By the letter reproduced below, the Commission notified the Portuguese Republic of its decision to initiate the procedure laid down in Article 93(2) of the EC Treaty.

The Commission wishes to inform your authorities that, having examined the plan to grant aid referred to above, it has decided to initiate the procedure laid down in Article 93(2) of the EC Treaty.

As a result of the project, your authorities stated that the company's capacity to extrude polypropylene yarn would diminish from [...] tonnes per year to [...] tonnes per year, a reduction of 2,89%. Your authorities also pointed out in the letter dated 12 August 1998 that this 2,89% capacity reduction takes place in the context of a general capacity reduction trend in the company since 1992. Cotesi had already reduced installed capacity by 2,1% immediately before the project (from 1992 to 1995) and foresees a further 2% capacity cut in the next three years (1999 to 2001).

2. The aid planned

The eligible costs for the project total ECU 10 006 095 and the proposed financial support comprises (including the element of Community co-financing) ECU 2 883 864. Of this amount, ECU 318 446 is a direct subsidy while ECU 2 565 418 is in the form of a reimbursable subsidy ("subsídio reembolsável") at zero interest, repayable over a period of five years with a grace period of eighteen months. The Commission calculates the total amount of aid (including the grant equivalent of the "subsídio reembolsável") to be approximately ECU 899 696, with an aid intensity of approximately 9% (gross), which is well below 50% of the ceiling of 75% (gross) allowed under the PEDIP II programme, which the Commission authorised as compatible with the common market by virtue of Article 93(3)(a) of the EC Treaty (1).

The proposed aid would be awarded under the programme for the modernisation of the Portuguese textile and clothing industry (IMIT—Iniciativa para a Modernização da Indústria Têxtil), as foreseen by Council Regulation (EC) No 852/95 of 10 April 1995 (OJ L 86 of 20 April 1995), which stipulated that the programme would be jointly financed by the Member State and the Community and executed in conformity with the applicable Structural Funds regulations.

3. Assessment

Article 92(1) of the EC Treaty lays down the principle that, except where otherwise allowable, aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade among Member States, incompatible with the common market. Similarly, Article 61(1) of the EEA Agreement states that, except where otherwise allowable, such aid is incompatible with the functioning of the EEA Agreement.

The proposal to award aid to Cotesi undoubtedly constitutes aid within the meaning of the articles mentioned above as it would allow the company to carry out the investment in question without having to bear the full cost. There is significant intra-EEA trade in the products concerned by the investment placed on the market by the company (CN Codes 5607 04 90, 6305 32 81, 5608 11 91 and 6002 43 31), totalling about 30 000 tons in 1997. Accordingly, it can be affirmed that the proposed aid would be likely to distort competition and affect trade within the meaning of Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

The exception provided in Article 92(3)(a) of the EC Treaty and Article 61(3)(a) of the EEA Agreement relates to aid intended to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. By enabling the company to carry out the investment in question, the proposed aid would promote the economic development of Carvalhos, an Objective 1 area. However, the effects of the aid on the synthetic fibres sector are subject to control even for the most underdeveloped areas of the Community.

Since 1977, the conditions under which aid may be awarded to synthetic fibres producers by way of support for such activities have been prescribed by a code whose terms and scope have been revised from time to time, most recently in 1996 (\(^\) ).

The current code requires the notification of any proposal to award aid, in whatever form, irrespective of whether the Commission has authorised the scheme concerned, (except where the aid would satisfy the de minimis criterion) to synthetic fibres producers by way of support for any of the following activities:

- extrusion/texturisation of all generic types of fibre and yarn based on polyester, polyamide, acrylic or polypropylene, irrespective of their end-uses, or
- polymerisation (including polycondensation), where it is integrated with extrusion in terms of the machinery used, or
- any ancillary process linked to the contemporaneous installation of extrusion/texturisation capacity by the prospective beneficiary or by another company in the group to which it belongs and which, in the specific business activity concerned, is normally integrated with such capacity in terms of the machinery used.

In the present case, the proposed aid would be awarded to a large extent in support of the production of synthetic fibres which fall within the scope of the code, namely the installation of new capacity for the extrusion of polypropylene filament yarn. The extrusion of polyethylene on the other hand falls outside the scope of the code.

The Commission regrets that the Portuguese authorities did not notify the project much sooner, bearing in mind that the company applied for the aid in 1996, the year in which the project started. Nevertheless, the Commission notes that the proposed aid conforms with the IMIT specific programme which the Commission authorised on 5 October 1995 and is carried out within the framework of the above-referred PEDIP II programme.

The code sets out in detail the criteria to be applied when the Commission scrutinises proposals coming within the scope of control. It states, inter alia, that in assessing the compatibility of the proposed aid the fundamental consideration is the effect of that aid on the markets for the relevant products, namely the fibre/yarn whose production would be supported by the aid. In all cases and irrespective of the state of the market for the relevant product and the effect of the aid on that market, the code provides for the limitation of the intensity of aid. Investment aid will be authorised for companies which are not SMEs, at up to 50 % of the applicable aid ceiling, only on condition that either the aid would result in a significant reduction in the relevant capacity or the market was characterised by a structural shortage of supply and the aid would not result in a significant increase in the relevant capacity.

Given that the market does not appear to be characterised by a structural shortage of supply, the Commission must be satisfied that the aid results in a significant reduction in the relevant capacity, which is the capacity to extrude polypropylene filament yarn.

The Commission concludes from the data transmitted by your authorities that the capacity reduction during the course of the project corresponds to only 2.89%. Even considering this capacity cut in the larger context of past capacity cuts of the order of 2.1% (between 1992 and 1995) and of foreseen capacity cuts of a further 2% after the end of the project, the Commission is not satisfied that, as required by the Code on aid to the synthetic fibres industry, the aid results in a significant reduction in the relevant capacity.

Therefore, on the basis of the information submitted to it, the Commission has doubts about the compatibility of the proposed aid with the common market and the functioning of the EEA Agreement because it would not appear to conform with the current Code on aid to the synthetic fibres industry.

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 93(2) of the EC Treaty, requests the Portuguese Republic to submit its comments and to furnish all such information as may help to evaluate the plan to grant aid, within one month following the date of receipt of this letter. In particular, your authorities should, having regard to the indicators mentioned in the Code on aid to the synthetic fibres industry, provide the arguments which they consider demonstrate that the aid results in a significant reduction of the relevant capacity, in view of the circumstances of the company in question. The Commission requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind the Portuguese Republic that Article 93(3) of the EC Treaty has a suspensive effect, and would draw your attention to the letter sent to all Member States on 22 February 1995, stating that all aids granted unlawfully could be recovered from the recipient according to the relevant provisions of national law; the amounts thus recovered will include interest calculated on the basis of the reference rates used to calculate the grant-equivalent for the purposes of regional aids, running from the date on which the aid was payable to the recipient until the date of actual recovery.

The Commission warns the Portuguese Republic that it will inform interested parties by publishing this letter in the Official Journal of the European Communities. 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 Communities 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 following the date of such publication.'

The Commission hereby gives notice to the other Member States and interested parties to submit any observations on the measures in question within a month of the date of this publication to the following address:

European Commission
Directorate-General for Competition (DG IV)
Directorate H (State aid II)
Rue de la Loi/Wetstraat 200
B-1049 Brussels
Fax (32-2) 296 95 79.

These comments will be communicated to the Portuguese Republic.