COMMISSION DECISION

of 7 March 2007

on State aid C 41/2004 (ex N 221/2004) Portugal Investment aid to ORFAMA, Organização Fabril de Malhas S.A.

(notified under document number C(2007) 638)

(Only the Portuguese version is authentic)

(Text with EEA relevance)

(2007/494/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 those provisions [1] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) By letter of 5 May 2004 (registered as received on 19 May), Portugal notified the Commission of its intention to provide aid to Organização Fabril de Malhas S.A. (hereinafter 'ORFAMA') in order to help finance an investment by the company in Poland. The Commission requested further information by letter of 15 July 2004, to which Portugal replied by letter of 30 September 2004 (registered as received on 5 October).

(2) By letter of 6 December 2004, the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.

(3) By letter of 4 February 2005 (registered as received on 9 February), the Portuguese authorities presented their comments in the context of the above-mentioned procedure.

(4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [2]. The Commission called on interested parties to submit their comments. There were no comments from third parties.

[1] OJ C 14, 20.1.2005, p. 2.

[2] See footnote 1.

II. DETAILED DESCRIPTION OF THE AID

The beneficiary

(5) ORFAMA is a producer of fashion knitwear located in Braga, a region falling under Article 87(3)(a) of the EC Treaty. It was set up in 1970. It has 655 employees and an annual turnover of about EUR 25 million. It owns 45 % of another garment producer 'Marrantex'. The company sells most of its products in the European Union (50 %), the United States and Canada (38 %) and Japan (5 %) [3].

The project

(6) The project consists in the acquisition of two textile companies, Archimode SP and Wartatex SP, located in Lodz, Poland. Both companies are involved in clothing production.

(7) ORFAMA started working with the Polish companies in 1995 under a subcontracting arrangement whereby these companies accounted for some 30 % of ORFAMA's turnover. ORFAMA then decided to consolidate its presence in Poland and in Eastern European markets by acquiring the two Polish companies.

(8) The Portuguese authorities noted that ORFAMA will maintain the capacity currently installed in Portugal without relocating activities to Poland. The objective of the project is to raise the volume of production, to free up capacity in Portugal for the manufacture of higher-value-added products and to gain access to the German and Eastern European markets.

(9) The Portuguese authorities considered that this project would contribute to strengthening the competitiveness of the textile industry in the European Union, given that both ORFAMA and the Polish companies face mounting competition from Asian countries, in particular China. The project was completed in December 1999.

[3] All figures as provided in the notification.

The aid

(10) The investment in acquiring both companies amounted to EUR 9 217 516 (EUR 8 900 205 for Archimode and EUR 317 311 for Wartatex). ORFAMA financed 97 % of the investment with bank loans and the remainder with own capital.

(11) Portugal intends to grant ORFAMA a tax credit of EUR 921 752, corresponding to 10 % of the total eligible investment costs for the above-mentioned project.

(12) The measure was notified under a Portuguese scheme for promoting the modernisation and internationalisation of economic agents [4]. This scheme requires aid to large companies to be notified on an individual basis.

(13) The Portuguese authorities explained that the request for aid was presented on 31 March 2000. The project was carried out just before this date for strategic reasons, on the assumption that it would be eligible for aid under the relevant Portuguese legislation. Internal delays meant that the Portuguese authorities notified the aid only in January 2004.

III. GROUNDS FOR INITIATING THE PROCEDURE

(14) The Commission, in its decision to initiate the procedure in respect of the present case, stated that it would examine the measure in the light of the derogation under Article 87(3)(c) of the EC Treaty in order to determine whether the aid could be considered as facilitating the development of a certain economic activity without adversely affecting trading conditions to an extent contrary to the common interest.

(15) The Commission also stated that it would examine the measure on the basis of the criteria normally used for assessing aid to large companies for foreign direct investment (FDI) projects, given the similarity of this case to cases of investment aid outside the European Union. The measure was notified under a Portuguese scheme for promoting the internationalisation of Portuguese companies. It shuld be noted that, at the time the project was carried out and the aid applied for, Poland was not yet a member of the European Union. The investment thus qualifies as foreign direct investment under the relevant Portuguese aid scheme.

(16) In these cases the Commission normally weighs the benefits of the measure, in terms of its contribution to the international competitiveness of the EU industry concerned, against possible negative effects in the Community, such as the risks of relocation and any adverse impact on employment. The Commission also takes into account the necessity of the aid by reference to the risks associated with the project in the country concerned as well as to the deficiencies of the company, such as those faced by SMEs. One other criterion relates to a possible positive regional impact. Lastly, the Commission excludes any aid to export-related activities.

(17) In this connection the Commission noted that, as the investment was taking place in a Member State of the European Union, the impact of the aid on the Community market was likely to be greater than in the case of aid for a project in a third country.

(18) The Commission also questioned what the impact would be on employment and other factors for the regions concerned or indeed for the relevant industries in both Member States, as well as whether the same project would receive aid from Poland.

(19) It was also doubtful whether the aid was necessary and/or provided any incentive for the applicant to carry out the investment since the project had been completed even before ORFAMA applied for State aid. Lastly, the Commission questioned whether the project could qualify as 'initial investment' within the meaning of the Commission national regional aid guidelines [5]. It requested Portugal to submit comments and provide any information that might help with the assessment of the case.

[4] N 96/99 (OJ C 375, 24.12.1999, p. 4).

[5] See point 4.4 of the Guidelines on national regional aid (OJ C 74, 10.3.1998, p. 9). According to these guidelines, initial investment is investment in fixed capital relating to the setting-up of a new establishment, the extension of an existing establishment or the starting-up of an activity involving a fundamental change in the product or production process of an existing establishment (through rationalisation, diversification or modernisation). Initial investment is defined by reference to a set of eligible items of expenditure (land, buildings and plant/machinery, intangible assets and/or wage costs).

IV. COMMENTS SUBMITTED BY THE PORTUGUESE AUTHORITIES

(20) The Portuguese authorities noted that, although the investment took place within the European Union, it contributed to strengthening economic links with Eastern European markets. They stated that ORFAMA, Archimode and Wartatex were located in assisted regions with high unemployment rates. The textile industry accounts for 331 000 jobs in Poland and 95 446 jobs in Portugal. Employment rates in the industry declined by 15 percentage points between 2000 and 2003 in Portugal. The Portuguese authorities considered that, in this context, ORFAMA's investment contributed to maintaining employment in both the source and the host country and would have a positive impact on the regions concerned.

(21) The Portuguese authorities considered that the necessity of the aid was justified by the fact that this was the first foreign direct investment project by ORFAMA. It required a significant financial effort of EUR 9 217 516, of which EUR 8 978 362 was financed by bank loans and the remainder by the company's own capital. The aid would compensate ORFAMA for part of this effort.

(22) The project also aims to modernize production and information technologies in the Polish companies with a view to increasing productivity and improving product quality and energy efficiency. ORFAMA intended to replace industrial equipment. In the opinion of the Portuguese authorities, the project thus contributes to facilitating the development of an economic activity within the meaning of Article 87(3)(c) of the EC Treaty.

(23) Lastly, the Portuguese authorities argued that the aid would not have a negative impact on intra-Community trade. The investment in question concerned simply consolidates a pre-existing commercial relationship, from a subcontracting situation to one of ownership. In support of this argument, the Portuguese authorities provided statistics showing that between 1999 (when the investment took place) and 2003 ORFAMA's sales in Poland remained stable. In the same period ORFAMA's overall sales in the EU actually declined.

(24) Similarly, Poland's own exports to the EU of the products concerned also declined during this period.

(25) There were no comments from third parties.

V. ASSESSMENT

Presence of aid within the meaning of Article 87(1) of the EC Treaty

(26) Under Article 87(1) of the EC Treaty, 'any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market'.

(27) The Commission, in its decision of 6 December 2004, concluded that the aid fell within the scope of Article 87(1) of the EC Treaty for the following reasons: by helping ORFAMA to carry out an investment in Poland, the notified measure favours a certain undertaking or the production of certain goods; the industry concerned (textiles) is the subject of substantial trade within the European Union and the aid may thus distort competition there; and the aid is financed through state resources. These conclusions have not been contested by the Portuguese authorities and are hereby confirmed.

Compatibility of the aid with the EC Treaty

(28) The Commission indicated that it would assess the compatibility of the aid with the EC Treaty in the light of the derogation under Article 87(3)(c) of the Treaty, which authorises aid 'to facilitate the development of certain economic activities' where such aid does not adversely affect trading conditions to an extent contrary to the common interest. It must, therefore, assess whether the aid will contribute to the development of fashion knitwear and clothing production and/or other economic activities in the European Union without adversely affecting trading conditions between Member States.

(29) In the decision to initiate the procedure, the Commission also noted that it would take into account certain criteria which it had applied in previous cases of aid to large companies for outward foreign direct investment projects (see paragraph 16) with a view to striking a balance between the benefits of the measure in terms of contributing to the international competitiveness of the EU industry concerned (e.g. whether the aid is necessary by reference to the risks associated with the project in the country of investment) and its possible negative effects on the EU market.

The necessity of the aid

(30) As a general principle of State aid legislation, in order for aid to be compatible with the common market, it must be demonstrated that the aid leads to an additional activity by the beneficiary which would not be carried out without the aid. Otherwise, the aid would simply distort without having any positive counter-effect.

(31) The Commission doubted already in the decision to initiate the procedure that the aid was necessary for ORFAMA to carry out this investment.

(32) According to the information available, ORFAMA is a well-established producer in the EU market, producing for well-known brands as well as under its own brand. The Portuguese authorities argued here that this was the first foreign direct investment project of ORFAMA and that the project involved risks relating to structural and cyclical aspects of the Polish market (namely the fact that Poland was in the process of negotiating accession to the European Union) and to conditions inherent in the structural factors of the promoter and of the country of origin. However, they did not specify the exact form that such risks took.

(33) The Portuguese authorities considered that the necessity of the aid was justified by the fact that this was the first foreign direct investment project of ORFAMA. The Commission, however, notes here that ORFAMA's business relations with Archimode and Wartatex started in the 1990s, when ORFAMA began producing garments under a subcontracting arrangements with these companies. In 1995 these two Polish companies already accounted for some 30 % of ORFAMA's turnover. ORFAMA was therefore familiar with the functioning of these companies before carrying out the project and thus has experience of both the Polish and international markets. Indeed, the beneficiary's objective of expanding production and gaining access to the Polish and neighbouring markets was already partly met even prior to acquiring these companies or applying for aid. Portugal itself seemed to confirm this assessment when it stated in the notification that ORFAMA's decision to invest in Poland was determined partly by the knowledge that the beneficiary already had of the Polish market and of the companies it acquired, thereby limiting the risks associated with the investment. The Commission, therefore, considers that the investment in question was essentially a financial operation for acquiring the Polish companies concerned in the context of an existing commercial relationship, rather than a first substantive foreign investment [6].

(34) The Commission also emphasises that ORFAMA applied for the aid only after the project had been completed and so did not comply with the 'incentive effect' criterion normally required by the Community rules on national regional aid [7]. It also notes that ORFAMA was apparently able to finance the investment out of own resources and by resorting to commercial loans obtained even before it applied for the aid.

(35) Accordingly, the Commission concludes that Portugal has failed to demonstrate that the proposed aid is necessary to compensate for any specific risks associated with the project.

The impact of the aid on the Community market

(36) The Commission has maintained in previous cases that aid for foreign direct investment is likely to strengthen the beneficiary's overall financial and strategic position and thus affect its relative position with regard to competitors on the EU market [8].

(37) Portugal has argued in this respect that the objective of the investment is to allow ORFAMA to expand production, which has reached its capacity limits in Portugal, and to increase productivity by taking advantage of lower costs and a generally skilled and younger workforce in Poland. However, according to the Portuguese authorities, this project will also contribute to strengthening the European industry concerned by increasing the supply of products of EU origin and by promoting EU brands in the face of increasing competition from imports. For Portugal, granting aid to companies such as ORFAMA (and, indirectly, Archimode and Wartatex) is essential to ensuring that the EU textile industry remains competitive on EU and international markets.

(6) A similar concept to that applied in point 4.4 of the Guidelines on national regional aid, which relates to 'initial investment'; see footnote 5.

(7) See point 4.2 of the Guidelines on national regional aid, which states that an application for aid must be submitted before work on the project is started in order to ensure that the required incentive effect exists (OJ C 74, 10.3.1998, p. 13).

(8) See Commission Decision 1999/365/EC in Case C 77/97 (Austrian LiftGmbH – Doppelmayr).

(38) The Commission notes, however, that the present investment is located in a country (Poland) that is now a member of the EU. The aid would affect a sector (textiles) which is presently under considerable pressure from the liberalisation of imports in January 2005. Other EU companies may be interested in reorganising themselves along similar lines to ORFAMA and the aid would thus give ORFAMA an advantage in comparison with companies that do not benefit from such aid.

(39) Portugal also stressed that the aid would benefit employment in both the Portuguese and the Polish regions concerned (Braga and Lodz respectively), which are assisted regions with high unemployment rates (see paragraph 20), but did not specify the way in which the aid could have an impact on employment in those regions.

(40) Lastly, the Commission notes that, even if the investment by ORFAMA could have a positive impact on the regions concerned (which was not demonstrated), this cannot, in principle, be attributable to the aid since, as explained above, the aid has no incentive effect in this case as the project was concluded prior to ORFAMA's requesting the aid and was not necessary to carry out the investment.

(41) When assessing the compatibility of aid, the Commission takes a close look at the balance between its positive and negative effects and determines whether its beneficial effects for the Community outweigh its negative effects on competition and trade on the Community market. On the basis of the above, it is not convinced that granting aid to ORFAMA in respect of its investment in Poland would help to improve the competitiveness of the European industry or would have a positive impact on the EU regions concerned. On the contrary, the aid would be likely to strengthen the position of the beneficiary to the detriment of its competitors not receiving State aid in a market that is characterised by intensive competition and trade. Therefore, the Commission considers that the aid does not have any positive effects for the Community that would outweigh its negative impact on competition and trade on the Community market.

VI. **CONCLUSION**

(42) On the basis of the above, the Commission concludes that the Portuguese authorities have failed to demonstrate that the aid is necessary for ORFAMA to carry out the investment concerned. The aid would thus simply have a distorting effect on competition in the common market without contributing to any additional activity on the part of the beneficiary. On this basis, the aid cannot be considered to facilitate the development of an economic activity within the meaning of Article 87(3)(c) of the EC Treaty without adversely affecting trading conditions to an extent contrary to the common interest and is therefore incompatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The tax incentive of EUR 921 752 proposed by Portugal for ORFAMA (Organização Fabril de Malhas S.A.) for its investment in Poland is incompatible with the common market since it does not meet the criteria under Article 87(3)(c) of the EC Treaty and must not therefore be implemented.

Article 2

This Decision is addressed to the Portuguese Republic.

Done at Brussels, 7 March 2007.

For the Commission

Neelie KROES

Member of the Commission