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Department of Finance

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Regional Aid
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9 October 2009

**Subject: State Aid N 660/2008 – Ireland – LIP – Hotel Capital
Allowances in respect of the Ritz Carlton, Powerscourt, Co. Wicklow.**

Dear Ms. Rodriguez Galindo,

I wish to express my appreciation for the meeting and discussion on Thursday 2 September 2009 with you and your colleagues. It was useful and informative. I wish to also acknowledge the subsequent email which I received from Andras Tari in which he submitted a number of additional questions seeking clarification /additional information. I trust that this letter and the Exhibits attached will comprehensively address and serve to bring clarity to the questions in your email.

We have numbered the various bullet points contained in the three page document received from your services following our meeting of 3 September 2009 and set out to provide some further background to structure. The structure chart “Schedule 1” which was included on our response of 1 April 2009 and attach same as Appendix 1. Following this general information we then provide specific responses to each of the questions in numerical order.

We would reiterate our previous comments, that in our view, Carrylane is a beneficiary of the aid but only to the extent of the benefit conferred on Carrylane under the buy-back arrangements with the Exhort Co-ownership which we have previously quantified as being circa €5.2m. As this figure is below the maximum permitted aid for the Project in NGE terms of €20.376m (Ref: Notification Documentation Dec 2008) no restriction should apply. Furthermore, when one examines the development component of the Ritz Carlton project we believe that the Commission can be satisfied that any aid involved has contributed substantially to the regional development of the Mid East region and can reasonably conclude that the aid is proportionate to the regional development benefits and thus compatible with the common market and arises under an approved scheme.

The attached responses contain business secrets/commercially sensitive information and should be covered by the obligation of Professional Secrecy.

Background information relating to questions 1, 2, 4, 5, 6 and 13

Each of the above questions relate to the overall structure of the transaction and accordingly we set out by way of further background a detailed explanation of how the project was structured from its inception right up to hotel opening.

As you will appreciate the project started as a proposal for the development of a hotel by the Treasury Holdings Group some 15 years ago.

In order to get from the position where the proposal to develop a hotel is transformed into a fully built and operational hotel a number of key aspects had to be undertaken as set out at (a) to (f) below. Throughout the development phase each of these aspects of the project were revisited and refined as the transaction progressed.

(a) Acquisition of a site/piece of land on which to construct the hotel property

Carrylane was established by the Treasury Holdings Group as the vehicle through which the development would be undertaken. Carrylane acquired a green field site from [REDACTED] (a corporate entity) on which to construct the hotel on behalf of the

ultimate owners. This was an arm's length purchase from an unconnected third party. The legal manner in which this site purchase was arranged was [REDACTED]

(b) Obtaining planning permission from the Irish planning authorities to develop the hotel

Carrylane then set about obtaining planning permission to develop a hotel on the land and the relevant planning permission was granted in 1999. While planning permission was being obtained and refined, Carrylane began evaluating its funding and operational strategy for the development of the hotel.

(c) Formulating a strategy for the ownership and commercial operation of the hotel

Carrylane and the Treasury Holdings group of companies are primarily property developers and investors whereby they construct property for outright sale to third parties or for retention and letting to third party tenants. Accordingly the primary intention in relation to the Powerscourt Hotel was to construct the hotel for sale to third party owners/investors who would then let the hotel to the Hotel Operator.

The Group also decided that it would seek a world renowned Hotel Group to operate the hotel.

(d) Obtaining bank funding to construct the hotel

Carrylane received some funding by way of [REDACTED]

[REDACTED] However the remaining balance of the construction and development budget was funded by bank borrowings drawn down by Carrylane in its own right as property developer, [REDACTED]

(e) Identification of potential owners for the hotel

Given the size of the project, two types of ownership interests were sold to third party owners/investors.

The first was by way of a legal Co-ownership whereby a significant portion of the Hotel was developed for by Carrylane on behalf of the Co-ownership and then leased back to the Hotel Operator by the Co-ownership at a market rent. This group of owners (the Exhort Co-ownership) were to take ownership of the hotel for the duration of the 7 year writing down period of the capital allowances.

The second group of owners were investors who acquired an interest in their element of the hotel under a [REDACTED] year lease with no buy back arrangements. These individuals are unconnected and not legally related to each other in any way, but for simplicity they have been referred to as the Suite Owners.

The Exhort Co-owners acquired their interest in the land on which the hotel was to be built by way of a [REDACTED] year agreement for long lease from Carrylane at an annual rent of [REDACTED] per annum [REDACTED]. They then entered into a development agreement with Carrylane whereby Carrylane agreed to construct their element of the hotel, on the land which they had leased, for the agreed price of [REDACTED]. The Co-owners are not involved in the hotel operations but rather are property investors/landlords.

The Suite Owners individually obtained their ownership interest in the land/site by way of a [REDACTED]. This gave them an ownership interest in the land on which their element of the hotel was to be built. They then entered into a development agreement with Carrylane whereby Carrylane agreed to construct their element of the hotel, on that land for an agreed price. The development price varied depending on the location and size of hotel suites being built for each individual investor.

The manner and timing of when the various agreements were entered into and completed is as follows:

- [REDACTED]

[REDACTED]

• [REDACTED]

• [REDACTED]

(f) Identification and negotiations with a hotel operator

The typical approach in the hotel industry at the time that this transaction was structured was for the world renowned hotel brand names to agree to manage and run hotels on a contract basis without taking ownership of the underlying property or taking material trading risk.

[REDACTED]

Accordingly, Carrylane as Hotel Operator acquired occupational leasehold interests in the property from its owners (i.e. the Exhort Co-ownership and the Suite Owners) and entered into a management agreement with the Ritz-Carlton Hotel Group whereby the Ritz-Carlton Hotel Group undertook to manage the hotel on Carrylane's behalf.

1. BENEFICIARIES OF THE AID

1. Please provide a step-by-step description of the project from its inception until the opening of the hotel (i.e. who initiated the project? was it Carrylane who started building the hotel and sought to involve

third party investors to get the necessary financing or did the investors contract Carrylane to build the hotel on their behalf? Did the financial contribution of the investors precede the signing of the investor lease agreements? etc.)

Carrylane was the entity that initiated the overall project, obtained planning permission to build a hotel and commenced building the hotel. During that time Carrylane identified a number of third party investors to take ownership of various aspects of the hotel via the Co-ownership and Suite Owner categories. These investors acquired ownership in the underlying land by way of lease agreements (i.e. the Investor Leases) and engaged Carrylane to build the hotel on their behalf by way of development agreements.

On signing their respective investor leases and development agreements with Carrylane, a small amount of funds were introduced as deposits by the various investors as a financial contribution to the project. However the majority of funds due under the leases and the development agreements were paid when the building work was complete and the hotel ready for opening. Accordingly Carrylane funded the remaining cost of developing the hotel from its own bank borrowings. This is the standard development structure used in Ireland.

2. It appears that some of the beneficiaries were involved from the outset and contributed towards the construction of the hotel whereas other investors stepped in at a later stage and acquired ownership in the hotel. In this respect, do the eligible costs specified by the Irish authorities refer to the construction costs or the costs of acquiring the ownership (the two are not necessarily the same). Please indicate the figures for construction costs, costs of acquiring ownership and the eligible costs.

[REDACTED]

[REDACTED]

[REDACTED]

In all instances the Total Amounts Paid by the various investors are made up of (i) the price paid under the development agreements entered into with Carrylane to build the hotel on their behalf, and (ii) the upfront premiums paid to Carrylane under the Investor Leases. A formula set out in Irish tax law which excludes non qualifying items (such as site cost) from qualifying amount is then applied to the Total Amount Paid figure to arrive at the amount qualifying for hotel capital allowances before and after the 75% restriction for 2007, this is referred to as the Eligible Cost/Expenditure. The figures for each investor group are summarised in the table below.

Investor Group	Total Amounts Paid*	Eligible Expenditure**	[REDACTED]
Exhort	[REDACTED]	[REDACTED]	[REDACTED]
Suite Owners	[REDACTED]	[REDACTED]	[REDACTED]
Ilesca	[REDACTED]	[REDACTED]	[REDACTED]
Total	€224,408,314	€12,360,683	[REDACTED]

[REDACTED]

We attach in Appendix 4 further details of the formula set out in Irish tax law for determining Eligible Expenditure followed by detailed calculations for each group outlining how the above figures are arrived at.

The formula for calculating eligible expenditure for each of the Investors is the same regardless of whether they acquired their interest in the hotel before or after the hotel was fully constructed. The calculation of eligible costs is also the same for individuals and corporate entities.

- 3. Did the price of acquiring ownership by the Investors potentially take into account the fact that the Investors will be eligible for the capital allowance (i.e. did this price contain a premium through which part of the benefit resulting from the capital allowance was transferred to Carrylane) or did it simply cover the construction costs?***

Carrylane priced the sale of the various elements of the hotel with a view to making a reasonable commercial return on the costs it incurred in developing the hotel. The only situation in which the benefit of the capital allowance is clearly and expressly shared arises from the buy-back arrangements entered into with the Exhort Co-ownership. Whilst the Suite Owners would have been aware of the availability of capital allowances, they acquired their hotel suites primarily for capital appreciation over a long term horizon. The Suite Owners are not and never have been a party to any buy back arrangements, they have they received any warranties in respect of the availability of the allowances

[REDACTED]

Carrylane's total cost of developing the entire hotel including its financing costs amounted to [REDACTED] including the cost of the unsold suites transferred to Ilesca of [REDACTED]. Carrylane's revenue to date from the sale of various aspects of the completed hotel amounts to [REDACTED] including [REDACTED] from the sale of unsold hotel suites to Ilesca Limited (see further comments on the unsold hotel suites held by Ilesca Limited at questions 15 below). This equates to a profit of circa

[REDACTED]

4. As not all the Investors were present at the time the investment started back in 2005, who covered the remaining part of the construction costs? Was it Carrylane?

As explained in further detail above, the vast majority of Investors signed up for the project during [REDACTED]

[REDACTED] The balance of the cost of developing the hotel was funded by bank debt drawn down by Carrylane (supported by the signed Investor development agreements and leases). [REDACTED]

5. *In their draft reply of 25 August 2009 the Irish authorities indicated that Carrylane agreed to construct the hotel on behalf of the Investors on trading account as a property developer and not for its own use and retention on capital account as a hotel operator. In case the Investors ordered the construction of the hotel and paid for the construction (thus becoming the owners), why was there a need for the long-term ([REDACTED] years) investor leases between Carrylane and the Investors (in which Carrylane seems to act as the owner of the Hotel)?*

Ownership of the land on which the hotel was built and the actual hotel

6. *In what way are the investor lease agreements related to the expenditure incurred by the investors when contributing towards the construction/acquiring ownership in the hotel?* [REDACTED]

The investor leases are the agreements by which the Investors acquired their interest in the land on which the hotel was eventually built. The price paid for land does not qualify for hotel capital allowances. The actual development of the hotel building is paid for under the terms of the development agreements with Carrylane and the owners/investors. The majority of this figure qualifies as eligible expenditure (See summary table in response to question two above).

Exhort Co-ownership:

The Exhort Co-ownership, entered into a development agreement with Carrylane for the development of its element of the hotel

[REDACTED]

[REDACTED]

[REDACTED]

Suite Owners:

[REDACTED]

[REDACTED]

[REDACTED]

As set out in further detail in Appendix 4 a formula based on Irish tax law is the applied to the total price payable by the Suite Owner (i.e. [REDACTED] in the above example) to arrive at the Eligible Cost for hotel capital allowance purposes. Not all of the total price paid will qualify for hotel capital allowances as can be seen from the examples in Appendix 4.

- 7. Please specify how the rents to be paid by the Investors on the basis of the long term investor lease agreements are established. How high are these rents? Are they market conform? Why is there a need for the Investor to pay this rent in light of the fact that they already contributed significant sums to construct/acquire ownership in the hotel?***

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

8. *Are the terms of the occupational leases (by which the Invertors lease the hotel back to Carrylane as hotel operator) market conform?*

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

9. How are the rents to be paid by Carrylane to the Exhort Co-ownership established? Can these rents also be considered market conform?

Due to the existence of the buy-back arrangements in place between Carrylane and the Exhort Co-ownership, the rent payments due from Carrylane as occupational tenant to the Exhort Co-ownership under the occupational lease differ from those payable by Carrylane to the Suite Owners.

[REDACTED]

[REDACTED]

[REDACTED]

As set out at the start of this note, we accept that Carrylane is a beneficiary of the aid but only to the extent of the benefit conferred on Carrylane under the buy-back arrangements with the Exhort Co-ownership which we have previously quantified as being circa €5.2m.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

11. Why is such buy-back agreement not in place with the other Investors?

The buy-back agreement is not in place with other investors (i.e. the Suite Owners) on the basis that they have acquired an outright ownership interest in the land on which their hotel suites were built via their [REDACTED] year lease agreements. [REDACTED]

[REDACTED]

[REDACTED]

12. Some of the lease contracts (Exhibit B and E of the reply of 1 April 2009) refer to 'Ritz Hotel Limited (now Carrylane Limited)'. What is the reason for this? Is/Has there been a connection between the two companies? Is Carrylane linked to the Ritz-Carlton Hotel Company in any way?

There is no legal connection between Ritz Hotel Limited (now Carrylane Limited) and the Ritz-Carlton Hotel Company. The only

connection between the two companies is the fact that they have entered into an arm's length operating agreement (Exhibit E) under which Carrylane has hired the Ritz-Carlton Hotel Group to manage the Powerscourt Hotel under the Ritz-Carlton brand on behalf of Carrylane.

Carrylane Limited was originally established as Ritz Hotel Limited on the 7 April 1995 some 14 years ago. The use of the name Ritz Hotel was chosen in anticipation of either the Ritz Carlton or the Ritz Hotel operating the hotel and so the Treasury Holdings Group wanted to protect the use/ownership of the name from an early date. At that time no discussions had been entered into with the Ritz-Carlton Hotel Group.

Matters progressed over the next number of years and the Ritz-Carlton Hotel Group was selected as the hotel manager by the Treasury Holdings Group. At that time the Ritz-Carlton Hotel Group insisted on the name of the company being changed to ensure it was clear that there was no connection between the Ritz-Carlton Hotel Group and Ritz Hotel Limited. With effect from 21 July 2005 Ritz Hotel Limited was renamed Carrylane Limited.

13.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

14. Ireland specified that Carrylane has entered into a management agreement with Ritz-Carlton Hotel Company employing Ritz-Carlton as hotel manager. It was indicated that Ritz-Carlton is paid an arm's length fee for its management operations. Could you provide more details about this fee? How is it established and why can it be considered arms length? Is it a fixed fee or performance related remuneration?

The Ritz-Carlton Hotel Group was hired by Carrylane to provide hotel management and operational services to Carrylane and has no ownership interest in the hotel. The fee arrangements are arm's length in nature as they were negotiated between Carrylane and the Ritz-Carlton Hotel Group as two independent parties.

[REDACTED]

[REDACTED]

2. AMOUNT AND INTENSITY OF THE AID

¹ The Agreement contains business secrets/commercially sensitive information and should be covered by the obligation of Professional Secrecy.

15.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

16.

3. MARKET ANALYSIS

17. *In order to substantiate Ireland's position that the relevant geographic market in this case should be the EEA, please explain what the main attraction of the area is, capable of drawing visitors from all over the EEA (in the Atlantica case referred to by Ireland, for instance, there was a theme park)*

Based on our analysis of the origin of hotel visitors at the hotel for 2008 and for 2009 (up to mid September) we propose that for the

² P. 29 of the decision in the case N 832/2000 indicates that the aid intensity depends on certain parameters such as the corporate and personal tax rates.

purposes of this notification the relevant geographical market should be Ireland. Essentially this contention rests on the fact that almost [REDACTED] of the hotel guests at the hotel in 2009 originated in Ireland, while the corresponding proportion from the rest of the EEA was circa [REDACTED] (see appendix 3). It should be noted however that the Irish authorities are of the view, that for the purposes of marketing and sales promotion of the hotel generally, the EEA and indeed the global market are the relevant geographical market. However, for reasons chiefly arising from the heterogeneity of hotel classification standards and criteria across EEA Member States and the lack, therefore, of objective standardised data on hotel accommodation, it is considered that for practical reasons for the purposes of this notification that the relevant geographical market should be Ireland.

18. Please provide information on the country of origin of the guests since the opening of the hotel in 2007 and their percentage share in the total.

Appendix 3 contains the percentage allocation of guests from Ireland, the EEA, the Americas/Canada and the rest of the world for the calendar year 2008 and the calendar year 2009 from 1 January 2009 to 10 September 2009.

19. Please provide more detail about Treasury Holdings being the passive landlord of two hotels in Dublin. What does passive landlord mean? Which are the hotels in question?

As set out in our draft response of 25 August 2009, the Treasury Holdings Group is not involved in the operation of any hotels other than Powerscourt Hotel. For completeness we highlighted the fact that as landlord Treasury Holdings or members of its group own two properties as landlord which is rented out to tenants who carry on hotel operations in those properties.

The term passive landlord refers to the fact that Treasury Holdings simply owns the property, receives a rent from the occupant (i.e. the hotel operators) and is not connected or involved in any way with the hotel operations carried out on the premises.

The hotels in question are the [REDACTED]
[REDACTED]
[REDACTED]

20. *Regarding the question of the relevant product market, it seems that the data provided by Ireland include all types of accommodation. However, the Commission services consider at this stage that not all hotels in the EEA/Ireland are a real substitute. According to the hotel website, the Ritz-Carlton Powerscourt is a 'luxury hotel showcasing Palladian-style architecture and offering guests a host of amenities. Two championship-calibre golf courses on the grounds, a 30,000-square-foot luxury spa and a Gordon Ramsay signature restaurant are among this Ireland luxury hotel's distinctive attractions.' Thus Ritz-Carlton Powerscourt is arguably best suited for guests looking for remoteness and proximity to nature and specific amenities rather than city travellers.*

In light of this, please provide arguments as to which types of hotel could be considered close substitutes for Ritz-Carlton Powerscourt and submit new data enabling the calculation of market share and capacity increase pursuant to p. 24 (a) and (b) of the Multisectoral Framework 2002 on this possibly narrower market.

The point that not all hotels and similar establishments in the EEA/Ireland are a real substitute is accepted. On the basis of an analysis of national hotel classification criteria it is our view that 4 and 5 star hotels combined form the relevant product market. The contention that the relevant product market encompasses 4 and 5 star hotels is based on the premise that there exists a high degree of substitutability within this segment of the tourism market. Switching costs are low or negligible should customers choose to react to price increases on an individual hotel level or even national or regional hotel level by the use of an alternative destinations or alternative class of hotel accommodation. This ease of switching has been facilitated in recent years by an absolute and relative decrease in air travel costs through the increased market share of low cost carriers. The increased penetration of internet use in the hotel sector either as a means of advertising or as a means of booking accommodation has increased customer power. Ease of access to market information on relative accommodation prices and standards ensures that the hotel market is among the most efficient consumer markets. Potential hotel customers have real time access to price developments and can make informed decisions based on this information.

With regard to your services point that Hotel is best suited for guests looking for remoteness and proximity to nature and specific amenities

rather than city travellers. Our services do not hold the same view, take, for example, the following quote from the Ritz Carlton website

"Whisk yourself away to a Palladian estate tucked back in the woodlands of County Wicklow, on Ireland's east coast. Take an enchanting stroll amidst the gentle green hills and sparkling lakes of Powerscourt Gardens, then head into Dublin for some cosmopolitan flair. The sumptuous surroundings of our Ireland hotel combine the luxury and tranquility of country living with city chic."

This is what the Hotel offers - the combination of remoteness and city chic. A customer can choose either or both by remaining in the surrounds of the Hotel or by taking the bus/car into the city centre just 35 minutes away. This closeness to the city also opens up the possibility of conference and events business from the city. In one day visitors can experience both worlds without any need to move hotel. The attached link to its press release on the development of the hotel may also be useful.

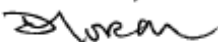
<http://corporate.ritzcarlton.com/en/Press/Properties/Powerscourt/Releases>

CONCLUSION

The Irish Authorities would welcome the opportunity to clarify any remaining matters in relation to this project before the Commission comes to a decision. While we understand that the Commission is processing a large volume of projects, we would welcome an indicative response at the earliest opportunity.

Yours sincerely

Yours sincerely



Derek Moran
Assistant Secretary
Budget, Taxation and Economic Division.