Flemish region authorized to participate in the capital increase of the R&D company OCAS

Christophe GALAND, Directorate-General Competition, unit H-1

On 20 October 2004, the Commission authorized the region of Flanders, Belgium, to participate to the capital increase of O.C.A.S, whose initials stands in Dutch for Research Centre for the Application of Steel. Up to that date the company was a 100% subsidiary of the steel group Arcelor. Within the latter, OCAS was charged with research and development in the flat carbon sector with a specialisation on application for the automotive sector.

Arcelor wished to transform OCAS from an automotive-focused centre to a general-industry dedicated centre. This meant a shift from a concentrated to a highly fragmented customer base, requesting a more client oriented approach. Consecutively and in parallel, Arcelor planned to transform OCAS from a research department fully financed by the group to a profit centre, which means a more autonomous company responsible to generate its own revenues.

The new business plan of OCAS comprises three main fields of activities:

(1) First, OCAS will continue to carry out research for the Arcelor group, its main activity up to now, but will start to charge the latter for this service. The price will cover the costs incurred increased by a profit margin.

(2) Secondly, OCAS will start to offer R&D services to third parties, more precisely steel-using companies. OCAS has indeed at its disposal very specialized staff and infrastructure which allow it to become a competitive provider of R&D services in this field. These services will be charged to the client.

(3.a) Thirdly, OCAS will start to undertake research activities for its own account.

(3.b) The business plan foresees to value the results of this activity by means of licences sold to third companies or through the creation of spin-off companies responsible to bring niche products to the market and organise appropriate selling.

In order to realize this ambitious business plan, the company needs additional equity. The first two activities mentioned above do not require a lot more equity than OCAS had until now at its disposal. Indeed, these activities mainly use existing infrastructure. In addition, they generate continuous revenue from the clients, limiting the need for increased working capital. Conversely, the launch of the third activity will require a lot of fresh capital. Indeed, research activities require years of investment before being able to generate the first revenues from it. Moreover, as the outcome of research is uncertain, the risk of this activity is very high and a buffer in the form of additional capital is required.

The Flemish region notified its participation in the capital increase of OCAS not as an aid but for the sake of legal certainty. Indeed it considered that its investment would be acceptable for a normal market economy investor, as the outlook for profit was sufficiently promising. In addition, Flanders underlined that a private sector company, namely Arcelor, was participating in the same capital increase, buying the other half of the new shares.

The Commission undertook a detailed analysis of the case. It first verified whether or not the investment of the Flemish government fulfilled the definition of State aid under Article 87 (1) of the EC Treaty. It came to the conclusion that the profit forecasts were not precise and high enough to conclude that this investment would generate a return which was sufficient to remunerate the high risk endured. The importance of the risk follows from the kind of activities undertaken and the turn the project represents compared to current organisation. The comparison of the investment with the one of a private sector company was not considered as applicable because the company, Arcelor, is able to benefit from its investment by other means than the mere dividends and capital gains.

The two first activities included in the business plan, R&D services for Arcelor and third parties, were deemed to contain few or no elements of aid. Indeed, these services will be charged to the clients on the basis of the costs increased by a profit margin. They therefore have the potential to be profitable and should not create any advantage for the clients. On the other hand, the third activity that OCAS would like to develop, namely own R&D activities and valorisation of it, which should
consume the majority of the financial resources collected, was more problematic. Indeed, a provision of the shareholders agreement provides that the Arcelor group can use for free the intellectual property developed by OCAS, while all the other companies will of course have to pay. Even if this provision is the counterpart of the access of OCAS to the know-how of the Arcelor group, the Belgian authorities were not able to prove that this does not represent an advantage to Arcelor. The Commission therefore concluded that the participation of the Flemish region to the capital increase of OCAS, which will mainly be used to finance the own research activities of OCAS (3.a here above), creates an advantage to Arcelor through the free access of this group to the result of these activities. However, the creation of spin-offs in order to value the result of the research activity as described under 3.b was considered as free of aid. Indeed, Arcelor, main shareholder of OCAS, can not derive any advantage from the activity of the spinoffs other than the mere financial return, as it generates no or few intellectual property. Therefore, this private sector company will authorise the creation of such spin-offs only if the profit outlook is sufficient, which implies that there is no aid element included in the simultaneous provision of capital by the Flemish region to these spin-offs.

Given the conclusion that the participation in the capital increase of OCAS represented, State aid in favour of Arcelor as far as activity 3.a is concerned, the Commission services analysed its compatibility with the Treaty and came to the conclusion that it was compatible under the R&D guidelines since the research activities at stake represent additional research for Arcelor compared to the ones normally undertaken. Indeed, these latter, included in the first activity of OCAS, will be charged to Arcelor and were deemed to contain no aid. In addition, the State intervention has a real incentive effect. As this ambitious project to transform OCAS requires a lot of resources and presents a high level of risk, it is unlikely that it would have been undertaken without public support. Thirdly, given the fact that Arcelor owns the current shares of OCAS and will contribute to half of the capital increase, the aid intensity in favour of OCAS derived from the public participation to the capital increase will in any case remain below the level of 50% authorised for industrial research.

This case illustrates that public measures promoting innovation and competitiveness of the European industry can, if correctly designed, be approved by the Commission on the basis of the existing guidelines.