

7TH MEETING OF THE EXPERT GROUP ON THE CPR FUNDS (CPR EXPERT GROUP)

ONLINE MEETING – 29 NOVEMBER 2022 (10:00 – 13H00)

WORKSHOP STATE AID –

COMMISSION’S AUDIT FINDINGS, LESSONS LEARNED, GOOD PRACTICES

SPEAKER	REGIO-DAC.7
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DISCLAIMER

This working document was prepared by/expresses the view of the Joint Audit Directorate for Cohesion (DAC) and does not commit the European Commission. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law.

LEGAL BASIS

The basic principles of State aid stem from Articles 107 and 108 of the Treaty for the Functioning of the European Union (TFEU).

The *de minimis* Regulation

COMMISSION REGULATION (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid.

The **General Block Exemption Regulation (GBER)**

COMMISSION REGULATION (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, which applies as of 1 July 2014. The GBER features a wide range of types of compatible aid relating to a variety of sectors.

1. DE MINIMIS THRESHOLD

Important concepts

The *de minimis* Regulation exempts small aid amounts from the scope of EU State aid control because they are deemed to have no impact on competition and trade in the internal market. This Regulation allows small amounts of aid - less than € 200,000 (€100,000 in the road transport sector) over three fiscal years - to be given to an undertaking for a wide range of purposes.

The total amount of *de minimis* aid granted per Member State to a single undertaking shall not exceed € 200,000 over any period of three consecutive fiscal years. The restriction applies to aid granted by the MS as a whole. Undertakings may have received *de minimis* aid under different programmes, possibly from local authorities, as well as central government. The *de minimis* aid ceiling applies to all such aid.

Undertaking is not limited to a single company in receipt of aid. A single undertaking includes all enterprises that have at least one of the relationships with each other as set out in Article 2(2) of the *de minimis* Regulation. Undertaking may apply to a business group. An undertaking or firm that is part of a larger group may need to include staff headcount/turnover/balance sheet data from that group too.

Finding 1.1 Insufficient audit work on GBER and de minimis

Insufficient audit work on GBER and de minimis (system finding). Out of 35 operations audited by the AA, at least 27 have a State aid component (13 GBER and 14 de minimis). The audit work performed by the AA on these State aid components was not sufficient. In case of State aid falling under the GBER exemption, the incentive effect and the size of the undertaking (crucial information for the intervention rate) were not verified. In case of de minimis, for instance no self-declarations were obtained from the beneficiaries, demonstrating that the aid obtained over the last 3 fiscal period is less than €200.000. The Commission auditors found that the AA consistently completes the

State Aid checklist but that AA staff did not always provide any further comments, justifications or references to supporting documents to substantiate work done.

Finding 1.2 De minimis threshold exceeded, no Gross Grant Equivalent

De minimis threshold exceeded, no calculation of Gross Grant Equivalent (project finding). The certified amount for this project is an advance payment. The call for proposals indicates de minimis aid. The project aimed at supporting enterprises for internationalization. The beneficiary provided (in kind) the business partners with training services, mission organizations, B2B meetings, market research. The business partners had to present a de minimis self-declaration at the moment of the partnership application, listing the de minimis aid that they had already received. The MA did not verify any other information and did not explain (the methodology used for the calculation of) the gross grant equivalent. The AA only verified that the businesses were still registered as indicated in the application form and whether a self-declaration existed. The MA did not provide further explanations and due to the in-kind nature of the aid received by the partners, it is unclear if and how the MA verified the respect of the de minimis ceilings.

Finding 1.3 De minimis ceiling at the level of “single undertaking”

De minimis ceiling at the level of “single undertaking” (project finding). Project X supports the installation of cable extensions to connect four berths to the local grid network and to enable up to four developers to generate electricity to shore at any one time. These developers/beneficiaries use Project X to test their wave energy devices to demonstrate commercial viability and bring their technology to the market. One of the outputs of the operation is the number of enterprises receiving support. Public aid received by the project is passed to the developers of the project.

During an audit of the operation, the AA concluded that aid had arisen as a result of the non-financial support provided to developers/beneficiaries. Independently of the presence or not of State aid at the level of beneficiary, developers can indeed receive State aid. The grant recipient has taken steps to retrospectively manage this state aid under the de minimis regulation. This included issuing letters to some developers/beneficiaries with the amount of de minimis aid received and obtaining de minimis declarations from the developers/beneficiaries.

For one of the developers/beneficiaries, DB-X, the notification letter indicates the value of the aid received – for - and further states “This aid can be in addition to the aid you have received under the General Block Exemption Regulation for the Project Y part funded by the XYZ ESIF Programme”. Project Y is an ERDF funded operation that ran from April 2016 to March 2018 with an ERDF funding of € xxx. The grant recipient of this operation, DB-X is a wholly owned subsidiary of DB-Y.

As a consequence, DB-X and DB-Y are to be considered as a ‘Single undertaking’ as provided for Article 2(2) of the de minimis regulation. De minimis conditions are therefore to be assessed at the level of the single undertaking. There is no evidence in the audit file that this was done.

The AA confirmed that DB-X were in receipt of the assistance. The declaration was therefore for DB-X (the sole subsidiary). I would suggest that the letter was therefore formally declaring for that company/entity alone. However, the letter was addressed to the CEO of DB-Y which may indicate more of a perspective of the group position with regard to aid. The letter also indicates that Project X had a good oversight of other aid from the Member State. While the risk is considered low, it is not 100% clear whether the confirmation is made at the level of the ‘single undertaking’.”

The Commission auditors found that the AA cannot confirm that the declaration made by the developer/beneficiary DB-X is at the level of the 'single undertaking' (i.e., DB-X and DB-Y). Therefore, there is no evidence that the de minimis ceiling was not exceeded.

2. AID INTENSITY

Important concepts

'Aid intensity' (Article 2 and 7 GBER) means the gross aid amount expressed as a percentage of the eligible costs, before any deduction of tax or other charge.

Finding 2.1 Lack of justification to increase the State aid intensity

Lack of justification to increase the State aid intensity (system finding). Calls A and B allow for an increase of aid intensity under GBER Article 25(6)(b)(ii). State aid intensity can be increased by 15%, if the beneficiary commits to widely disseminate research results through conferences, publication, open access repositories, or free or open source software. The Commission auditors did not obtain any evidence that the MA/IB checked this aspect for the five R&D projects audited under PA2, all of which made use of this increase. Also, there was no evidence demonstrating how the beneficiaries complied with this requirement. The 15% increase of intensity was accepted in all cases when the beneficiary replied 'yes' to the relevant question in the project application (simple box ticking exercise).

Following the audit, additional information and documents were requested for Project X to justify the 15% increase. The MA explained that the product will be marketed through product channels (large supermarkets) already used for other products of the beneficiary. Channelling products in the retail market is a commercial activity but this cannot be considered as dissemination of research results. The MA also referred to Annex 11 of the grant contract (communication plan), which sets out the compulsory publicity activities and aims to fulfil the conditions required by Commission Implementing Regulation (EU) No 821/2014. However, this plan is not about R&D activities and results and it cannot be considered as a justification for the increased aid intensity. Finally, the MA concluded that the wide dissemination of the project result can be verified only during an on-the-spot check after the project is completed.

Out of the five projects, one (Project 1) was completed and an on-the-spot check was carried out. Commission auditors reviewed the report with documents and photos. The report did not include questions or references, which would indicate that the fulfilment of the commitment generating 15% higher aid intensity was verified. As to communication, the MA only checked that the publications required in Annex 11 of the grant contract (see above) were made.

The Commission auditors concluded that the 15% increase of State aid intensity was not justified.

As regards acceptable dissemination activities, the relevant GBER article mentions conferences, publication, open access repositories, or free or open source software. As to the quality of such activities, the Commission practice indicates that the way results have to be disseminated should be in line with the standards of R&D&I publications of the scientific community.

The Commission auditors are of the opinion that the MA has not demonstrated having adequate rules for the verification of the fulfilment of GBER Article 25(6)(b)(ii). The projects did not comply with the conditions of the GBER to benefit from the 15% increase.

3. INCENTIVE EFFECT

Important concepts

The '*Incentive Effect*' (Article 6 GBER) requirement is a frequently found cause of error. Aid shall be considered to have an incentive effect if the beneficiary has submitted a written application for the aid to the Member State concerned before work on the project or activity starts. All GBER funded operations must demonstrate an incentive effect, which tests that the State aid is being used to leverage a change in behaviour by the beneficiary. An operation which has already been started or where all the necessary funding is already in place prior to the application will not be able to demonstrate the required incentive effect.

Finding 3.1 Ineligible project, no incentive effect

Ineligible project due to absence of incentive effect (project finding). The project concerns the acquisition of production equipment in order to allow the beneficiary to use a new methodology for refining fat, creating higher added value, for the production of flours for animal feed. It also includes the construction works needed in order to accommodate the equipment.

The beneficiary accepted the offers prior to the submission of the project application. A legally binding commitment existed between the beneficiary and the supplier of the equipment. This is a firm commitment and should be regarded as the start of works in line with Regulation 651/2014. Consequently, the investment cannot be considered to have an incentive effect and hence the project is ineligible.

The suppliers provided self-declarations stating that the contract can be cancelled at any time by the beneficiary, without any financial penalties being applied. The supplier however only signed the declaration for the supply and assembly of the equipment on 14 November 2017, 14 months after the application date, and more than 20 months after the confirmation of the order.

4. OTHER FINDINGS

Finding 4.1 Various State aid issues

Various State aid issues (project and system finding). The Commission auditors found that 11 of the 16 projects selected for audit contain a State aid or potential State aid component, for which checks made on the existence or the absence of State aid and compliance with State aid rules were not demonstrated / documented.

For 3 projects State aid was explicitly mentioned in the grant agreement (all projects for which the MAs/IBs considered there is a State aid component) but the State aid regime referred to was wrong. For two projects there is no audit trail and evidence for the SME status of the beneficiaries. For two

projects under a Commercialisation fund scheme the auditors found a State aid component i.e. a scheme referred to as “applied research that may lead to licensing agreements and spin-out”.

In relation to the XYZ programme schemes, the Intermediate Body (IB) had a working document explaining that all projects since 2017 are set within the framework for State aid for research and development and hence XYZ excluded the existence of State aid. XYZ informed that State aid does not need to be checked project by project. The auditors consider that State aid needs to be checked at the level of each project.

The management verification checklist used by the MAs and IBs contains two questions to assess State aid. These questions are considered insufficient to assess compliance of the operation with State aid rules. The replies to these questions would not constitute a sufficient audit trail to prove the presence of State aid and the fact that all conditions under the applicable State aid regime are met or that State aid is absent.

State aid verifications are performed at scheme level and through overarching management verifications which cover one, two or even more calendar years of expenditure of unspecified projects. Consequently, the compliance of these projects with State aid rules cannot be assessed. The auditors consider that for each project a proper assessment of compliance with State aid rules should be made. For instance, if the aid is granted under GBER, the checklist should indicate the applicable article and should include a proper audit trail to demonstrate that all conditions set are met.

The auditors conclude that for the projects mentioned above, the audit trail does not demonstrate that State aid at the level of the beneficiary or at the level of the enterprise in case of collaborative research, meets all conditions set under respectively either GBER, or Framework for State aid for research and development. If State aid is claimed to be absent, the audit trail does not demonstrate that the conditions for the absence of State aid are met.

Finding 4.2 No AA review of potential State aid issues

No AA review of potential State aid issues (project finding). Projects X and Y cover the Apprenticeships programme of the Member State concerned, respectively for Region X and Region Y. The AA concluded in the planning stage of the audit that the Apprenticeship Programme’s funding did not constitute State Aid. This conclusion was based solely on the Sponsor’s qualification of the Programme (“no State Aid”), but not substantiated by further analysis. However, the training costs funded by the Apprenticeship programme might constitute State Aid to the employers of the apprentices. First, the employers of the apprentices are engaged in economic activities. Secondly, the programme is fully financed with public funds (ESF and Member State funds). Next, the programme confers an advantage to the employers of apprentices. These businesses benefit from the training costs paid by the Apprenticeships programme. Also, the aid is selective. Only businesses in the Member State concerned are eligible. Finally, the aid can potentially affect trade between EU Member States. The training aid might strengthen the competitive position of those businesses in the Member State concerned.

The AA did not perform any further review or analysis of potential State Aid issues for this Programme. The AA just referred to the Member State Government’s State Aid unit that considered it unlikely that State Aid issues would arise in relation to Apprenticeships. No further analysis was available. No measures were taken to ensure that the conditions for de Minimis aid were fulfilled. No

assessment was made to verify whether the Apprenticeships programme complied with the GBER ((EU) N° 651/2014), more in particular with the provisions for Training Aid.

Finding 4.3 Project not compatible with State Aid rules

Project not compatible with State Aid rules (project finding). The objective of this operation was the construction of a tunnel leading to the Port of Town XYZ and rearrangement of the urban space in the vicinity of the port. The operation was implemented through one contract. It was co-financed under priority axis 15 ‘reduction of additional costs hindering the outermost regions development’ and under investment priority 12a: ‘freight transport services and start-up aid for transport services. This is indication of an ‘economic activity’. The operation was treated as an autonomous project but was in fact part of a larger investment plan aimed at revitalising the urban area and reorganising the traffic flows in Town XYZ. The specific objective of the operation is to segregate cargo traffic from passenger traffic to and from the Port of Town XYZ. This traffic segregation was also for safety reasons. The project consists of a junction and an access road to the Port, both underground. The developer of the access road is the Port Authority, which also operates the port infrastructure on a commercial basis. On 7 September 2016, the Port authority applied for ERDF co-financing. The IB assessed the project as not involving State aid. It considered that the public financing was aimed at increasing the security of port operations and would therefore not constitute an economic activity subject to State aid rules. In addition, it considered that the project would not distort or threaten to distort competition, since the conditions of access to the infrastructure would be the same as without the service tunnel. Finally, the IB considered that the operation is not subject to Article 107(1) TFEU, as it is part of the global operation ‘ABC’, not constitutive of State aid.

Based on the information obtained during the audit, it is unclear:

- whether access to the tunnel is subject to fees,
- whether or not the passenger and cargo traffic had been already segregated with direct connection between the town and the Port before the project in question had been realised. In other words, it is not clear whether or not the port vehicles could have reached the port area by one of the already segregated roads for passengers or cargo,
- what is understood under ‘port vehicles’ and whether or not the service road is open to all cargo operators or if it is reserved for Port Authority vehicles only. There is no information in the file indicating that the project will be administrated as a service of general economic interest.

Finding 4.4 Beneficiary not a research organisation

Beneficiary is not a research organisation (GBER) (project finding). The project comprises works to install four subsea power cable extensions at the project for the XYZ offshore deployment site (Project X) and connect them to the existing XYZ subsea infrastructure (four berths to test advanced wave energy devices). The grant recipient of the operation, Company A, is a private company limited by shares. It is considered by the MA and the AA as a research organisation as defined in the framework for State aid for research and development and innovation (2014/C198/01) (hereinafter, ‘the framework’).

The authorities based their conclusions on a legal opinion from a law firm hired by the grant recipient. In its State aid advice, the law firm considered that “*Company A is a research organisation in*

accordance with the Commission's Communication Framework State aid for research and development and innovation (2014/C198/01). At least 80% of its annual capacity will be expended on non-economic activities, with the remainder of its annual capacity taken up by economic activities that are ancillary to the non-economic activities". However, the Commission auditors did not find an assessment on how WHL meets the conditions for a research organisation.

Neither the MA during the appraisal of the operation, nor the AA during the audit of the operation, questioned the correctness of the law firm's legal advice. During the appraisal process, the MA concluded that *"(...) the advice appears compliant. In essence the legal opinion does not identify any State aid to the applicant or any other beneficiary or partner"*. The AA analysed the law firm's legal advice and considered reasonable to qualify Company A as a research entity in accordance with the framework, without further assessment.

Based on a comprehensive analysis, the Commission auditors considered that:

- The project is not a research project as in Point 15(cc) of the framework, as it concerns the installation of subsea cables. Such activity cannot qualify as fundamental research, industrial research and experimental development, and has no innovative character as pointed out by the MA at the time of its appraisal.
- The grant recipient cannot be considered as a research organisation in accordance with the framework for State aid for research and development and innovation. Neither the object of the grant recipient nor its activities qualify as almost exclusively non-economic. There is no evidence in the financial statements of the grant recipient that the costs, funding and revenues of the economic and non-economic activities are separated. Therefore the applicability of the "ancillary" approach of the economic activities is not relevant in this case.
- The law firm did not perform a critical assessment of the research organisation status of the grant recipient nor did the MA and AA.
- The aid should therefore have been notified and its compatibility should have been assessed. As the aid has not been notified to the Commission services, the aid is therefore considered unlawful and all the expenditure declared for this operation is considered ineligible.