

## **Explanatory Note**

### **Draft guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty**

#### **I. Background and context**

##### **1. State aid modernisation (SAM)**

Rescue and restructuring ('R&R') aid are among the most distortive types of State aid. By preventing exit, they impede a key mechanism of productivity growth, namely the displacement of inefficient firms by more efficient and innovative competitors. R&R aid can also set off wasteful subsidy races that undermine the internal market. The main focus of the draft R&R guidelines is therefore the same as in previous versions, namely to ensure that R&R aid is given only on strict conditions that mitigate the harm to competition.

At the same time, the draft guidelines also set the R&R guidelines in the context of the Commission's State aid modernisation (SAM) programme. The programme was launched on 8 May 2012, when the Commission adopted the SAM Communication, setting out the objectives of an ambitious reform of State aid control. That reform aims to contribute to the broader EU agenda for fostering growth while contributing to Member States' efforts towards budgetary consolidation. In this context, State aid policy should concentrate on facilitating well-designed aid targeted at market failures and objectives of common European interest ('good aid'). The Commission also aims to focus its enforcement on the cases with the biggest impact on the internal market, and to streamline rules and speed up decision making. In the context of the R&R guidelines, the principles of the SAM programme are particularly visible in the attempts to ensure that aid is better targeted and to simplify the conditions applicable to less distortive forms of R&R aid.

##### **2. The review of the R&R guidelines**

The current R&R guidelines date from 2004. They were originally due to expire in 2009, but have been extended twice, first until 2012 and then until their replacement by new rules in line with the SAM programme.

In the context of the earlier planned expiry of the guidelines, the Commission has consulted Member States and other stakeholders on two occasions, in 2007 and in 2010-11. It also commissioned a study from the economic consultancy Oxera in 2009 on counterfactual scenarios to restructuring aid. The draft guidelines draw on all of that work, as well as on the Commission's experience in applying the current R&R guidelines and in assessing R&R aid for banks during the crisis.

#### **II. Content of the proposal**

##### **1. Temporary restructuring support**

The current guidelines treat all forms of restructuring aid alike: loans, guarantees, capital injections, debt waivers and even outright cash grants. However, liquidity assistance (loans and guarantees) that is limited in both amount and duration is less distortive than other forms of aid, since it does not go

beyond what is needed to address the liquidity problems that are commonly the main obstacle to restructuring and since it must be repaid with interest.

To simplify the provision of aid for restructuring, while also reducing distortions of competition, the draft guidelines include a new concept of temporary restructuring support. This allows liquidity support to be made available to SMEs in difficulty for a period which, while limited, is longer than the six-month period for which liquidity assistance in the form of rescue aid can currently be given (the draft guidelines invite comments on two possible options, namely 12 or 18 months). Recipients of temporary restructuring support do not have to submit a full restructuring plan, but they are required to provide a simplified plan that identifies the actions that they intend to take to restore their long-term viability.

## **2. Better targeting of aid**

While the current R&R guidelines already contain strong conditions to minimise the distortions of competition caused by R&R aid, they are less effective in ensuring that aid is well targeted at cases where intervention serves a real public interest.

The draft guidelines therefore contain new filters designed to check that aid is truly in the public interest in a given case. First, it must be shown that the aid pursues an objective of common interest, in the sense that saving the undertaking would prevent social hardship or address market failures. The draft guidelines set out a non-exhaustive list of situations in which aid would be justified under this provision; a separate provision for SMEs applies a less strict standard and identifies situations that are more relevant to the position of SMEs.

Aid will also only be in the public interest if it can make a difference to the situation that would prevail without aid. The draft guidelines therefore require Member States to present a comparison with a credible alternative scenario not involving State aid. For reasons of simplification, this requirement does not apply to rescue aid or temporary restructuring support.

## **3. Burden sharing**

The existing guidelines require undertakings that are being restructured to make a contribution to the restructuring costs from their own resources. This "own contribution" rule has helped to limit the amount of aid to the minimum necessary. However, it has lacked the precision needed to ensure that the costs of restructuring are distributed fairly among investors and taxpayers.

In dealing with State support to banks during the crisis, the Commission developed a more targeted approach in this respect, using the concept of "burden sharing". This concept looks not only at the amount of own contribution, but also at who is providing that contribution. In particular, since the high returns that shareholders obtain when a firm is performing well are balanced by the risk of losses that they bear, there is no justification for expecting taxpayers to bear losses in place of shareholders.

The draft guidelines set out two possible approaches to this question. Option 1 takes a more broad-brush approach by requiring that the contributions made by incumbent shareholders and creditors should be reasonable in view of the likely losses that they would have suffered in the event of insolvency. Option 2 is more precise, requiring first that all past losses be borne by shareholders and

then, if that is not sufficient, that subordinated creditors also contribute. Both options contain an identical first paragraph which makes clear that the type of contribution must match the nature of the undertaking's difficulties: equity shortages should be dealt with by capital-enhancing measures, while liquidity problems require contribution in a form that raises cash for the business.

#### **4. Definition of "undertaking in difficulty"**

Only businesses that qualify as "undertakings in difficulty" can receive aid under the R&R guidelines. At the same time, since their viability is in doubt, undertakings in difficulty are generally prohibited from receiving other types of aid without a consideration of their viability prospects within the framework of the R&R guidelines.

The definition of "undertaking in difficulty" should therefore be approached from a horizontal perspective. It should be seen not as a criterion that makes a given undertaking eligible or ineligible for State aid, but as a test that determines which of two approaches to follow in order to show that aid is compatible with the internal market.

For undertakings that are not in difficulty, the focus is predominantly on the terms and circumstances of the aid itself. Once an undertaking is in difficulty, however, it becomes necessary to look at all the aid that the undertaking receives, in the context of its overall business and prospects, to ensure that distortions are not caused by keeping a failing undertaking on the market.

Since the definition plays this role of determining the scope of these two approaches, there is a general presumption that a single definition should be established in the R&R guidelines and should apply to all State aid regulations and guidelines, except where specific circumstances make it necessary to deviate from that presumption.

The current definition of "undertaking in difficulty" contains both so-called "hard" (objective) criteria and "soft" criteria which require a broader and more subjective assessment of the undertaking's situation. To improve clarity and legal certainty, the draft guidelines aim to shift the emphasis from soft to hard criteria, making it easier for granting authorities and potential aid beneficiaries to determine whether a given undertaking is in difficulty.

The soft criteria are therefore reduced to a residual category that will apply only in exceptional circumstances. To keep the coverage of the definition approximately the same overall, the draft guidelines balance the reduction in the scope of the soft criteria by introducing new hard criteria.

Having heard the views of Member States and other stakeholders on the hard criteria presented in the context of the second draft of the *de minimis* regulation, the Commission is reflecting on how best to identify undertakings in difficulty in the context of that regulation. At the same time, in view of the wish of many stakeholders to discuss the definition in detail in the context of the R&R guidelines, the draft guidelines seek to enlarge the debate on how the hard criteria can be refined to improve clarity and certainty for all stakeholders. Stakeholders are therefore encouraged to comment on whether the proposed criteria are an appropriate means to identify undertakings in difficulty and on whether other criteria are available that could do so more reliably. Submissions supported by data would be particularly valuable in this respect.

The draft guidelines also propose some additional options in relation to the hard criteria, including making the criteria linked to debt to equity and interest cover ratios cumulative, and replacing EBIT with EBITDA in the interest cover ratio. However, submissions need not be limited to the options proposed.

As regards the principle of a single definition for all State aid regulations and guidelines, the draft guidelines propose one exception aimed at simplifying the use of the definition in practice. Given the complex assessment needed to determine whether or not an undertaking meets the soft criteria, the draft guidelines provide that in relation to Commission regulations and aid schemes (that is to say, in cases which do not require notification to the Commission), only the hard criteria will apply. That provision extends an approach that has so far applied only to aid for SMEs under the general block exemption regulation and to aid schemes for SMEs under the R&R guidelines themselves.

In addition, in view of the particular need for simplification in the context of the *de minimis* regulation, an alternative definition of "undertaking in difficulty" based on a reduced set of hard criteria is appropriate for that regulation. That definition will be included in the *de minimis* regulation itself and will not affect the text of the R&R guidelines.

## 5. Other proposed changes

Other significant changes proposed in the new draft guidelines include the following:

- An increase in the minimum level of **remuneration for rescue aid**, to give aid beneficiaries an incentive to repay the aid as soon as possible; a similar provision applies to temporary restructuring support, with "step-ups" every six months to further enhance the exit incentives.
- More detailed provisions on the required **content of a restructuring plan**, making it easier for Member States and aid beneficiaries to know what information the Commission requires.
- **Measures to limit distortions of competition** replace the "compensatory measures" that apply under the existing guidelines, with a view to focusing less on protecting competitors and more on preserving competition in the market; detailed guidance is given on the **form and calibration** of competition measures.
- Since the R&R guidelines apply to providers of **services of general economic interest (SGEI)** as well as to undertakings in other sectors; the new guidelines contain a limited set of **special provisions** for SGEI providers.
- Eligibility for aid under R&R **schemes** is extended to cover, as well as SMEs, those undertakings that fail to qualify as SMEs only because they are 25% or more State-owned. At the same time, to limit the distortive effect of schemes, the maximum amount of aid that any one undertaking can receive under a scheme is reduced from EUR 10 million to EUR 5 million.
- In line with the principles of the SAM programme, the draft guidelines also include provisions on **transparency** and on **ex post evaluation**.

Stakeholder comments are also welcome on the parts of the draft guidelines where no major changes to current practice are proposed – such as the interaction between rescue aid and

restructuring aid, the exclusion of the coal, steel and financial services sectors, the exemption of small undertakings from the competition measures requirement and the special provisions on restructuring aid in assisted areas – taking into account the principles of the SAM programme, in particular the need to allow targeted support for restructuring when necessary without weakening incentives for firms to restructure using their own means.