity of 31,5% or 35%. It assumed that the expected intensity would lie between these two values, depending on the probabilities attached to the two possible outcomes. Kronoply based its investment decision on the expected amount of aid.

- The Commission notes that Kronoply decided to undertake the investment even though the precise amount of aid or the aid intensity was not known. Moreover, Kronoply completed the investment after an aid intensity of 31,5% was approved. It was, therefore, clearly prepared to take on the risk attaching to an aid intensity of only 31,5%.

- The fact that Kronoply met the test of point 4.2 of the regional aid guidelines does not therefore mean that the expectation of these extra 3,5 percentage points provided an incentive effect.

5.2.3. Ex post *assessment of the incentive effect on the basis of the facts*

(32) Instead of examining even more closely the *ex ante* decision of Kronoply, the Commission considers it more appropriate to rely on the facts. It is apparent that Kronoply decided to invest and continued its operations after having been granted an aid intensity of only 31,5%. The investment project was completed as originally planned. Kronoply did not scale down the investment project in response to the lower aid intensity.

(33) Whether further aid is granted or not, Kronoply will not change its behaviour: There is no indication that further aid will induce it to increase production or enlarge its production facilities. As the investments have already been carried out, there is also no reason to assume that Kronoply will shut down production if it does not receive any more aid.

(34) Accordingly, the Commission has come to the conclusion that granting further aid of 3,5% will not provide any incentive effect.

(35) As stated in the decision to initiate the procedure, for aid measures to help promote the development of certain economic activities or of certain economic areas within the meaning of Article 87(3)(a) and (c) of the EC Treaty, they must act as an incentive. If, as in the case in point, the investments have already been carried out, the aid provides no such incentive and does not lead to new investment or job creation. Therefore the Commission is not in a position to justify the aid because of an increase in new investment or job creation within the meaning of Article 87(3)(a) and (c). It again concludes that the additional aid of €3 936 947 constitutes operating aid.

5.3. **Necessity**

(36) As regards the statements in the decision to initiate the procedure, the Commission considers that the principle of necessity derives directly from the logic of state aid control. It can declare aid compatible with Articles 87(2) and (3) of the EC Treaty only if it can establish that the aid contributes to the attainment of one of the objectives specified, something which, under normal market conditions, the recipient firms would not achieve by their own actions. This is in accordance with the Commission's standard practice, as confirmed by the Court of Justice of the European Communities in *Philip Morris* ([13]).

(37) As explained in paragraphs 26 to 35, the planned aid does not provide any incentive for new investment or job creation. It does not require from the recipient any *quid pro quo* or any contribution to an objective of common interest. Therefore, it is operating aid which covers current costs that Kronoply itself must normally bear.

(38) Point 4.15 of the regional aid guidelines normally prohibits operating aid. Exceptionally, however, such aid may be granted in regions eligible under the derogation in Article 87(3)(a) provided that (i) it is justified in terms of its contribution to regional development and its nature and (ii) its level is proportional to the handicaps it seeks to alleviate. Germany has not demonstrated the existence of any handicaps or shown how the additional aid is to contribute to regional development.

(39) It is evident from the facts that any further aid is not necessary because Kronoply decided to continue its operations even after only the lower aid intensity of 31,5% was approved. This means that Kronoply runs a viable economic operation or that, in any event, it does not need any more aid. At this stage, any further aid would provide a windfall profit for Kronoply.

([13]) Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671.

(40) The Commission concludes therefore that, in the present case, the aid is also not compatible with Article 87(3)(a) of the EC Treaty because it is not necessary for regional development.

(41) Lastly, it will be examined whether the derogations in Article 87(2) and (3) are applicable:

- The derogations in Article 87(2), which concern aid of a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences and aid granted to compensate for the economic disadvantages caused by the division of Germany, do not apply in this case.

- The aid cannot be considered as aid for a project of common European interest or to remedy a serious disturbance in the German economy, as provided for by Article 87(3)(b). Nor does it have as its object the promotion of culture and heritage conservation, as provided for by Article 87(3)(d).

- Article 87(3)(c) provides for the approval of aid to facilitate the development of certain economic activities or of certain economic regions, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest. As the aid has been found to be incompatible with Article 87(3)(a) because it neither provides an incentive effect nor is necessary, the aid cannot be declared compatible with Article 87(3)(c) for the same reasons.

6. **CONCLUSIONS**

(42) The Commission concludes that the notified aid constitutes state aid within the meaning of Article 87(1) of the EC Treaty. As the aid neither provides any incentive effect nor is necessary, none of the derogations in Article 87(2) or (3) apply. The aid therefore constitutes incompatible operating aid and may not be implemented,

HAS ADOPTED THIS DECISION:

Article 1

The state aid which, according to notification N 609/2003, Germany is planning to implement for Kronoply, amounting to €3 936 947, is incompatible with the common market.

The aid may accordingly not be implemented.

Article 2

Germany shall inform the Commission, within two months of notification of this decision, of the measures taken to comply with it.

Article 3

This decision is addressed to the Federal Republic of Germany.

Done at Brussels, 21 September 2005.

For the Commission

Neelie KROES

Member of the Commission