EUROPEAN COMMISSION

Brussels, 28.10.2009
C(2009)8131 final

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 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, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		**PUBLIC VERSION** **WORKING LANGUAGE** **This document is made available for information purposes only.**

Subject: State aid C 31/2009 (ex N 113/2009) – Hungary – LIP – Aid to Audi Hungaria Motor Kft.

Sir,

The Commission wishes to inform Hungary that, having examined the information supplied by your authorities on the aid measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

1. PROCEDURE

(1) By electronic notification registered on 26 February 2009 at the Commission (SANI 2334), the Hungarian authorities notified their intention to grant regional aid under the Guidelines on national regional aid (hereinafter "RAG")[1] to Audi Hungaria Motor Kft. for its investment project in Győr in the Western Transdanubia (Nyugat-Dunántúl) region of Hungary.

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1 OJ C 54, 04.03.2006, p. 13.

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(2) By letters of 21 April 2009 (D/51611) and 21 August 2009 (D/53595), the Commission requested supplementary information on the notified aid measure. The Hungarian authorities submitted the requested additional information by letters registered at the Commission on 29 June 2009 (A/15528) and 17 September 2009 (A/20041).

2. DESCRIPTION OF THE PROJECT AND THE AID MEASURE

(3) The Hungarian authorities intend to promote regional development by providing regional aid in the form of a direct grant and a corporate tax allowance to Audi Hungaria Motor Kft. (hereinafter "Audi Hungaria") for the establishment of manufacturing facilities for the production of a new generation of engines in Győr.

2.1. The beneficiary

(4) The beneficiary of the aid will be Audi Hungaria, a subsidiary of the Germany-based Audi AG, which itself is a member of the Volkswagen Group (hereinafter: "VW-Group"). VW-Group is seated in Wolfsburg and its business is divided into two divisions: the Automotive Division and the Financial Services Division. The Automotive Division manufactures various car brands, whilst the Financial Division includes vehicle financing and insurance.

(5) The car brands belonging to the VW-Group are Audi, Bentley, Bugatti, Lamborghini, Seat, Skoda, Volkswagen and Scania. Each brand is present on the market as an individual unit, in the form of subsidiaries. The VW-Group manufactures cars ranging from small cars to luxury and commercial vehicles.

(6) The group operates a total of 44 factories in 12 European countries and six additional countries in America, Asia and Africa. In 2008, it produced 6.44 million vehicles and employed a workforce of over 369,928 people; revenues totalled EUR 113,808 million.

(7) VW-Group has around […][*] manufacturing and/or sales joint venture agreements. In addition to own sales and sales through joint ventures, VW-Group also outsources a limited part of its sales to third parties. In this context the VW-Group concluded […] marketing / commercial agreements with third parties. The Hungarian authorities confirm that the submitted market share data include all vehicles manufactured and/or sold through joint venture agreements, through outsourcing or business agreements.

(8) Recently the supervisory boards of Volkswagen AG and Porsche SE have agreed on the foundation of an integrated car group (hereinafter: "VW-PO-Group")[2]. It is expected that the merger, which will require the approval of both companies'

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* Business secret

2 See the official communication at: http://www.porsche-se.com/pho/en/investrorelations/adhocreleases/

shareholders, will be completed in the course of 2011. As shown below, this fact is taken into account in the calculation of market share data.

(9) Audi Hungaria was established in Győr in 1993 as a 100 % subsidiary of Audi AG and it has since become one of the strategically most important sites of Audi AG. In 2008 it employed 5,879 persons, while revenues totalled EUR 5,607 million. The main products of Audi Hungaria are engine components and engines for cars sold almost exclusively within the VW-Group. It offers four to ten cylinders Otto and diesel engines to nearly every model of the brands of the VW-Group.

2.2. The investment project

(10) Audi Hungaria will produce new generation engines, running from 4 to 12 cylinder petrol and diesel engines. These engines will have significant novelties, such as a new Audi valve lift system (AVS), direct fuel injection, reduced internal friction, reduced fuel consumption and reduced emission levels. The engines produced will be built into cars belonging to segments A00, A0, A, B, C, D and E on the basis of the segmentation standards set by POLK.[3]

(11) As a result of the investments, Audi Hungaria will start the production of new engine components […] not manufactured before. These components were previously purchased from external suppliers or from other suppliers within the VW-Group.

(12) Moreover, as a result of the investment, the plant in Győr will have an additional production capacity of approximately [100,000 – 250.000] new engines per year. In particular, the production capacity of the 4 and 6 cylinder […] engines will increase. In addition, a new generation of 4 and 6-cylinder […] engines, as well as 8 and 10-cylinder […] engines will be introduced as well, although overall production capacity for these types of engines will not increase.

Table I: Capacity increase

Engine	*Capacity per day*	
	2006	*2012*
[…] 4-cylinder […] engines	*[…]*	*[…]*
[…] 4-cylinder […] engines	*[…]*	*[…]*
V6-cylinder […] engines	*[…]*	*[…]*
V6-cylinder […] engines	*[…]*	*[…]*
V8/V10-[…] engines	*[…]*	*[…]*
V12-cylinder engines	*[…]*	*[…]*
k ***Total capacity***	***[…]***	***[…]***

(13) Furthermore, Audi Hungaria will implement the production of technically new components as well. In terms of technically new components, the most important

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3 POLK, along with Global Insight, is one of the major service providers analysing the car market.

and most innovative novelty is the introduction of the new AVS camshafts. This is the first system to integrate the complete valve adjustment mechanism into the rotating and the stationary valve control components. AVS is of strategic importance since it is a unique technology affecting the production of all petrol engines manufactured by Audi Hungaria. It will result in a 7% decrease in fuel consumption and in less harmful emission. In addition, with this investment Audi Hungaria also begins the production of V12-cylinder diesel engines.

(14) Whilst the production depth will be extended as described above, new mechanical machining technologies will be introduced in the existing component production that enables the production of components with entirely new features. […].

(15) The project involves investments in land, buildings, machinery, equipment and vehicles enabling the production of new engine components and engines. As regards machinery, new production lines will be purchased and existing lines will be equipped with new tools that will fundamentally change the features of these lines to guarantee the new characteristics of the produced components. Hungary confirmed that no used or existing equipment forms part of the eligible expenditure. The land was purchased from private individuals at market price and does not constitute state aid.

(16) According to the Hungarian authorities, the investment is divided into two sub-projects: the first of these, […] consisted in installing production lines for new generation 4 cylinder […], 6 cylinder […] petrol engines and 6 cylinder […] diesel engines. […]. The Hungarian authorities therefore take the view that sub-project 1 can be considered as a pilot-project which facilitates obtaining the necessary experience and know-how before starting the second, larger scale project.

(17) In the second sub-project, running from[…], the production lines for more complex and/or higher performance engines will be established. […].

(18) The Hungarian authorities consider the two sub-projects to form part of the same single investment project within the meaning of the RAG.

(19) The overall investment project – consisting of sub-project 1 and 2 – started in September 2006. The planned date of completion is December 2011. Full production for the project is expected in 2012. This timeline is represented in the table below.

Table II: Timing of the investment project

	Start of project	*End of project*	*Full production*
Project	*17.09.2006*	*31.12.2011*	*2012*
Sub-Project 1	*[…]*	*[…]*	
Sub-Project 2	*[…]*	*[…]*	

(20) Audi Hungaria presented its investment plans in a general application for aid to the Hungarian Government on 15 September 2006, i.e. two days before the start of works on sub-project 1. By letter of 26 September 2006 the Hungarian authorities confirmed that Audi Hungaria will in principal be entitled to obtain direct grant and corporate tax allowance as incentive for the realisation of the investments.

(21) After lengthy negotiations, the Hungarian authorities decided on the direct grant on the basis of a subsidy agreement with the beneficiary on 17 December 2008. The application for the tax allowance was submitted by the beneficiary to the Hungarian authorities on 31 October 2007. The decision on the tax allowance is pending awaiting the Commission's clearance.

2.3. Costs of the investment project

(22) The project's total estimated investment costs in nominal value amount to HUF […] million (EUR […] million[4]). The total eligible investment costs of the project are HUF 154,092 million (EUR 513.61 million) in nominal value. In present value[5] this amount is HUF 153,396 million (EUR 511.28 million). Table III provides a breakdown of the total eligible costs of the project and the sub-projects by year and category.

Table III: Eligible investment costs (HUF million)

Detailed breakdown of the eligible costs in nominal value (HUF million)

	Sub-Project 1			***Sub-Project 2***						***TOTAL***
	2006	***2007***	***Total***	***2007***	***2008***	***2009***	***2010***	***2011***	***Total***	
Land	*[…]*	*[…]*	***[…]***	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	***[…]***	***[…]***
Building	*[…]*	*[…]*	***[…]***	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	***[…]***	***[…]***
Machinery/ Equipment	*[…]*	*[…]*	***[…]***	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	***[…]***	***[…]***
Vehicles	*[…]*	*[…]*	***[…]***	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	***[…]***	***[…]***
Total	***[…]***	***[…]***	***[…]***	***[…]***	***[…]***	***[…]***	***[…]***	***[…]***	***[…]***	***154,092***

(23) The Hungarian authorities confirm that no aid will be requested for used equipment, and that any such equipment is not included in the eligible expenses

4 Figures expressed in EUR are given in this decision on the basis of an exchange rate of 300.02 HUF/EUR, applicable at the time of notification.

5 The present values in this decision are calculated on the basis of a discounting rate of 11.01 %, applicable at the time of notification. The base year for discounting purposes is 2009, i.e. the year of notification.

for the project. It should be noted in this respect that parts of the new production lines will be based on the existing production lines of the Győr production facility. However, in this case only the technical adaptation and refurbishment costs (for example, costs of new supplementary parts) are included in eligible costs, and not the costs of production line elements which are re-used.

(24) The Hungarian authorities indicate that immaterial assets are not included in the total eligible costs.

(25) Both the direct grant and the tax allowance are granted under the condition that the beneficiary will maintain the investment in the assisted region for a minimum period of five years after the completion of the investment project.

2.4. Financing of the investment

(26) The Hungarian authorities confirm that the own contribution by the beneficiary exceeds 25 per cent of the eligible costs, which is free of any public support.

2.5. Regional aid ceiling

(27) Győr is situated in the Western Transdanubia (Nyugat-Dunántúl) region, which is an assisted area in virtue of Article 87(3)(a) of the EC Treaty with a standard regional aid ceiling for large enterprises of 30 per cent Gross Grant Equivalent (GGE) according to the Hungarian regional aid map 2007-2013[6].

2.6. Legal basis

(28) The indicated national legal basis for the financial support to Audi Hungaria under existing aid schemes is the following:

a. The Ministry of Economy and Transport will give a grant on the basis of the aid scheme XR 47/2007[7] (predecessor: HU 1/2003 aid scheme) which is exempted pursuant to Commission Regulation (EC) No 1628/2006[8] (hereinafter: "RAG BER"). This scheme has as its legal basis "Government Decree 8/2007 (I. 24.) of the Minister of Economy and Transport on Investment Subsidies Granted by Individual Government Decision".

b. The Ministry of Finance will grant a tax allowance based on the scheme “Development Tax Benefit” N 651/2006 (predecessor: HU 3/2004 aid scheme)[9]. This scheme was established by “Act LXXXI of 1996 on Corporate Tax and Dividend Tax” and by "Government Decree 206/2006 (X.16.) on Development Tax Benefit".

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6 Commission decision of 13.09.2006 State aid N 487/2006 – Hungary – Regional aid map 2007-2013, OJ C 256, 24.10.2006, p. 7.

7 The summary information sheet on the scheme XR 47/2007 (A Kormány egyedi döntésével megítélhető támogatás) was published in OJ C 180, 02.08.2007, p. 6.

8 Commission Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid, OJ L 302, 01.11.2006, p. 29.

9 Commission decision of 10.05.2007 in case N 651/2006 concerning the Development tax benefit (amendment of N 504/2004), OJ C 152, 06.07.2007, p. 2.

2.7. Aid amount

(29) The aid to Audi Hungaria Motor is granted as follows:

- the direct grant will be paid in yearly instalments from 2009-2013;
- the corporate tax allowance (i.e. development tax allowance) is planned to be used in 2012;

(30) The total nominal aid amount of the aid is HUF 18,107.66 million (EUR 60.35 million). The Hungarian authorities plan to pay out the aid for the project from 2009 to 2013. This results in an aid amount in present value of HUF 14,858.15 million (EUR 49.52 million). Table IV below presents a breakdown of the aid amount by each of the aid instrument in nominal and present values.

Table IV: Aid amount in nominal and present values (HUF million)

Aid instruments	Nominal value	Present value
Direct grant	9,009.00	8,207.09
Development tax allowance	9,098.66	6,651.06
Total	18,107.66	14,858.15

(31) The Hungarian authorities confirm that the amount of the State aid in present value will be proportionally reduced if the present value of the eligible cost amount in HUF decreases compared to the forecast amount.

(32) The Hungarian authorities also confirm that the aid for the project will not be cumulated with aid received for the same eligible costs from other local, regional, national or Community sources.

(33) Audi Hungaria had previously received investment aid for investment activities at Győr started before 2003.

2.8. Contribution to regional development

(34) The Hungarian authorities indicate that because of the investment project 150 jobs will be directly created.

(35) The technological modernization is expected to contribute also to the development and expansion of the technological standard of the Hungarian supplier network. In addition, to capitalize on synergies, the existing automotive cluster is expected to expand in the region, which is expected to have a great take-up effect on the suppliers and also on other enterprises which may only be indirectly related to the production at Audi Hungaria in Győr.

(36) The Hungarian authorities also indicate that by conveying the knowledge and experience resulting from the investment project though the existing co-operations with the University of Győr and technical universities in Budapest, the

investment will also contribute to the development of the quality and technical focus of higher education in the region as well as in the capital.

2.9. General provisions

(37) The Hungarian authorities have committed to submit to the Commission:

- within two months of granting the aid, a copy of the relevant acts concerning this aid measure;
- on a five-yearly basis, starting from the approval of the aid by the Commission, an intermediary report (including information on the aid amounts being paid, on the execution of the aid contract and on any other investment projects started at the same establishment/plant);
- within six months after payment of the last tranche of the aid, based on the notified payment schedule, a detailed final report.

3. ASSESSMENT OF THE AID MEASURE AND COMPATIBILITY

3.1. Existence of aid

(38) The financial support to Audi Hungaria will be given by the Hungarian authorities (in the form of a direct grant and a corporate tax allowance) and is financed through the general budget of the state. The support can thus be considered as given by the Member State and through State resources within the meaning of Article 87(1) of the EC Treaty.

(39) As the aid is granted to a single company, Audi Hungaria, the measure is selective.

(40) The financial support in the form of a cash grant and a corporate tax allowance given to Audi Hungaria will relieve the company from costs which it normally would have had to bear itself and therefore the company benefits from an economic advantage over its competitors.

(41) The financial support in the form of a direct grant and a corporate tax allowance by the Hungarian authorities will be given for an investment resulting in the production of engines for vehicles. Since this product is subject to intensive trade between Member States, the support given is likely to affect trade between Member States.

(42) The favouring of Audi Hungaria and its production by the Hungarian authorities means that competition is distorted or threatened to be distorted.

(43) Consequently, the Commission considers that the aid in the form of a cash grant and a corporate tax allowance given to Audi Hungaria constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

3.2. Legality and compatibility of the aid measure

(44) By notifying the planned aid measure before putting it into effect, the Hungarian authorities respected their obligations under Article 88(3) of the EC Treaty.

(45) As the measure relates to a regional investment aid, the Commission assessed it on the basis of the RAG. The measure was notified as aid which exceeds the thresholds defined in paragraphs 64 and 67 of the RAG. Therefore the Commission took into account the provisions of the RAG and, specifically, the provisions of section 4.3 of the RAG relating to large investment projects.

3.3. Compatibility with the general provisions of the RAG

(46) There is no indication that the VW-Group in general or Audi Hungaria in particular would be in financial difficulty as the conditions laid down in the Community guidelines on State aid for rescuing and restructuring firms in difficulty[10] are not fulfilled. Therefore the aid beneficiary is eligible for regional aid.

(47) The aid is granted in application of a block-exempted scheme (grant on the basis of the aid scheme XR 47/2007) and an approved aid scheme (tax allowance on the basis of the aid scheme N 651/2006), which respect the standard compatibility criteria of the RAG.

(48) In particular, the project comprises an initial investment within the meaning of paragraph 34 of the RAG. As regards the production of new engine components not manufactured before the investment and the increase in the production capacity of some engine types qualify as extension of an existing establishment. The production of technically new components (such as the introduction of the new AVS camshafts) constitutes a diversification of the output of the establishment into new, additional products and the introduction of new mechanical machining technologies in the existing component production corresponds to a fundamental change in the overall production process of an existing establishment in the meaning of paragraph 34 of the RAG.

(49) The costs eligible for investment aid (see Table III above) are defined in line with the RAG, and the rules on cumulation are respected.

(50) Audi Hungaria also has the obligation to maintain the investment in the region for a minimum of five years after completion of the project. The beneficiary provides a financial contribution of at least 25% of the eligible costs in a form which is free of any public support.

(51) As the aid is granted under regional aid schemes, paragraph 10 of the RAG requiring additional elements to be taken into account for the assessment of ad hoc aid is not pertinent at this stage of investigation.

3.3.1. Incentive effect

(52) The beneficiary applied, in general terms, for aid on 15 September 2006, i.e. two days before works on the project started. The Hungarian authorities confirmed

[10] OJ C 244, 1.10.2004, p. 2. In particular, the following conditions laid down in paragraph 10 of the rescue and restructuring guidelines are not fulfilled: (a) in the case of a limited liability company, where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months; (c) whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings.

only by letter of 26 September 2006 that Audi Hungaria will in principal be entitled to obtain a direct grant and a non-quantified indirect tax allowance as incentive for the realisation of the investments.

(53) As regards the direct grant the beneficiary applied for the aid under the predecessor aid scheme "HU 1/2003 – Earmarked Scheme for Investment Promotion" which was in force at the time of application[11], and which, in line with the Guidelines on national regional aid 1998-2006[12], only required that the application for the aid must be submitted before the start of the works.

(54) In accordance with paragraph 107 of the RAG the Commission proposed by letter dated 6 March 2006 appropriate measures and invited Member States to limit the application in time of all existing regional aid schemes to aid to be granted on or before 31 December 2006. Following the acceptance by Hungary of these appropriate measures the scheme HU 1/2003 expired at the end of 2006 and became XR 47/2007 as from January 2007.

(55) Since the direct grant was conditionally granted only on 17 December 2008 and notified on 26 February 2009, RAG 2007-2013[13] and RAG BER together with Regional aid Map for Hungary for 2007-2013[14] are applicable.

(56) Article 5 of the RAG BER stipulates that in respect of applications submitted from 1 January 2007, the authority responsible for administering the scheme has to confirm in writing that, subject to detailed verification, the project in principle meets the conditions of eligibility laid down in the scheme before the start of work on the project.

(57) It needs to be examined whether the incentive effect condition is met with respect to the direct grant given under the block-exempted scheme XR 47/2007 (former HU 1/2003).

(58) Article 5 paragraph 1 of RAG BER, provides that only for applications submitted after 1 January 2007 a written confirmation of eligibility before the start of work is necessary. This was as well confirmed in the Commission's letter to the Member States of 12 June 2006[15]. Given that the beneficiary applied for the aid under scheme "HU 1/2003 – Earmarked Scheme for Investment Promotion", which was in force at the time of application and there was no break in continuity in the application of the said scheme, according to constant practice of the Commission regarding projects starting before 31 December 2006 the

[11] HU 1/2003 – Earmarked Scheme for the Investment Promotion" was submitted under the interim procedure and accepted by the Commission as existing aid within the meaning of Annex IV, Chapter 3, paragraph (1)(c) (under Article 22) of the Treaty of Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia to the European Union.

[12] Guidelines on national regional aid, OJ C 74, 10.03.1998, p. 9, point 4.2.

[13] See point 63 of the RAG.

[14] See point 106 of the RAG.

[15] Letter to the Member States of 12 June 2006, D/54908.

beneficiary's application before the starts of the works has to be regarded as sufficient.

(59) Paragraph 38 of the RAG stipulates that the authority responsible for administering the scheme has to confirm in writing that, subject to detailed verification, the project in principle meets the conditions of eligibility laid down in the scheme before the start of work on the project. However this provision does not apply to aid schemes where a tax reduction is granted automatically to eligible expenditure[16].

(60) In this context it should be noted that the aid scheme N 651/2006, which is the successor scheme to HU 3/2004, amended under N 504/2004,[17].is an automatic tax measure thus the incentive effect condition described above does not have to be fulfilled for the development tax allowance granted to Audi Hungaria.

3.3.2. Transparency

(61) Regarding the rules on transparency of aid Article 8(5) of the RAG BER as well as paragraph 108 of the RAG stipulate that Member States should publish the full text of regional aid schemes and exclude projects for which expenses were incurred before the date of publication of the aid scheme. Since the legal basis for the applied scheme XR 47/2007 was formally adopted only on 24 January 2007 and the Commission approved the aid scheme N 651/2006 only in 10 May 2007, *prima facie*, this condition does not seem to be respected.

(62) However, since at the time of application for aid the predecessor regional aid schemes HU 1/2003 and HU 3/2004 had been published and thus all potential beneficiaries and interested parties could be aware of their content, the new schemes are specifically identified as successors of existing schemes, the transparency requirement could be considered as met in the present case.

(63) Moreover, the Commission considers that the transitional rules included in Article 5 (1) of the RAG BER and Letter to the Member States of 12 June 2006 to exempt aid cases from the obligation to submit a confirmation of eligibility in principle before start of work, if the aid application was introduced before 2007, also exempt from this publication requirement of the successor scheme at the time of the application. Any other interpretation would deprive the transitional rule regarding incentive effect of its *effet utile*.

3.3.3. Conclusion

(64) In view of these considerations to the Commission considers at this stage that the standard compatibility criteria are met.

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16 See footnote 41 of the RAG.

17 HU 3/2004 – "Development Tax Benefit Scheme", was submitted under the interim procedure and accepted by the Commission as existing aid within the meaning of Annex IV, Chapter 3, paragraph (1)(c) (under Article 22) of the Treaty of Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia to the European Union and amended under N 504/2004 State Aid – Hungary – "Amendment of the tax development benefit", 28.05.2005, OJ C 131, p.12

3.4. Compatibility with the provisions for aid to large investment projects

3.4.1. Single investment project (paragraph 60 of the RAG)

(65) In agreement with the Hungarian authorities the Commission considers sub-project 1 and 2 as one single investment project.

(66) The beneficiary received aid for investment activities at Győr started before 2003, i.e. outside the 3-year period defining a single investment project.

3.4.2. Aid intensity (paragraph 67 of the RAG)

(67) The planned total eligible expenditure in present value for the project is HUF 153,396 million (EUR 511.28 million) in present value. According to the scaling down mechanism laid down in paragraph 67 of the RAG, this leads to a maximum allowable aid intensity of 12.61% GGE (Gross Grant Equivalent) for the project.

(68) Since the intensity of the proposed aid (9.69 % GGE) does not exceed the maximum allowable aid intensity (12.61 % GGE), the proposed aid intensity for the project complies with the RAG.

3.4.3. Compatibility with the rules under paragraphs 68(a) and (b) of the RAG

(69) The Commission's decision to allow regional aid to large investment projects falling under paragraph 68 of the RAG depends on the market power of the beneficiary before and after the investment and on the capacity created by the investment. To carry out the relevant tests under paragraph 68(a) and (b) of the RAG, the Commission has first to establish appropriate product and geographic market definitions.

Product concerned

(70) As a result of the investment Audi Hungaria will produce engine components and engines to be built in cars belonging to segments A00, A0, A, B, C, D and E on the basis of the segmentation standards set by POLK.

(71) Moreover, although the investment project is directed at the manufacturing of passenger car engine components and engines, Audi Hungaria also manufactures yacht engines for the marine division of the VW-Group in a small volume. Audi Hungaria supplies the core of the base engines from which Volkswagen's Marine division manufactures its marine engines. The base engines for marine purposes are manufactured on the same production lines as the V6 and V8 diesel passenger car engines. The final manufacturing and assembly processes for marine engines are carried out at the plant of the Volkswagen Marine division in Salzgitter (Germany).

(72) According to point 69 of the RAG, the product concerned is normally the product covered by the investment project. However, when the project concerns an intermediate product and a significant part of the output is not sold on the market, the product concerned may be the downstream product. In Decision 2002/781/EC the Commission considered that "*the relevant market for engine production by a*

vehicle manufacturer is the vehicle market for which the engines are built".[18] This is also the line taken of Commission Decision 2003/647/EC[19] and most recently in Decision 2008/1613/EC[20]. In the case at hand more than [90-100]% of the engines manufactured by Audi Hungaria will be sold within the VW-PO-Group. Almost all engine components will be built directly into engines for cars. The remaining negligible quantity will be used later on for guarantee replacement and only a very small amount of sales outside the VW-PO-Group.

(73) As a consequence, for the purposes of paragraph 69 of the RAG, the Commission considers motor vehicles (passenger cars) to be the product concerned in this decision.

(74) The base engines for marine purposes are not sold on the market but are sold to Volkswagen in Salzgitter where they go through specialized assembly processes and treatments, which will enable them to be sold on the market by Volkswagen Marine as marine engines. Consequently, the products manufactured at Audi Hungaria are intermediate products, and the downstream product, i.e. the finished marine engines, for which Audi Hungaria provides the base engines should be regarded as products concerned.

Relevant product market

(75) Point 69 of the RAG stipulates that the relevant product market includes the product concerned and its substitutes considered to be such either by the consumer (by reason of the product's characteristics, prices and intended use) or by the producer (through flexibility of the production installations).

(76) The Commission recognised in its merger decisions that, although the car market has traditionally been segmented on the basis of a number of objective criteria like engine size or length of car, the boundaries between segments are blurred by other factors. These factors include price, image and the amount of extra accessories. Therefore, until now all merger decisions left open the question whether, for the purposes of the competitive analysis, the passenger car segment should be considered as one product market or should be further subdivided.

(77) The Commission notes that Prodcom codes[21] are not relevant for a further segmentation in this case, among others because there are too many overlaps and the classification is not generally used in the industry to assess markets.

(78) Several other classifications could be considered, such as the ones used by the European Association of Manufacturers (ACEA), the European New Car

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[18] Commission Decision of 20 December 2001 on the State aid which Germany is planning to implement for Daimler Chrysler AG in Kölleda (OJ L 282, 19.10.2002, p. 23.), paragraph 35.

[19] Commission Decision of 27 May 2003 on the State aid which Austria is planning to implement for BMW Motoren GmbH in Steyr (OJ L 229, 13.9.2003, p. 23), paragraph 61.

[20] Commission Decision of 30.4.2008 (C(2008)1613) in the case N 767/2007, Ford Craiova, OJ C 238, 17.9.2008, p. 4, paragraph 76 and 77.

[21] 34.10.12.00, 34.10.13.00, 34.30.11.00 and 34.30.12.00

Assessment Programme (NCAP), the US department of energy, and other large car manufacturers on their website.

(79) These classifications differ because they are used for different purposes (crash tests for example), because of geographic differences (US market is more dominated by large cars) and because no generally agreed classification exists.

(80) There are a number of service providers analysing the car market. Among the most renowned and acknowledged providers are Global Insight and POLK. Global Insight, a major forecasting consultancy, proposes a narrow segmentation of passenger cars (27 segments). POLK differentiates the car market along segments A000, A00, A0, A, B, C, D and E, where segment A000 means urban small cars and segment E is the ultra luxury category. From segment A000 to E, the average price, size and the average engine performance of passenger cars gradually increase.

(81) The Hungarian authorities have chosen POLK for the purpose of the notification, […]. The Commission considers at this stage that the POLK market classification can be considered as an appropriate and sufficiently detailed reference and applies this segmentation for the purposes of the assessment of the aid project at hand.

(82) As regards subdivision into separate segments for Passenger Car Vehicles ("PCV") and Light Commercial Vehicles ("LCV"), the Hungarian authorities submitted that such market segmentation is not clearly defined and thus not conclusive. Thus vehicles (the VW Touareg, for instance) with the same equipment are classified as "PCV" in one EU Member State and as "LCV" in another.

(83) In addition, automakers offer model variants with certain equipment features, allowing the customer to opt for a version as a PCV or LCV according to the definition valid in the respective Member State. The car manufacturers' production lines are designed in such a way as to be able to manufacture the PCV as well as the LCV variants with equipment specific to the country.

(84) Against this backdrop, PCVs and LCVs are not considered separately in this decision but are allotted to the respective A00, A0, A, B, C, D and E segments in their entirety. The Commission invites third parties to submit comments on this aspect.

(85) The Commission notes that some possibility for demand-side substitution at the margins of each segment exists, for example, between A segment and B segment cars or between the luxury segments. It considered the possibility of a chain of substitution[22] on the demand-side across the different segments. However, it might be difficult to argue for the substitutability of vehicles at the extreme ends of the possible segmentations, for example, the cheapest passenger cars are not direct substitutes for more expensive passenger cars.

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[22] See paragraphs 57-58 of the Commission notice on the definition of relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p.5.

(86) Producers of passenger cars are generally present in many of the different segments. Producers can switch from one type of passenger car to another because many cars are based on the same platform. Passenger car segments overlap.

(87) At this stage, for the present case, the Commission leaves the precise definition of the relevant product market open and will consider all plausible alternative market definitions (including the narrowest segmentation for which data are available). This approach is in line with the Commission's State aid decisions N 767/07 (Ford Craiova)[23], N 635/2008 (Fiat Sicily)[24] and N 473/2008 (Ford Espana)[25].

(88) Since Audi Hungaria will produce engine components and engines to be built into cars belonging to segments A00, A0, A, B, C, D and E, the Commission considers at this stage these segments and the total passenger car vehicles market (respectively including Light Commercial Vehicles) as relevant plausible markets for this case.

(89) However, it should be stated that at this stage there exists a divergence of opinion with Hungary as to the definition of the relevant markets. The Hungarian authorities argued that a specific engine type can be installed in several models and segments, limited by certain technical barriers. It depends on market demand for the different models of vehicles in which segment the engines that are manufactured will be ultimately installed. It is the number of the cylinders of each engine which determines essentially the vehicle types into which it can be installed, and thus the segments affected. Furthermore, the Hungarian authorities explained that at the premises of Audi Hungaria, the engines are primarily distinguished by number of cylinders during the manufacturing process. Therefore, there are separate lines, halls and even organisational divisions for each engine types, e.g. 4-cylinder, 6-cylinder, etc.

(90) According to the Hungarian authorities, the following segment groups should be considered instead of the individual segments:

- the 4-cylinder engines are to be built in segments A00 to C,
- the 6-cylinder engines are to be built in segments B to D,
- the 8-cylinder engines are to be built in segments B to E and
- the 10/12-cylinder engines are to be built in segments C to D.

(91) Regarding marine engines, since Audi Hungaria manufactures diesel base engines only and Volkswagen Marine produces and sells diesel marine engines only, the relevant product market is deemed to be the diesel marine engine market.

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[23] Decision of 30.4.2008 (C(2008)1613) in the case N 767/2007, OJ C 238, 17.9.2008, p. 4.

[24] Decision of 29.4.2009 (C(2009)3051) in the case N 635/2008, not yet published.

[25] Decision of 17.6.2009 (C(2009)4530) in the case N 473/2008, not yet published.

Relevant geographic market

(92) Paragraph 70 of the RAG stipulates that for the purposes of carrying out the tests under paragraph 68 of the RAG, markets should normally be defined at EEA level.

(93) In line with recent decisions the Commission is of the opinion, that from a supply side perspective, production in the car sector is at least EEA wide or even global. Considering the argument that the major car manufacturers are global players having manufacturing facilities and distribution systems in different continents and countries, the VW–PO-Group is at least a European player. On average, more than [15-30]% of the vehicles produced by the VW group in the EEA are exported.

(94) From a customer perspective, conditions of competition have significantly improved in the EU, in particular as regards technical barriers and distribution systems, although differences in prices and taxation systems are still limiting factors and penetration rates of major competitors differ across Member States and in particular continents. Low transportation costs and the presence of all major manufacturers in almost all Member States and the largest countries worldwide are indicators of an EEA or even worldwide market.

(95) For the purpose of State aid decisions on aid to production facilities, which assess the effects of aid on distortions of competition between manufacturers and on trade between Member States, the manufacturing aspects are decisive.

(96) The Hungarian authorities advanced the opinion that the geographically relevant market for the VW-PO-Group is the global market, because the large, internationally active car manufacturers are in global competition. The markets of the EEA and North America are saturated. In contrast to that, a growth of roughly 64% between 2005 and 2013 is assumed for the global growth markets in Asia, South America, Russia and Africa. This development will lead either to a further integration of markets and the globalisation of the car market or to a production relocation into growth markets.

(97) In particular, the Hungarian authorities justified their position by the following arguments:

- VW-Group's production sites and sales areas are located in Europe, North America, South America, Africa and Asia.
- The EEA is the only region where cars of all segments A00, A0, B, C, D and E are produced.
- VW-Group's cars belonging to the B-segment are almost exclusively produced within the EEA. In 2008, VW-Group produced […]cars in the B-segment, thereof […]in the EEA. These cars were distributed in the EEA […] as well as outside the EEA. The export quota in relation to the total number of produced cars amounts to [25-35]%.
- VW-Group's cars belonging to the D- and E-segment are produced solely in the EEA. Of the […] cars produced by the VW-Group in these

segments in 2008, more than [45-60]% were exported to North America, South America, Africa and Asia.

- As production and sales in the single regions do not equal, cars belonging to all segments are shipped worldwide from production facilities to the sales areas.

(98) Furthermore, the Hungarian authorities explained that the construction/expansion of new production sites for car components is tendered by the car manufacturers globally, across the entire group.

(99) In light of the above, for the purpose of the assessment of the present case, the Commission considers that the relevant geographic market for the products concerned is at least EEA-wide. Market shares for car segments are calculated both at the EEA and worldwide levels.

(100) According to Hungary, the relevant geographic market for marine engines could be considered worldwide as many competitors have worldwide presence in the diesel marine engine market. Volkswagen Marine also manufactures diesel marine engines for worldwide sale, however, current statistics show that the majority of the sales is carried out in the EEA. Therefore, the relevant geographic market for diesel marine engines is at least the EEA if not worldwide. Both global and EEA data are provided below when analyzing the market share of the VW-Group.

Market shares

<u>Passenger cars</u>

(101) To examine whether the project is compatible with paragraph 68(a) of the RAG, the Commission has to analyse the market share of the aid beneficiary before and after the investment and check if the market share exceeds 25%.

(102) The beneficiary's market share is assessed at group level in the relevant product and geographic markets. As the new investment project of Audi Hungaria started in 2006 and full production is foreseen to be reached in 2012, the Commission will examine the market share of the VW-PO-Group (including all the brands belonging to the group) on the relevant markets between 2005 and 2013.

(103) As confirmed by the Hungarian authorities, the data submitted takes account of the relevant business- and marketing agreements regarding the manufacturing and sales of vehicles between VW-Group and other companies.

(104) Considering significant differences in production costs and prices of different passenger car and difficulties in obtaining reliable price estimates, volume data are commonly used in the sector to define markets and market evolutions. The Hungarian authorities provided the following market share data:

Table V: Market shares of the VW-Group / the VW-PO-Group on the basis of single passenger car segments (including LCVs)

Segment A00				**VW-Group**	**VW-PO-Group**				
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment A0									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment A									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment B									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<25]%	[<25]%	[<25]%	**[>25]%**	**[>25]%**	**[>25]%**	**[>25]%**	[<25]%	[<25]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment C									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment D									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	**[>25]%**	**[>25]%**	**[>25]%**	**[>25]%**	**[>25]%**
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment E									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	**[>25]%**	[<25]%	**[>25]%**	**[>25]%**	[<25]%	[<20]%	**[>25]%**	**[>25]%**	**[>25]%**

WW	**[>25]%**	**[>25]%**	**[>25]%**	**[>25]%**	**[>25]%**	[<20]%	[<20]%	[<20%]	[<20]%
All segments									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<25]%	[<25]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%

(105) On the basis of the above figures, market shares exceed the 25% threshold. That is not only the case for the figures at EEA level (regarding the B-segment in 2008, 2009, 2010 and 2011, the D-segment in 2009, 2010, 2011, 2012 and 2013, the E-segment in 2005, 2007, 2008, 2011, 2012 and 2013), but also for the figures at global level (regarding the E-segment in 2005, 2006, 2007, 2008 and 2009).

(106) As indicated above, the Hungarian authorities suggest that market shares should be calculated at the level of combined segments which would result in the figures presented below:

Table VI: Market shares of the VW-Group / the VW-PO-Group on the basis of combined segments

Segment A00-C			**VW-Group**	**VW-PO-Group**					
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<25]%	[<25]%	[<25]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment B-D									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%
WW	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
Segment B-E									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%	[<25]%

WW	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %
Segment C-D									
	2005	2006	2007	2008	2009	2010	2011	2012	2013
EEA	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %
WW	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %	[<20] %

(107) On the basis of these figures, market shares would be below the 25% threshold.

(108) The Commission doubts that it is justified to calculate the market shares only on the basis of combined segments. The Commission's practice to consider all plausible alternative market definitions (including the narrowest segmentation for which data are available), has been recently confirmed in State aid decisions of the Commission (N 767/07 Ford Craiova[26], N 635/2008 Fiat Sicily[27] and N 473/2008 Ford Espana[28]) . In these decisions, the project did not raise concerns even on the narrowest plausible market so the exact market definition could be left open (even if, as acknowledged in these decisions, there might be some degree of substitutability between different segments).

(109) The Commission considers at this stage that the aided project may influence Volkswagen Group's market position in the individual (narrowest) segments and therefore, it seems possible and justified to calculate market shares at this narrowest level and not at the level of the segment groups which the different engine types will serve.

(110) The aid beneficiary seems to account for more than 25 % of the sales of the product(s) concerned on the narrowest plausible market taken as a 'worst case scenario' (see table V). Therefore, the requirement as laid down in paragraph 68 (a) of the RAG is considered not to be met at this stage.

(111) Hungary also submitted that measuring the applicant’s market position one year before and one year after the implementation of the investment leads to a distorted result when applied to the automotive industry.

(112) The automobile market is strongly influenced by the launching of new models and the modification of existing models. The announced launch of a new model immediately leads to reduced sales figures for the current model, since the new model has a consistently negative impact on the resale value of the current model. In the year the new model is launched, by contrast, sales figures skyrocket.

[26] Decision of 30.4.2008 (C(2008)1613) in the case N 767/2007, OJ C 238, 17.9.2008, p. 4.
[27] Decision of 29.4.2009 (C(2009)3051) in the case N 635/2008, not yet published.
[28] Decision of 17.6.2009 (C(2009)4530) in the case N 473/2008, not yet published.

Moreover, the launch of a new model by another car manufacturer can have a negative impact on the sales figures.

(113) In the E segment, for instance, the VW-PO Group's market share on the global market will be reduced to a considerable extent from 2010 onward, according to the POLK forecast. This loss of market share is due to the launch of the new […] model, according to the forecast by POLK.

(114) Thus, Hungary considers that in order to assess a car manufacturer's actual market position, a time period-oriented consideration is appropriate, not a punctual one. In Hungary's view, a period of consideration of 5 years should be adequate for attaining a conclusive averaged value.

(115) The following table shows VW-/VW-PO-Group's segment shares in a consideration of a 5-year average:

Table VII: Global segment shares of the VW Group/VW-PO Group in a consideration of a 5-year average

	2005-2009	2006-2010	2007-2011	2008-2012	2009-2013
A00	[< 20]%	[<20]%	[<20]%	[<20]%	[<20]%
A0	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
A	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
B	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
C	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
D	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%
E	[>25]%	[20-25]%	[20-25]%	[<20]%	[<20]%
Others	[<20]%	[<20]%	[<20]%	[<20]%	[<20]%

(116) As can be seen, even a five year averaging (which runs counter to the Commission's constant interpretation of paragraph 68(a) of the RAG as confirmed in several State aid decisions in the car sector[29]) results in market shares exceeding 25 % at least in segment E at global level. At the level of the EEA this would be the case for an even greater number of segments.

Marine engines

(117) Regarding the marine engine market, the Hungarian authorities note that official data and established methodology similar to the motor vehicle industry have not yet been developed. The following data are based on the figures and calculations provided by the International Marine Products Association ("IMPA") and the estimates of the VW-Group.

[29] Decision of 18.6.2009 (C(2009)5533) in the case N 671/2008 (Mercedes-Benz Hungary), not yet published; Decision of 30.4.2008 (C(2008)1613) in the case N 767/2007 (Ford Craiova), OJ C 238, 17.9.2008, p. 4; Decision of 29.4.2009 (C(2009)3051) in the case N 635/2008 (Fiat Sicily), not yet published; Decision of 17.6.2009 (C(2009)4530) in the case N 473/2008 (Ford Espana), not yet published

Table VIII: Market share of the VW-Group in the global diesel marine engine market (volume)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Sales of all producers in the global market	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Sales of the Volkswagen Group in the global market	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Market share of the Volkswagen Group in the global market (in %)	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[2.5-5]%

Table IX: Market share of the VW-Group in the EEA diesel marine engine market (volume)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Sales of all producers in the EEA market	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Sales of the Volkswagen Group in the EEA market	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Market share of the Volkswagen Group in the EEA market (in %)	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[<2.5] %	[2.5-5]%	[2.5-5]%	[2.5-5]%	[2.5-5]%

(118) The data above indicate that the market share of the Volkswagen Group in the EEA and at global level does not exceed 5%. Accordingly, the threshold of 25% set out in paragraph 68 (a) of the RAG is not exceeded for marine engines.

Production capacity

Passenger cars

(119) The Commission also has to examine whether the investment project complies with paragraph 68(b) of the RAG. It needs to verify whether the capacity created

by the project is less than 5% of the size of the market measured using apparent consumption data of the product concerned, unless the average annual growth rate of its apparent consumption over the last five years is above the average annual growth rate of the EEA's GDP.

(120) The Commission should thus first assess if the market is underperforming in the EEA based on the average annual growth rate of the apparent consumption of the product concerned. Hungary only submitted apparent consumption data regarding the total passenger car market between the years 2002 and 2007 (i.e. the years for which data were available at the time of notification). On this basis, the average annual growth was 1.18 %, i.e. below the average annual growth of GDP in the EU-27 in the same period (3.97%).

(121) As regards the extent of the capacity created, it should be recalled the production lines (i.e. the capacity created) are specific to each engine types, e.g. 4-cylinder, 6-cylinder, etc. It is also recalled that an engine type can and will be installed in several models belonging to different segments, and, according to the Hungarian authorities, it is not possible to allocate the capacity created in advance to the individual car segments.

(122) The Commission notes in this respect that in the case N 767/2007 – Romania – LIP – Ford Craiova, it was possible to estimate in what proportion the engines to be produced at the aided plant will be installed in the different individual segments. Moreover, the market definition should normally be the same for the purposes of paragraph 68(a) and (b) of the RAG. Therefore, the Commission invites interested parties to submit their observations on the appropriateness of the approach suggested by Hungary.

(123) It should also be noted that the investment takes place at an existing plant in Győr where previous models of the engine types concerned by the notified investment have already been in production. Therefore, only the additional net capacity created by the investment should be considered.

(124) The total additional net capacity created by the investment of Audi Hungaria in volume terms equals to approximately [100,000 – 250,000] engines i.e. [0.5-2.5]% of the total passenger car market in the EEA[30].

(125) In terms of the different engine types and the corresponding segment groups, the figures are the following:

[30] For certain segments groups, the gross capacity increase exceeds 5%.

Table X: Additional local net capacity in percentage of the output of the total passenger car market in the relevant combined segments (without LCVs)

4-cylinder engines	2005	2013
Segments A00 - C	[ ]	[ ]
Capacity increase	[ ]	
Proportion of capacity	[0-2.5]%	[0-2.5]%

6-cylinder engines	2005	2013
Segments B-D	[ ]	[ ]
Capacity increase	[ ]	
Proportion of capacity	[0-2.5]%	[0-2.5]%

12-cylinder engines	2005	2013
Segments C-D	[ ]	[ ]
Capacity increase	[ ]	
Proportion of capacity	[0-2.5]%	[0-2.5]%

(126) The investment will not lead to a net capacity increase in the 8-cylinder and 10-cylinder engine production. Hence, the relevant data have not been included in the tables above.

(127) On the basis of the market definition suggested by Hungary (i.e. combined segments as opposed to individual ones), the threshold of 5% set out in paragraph 68 (b) of the RAG is not exceeded.

<u>Marine engines</u>

(128) Regarding marine engines it is recalled that Audi Hungaria only manufactures base engines which represent the "raw" engines for marine purposes. The base engines are manufactured on the same production lines as the V6 and V8 passenger car engines. However, base engines for marine purposes only go through (1) the mechanical machining of the engine components and (2) certain basic assembly activities […]. Complete engines contain at least […] more engine components and parts, which are not assembled at Audi Hungaria. Consequently, these "raw" base engines do not go through the stages of production which are established for passenger car engines.

(129) Another major difference between the marine base engines and the passenger car engines is that while passenger car engines leave Audi Hungaria as fully assembled and car ready, marine base engines are incapable of marine functioning and cannot be built into any yachts or ships at this stage in the production process. Therefore, they are transported to the Volkswagen Marine division where they receive special treatments within the framework of the so-called "marinization processes". Audi Hungaria would need to make substantial investments in assets, know-how and human capital, and achieve significant transformation of the production lines if it were to decide to implement a complete marine engine production process. Furthermore, due to the special technical parameters of the raw engines produced by Audi Hungaria, the marinization processes could not be carried out by manufacturers outside the VW-Group without substantial additional investments.

(130) Due to the specialized processes involved, marinization must take place at Volkswagen Marine in Salzgitter which has been specifically developed to cater for these activities. Approximately […] marine engines can be produced at Volkswagen Marine per week, i.e. the current maximum production capacity is […] units per year. Thus even if Audi Hungaria increases its capacity of manufacturing base engines for marine purposes, Volkswagen Marine would not be able to manage the increased production demand since its production capacity is limited and not affected by the investment project under scrutiny. Capacity increase could only be achieved with significant additional investments in Salzgitter which is not subject to the present notification.

(131) Thus the notified project does not create additional production capacity for the ready-made marine engines (capacity increase is nil).

(132) It appears at this stage therefore that the project is in line with paragraph 68 (b) of the RAG on all relevant markets.

3.5. Doubts and grounds for opening

(133) For the reasons set out above, the Commission, after a preliminary assessment of the measure, has doubts as to whether the notified aid can be considered compatible with paragraph 68 of the RAG.

(134) In this respect, the Commission recalls the doubts it has expressed in the present decision as to whether the market delineation proposed by Hungary can be accepted and whether the beneficiary does not account for more than 25 % of the sales of the product concerned on the market concerned and capacity created does not exceed 5 % in case the relevant market is underperforming.

(135) The Commission notes the disagreement with the Hungarian authorities as regards the definition of the relevant product market for passenger cars. At this stage, the Commission has doubts whether certain segments groups, as opposed to individual passenger car segments according to the POLK classification, can be considered the relevant product market for the purposes of applying paragraphs 68(a) and 68(b) of the RAG. Moreover, the Commission has also doubts at this stage as regards the joint treatment of passenger cars and Light Commercial Vehicles. It is recalled that, according to paragraph 70 of the RAG, the burden of proof that the situations to which paragraphs 68(a) and (b) of the RAG do not apply lies with the Member State.

(136) Consequently, the Commission is under duty to carry out all the required consultations and, therefore, to initiate the procedure under Article 88(2) of the EC Treaty, if the initial investigation does not enable the Commission to establish that the measure is in line with paragraph 68 of the RAG. This would give the opportunity to third parties whose interest may be affected by the granting of the aid to comment on the measure. In the light of both the information notified by the Member State concerned and that provided by any third parties, the Commission will assess the measure and will take its final decision.

(137) In the event that the information provided in the course of the formal investigation procedure does not make it possible to confirm that the thresholds provided for in paragraph 68 of the RAG are respected, the Commission also has

to investigate whether the aid is necessary to provide an incentive effect for the investment and that the benefits of the aid measure outweigh the resulting distortion of competition and effect on trade between Member States. The Commission therefore requests the Member State and third parties to provide any available evidence which would allow the Commission to substantiate its assessment of the measure.

(138) In footnote 63 of the RAG, the Commission announced its intention to "draw up further guidance on the criteria it will take into account during this assessment". This announcement has been implemented by the adoption of the Commission Communication on Criteria for an In-Depth Assessment of Regional Aid to Large Investment Projects[31] which will serve as the basis of the in-depth assessment. In particular, the following criteria will be considered: objective of the aid, appropriateness of the aid instrument, incentive effect, proportionality of the aid, crowding out of private investment and effects on trade. At this stage, it appears that competition could be distorted especially in the segments where market shares of the beneficiary exceed 25 %.

(139) In view of this in-depth assessment, interested parties are invited in particular to provide all information necessary to establish the economic incentive effect of the aid, i.e. whether (1) the aid gives an incentive to adopt a positive investment decision because an investment that would otherwise not be profitable for the company at any location can take place in the assisted region or (2) the aid gives an incentive to opt to locate a planned investment in the relevant region rather than elsewhere because it compensates for the net handicaps and costs linked to a location in the assisted region. Whether scenario (1) or (2) is applicable determines the counterfactual situation (i.e. what would happen in the absence of aid) and thus the possible distortion of competition and trade caused by the aid.

(140) On the basis of the evidence submitted concerning the above mentioned issues, the Commission will perform a balancing exercise of the positive and the negative effects of the aid, conducting an overall assessment of the impact of the aid in each of the markets concerned, in such a way as to allow the Commission to close the formal investigation procedure.

4. DECISION

(141) In light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 88(2) of the EC Treaty, requests Hungary to submit its comments and to provide all such information as may help to assess the aid measure, within one month of the date of receipt of this letter. It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

(142) The Commission wishes to remind Hungary that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

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[31] Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJ C 223, 16.09.2009, p.3.

(143) The Commission warns Hungary that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax (32-2) 296 12 42

Yours faithfully,

For the Commission

Neelie KROES

Member of the Commission