COMMISSION DECISION

of 15 October 2003

on a proposal by Portugal to grant aid to Vila Galé — Cintra Internacional, Investimentos Turísticos, SA

(notified under document number C(2003) 3376)

(Only the Portuguese text is authentic)

(Text with EEA relevance)

(2004/168/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having called on interested parties to submit their comments pursuant to the provisions cited above [1],

Whereas:

I. PROCEDURE

(1) By letter No 521 dated 21 February 2002 from their Permanent Representation, registered as received by the Commission on 27 February, the Portuguese authorities notified the Commission of the proposed aid for Vila Galé — Cintra Internacional, Investimentos Turísticos, SA. By letter No 1167 dated 22 April 2002 from their Permanent Representation, registered as received by the Commission on 25 April, they provided the Commission with further information.

(2) By letter No SG(2002) D/230500 dated 4 July 2002, the Commission informed the Portuguese Republic of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.

(3) By letters Nos 2183 dated 24 July 2002, 2278 dated 6 August 2002 and 2163 dated 7 July 2003 from their Permanent Representation (registered as received on 29 July 2002, 12 August 2002 and 10 July 2003 respectively), the Portuguese authorities presented their observations under the abovementioned procedure.

(4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* of 22 October 2002 [2]. The Commission called on interested parties to submit their comments on the aid within one month of that date.

(5) The Commission received no comments from interested parties.

II. DETAILED DESCRIPTION OF THE AID

The investment and the objective

(6) The notified measure consists in the granting of aid to Vila Galé — Cintra Internacional — Investimentos Turísticos, SA (hereinafter Vila Galé Cintra) to finance in part the costs incurred by the enterprise in acquiring and refurbishing an unfinished building located in the State of Ceará (Brazil). The building was acquired on 29 September 2000 and was transformed into a five-star hotel that was opened in October 2001 and is now fully operational.

(7) The present measure consists of an individual application in respect of two schemes. One is measure N 667/1999 [3], which covers the period 2000-2006 and is aimed at promoting modern and competitive entrepreneurial strategies. The individual application notified falls into one of the specific investment categories of this scheme, namely investments related to the internationalisation of economic agents. The second scheme is measure N 96/1999 [4] promoting

[1] OJ C 253, 22.10.2002, p. 5.

[2] See footnote 4.

[3] Approved by the Commission on 26 July 2000 (OJ C 266, 16.9.2000, p. 7).

[4] Approved by the Commission on 8 September 1999 (OJ C 375, 24.12.1999, p. 5).

internationalisation projects by Portuguese firms through the Tax Benefits Scheme.

Recipient

(8) The aid recipient does not meet the criterion of independence necessary to be considered an SME ([5]). Vila Galé Cintra is owned as to more than 25 % by two enterprises which fall outside the definition of an SME.

(9) The two enterprises are, nevertheless, relatively small players. Their annual balance-sheet totals (1999 values) are EUR 36 million and EUR 51 million respectively. Their annual turnovers are EUR 6 million and EUR 31 million respectively. The Portuguese market shares of the three shareholders in Vila Galé Brazil in their sectors of activity are 3,9 %, 3,0 % and 3,6 % for Cintra (construction), Vila Galé (tourism) and FCR (risk capital in the tourism sector) respectively.

The aid measure

(10) The aid instruments to be used for the purposes of the present project are a non-repayable grant (which the Portuguese Authorities intend to make available under the *de minimis* Regulation ([6])), a soft loan under scheme N 667/1999 (part-financed with Community funds from the ERDF) and a tax credit under scheme N 96/1999.

(11) The data relating to the measure are the following:

(a) eligible investment: EUR 13 869 076;

(b) eligible costs: acquisition of the building (EUR 3 691 104), external infrastructure works (EUR 448 918), civil engineering (EUR 5 726 200), equipment (EUR 3 653 695), and studies and projects (EUR349 158);

(c) soft loan: the nominal amount of the loan is EUR 3 467 269, corresponding to an aid amount in nge terms of EUR 538 218 and a net aid intensity of 3,88 % ([7]).

(d) tax credit: the tax credit involves estimated aid in nge terms of EUR 373 166 ([8]), corresponding to a net aid intensity of 2,69 %;

(e) total amount of aid: the total amount of aid from the soft loan and the tax credit in nge terms is EUR 911 384;

(f) total net intensity of the aid: 6,57 %.

III. **THE ARTICLE 88(2) PROCEDURE**

Grounds for initiating proceedings

(12) The grounds for deciding to initiate proceedings in this case were twofold. At the time the decision was taken, the Commission considered that the Portuguese authorities had not demonstrated that State aid would be needed to reduce or offset the underlying political or economic risks in Brazil. It also harboured doubts as to whether the aid would be necessary for the purposes of the planned investment. It could not, therefore, state unequivocally that the aid would facilitate certain economic activities and so could benefit from an exemption under Article 87(3)(c) of the EC Treaty.

Comments from the Portuguese authorities

(13) By letters dated 24 July and 6 August 2002, the Portuguese authorities presented their observations. In essence, they contested the two arguments on the basis of which the Commission initiated proceedings, namely its doubts about the existence of significant risks and uncertainties on the Brazilian market that might justify the granting of state aid and about whether or not the necessity criterion was met.

(14) As regards the existence of significant risks and uncertainties on the Brazilian market, the Portuguese authorities informed the Commission that the company belonging to Grupo Cintra (one of the shareholders in

([5]) Article 1(3) of the Annex to the Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises (OJ L 107, 30.4.1996) states that: Independent enterprises are those which are not owned as to 25 % or more of the capital or the voting rights by one enterprise, or jointly by several enterprises, falling outside the definition of an SME or a small enterprise, whichever may apply.

([6]) Commission Regulation (EC) No 69/2001 of 12 January 2001 (OJ L 10, 13.1.2001).

([7]) The calculation is based on the following:
1. duration of the loan: six years,
2. grace period: two years,
3. interest rate on the loan: 0 %,
4. reference interest rate for Portugal applicable at the time the investment took place: 6,33 %,
5. corporation tax rate currently in force in Portugal: 35,2 %.

([8]) This is the net aid element of the tax credit as estimated by the Portuguese authorities.

Vila Galé Cintra) which is involved in the investment project under scrutiny has no business relationship with Grupo Cintra in the beer sector in Brazil, as stated in the decision initiating the formal investigation procedure. This investment project therefore represents the first foreign venture for the companies involved. Moreover, the fact that Portugal is one of the leading foreign investors in Brazil does not, on its own, preclude the existence of high market risk and uncertainty that are indeed features of the Brazilian market. This fact is related to the very pronounced exchange-rate volatility of the real, on the one hand, and to the instability of the Brazilian capital market brought about by the recent economic and financial crisis in Argentina, on the other. The proposed State aid is, therefore, intended to compensate for these risks and uncertainties through risk sharing, leverage and reduction of the financial costs linked to the investment project. The Portuguese authorities concluded that investments are made in Brazil by entrepreneurs who are determined to take on the additional risks inherent in the investments, notwithstanding the existing market conditions.

(15) As regards fulfilment of the necessity criterion, the Portuguese authorities argued that the fact that the recipient had already completed its investment and opened the hotel before a decision on the granting of aid had been taken does not rule out the incentive effect of the aid. In fact, the application for State aid was made in July 2000, before the investment costs were incurred. What is more, the fact that the investment went ahead without any State support shows the determination of the recipient to undertake its first foreign venture in spite of the additional risks involved and its expectations in relation to obtaining the public support it applied for. It is the Portuguese authorities' opinion that the recipient should not be disadvantaged on the ground that vetting the application took longer than the period needed to carry out the investment.

Comments from interested parties

(16) The Commission did not receive any comments from interested parties.

IV. ASSESSMENT OF THE AID

Existence of State aid

(17) Under the notified measure, a specific Portuguese enterprise would receive funds for investing in the tourism sector in Brazil as part of an internationalisation strategy. This aid would strengthen the recipient's overall financial and strategic position. It is obvious that strengthening a European enterprise which carries out business in the EEA is likely to affect trade in the Community. Such is the view expressed by the Court of Justice of the European Communities in its judgment in Case 142/87 Tubemeuse ([9]). It cannot be excluded that the aid would give the recipient an advantage over its competitors operating in the European Union that had already invested or would be interested in investing in Brazil without receiving any aid for foreign direct investment. The measure is funded through state resources. Accordingly, the Commission considers that the measure would distort or threaten to distort competition and that it would amount to State aid within the meaning of Article 87(1) of the EC Treaty.

Possible exemption

(18) Firstly, since the proposed aid measure involves Community funds from the ERDF which will be used to co-finance an investment carried out outside the European Union, the Commission has assessed this possibility in the light of Commission Regulation (EC) No 1685/2000 of 28 July 2000 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards eligibility of expenditure of operations co-financed by the Structural Funds ([10]).

(19) Secondly, given the fact that there are no Community guidelines or framework for state aid in the tourism sector, the Commission has based its assessment directly on Article 87(3)(c) of the EC Treaty, which provides for an exemption for aid to facilitate the development of certain economic activities, without adversely affecting trading conditions to an extent contrary to the economic interest.

(20) The Commission must, therefore, assess whether the aid will contribute to the development of tourism and/or other economic activities in the European Union without adversely affecting trading conditions between Member States. It must also assess whether the aid will have an incentive effect for the recipient to carry out the investment.

Possibility of allocating Community funds from the ERDF to an investment carried out outside the European Union

(21) Article 160 of the EC Treaty states that 'the ERDF is intended to help to redress the main regional

([9]) [1990] ECR, I-959, at 35.
([10]) OJ L 193, 29.7.2000, p. 39.

imbalances in the Community'. Moreover, Article 3 of Regulation (EC) No 1260/1999 defines the geographical eligibility for the priority objectives, which concerns only the regions of the Community.

(22) Regulation (EC) No 1685/2000, mentioned above, lays down the eligibility criteria for operations to receive Community funds from the ERDF depending on their location ([11]). It is mentioned there that the possibility of accepting operations located outside the region to which the assistance relates for co-financing: '(…) shall be subject to prior approval by the Commission on a case-by-case basis following a request submitted by the Member State, taking into account in particular the proximity of the operation to the region, the level of benefit to the region which can be foreseen, and the amount of the expenditure in proportion to the total expenditure under the measure and under the assistance.' ([12]).

(23) Since the investment is located in an area distant from the assisted region, the Commission considers that the above-mentioned condition is not met.

(24) The Commission therefore considers that the notified investment is not eligible for Community financial support under the ERDF. The remainder of this decision assumes that the total amount of aid indicated at point (e) in paragraph 11 will be fully covered by national funds.

Effect of the aid on trade between Member States

(25) The amount of aid is relatively small. It represents a net grant equivalent of EUR 911 384, corresponding to a net aid intensity of 6,57 % of the eligible investment. A small amount of aid that covers a limited portion of the eligible investment is unlikely to affect trade between Member States significantly.

(26) The recipient is a small player in the market. Its shareholders only narrowly exceed the thresholds laid down in the definition of an SME. They have market shares of less than 4 % on the respective markets in Portugal and their corresponding market shares in the EU are therefore negligible. Individual aid to an enterprise with a small market share is less likely to impose negative externalities than aid to an enterprise with a large market share. Given the recipient's small market share, the limited amount of aid would not be such as to affect the position of its competitors.

([11]) Rule 12, Annex I to Regulation (EC) No 1685/2000.

([12]) Rule 12, point 3, Annex I to Regulation (EC) No 1685/2000.

(27) The tourism and hotel sector accounts for around 3,5 % of Brazilian GDP and there are some 10 000 hotels in Brazil, of which an estimated 5 % to 7 % belong to international companies ([13]). Currently, the main European investors in Brazil are the French group Accor (108 hotels) and the Spanish group Sol Melia (23 hotels) ([14]). Since the notified project was the first investment by Vila Galé in Brazil, its resulting share of the Brazilian market is insignificant compared with the European companies mentioned above. It can reasonably be concluded that the construction of another five-star hotel in Brazil will not significantly increase local supply or affect the relative position of the European companies already established on the market or their ability to attract tourists.

(28) The share of the 'luxury' segment in the Brazilian hotel market is quite high. According to ABIH Nacional, around 53 % of the total number of hotel beds registered since 1964 was in four- or five-star hotels. This market is characterised by a very large number of players (mostly non-European), with none of them having a substantial market share. Consequently, the hotel sector in Brazil can be described as a competitive market with a very low degree of concentration. Aid granted to a company in such a market is less likely to distort competition than aid granted to a company in a highly concentrated market since the advantage conferred is more likely to be transferred to consumers than retained by the recipient.

(29) The aid recipient is in a relatively unfavourable position compared with its main EU competitors. These have a much higher share of the Brazilian market, are recognised at international level and have been established in the market for several years. Their larger size confers on them greater bargaining power vis-à-vis international tourism operators, and this results in much higher occupancy rates and income, thereby reducing the relative weight of their commercial costs.

(30) The investment in question requires a significant local content in Brazil and does not involve the relocation of activities from Portugal to Brazil. For that reason, the aid is not expected to have a negative impact on economic activity or on employment in Portugal.

([13]) Source: ABIH Nacional — Brazilian Association of the Hotel Industry, 'Statistics on the national hotel industry', 22 February 2001.

([14]) See footnote 17.

(31) For the reasons set out in paragraphs 25 to 30, the Commission considers that the aid is unlikely to have a significant direct impact on trade between Member States. In this respect, it would also stress that it received no comments from interested parties.

Contribution of the aid to the development of the tourism sector in Portugal

(32) Tourism is one of the most important sectors of activity in the Portuguese economy. Currently, it accounts for around 8 % of GDP and employs directly and indirectly around 500 000 people. It is therefore one of the priority areas in Portugal for promoting cohesion. This cohesion effect has often been recognised by the EU institutions. The Council Resolution of 21 May 2002 on the future of European tourism ([15]) states that 'Tourism […] contributes largely to the fulfilment of the targets established in the Lisbon and Cardiff Process and to the attainment of a true internal services market. It is conducive to a high level of employment and social welfare, sustainable growth, better quality of life and European integration and also to social and economic cohesion, making a considerable contribution to the objectives of convergence.' The same Resolution emphasises that 'tourism in Europe being comprised mostly by small and medium-sized enterprises (SMEs), it is essential to give tourism industry a better access to instruments within the framework of the EU to help them to increase their economic performance and to strengthen their competitiveness […]'. The tourism sector is characterised by strong vertical and horizontal connections with other sectors of the economy. Its development therefore leads to development of the economy as a whole.

(33) The aid will strengthen the long-term position of a Portuguese tourism enterprise, enabling it to broaden and diversify its product range and thereby to improve its business potential.

(34) It is likely that strengthening the recipient's financial position will produce benefits mainly in the Portuguese tourism sector for the following reasons:

(a) The recipient's parent company carries out most of its activities in Portugal, where it owns fourteen hotels throughout the country. This is its first foreign venture. Its investment strategy is concentrated mainly in Portugal, where it set up three new hotels in 2002 and is in the process of constructing a further two. It thus seems likely that, if successful, this project will enhance the enterprise's investment capacity in the Portuguese tourism market.

(b) The tourism sector in Portugal is dominated by SMEs, which account for 95 % of the market. Given their small economic size and turnover, Portuguese tourism companies have very limited experience of ventures abroad and tend to concentrate their activities in Portugal. It can, therefore, be reasonably assumed that the current project will have a demonstration effect among other Portuguese tourism market players as regards the profitability and sustainability of foreign investment projects.

(c) Although the investment had a very limited impact in terms of direct job creation in Portugal, the implementation of the project benefited the Portuguese companies that coordinated the project, monitored its implementation and supplied material and equipment.

(d) The Brazilian subsidiary pays the Portuguese parent company a management fee for the services it provides and, in so doing, increases its turnover and has a positive effects on the State's tax revenue.

(e) The positive cash flows generated by the Brazilian company will, according to the Portuguese authorities, be transferred to Portugal, primarily in order to repay the outstanding debt contracted by Vila Galé Cintra to finance part of the construction and refurbishment of the hotel. Once this debt has been repaid in full, the income from Brazil may be reinvested in Portugal in line with the company's strategy.

(35) For the reasons mentioned in recitals 32 to 34, the aid can be considered as having a positive impact on the tourism sector in Portugal and an equally positive effect on cohesion.

Incentive effect of the aid

(36) The present case concerns the first venture abroad by the recipient. Its shareholders too have no experience of foreign investment in the tourism sector. As mentioned previously, the companies involved in the investment are small players on the markets concerned. The cost of the investment is equivalent to 12 % of their combined annual balance-sheet total (1999 values). The project therefore entails a significant risk for the financial situation of the companies involved.

(37) The Brazilian market presents some serious difficulties for potential investors. Firstly, there is the marked exchange-rate volatility of the national currency. Secondly, the recent economic and financial crisis in

([15]) OJ C 135, 6.6.2002, p. 1.

Argentina has led to some instability on the Brazilian capital market. Thirdly, there are some bureaucratic difficulties mainly related to the transfer of financial funds to Brazil, which are controlled by the Central Bank.

(38) Although the recipient is not an SME within the meaning of the Community definition, it encounters similar difficulties in carrying out this type of investment, given its lack of experience at international level, its small market share, the size of the investment compared with its financial position and the problems specific to the country that make it difficult for it to enter the market.

(39) The Portuguese authorities have stated that the application for public support was made before the investment started, even though it has been carried out unaided. The aid schemes under which this individual application was submitted (N 667/1999 and N 96/1999) contain a clause which requires that an application for aid be submitted before work on the project is started. This requirement is in accordance with point 4.2 of the guidelines on national regional aid ([16]) and was met in the present case. The fact that the recipient applied for public financial assistance before embarking on the investment is proof that the required incentive effect exists.

(40) For the reasons set out in recitals 36 to 39, and given that the investment represents the first foreign venture for a relatively small enterprise on a volatile foreign market (Brazil), the aid can be considered to have an incentive effect that will compensate the recipient for the additional financial risks incurred in investing in an unknown and risky market.

V. **CONCLUSIONS**

(41) The Commission has accordingly reached the conclusion that the proposed aid for Vila Galé — Cintra Internacional, Investimentos Turísticos, SA in respect of foreign direct investment contributes to the development of certain economic activities within the meaning of Article 87(3)(c) of the Treaty without adversely affecting trading conditions between Member States and thus is compatible with the common market provided that it is not co-financed by Community funds from the European Regional Development Fund.

(42) The granting of aid by Portugal to Vila Galé — Cintra Internacional, Investimentos Turísticos, SA in the form of a soft loan and a tax credit can therefore be authorised, provided that no Community funds are used.

(43) The Commission does not intend to use this Decision to lay down its future policy on foreign direct investment. It normally considers investment aid granted to large enterprises with a view to financing foreign direct investment to be incompatible with the common market, unless it can be proved that a project will contribute to the development of certain economic activities without adversely affecting trading conditions within the Community,

HAS ADOPTED THIS DECISION:

Article 1

The aid in the form of a soft loan and a tax credit which Portugal is planning to implement for Vila Galé — Cintra Internacional, Investimentos Turísticos, SA with a view to financing foreign direct investment in Brazil is, subject to the conditions set out in Article 2, compatible, pursuant to Article 87(1) of the Treaty, with the common market and, pursuant to Article 61(1) of the EEA Agreement, with the functioning of that Agreement.

Article 2

The soft loan and the tax credit to be granted to Vila Galé — Cintra Internacional, Investimentos Turísticos, SA must be financed exclusively by national funds. The measures may not be co-financed by Community funds from the European Regional Development Fund.

Article 3

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

Article 4

This Decision is addressed to the Portuguese Republic.

Done at Brussels, 15 October 2003.

For the Commission

Mario MONTI

Member of the Commission

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