STATE AID

C 76/97 (ex NN 115/97)

Spain

(98/C 266/05)

(Text with EEA relevance)

(Articles 92 to 94 of the Treaty establishing the European Community)

Commission notice pursuant to Article 93(2) of the EC Treaty to other Member States and interested parties concerning aid for Daewoo Electronics Manufacturing España SA (Demesa)

By the letter reproduced below, the Commission informed the Spanish Government of its decision to extend the Article 93(2) procedure.

1. PROCEDURAL ASPECTS

In June 1996, the Commission received a complaint from ANFEL, the Spanish federation of manufacturers of household appliances. The complaint mentioned the establishment by the Korean conglomerate Daewoo of a plant for the production of refrigerators in the Basque Country (Spain) which, according to the complainant, was receiving subsidies and fiscal incentives which went beyond the aid ceiling permitted for regional aid in the area. The Commission received further complaints from [.Ø.Ø., a competitor of Demesa; CECED, the European Committee of Manufacturers of Domestic Equipment and ANIE, the Italian Federation of Manufacturers of Household Appliances (through the Italian Permanent Representation).

By letter dated 21 October 1997, the Commission informed your Government that the case had been registered as non-notified aid, pursuant to Article 93(3) of the EC Treaty. It also pointed out that the information received from your Government was considered unsatisfactory.

On 16 December 1997, the Commission decided to open the Article 93(2) procedure in relation to:

— the fiscal credit applied as a 45% reduction of the final quota to be paid in corporate tax (¹) and other fiscal measures also granted in the framework of the fiscal regime of the Province of Álava (²) from which Demesa might benefit, in order to examine their cumulative effect with the abovementioned fiscal credit;

— Demesa’s free-of-charge use of a 500 000 m² plot in the Jundiz industrial estate since 1996 as well as a possible sale price for the land not being in line with market prices.

In the same letter, the Commission also decided to enjoin the Spanish Government to provide information enabling an assessment of:

— the non-refundable grant amounting to ESP 2 958,9 million covering 25% of the tangible investment in fixed assets (ESP 11 510,9 million) and the start-up expenses entered in the books as depreciable expenses (ESP 324,8 million), granted to Demesa respected all the conditions laid down in the regional aid scheme Ekimen (³);

— the investment costs provided by the Spanish Government (ESP 11 835,7 million) corresponded to the real amounts invested by Daewoo (the complainants alleged that the real cost of the plant would not be higher than ESP 5 785 million) (⁴).

2. THE BENEFICIARY

The beneficiary of the measures is the firm Daewoo Electronics Manufacturing España SA (Demesa), a 100% subsidiary of Daewoo Electronics Co., Ltd, one of the Daewoo Group’s companies. The firm was created in November 1996 and is established in the Jundiz industrial estate, where its production plant has been built.

¹ Sixth Supplemening Provision to Norma Foral 22/1994 of 20 December on the implementation of the budget of the Province of Álava for 1995, as extended by Norma Foral 33/1995 of 22 December (Fifth Supplemening Provision), Norma Foral 24/1996 of 5 July (Derogatory Provision, point 2.11) and Norma Foral 31/1996 of 18 December (Seventh Supplemening Provision).
² Norma Foral 24/1996 of 5 July on the corporate tax.
³ Approved by the Commission on 13 December 1996 and allowing an aid intensity of 25% gross.
⁴ The complainants have provided DG IV with a report in this sense drafted by a company specialised in building this kind of plant.
Daewoo Electronics Co., Ltd was created in 1971. It manufactures consumer electronic products and domestic appliances for both the Korean and foreign markets. Its sales in 1995 totalled USD 4,061 million worldwide.

3. THE INVESTMENT PROJECT

3.1. The Collaboration Agreement

A “Collaboration Agreement” was concluded on 13 March 1996 between the Basque regional authorities and Daewoo Electronics Co., Ltd. The Agreement stated the intention of Daewoo to establish a refrigerator manufacturing plant in the Basque country and the Basque regional authorities stated their commitment to collaborate in this investment by providing certain grants.

Daewoo would create a company with its seat in the Basque country (Demesa), whose purpose would be to sell consumer electronics and electrical products. The company would then establish a business plan which would be presented to the regional authorities for its approval.

Part 3 of the Agreement made reference to the grants and other facilities that the project could receive from the regional authorities. Demesa would be able to benefit, amongst others, from a non-refundable grant of up to 25% (which is the limit applicable to regional aid in the Basque country) of the tangible investments in fixed assets to be made in accordance with the project, and of the start-up expenses entered in the books of the company as depreciable expenses. This grant was to be awarded in the framework of the Ekimen aid scheme.

3.2. The business plan

Demesa concluded the business plan in September 1996 and then presented it to the Basque regional authorities. The plan, which covers the period 1996 to 2001, refers to the establishment of a plant in the Basque country for the manufacturing of refrigerators.

The foreseen investment is, according to the plan, of ESP 11,835.7 million, with the creation of 745 jobs. Sales were foreseen to begin in 1997, aimed mainly at the domestic (Spanish) market, as well as France and Italy. As of 1998, sales would extend to the UK, Germany and the rest of Europe. At the outset, the majority of the turnover would come from domestic sales, but exports would increase in importance each year, reaching over 60% of the total in three to four years.

3.3. Financing of the plan

According to the plan, the financing of the project would be done through different means and, in particular, through a non-refundable grant of up to 25% of the tangible investment in fixed assets, broken down as follows:

<table>
<thead>
<tr>
<th>(in million ESP)</th>
<th>Total investment</th>
<th>Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>474.4</td>
<td>118.6</td>
</tr>
<tr>
<td>Buildings</td>
<td>2,000</td>
<td>500</td>
</tr>
<tr>
<td>Production equipment</td>
<td>7,396.1</td>
<td>1,849</td>
</tr>
<tr>
<td>Moulds</td>
<td>1,603.5</td>
<td>400.9</td>
</tr>
<tr>
<td>Office equipment</td>
<td>36.9</td>
<td>9.2</td>
</tr>
<tr>
<td>Tangible assets</td>
<td>11,510.9</td>
<td>2,877.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(in million ESP)</th>
<th>Total investment</th>
<th>Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses prior to start-up</td>
<td>104.9</td>
<td>26.3</td>
</tr>
<tr>
<td>Monitoring</td>
<td>24.9</td>
<td>6.2</td>
</tr>
<tr>
<td>Training</td>
<td>162.7</td>
<td>40.6</td>
</tr>
<tr>
<td>Technical information</td>
<td>32.3</td>
<td>8.1</td>
</tr>
<tr>
<td>Depreciable expenses</td>
<td>324.8</td>
<td>81.2</td>
</tr>
</tbody>
</table>

According to the information presented, the total subsidy amounted to ESP 2,958.9 million, and was to be paid over the period of four years:
— ESP 30.5 million in 1996,
— ESP 1,557.6 million in 1997,
— ESP 759.9 million in 1998,
— ESP 610.9 million in 1999.

Amongst the conditions imposed by the scheme, to be eligible the project has to be implemented within a period of three years from the date of granting of the aid. The information provided by your Government mentioned that Demesa’s plan covered the period 1996 to 2001, i.e. six years. The financial forecasts provided also mentioned the payment of the subsidy over the period 1997 to 2001. Nevertheless, the Basque regional
authorities explain in a convincing way that the subsidies cover the period 1996 to 1999 and that the payment will be made over a period of three years (although given the date of signature of the contract, 24 December 1996, it will be split in four budgetary allocations). The Commission considers that the explanation given by the Basque regional authorities regarding this point is satisfactory.

The non-refundable grant covering 25% of the tangible investment in fixed assets was allegedly granted on 24 December 1996 within the framework of Ekimen, a regional aid scheme approved by the Commission by letter SG(96) D/11028 of 13 December 1996 (\(^1\)).

The scheme covers the period 1996 to 1998. Its purposes are regional development and the creation of jobs. The aid takes the form of a non-refundable grant or a soft loan (\(^2\)). It covers the creation of new establishments or the extension or modernisation of existing ones.

The beneficiaries are industrial companies, or those active in extractive activities or that provide services for the latter. They also have to comply with the following conditions:

- the investment project has to be technically, economically and financially viable;
- it has to be implemented within a period of three years from the date of concession of the aid;
- the investment has to be over ESP 360 million;
- it must entail the creation of a minimum of 30 jobs;
- a minimum of 30% of the investment has to be financed by the beneficiary’s own resources.

The eligible costs include land, buildings and plant, with a maximum of 25% net grant equivalent (\(^3\)) (35% for SMEs). Within the 25% limit, other expenses may be eligible. However, aid may not go beyond a limit of ESP 5 million per job created (except in the case of strategic projects) and a maximum of ESP 4 000 million per project.

The non-refundable grants are given according to the following percentages, depending on the type of project. The total aid granted cannot go, in any case, beyond the 25% (35% for SMEs) limit for regional aid in the Basque country:

- 10% as the general rule,
- an extra 5% for those projects considered strategic (i.e. those that consist of an investment of at least ESP 10 000 million or that create 300 jobs within three years),
- an extra 5% for those projects with a significant job creation (i.e. those that invest ESP 750 million and create 50 jobs),
- an extra 5% for those projects located within a preferential interest area (listed in Annex I of Decree 289/1996),
- Alternatively, there may be a 5% complementary increase based on the following criteria:
  - the project’s integration in the Basque industrial sector,
  - the project’s effects in a strategic sector for the Basque country,
  - the project’s significant job creation.

4. APPRAISAL

The Commission must examine first whether the non-refundable grant given to Demesa in the framework of Ekimen is covered by the general scheme and satisfies the conditions laid down in the decision approving it. From the outset, the Commission had serious doubts regarding the respect of the conditions laid down in the scheme. Therefore, according to the case law of the Court of Justice (\(^4\)), the Commission enjoined your Government on 16 December 1997 to supply all the information necessary in order to examine this question. This information was provided by your Government by letter dated 23 January 1998.

\(^1\) State aid N 529/96. The Decree of the Basque regional government establishing the scheme (Decree No 289/1996 of 17 December), was published in the Official Journal of the Basque Country on 23.12.1996.

\(^2\) The interest rate applied can be two and five points lower than the nominal interest rate.

\(^3\) The maximum limit for regional aid in the Basque country, according to the present Spanish map for regional aid (OJ C 25, 31.1.1996, p. 3).

\(^4\) The areas included are in industrial decline, included in objective 5b (structural funds) or some where fishing has a special incidence. Vitoria is not included in the list.

On the basis of the information currently available to the Commission, serious doubts remain about the conditions under which the scheme has been implemented in this case:

— The aid intensity in Ekimen is calculated according to the location of the beneficiary company and the type of project envisaged. To the general 10% which any eligible company receives, an extra 5% is granted to those projects considered strategic.

In relation to the strategic consideration of the investment, the Basque authorities refer to the economic theory of clusters as the basis of their industrial policy whose aim is to improve the competitiveness of their industry. This theory refers to the hypothesis that in order to improve the innovation and competitiveness levels within a given cluster/sector (the household appliances industry and its part suppliers constitute a cluster), a new, strong and external competitor has to be introduced into it. The Basque authorities consider that a new enterprise, such as Daewoo, will force the existing Basque industry in this sector to be more efficient. The justification of such a radical treatment is that companies in this sector are mainly cooperatives which do not compete among themselves and are not very dynamic.

The Commission cannot accept these arguments for the following reasons:

— the Commission has no information that the mechanisms for eligible cost control set out in the Ekimen aid scheme have been implemented with respect of the Demesa investment project. In addition, the Commission has not received from your authorities any independent audit detailing the effective investment costs of such project. On the other hand, the complainants have provided an estimate from an Italian firm generally recognised as the main constructor of this kind of plant in Europe, stating that the real cost of the investment cannot be higher than ESP 5,785 million. This estimate would include, amongst others, land, construction, machinery, equipment, technical facilities and other facilities,

— the consideration of any investment as strategic in a mature market is doubtful (\(^{(\ast)}\)). Both the Spanish and the European Committees of Manufacturers of Domestic Equipment (CECED and ANFEL) have stated that the sector suffers from excess production capacity and is a mature market where 95% of the sales are based on replacements. In the last two years, the size of the European market has diminished by 5%, which is a very significant figure for a mature industry. In 1996, an important part of the investments of the European companies were done outside the EU, in particular, in regions with lower labour costs.

The CECED and ANFEL declared that the refrigerators/freezers line is undergoing an increasing production over-capacity, which is more than 4 million units in the European Union and the European factories have a potential unused production capacity which varies from 15 to 45%. Consequently, it is difficult to understand that an investment in such a sector be considered as strategic,

— according to Demesa's business plan, the demand of refrigerators/freezers products in Spain has decreased since 1994 and the imports have increased so that the internal production has been reduced. In relation to the Basque country, the domestic appliances sector is one of the most significant ones and, considering both the manufacturers and the supplier industries, it reaches up to 6% GDP of the region. The participation of the Basque industries in the Spanish domestic appliances market reached 29% in 1994.

The Fagor group, located in the Basque country, is the leader in the Spanish domestic appliances sector (with a market share of 24%) and it has a significant and consolidated position in the European Union. The Basque authorities have always referred to FAGOR as a model for other companies not only in the region but also in the rest of Spain and in Europe.

Moreover, the arguments given by the Basque authorities are contradictory with Demesa's business plan which outlines the following strong points of the Basque domestic appliances industry:

1. the adequate competitive position of the Basque companies as to the modernisation of the production,

2. the predominant position of the Basque industry in the Spanish market (with the leadership of the Fagor group),

\(^{(\ast)}\) Such as it has been recognised by Daewoo itself in Demesa’s business plan.
3. the response capacity when facing new market conditions (development of new activities and conquest of new emergent markets),

4. the important role given to R&D,

5. and, finally, the existence of a domestic appliances cluster characterised by the intensification of the links among the different manufacturers, which guarantees the competitiveness of the companies in this sector.

On the basis of the above, the Commission raises the following points:

1. once more, it has to express reservation about the strategic condition of this investment for the Basque industry which will more likely suffer its consequences,

2. the assertion by the Basque authorities that it is particularly necessary to increase the competitiveness of the Basque domestic appliances cluster with the entry in the market of Demesa is not supported by the facts which show that the Basque domestic appliances sector has a strong position within the EU,

3. moreover, the Commission has to underline that until now the Spanish authorities have not given any indication of the impact of the investment for the Basque, Spanish and European industry.

4. consequently, the Commission considers that the justification of the strategic character of the investment given by the Basque authorities is contradictory and unsatisfactory and that in view of the situation of the sector, only regional and other kinds of incentives (which have been the object of the opening of the Article 93(2) procedure by letter dated 16 December 1997) may have convinced Daewoo to carry out such an investment,

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Consequently, in relation to the total aid intensity which has been granted to Demesa under the Ekimen when there are both an important strategic component of the project and a significant number of jobs created, so that they could decide to grant 25 %. As indicated above, the Commission has reservations regarding the strategic consideration of the project, as well as the effective job creation of this investment.

The Commission also enjoined your authorities to provide information on the effective investment costs which, according to the complainants, had been overvalued. Were this to be the case, the company would actually be receiving aid covering 51,14 % of the investment.

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The Commission would like to point out the following aspects:

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In their letter dated 23 January 1998, the Basque authorities reply that the subsidies will be paid following presentation of invoices and state that an external audit carried out by an independent consultant to check the equivalence between data provided by the company and Daewoo's real expenses is at the Commission's disposal.

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both the Collaboration Agreement and the regional aid scheme Ekimen refer to the Department of Industry, Agriculture and Fisheries, as the body in charge of the control and follow-up of the projects under the scheme. The Commission would like to be informed of this body’s conclusions about the costs alleged by Daewoo,

— if the audit is already available, the Commission does not understand the reason why the Spanish authorities have not submitted it to the Commission. Moreover, recent press releases (\(^{11}\)) allege that only now the Basque Government (in the Basque Parliament) is asking for such an audit.

On the basis of the unsatisfactory information provided, the Commission is so far not able to conclude that the figures on the effective investment costs submitted by the beneficiary of the aid correspond to a normal investment in the sector.

5. CONCLUSION

The information provided by your authorities have not served to remove the serious doubts expressed in the Commission’s decision of 16 December 1997 as regards

— the effective respect of the conditions laid down in the Ekimen aid scheme to award the non-refundable grant reaching 25% (the maximum aid intensity allowed for the Basque country) of the tangible investment in fixed assets, and of the start-up expenses entered in the books as depreciable expenses.

— the correlation between the investment costs provided by the Spanish Government and the real amounts invested by Daewoo.

Accordingly, the Commission, due to the serious doubts which remain, informs your Authorities that it considers the aid received by Demesa — regarding the part not covered by the general rule allowing an aid intensity of 10% of the effective eligible costs as a new individual aid not covered by the approved regime, since it appears that the conditions laid down in the regime in question have not been completely fulfilled.

Therefore, the Commission hereby informs the Spanish Government that it has decided to extend the current Article 93(2) procedure concerning this new individual aid, in order to assess its compatibility with the Treaty. In this respect, the Commission has doubts regarding the compatibility of the aid because, for the reasons previously outlined, the strategic nature of the investment and the net employment creation have not been demonstrated.

In addition, both the Cooperation Agreement signed between Daewoo and the Basque regional authorities, and the complainants recognise that the sector suffers from excess of supply in Europe. It should be also recalled that in this sector 95% of the sales are based on replacements. The difficult situation of the sector is confirmed by the fact that many producers are restructuring their activities by closing down several plants. Aid given to Demesa is therefore likely to include a further job reduction in its competitor’s plants in Spain and in the rest of the Community.

The Commission approved the regional aid scheme Ekimen (\(^{2}\)) considering that it favoured the regional development without affecting adversely trading conditions to an extent contrary to the common interest. However, as already said, in the present case it appears that the conditions laid down in the regime in question have not been completely fulfilled. Therefore, due to the difficult situation of the sector, the demonstration that aid to Demesa will not adversely affect trading conditions to an extent contrary to the common interest has still to be made by your authorities.

As part of the procedure, your authorities are hereby invited to present, within one month of this letter, their comments as well as any other information they might consider relevant for the assessment of the case.

The Commission would draw your attention to the communication published in the Official Journal of the European Communities C 318 of 24 November 1983 and to the letters sent to all Member States on 4 March 1991 and 22 February 1995, in which it was stipulated that any aid granted unlawfully may have to be recovered from the recipient firm in accordance with the procedures laid down by the national law, including interest calculated at the reference rate used for regional aid and with effect from the date on which aid was granted.

The Commission hereby requests that your Government inform the affected company without delay of the


(\(^{11}\)) See footnote No 3.
initiation of the procedure and of the fact that it might have to repay any aid improperly received.

The Commission also informs your Government that it will publish the present letter in the *Official Journal of the European Communities* giving the other Member States and other interested parties notice to submit their comments. Please note that third parties demonstrating sufficient interest can obtain a copy of this letter. You are therefore invited to inform the Commission, within seven days following the notification of this letter, whether you consider that it contains any significant market sensitive information which you would wish to be deleted before publication. You should state clearly the specific reasons in each case. If the Commission does not receive a reasoned request within the stipulated period, it will consider that you agree to the publication of the full text of this letter. Your request should be sent by registered letter or fax to:

European Commission,  
Directorate General for Competition (DG IV),  
State Aid Directorate,  
Rue de la Loi/Wetstraat 200,  
B-1049 Brussels,  
Fax No (32-2) 296 98 13.’

The Commission hereby gives the other Member States and interested parties notice to submit their comments on the measures in question within one month of the date of publication of this notice to:

European Commission,  
Rue de la Loi/Wetstraat 200,  
B-1049 Brussels.

The comments will be communicated to the Spanish Government.