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WORKING LANGUAGE

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**Subject: State aid N 467/08 – Portugal
Aware-P programme "advanced water management and rehabilitation in
Portugal"**

Sir,

The Commission wishes to inform Portugal that, having examined the information supplied by your authorities on the matter referred to above, it has decided to raise no objections to the proposed aid measure.

I. PROCEDURE

- (1) By electronic notification of 18 September 2008, the Portuguese authorities notified the above mentioned measure. A meeting with the Portuguese authorities was held on 29 October 2008. By letters dated 17 November 2008 and 1 December 2008 Portugal submitted additional information.

II. DETAILED DESCRIPTION OF THE AID

- (2) **Legal basis:** *Protocol 38A of the EEA Agreement¹ which establishes a Financial Mechanism through which EFTA States contribute to the reduction of economic and social disparities in the EEA.*

¹ OJ L 130, 29.4.2004, p. 3.

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- (3) **Budget:** The estimated total project cost is EUR 1 308 558. The EEA grant will not exceed the amount of EUR 747 841 (57.15% aid intensity).
- (4) **Duration:** until 30 April 2011.
- (5) **Description:** The purpose of the Aware-P project is to develop and implement a computer tool for the management of water supply and waste water infrastructure, with the overall objective of streamlining maintenance/rehabilitation operations and improving infrastructure management generally.
- (6) Many water distribution and wastewater drainage networks in Europe are reaching the end of their service life. Pipes show signs of deterioration, resulting in increased break rates, leakages, poorer water quality and a less efficient water distribution service. Water utilities must take investment decisions in order to maintain acceptable service levels. Such decisions must be well grounded, based on technical, functional and socio-economic criteria. One of the difficulties lies in the fact that water infrastructure is buried underground and not easy to inspect, which makes decisions on maintenance and works difficult and costly. The AWARE-P project intends to provide water utilities with computer-based tools designed to support their decision-making process in this respect in order to improve water management and the quality of service offered to the general public.
- (7) The project will build on the results of the CARE-S and CARE-W research projects, which received Community funding in the context of the 5th Research Framework Programme. These projects led to the development of a methodology and software prototypes designed to assist water utilities in planning rehabilitation interventions. However, significant software developments are still needed to turn the prototypes into user-friendly, professional tools which can be used in the water industry.
- (8) The AWARE-P project will involve the following activities: development of a professional software product for infrastructure management; development of rehabilitation manuals, training of the water and wastewater utilities in Portugal, implementation of demonstration pilot-studies, creation of a web-based dissemination platform and scientific papers.
- (9) A technical and scientific partnership has been established between public research institutes, key water utilities in Portugal and a software house. The members of the AWARE-P partnership include LNEC (the Portuguese National Civil Engineering Laboratory), IRAR (the Portuguese Water Regulator), SINTEF (the Norwegian Civil Engineering Laboratory), the Engineering School IST (Instituto Superior Tecnico) and YDREAMS, a Portuguese private software house. LNEC and SINTEF, as members of the CARE-W/CARE-S consortia, will handle the technical and scientific components of the project, with the assistance of IST (for the training materials). IRAR will provide close support during the development stage and will promote the use of the produced materials in Portugal. YDREAMS will recode and produce fully finished versions of the software programme.

- (10) All participants in the projects, including YDREAMS, will be required to provide a fraction of total eligible project costs, ranging from a minimum of 3.03% to a maximum of 8.74%.
- (11) All Portuguese water and wastewater utilities will have free access to the results of the project upon its completion. However, a number of selected utilities will participate in the process from the beginning. These end-users will play an advisory role to the developers. At a later stage, they will test the software by developing rehabilitation plans for selected case-studies.
- (12) As soon as the final versions of the project materials are available, IRAR will freely distribute them to all Portuguese water supply and wastewater utilities. In parallel, dissemination activities and training courses will contribute to creating awareness and spread know-how. The project will entail efficiency gains for water utilities.
- (13) The project is mainly addressed to Portuguese water supply and wastewater utilities. However, after the completion of the project, the consortium aims to provide the opportunity for other countries to use the material developed. This will be achieved by providing the code of the software application in open source as well as an executable version. The user interface will be in English. The software user manuals will be provided in Portuguese and English. The AWARE software will be made available free of charge on the market worldwide. The software developer will provide a project warranty to the other partners of the project for a period of 12 months.
- (14) **Beneficiaries:** The grant will be awarded to the partners in the Aware-P project to cover project costs. However, as explained above, the project will benefit water utilities, which will receive project deliverables free of charge. Therefore, such utilities should be considered the final beneficiaries of the project.

III. ASSESSMENT

Applicability of the EU State aid rules

- (15) The project will be financed by the EFTA States on the basis of Protocol 38 A of the EEA Agreement² (EAA Financial Mechanism). According to Article 4 (2) and (3) of the Protocol, the applicable rules on State aid shall be complied with, and the Commission of the European Communities should screen the proposed projects for their compatibility with Community objectives.
- (16) The project concerns Portugal. Therefore, the applicable aid rules are those laid down in Articles 87 to 89 of the EC Treaty.

² Inserted by the 2004 EEA Enlargement Agreement (OJ L 130, 29.4.2004, p. 14.)

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

- (17) Article 87(1) of the Treaty provides that “*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*”.
- (18) For a measure to constitute State aid, it must cumulatively meet the criteria set out in Article 87(1): it must be granted by the State or through State resources, it must confer an economic advantage to the beneficiaries, this advantage must be granted selectively and the measure must threaten to distort competition and trade between Member States.
- (19) In the case at hand, the Commission has examined whether the proposed measure constitutes State aid a) in favour of the participants to the project (the research institutes, IRAR, IST, YDREAMS and participating utilities) and b) in favour of the water utilities which will receive the results of the project free-of-charge.

No State Aid in Favour of the Participants to the Project

- (20) The Community Framework on State aid for Research, Development and Innovation³ (hereinafter: the Framework) provides guidance as regards the State aid character and compatibility of measures designed to finance research and development initiatives. It should be noted that the AWARE-P project concerns the development of a new product, but does not fall into any of the categories of research/development which are eligible for aid under the Framework⁴, since the results of the project consist in a directly marketable product. However, the guidance set out in the Framework is relevant to the case at hand insofar as the Framework codifies the criteria developed by the Commission and the Community courts to apply the test of Article 87(1) EC in the circumstances typically found in research and development (where, for example, projects may be carried out by public research institutions and there is a need to examine the presence and the compatibility of the aid at the level of both the research intermediaries and the final beneficiaries). These circumstances recur in the AWARE-P project. Therefore, the Commission has relied on the Framework for assessing the presence of aid in the case at hand.
- (21) According to section 3 of the Framework, the public financing of research, development and innovation activities by research organisations can only constitute State aid if the research organisation qualifies as an undertaking within the meaning of Article 87(1) of the EC Treaty. This does not depend upon its legal status (organized under public or private law) or economic nature (profit making or not). What is decisive for its qualification as an undertaking is whether the research organization carries out an economic activity, which is an activity consisting of offering goods and/or services on a given market.

³ OJ C 323, 30.12.2006, p. 1.

⁴ Fundamental research, industrial research and experimental development (where the research results are not intended for commercial use).

- (22) In the case at hand, the development of a directly marketable software product in the area of water management constitutes an economic activity. Therefore, the EEA grants awarded to the research institutions involved in the AWARE-P project, including those which are fully owned by the State (LNEC, IRAR and SINTEF) may, potentially, involve State aid.
- (23) However, according to point 3.1.2 of the Framework, if the research organization can prove that the totality of the State funding that they received to provide certain services has been passed on to the final recipient, and that there is no advantage granted to the intermediary, the intermediary organisation may not be recipient of State aid.
- (24) The Commission considers that this is the case for the AWARE-P project. The conditions established for the use of the results of the project, and in particular the requirement to distribute such results free-of-charge to Portuguese utilities and make the source code/operating manuals freely available outside Portugal, ensure that the benefits of the project will be fully passed on to the final beneficiaries of the measure, i.e. the water utilities. Besides, the partners do not have any exclusive intellectual property right and therefore they draw no direct economic advantage from participation in the project. The Commission can also exclude the presence of an indirect State aid to the participants in the form of privileged access to the project deliverables or the possibility to define the project's scope: on the one hand, the project results will be put at anyone's disposal directly after completion and testing, and on the other the project's scope has been defined in the general interest of all the water utilities to help improve efficiency and reduce leakage.
- (25) The financial mechanism also rules out the presence of an element of aid in favour of the software house YDREAMS, which acts as mere service provider and receives compensation for its development activity on market conform terms. As regards the involvement of selected water utilities during the implementation of the project, the Commission notes that the contribution given by utilities consists in advising the participants to the project and testing the products. This involvement does not entail an economic advantage in favour of the utilities concerned.
- (26) Therefore, the Commission concludes that the AWARE-P project does not involve State aid in favour of the organizations involved in the project implementation.

State Aid in Favour of Water Utilities

- (27) As regards the presence of State aid in favour of water utilities, the Commission notes that, while the majority of water utilities in Portugal are public (owned by municipalities) private ownership is also possible and private utilities (such as Veolia) are present on the Portuguese market. Generally speaking, it is conceivable that the use of the AWARE-P software will result in cost savings, due to the streamlining of maintenance and rehabilitation procedures. Such savings may benefit either the owner of the networks (the State) and/or the water utilities liable by contract to maintain the networks, according to the exact terms of the service contracts. Therefore, the existence of an economic advantage in favour of water utilities, at least in the short term (until service contracts are renegotiated) cannot be ruled out.

- (28) This potential advantage is granted through public resources (the EEA Financial Mechanism grants). The advantage is granted in a selective way to undertakings active in the water sector.
- (29) Even though all EU water utilities will be able to access free of charge the AWARE-P software, the Commission considers that impact on trade and potential distortions of competition cannot be ruled out completely. Firstly, the water sector is open to competition at the EU level and private utilities like Veolia are already active in more than one Member State. Besides, the AWARE-P project results will not be made available on the same terms in Portugal and elsewhere. In Portugal, the dissemination of results will be more pro-active, with demonstration activities and training courses being provided to utilities free of charge.
- (30) Therefore, the AWARE-P project constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

Compatibility of aid

- (31) The Commission notes, first of all, that the proposed measure does not fall within any of the existing Guidelines or Frameworks which lay down criteria for the assessment of the compatibility of State aid measures with the common market. In particular, the Community Framework on State aid for Research, Development and Innovation does not cover this type of projects for the reasons explained in point (20) above.
- (32) Therefore, the Commission has based its assessment by interpreting directly Article 87(3)(c) of the EC Treaty, which enables the authorization of "aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest".
- (33) Even though in some Member States the provision of water services has been privatised, a significant number of water utilities in the EU are State-owned. Municipalities typically hold stakes in water utilities, and the infrastructure is largely in public hands.
- (34) In Portugal the infrastructure is publicly owned, even though water supply and wastewater services may be managed by private utilities. The public authorities are therefore major investors in infrastructure and have an interest in ensuring that it is well-managed in order to guarantee an acceptable quality of service (in particular in terms of high quality drinking water) as well as public safety and environmental sustainability (avoidance of spills of polluted water, water leakage or discharge of untreated water into water bodies).
- (35) Underinvestment in water infrastructure is a common phenomenon. According to the Portuguese authorities, there are currently no incentives to improve the water network, which is a natural monopoly, since its functioning is taken for granted and has low social and political visibility. Besides, rehabilitation involves significant investments, and it is difficult to take sound decisions on how much, where, when and how to rehabilitate, given that water supply and wastewater infrastructures lie mostly underground. Adopting such decisions on the basis of a software incorporating refined scientific and technical criteria will contribute to greater cost-effectiveness of public spending.
- (36) In Portugal network rehabilitation is particularly urgent, since the quality of water services is significantly below average standards in the EU. Statistics provided by the Portuguese authorities point to an average water supply pipe breakage rate in the order of

10 times those of other European countries (above 200 per 100 km per year). In wastewater systems, average rates of obstruction point to figures 8 times those of other countries (above 150 per 100 km per year).

- (37) It can thus be considered that the development and dissemination of tools for sustainable water infrastructure management is a worthy public policy objective. The decision to finance preliminary research in this field in the framework of the projects CARE-W and CARE-S testifies to the importance the EU attaches to a more efficient and environmentally sustainable management of water resources. The results of these projects, on which Aware-P intends to build, received a favourable evaluation at the EU level and their potential for practical application was recognized.
- (38) The main long-term benefit of the Aware-P project therefore lies in the improvement of the water supply and wastewater network, with expected positive spillovers for society at large. However, as outlined in point (27) above, the use of the Aware-P software may, in certain circumstances, entail short-term gains for water utilities. Therefore, the Commission has assessed whether the ensuing distortions of competition would affect trading conditions to an extent which would be contrary to the common interest.
- (39) Firstly, it should be noted that the existence and magnitude of any economic advantage accruing to the utilities will depend on the terms of the contracts stipulated with the owner of the infrastructure. In particular, the exact nature of the rehabilitation obligations placed on utilities and the method for calculating their remuneration will determine whether the efficiency gains obtained through Aware-P will be passed through to utilities or remain with the owner of the infrastructure.
- (40) Besides, these potential gains for Portuguese utilities will not result in a sizeable competitive advantage vis-à-vis water utilities operating in other Member States, since all water utilities in the EU will be able to access the open-source software programme and user manuals free of charge, albeit under slightly different conditions than those applied in Portugal. Therefore, the actual distortions of competition caused by the aid will be minimal and will not affect trading conditions to an extent contrary to the common interest.
- (41) Therefore, the Commission has come to the conclusion that the aid in favour of the Portuguese water utilities can be considered compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty.

IV. CONCLUSION

- (42) On the basis of the foregoing considerations, the Commission finds that the measure notified by Portugal does not constitute State aid within the meaning of Article 87(1) of the EC Treaty as regards the entities carrying out the project. As regards water utilities in Portugal, the measure constitutes State aid which is compatible with the common market in accordance with Article 87(3)(c) of the EC Treaty.
- (43) If this letter contains confidential information which should not be disclosed to third parties, 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 the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/community_law/state_aids

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 Brussels
Fax No: 00-32-2-296-12-42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission