COMMISSION DECISION
of 09.03.2015
ON THE STATE AID
SA.15373 (2013/C-18) (ex 2013/NN))
implemented by the United Kingdom
with respect to the deployment of the risk capital scheme
Enterprise Capital Funds

(Text with EEA relevance)

(Only the English version is authentic)
COMMISSION DECISION
of 09.03.2015
ON THE STATE AID
SA.33186 (2012/C (ex 2011/NN))
implemented by the United Kingdom
with respect to the deployment of the risk capital scheme
Enterprise Capital Funds

(Text with EEA relevance)
(Only the English version is authentic)

THE EUROPEAN COMMISSION.

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(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 the provision(s) cited above\(^1\) and having regard to their comments,

Whereas:

1. Procedure

(1) The Enterprise Capital Funds ("ECFs") scheme (SA.15373) was approved by the Commission on 3 May 2005\(^2\) under Article 87(3)(c) of the EC Treaty (now Article 107(3)(c) of the Treaty on the Functioning of the European Union) and in particular on the basis of the State aid and Risk Capital Guidelines of 2001 ("RCGs of 2001")\(^3\), which were applicable at the time, after opening a formal investigation procedure (C 17/2004 (ex N 566/03)).

(2) In September 2006, following a meeting with the UK authorities, the services of the Commission informed the UK authorities that the ECFs scheme was not in

---
\(^1\) OJ C 40, 12.2.2013, p 53.
\(^2\) OJ L 91, 29.3.2006, p 16
line with the Risk Capital Guidelines adopted in August 2006\(^4\) (hereafter "RCGs of 2006") and invited them to take appropriate measures to bring the ECFs scheme into line with those guidelines.

(3) By letter of 18 October 2006, the UK authorities gave a commitment to take appropriate measures concerning all existing risk capital schemes.

(4) In 2011, the ECFs scheme was selected for the State aid monitoring exercise (SA.15373 (ex 2011/MX)). It was found that the United Kingdom had failed to take appropriate measures to bring the ECFs scheme into line with the RCGs of 2006.

(5) A meeting took place on 21 May 2013 between the Commission services and the UK authorities where the former proposed that the monitoring case and several changes to the scheme, which were subsequently notified on 21 August 2013 (SA.36428)\(^5\) by the UK authorities, be treated in two separate cases. The Commission accepted the proposal of the UK authorities.

(6) By e-mail of 16 June 2013, the Commission services received information from the UK authorities on the implementation of the existing ECFs scheme. The information was updated by e-mail of 12 July 2013.

(7) Two teleconferences took place on 1 and 2 July 2013 to discuss several elements of the monitoring case, and a meeting took place on 6 August 2013 where the UK authorities clarified several aspects of the operations carried out under the existing scheme.

(8) On 20 November 2013, the Commission decided to open a formal investigation procedure, calling on interested parties to submit their comments.\(^6\)

(9) The UK authorities and one interested party, the British Venture Capital Association (BVCA), submitted comments on 17 January 2014 and 18 February 2014, respectively.

(10) On 10 March 2014, the comments submitted by BVCA were transmitted to the UK authorities who, by letter of 7 April 2014, underlined the supporting position of BVCA in respect of the implementation of the scheme.

(11) Following an informal request for clarifications by the Commission services the UK authorities submitted additional information by letters of, respectively, 30 October 2014, 8 December 2014 and 12 December 2014.

\(^4\) OJ C 323, 30.12.2006, p. 1
\(^5\) OJ C 69, 7.3.2014, p 1
\(^6\) OJ C 37, 7.2.2014, p 50.
2. **Description of the Existing Scheme**

(12) Combining public and private investment, the ECFs scheme aimed at improving access to expansion capital for small and medium-sized enterprises ("SMEs") throughout the United Kingdom. Public investment was limited to twice the private capital raised by the fund, that is to say, a minimum of one third of an ECF fund was to be provided by private investors.

(13) The distribution of the profits and losses between public and private investors in the ECFs was based on the logic that, on the downside, the losses were distributed on equal terms with the private investors being fully exposed, while on the upside the distribution of the profits was non pari passu, that is to say, private investors received most of the profits above a certain profitability rate. This mechanism ensured that ECFs were commercially oriented even though they involved State aid.

(14) According to the rules of the ECFs scheme, an ECF may invest expansion capital in any company:

a) that falls within the Union definition of an SME;

b) where the purpose of the relevant investment, or the application of the proceeds of such investment by the relevant undertaking, is predominantly related to or for the benefit of the economy of the United Kingdom;

c) whose equity or other securities are not, at the time of investment, listed on a recognised stock exchange (such as the London Stock Exchange) or otherwise quoted on a non-recognised exchange, e.g. AIM or any other market on which prices are quoted publicly;

d) where the trade of such company is a qualifying trade as defined in Paragraph 4, Schedule 28B of the Income and Corporation Taxes Act 1988, or where the company is undertaking research and development with a view to carrying on a qualifying trade.

---

7 The government receives a prioritised return equivalent to the interest charged on the balance of outstanding loans to the fund (at the time 4.3%). Once the government has received its prioritised return, outstanding loans may then be repaid to the government and the private investors under the terms specified in the ECFs’ partnership agreement. All further distributions to investors are to be divided between the government and all other private investors in a fixed profit-sharing ratio.

8 Enterprise Capital Fund – Guidance for applicants

9 AIM is the London Stock Exchange’s international market for smaller growing companies.

10 A trade will not qualify if one or more excluded activities together make up a ‘substantial part’ of that trade. The main excluded activities are: (1) dealing in land, financial instruments, or in goods other than in the course of an ordinary trade of retail or wholesale distribution; (2) financial activities, property development, or providing legal or accountancy services; (3) leasing (including letting assets on hire, except in the case of certain ship-chartering activities); (4) receiving royalties or licence fees, except where these arise from an intangible asset such as a patent or know-how, most or all of which has been created by the company (or one of its subsidiaries); (5) farming, market gardening, or forestry; (6) operating or managing hotels, guest houses, hostels, or nursing or residential care homes; and (7) providing services to another company in certain circumstances where the other company’s trade consists to a substantial extent in excluded activities. Source: Enterprise Capital Funds – Guidance for applicants
The funds created under the scheme invested in eligible SMEs by means of equity and quasi-equity instruments of between GBP 250,000 (EUR 357,000) and GBP 2 million (EUR 2.9 million). Pure debt investments were explicitly forbidden under the scheme\(^{11}\).

Follow-on investments were permitted so long as the total equity funding raised by the SMEs from ECFs and other equity investors was no more than GBP 2 million (EUR 2.9 million).

Follow-on investments in excess of GBP 2 million (EUR 2.9 million), were permitted, where necessary, only after a period of at least 6 months and to prevent dilution, subject to an upper limit of 10% of each ECF’s committed capital.

Follow-on investments in excess of GBP 2 million (EUR 2.9 million), were permitted, where necessary, only after a period of at least 6 months and to prevent dilution, subject to an upper limit of 10% of each ECF’s committed capital.

From the evidence provided by the UK authorities, the Commission understands that three ECFs made follow-on anti-dilution investments in seven companies. The Commission understands that the scheme allowed the ECFs to use a "pre-emption mechanism" whereby the ECFs could exercise a right of first refusal to acquire new shares issued by any investee in the ECF's portfolio, in order to prevent private investors from investing in such companies and thereby diluting the ECF's shareholding. However, the UK authorities have indicated that such a mechanism has never been applied in practice and they gave a commitment not to make use of it in the future.

The ECFs scheme was initially approved for a period of 10 years, until 2 May 2015, and was intended to be self-financing over the medium term. For the first year of its operation, the United Kingdom allocated GBP 65 million to cover the cash-flow cost of the initial public participation.

12 funds were created under the ECFs scheme, out of which 7 were created after 18 August 2007 that is, the date after which the scheme should have been aligned with the RCGs of 2006. The pre-2007 funds invested in 67 companies, while the post 2007 funds invested in 94 companies. Therefore, a total of 161 undertakings have benefited from the scheme.

3. **DECISION TO OPEN THE FORMAL INVESTIGATION PROCEDURE**

The ECFs scheme was monitored by the Commission services in the light of the Commission's decision of 2005 approving the measure and the RCGs of 2006. The assessment of the implementation of the scheme led to the conclusion that several investments undertaken under the scheme seemed not to be in line with the RCGs of 2006. The UK authorities should have taken appropriate measures within 12 months from the date from which they were applied, that is to say, by 18 August 2007, which they failed to do. The issue of appropriate measures arose with respect to funds that received public capital after 18 August 2007, that is to

\(^{11}\) ECF's Partnership agreement, Point 3.6: "[ECF] may not acquire Investments in a Portfolio Company..... (d) in loan finance or debt instruments with no associated equity securities."
say, after the date by which the UK authorities should have adopted appropriate measures for existing schemes. In practice, this meant that only the funds which started to operate after 18 August 2006 needed to comply with the RCGs of 2006 as from that date.

(22) The Commission had doubts with respect to the compliance of the implementation of the ECFs scheme with the RCGs of 2006, and particularly with respect to: (a) the eligibility for investment of two investees and (b) an investment executed through a capital replacement operation. Therefore, the Commission decided to open the formal investigation procedure

3.1. Eligibility for investment of two investees

(23) The monitoring exercise revealed that since the creation of the scheme, the ECFs had invested in 161 companies, of which 94 were investments made after 18 August 2007. Out of the 94 companies, 40 companies had not had sales at the time of the first investment. Of the remaining 54 companies, 48 were early stage companies while 6 appeared to have been in expansion stage since at the moment of ECF's first investment they had had commercial activities for a significant number of years.

(24) The RCGs of 2006 (Point 4.3.2) limit the investment of risk capital to: (a) small enterprises up to the expansion stage, irrespective of their location, that is to say, located in assisted or non-assisted areas (b) medium-size enterprises up to the start-up stage, irrespective of their location, and (c) medium-sized enterprises up to the expansion stage located in assisted areas.

(25) The Commission noted that four out of the six above mentioned companies (see point 23) fell within the definition of small enterprises at the moment of the investment. Therefore, although they seem to have been in their expansion stage, the investments were made in accordance with the limits set out in the RCGs of 2006. The fund that invested in those companies was MMC.

(26) Based on the available information, the two other companies, Interactive Investor and Reevoo12, appeared to exceed, at the moment of the first investment, the threshold for the number of employees which must not be exceeded in order for a company to be considered a small enterprise.13 In addition, Interactive Investor exceeded the threshold for annual turnover14. Therefore, at the moment of the investment, the two companies appeared to be medium-sized enterprises.

---

12 At the moment of the first investment Reevoo had 9 years of commercial activity; it employed 64 persons and had an annual turnover of £2.8m (€3.5m). Interactive Investor had 11 years of commercial activity; it employed 81 persons and had an annual turnover of £10.9m (€12.7m).; Source: UK authorities


Moreover, given their location in London, which is a non-assisted area, they should have received investment only up to the start-up phase.\footnote{The Commission also notes that Reevoo had been backed by well-known venture capital firms, \textit{i.e.} Eden Ventures and Banexi Ventures (Source: UK authorities) which puts in question whether the company faced any market failure.}

(27) The Commission decided to open the formal investigation procedure with respect to the investments referred above (see point 26) and invited third parties to submit comments.

### 3.2. Use of a capital replacement transaction

(28) The evidence provided by the UK authorities showed that the fund Panoramic invested in one buy-in management buy-out\footnote{Management buy-out is a form of replacement capital through which one or more managers of a company take control of the company's capital by acquiring the majority of shares from the actual owner(s). When the buyer is an outsider of the company who will become manager once the operation is completed, the transaction is called management buy-in. A BIMBO occurs when existing management, along with outside managers, decide to buyout a company. Buy-in management buyout (BIMBO) is a form of a buyout that incorporates characteristics of both a management buy-out and a management buy-in.} (BIMBO). The target company, Andante Travels, had 28 years of commercial activities at the moment of the investment, employed 18 persons and had an annual turnover of GBP 2.7 million.

(29) The RCGs of 2006 only allow new capital to be provided to the investees. This is confirmed by the Commission's practice.\footnote{See, e.g., Case SA.36489 (2013/N), recital (41)} In order to further assess the conditions in which the transaction referred above (see point 28) took place and to test its impact on competition, the Commission decided to open the formal investigation procedure with respect to the BIMBO operation and invited third parties to present comments.

### 4. Position of the UK Authorities\footnote{Submission of UK of 17 January 2014.}

(30) Following the Commission's decision to open the formal investigation procedure, the United Kingdom submitted comments and claimed that the investments of the two funds were compatible with the RGCs of 2006 for the reasons set out in recitals 31 to 37.

#### 4.1. MMC

(31) The UK authorities argued that the rules relating to RCGs did not apply to MMC because the fund was created before the RCGs of 2006 were applied. Therefore, the transactions in question were still subject to the RCGs of 2001 and were compatible with them. The United Kingdom claimed that the bid process for the creation of the fund was launched in November 2006 and closed in February
2007. To submit a proposal to be selected as a financial intermediary under the ECFs scheme, MMC was required (a) to have already set the levels of subordination required by private investors and (b) to provide evidence of investors' willingness to invest. The terms of the agreement were thus already fixed in February 2007, which was prior to the end of the transition period following which the United Kingdom should have taken appropriate measures to align the ECFs scheme to the RCGs of 2006 (that is to say, 18 August 2007).

Moreover, the UK authorities submitted information proving that by June 2007, the MMC bid had entered the due diligence phase. The UK authorities also claimed that during the due diligence phase they had to assess 45 bids which took them a significant amount of time. Therefore, although the formal signature of the Limited Partnership Agreement ("LPA") by MMC was on 1 July 2008, the date of the commitment to invest is the relevant date to be taken into account for the purposes of this monitoring exercise.

In the light of these arguments, the United Kingdom considered that, as that commitment pre-dated the end of the transition period for appropriate measures under the RCGs of 2006, the investments of the fund in question should be regarded as in line with the Commission's decision of 2005 approving the scheme.

As a complementary argument, the UK authorities presented new facts which, they claim, support their view that the two investments identified in the Commission's decision to open formal investigation proceedings, that is to say, the investment made by MMC into Reevoo and Interactive Investor, were in line with the RGCs of 2006.

As regards Reevoo, the UK authorities claimed that, although it had been established for 9 years at the time of the investment, Reevoo fell within the definition of small enterprise, as it did not have a balance sheet value in excess of GBP 10 million and it had not breached the headcount number of 50, which meant it qualified as a small enterprise, for two consecutive years prior to the investment. In March 2010 the company employed 26 persons, in March 2011 it employed 28 persons, and in March 2012 it employed 39 persons.

As regards Interactive Investor, the UK authorities explained that MMC invested in Capital Accumulation Limited in 2010, and that Capital Accumulation Limited had acquired Interactive Investor in 2004. The investment of 2010 allowed Interactive Investor to expand its technology platform and develop an in-house share dealing and execution service. This was a new market for the company which, despite its long history, had been sold for GBP 1 in 2004. The MMC funding supported the establishment of a large “back office” in Glasgow with the hiring of approximately 50 people and the transformation of the business from a financial services media and client introducer to a financial services retail platform with a very different business model. Because the funding was used to transform the nature of the business, the investment can be considered as an early stage investment.
4.2. Panoramic investment

(37) The United Kingdom explained that the investment the fund undertook can be more accurately described as an early stage venture investment and not management buy-out. In fact, Panoramic fund invested directly into Specialist Tours Limited (“STL”), a newly established company set up as a buy and build aggregator\(^{19}\) in the travel/tour operator market which subsequently invested in Andante Travel. Panoramic’s initial investment was not a direct replacement capital deal and should not therefore be considered as falling outside the scope of the RCGs of 2006. STL has invested in one other company and three investments are currently under consideration.\(^{20}\)

5. Third parties' comments

(38) The only submission by a third party was provided by BVCA. In its submission, BVCA argued that the ECFs scheme sought, from its inception in 2005, to address the long term structural weakness in the provision of risk capital to SMEs in the United Kingdom. The scheme was structured in such a way as to minimise any economic distortion by properly incentivising management and avoiding any downside protection for investors. BVCA also argued that access to finance purely from the private sector continued to be difficult, even for slightly larger enterprises. In essence, BVCA's position was supportive of the ECFs scheme, which, it claimed, managed to fulfil market expectations.

6. Assessment

6.1. Existence of State aid

(39) In the decision of 2005 the Commission concluded that State aid within the meaning of Article 107(1) of the Treaty is present at the level of the investors and at the level of the beneficiary SMEs. Therefore, through the implementation of the ECFs scheme, the companies that were the object of monitoring in this case received State aid within the meaning of that article. The UK authorities do not contest this conclusion.

6.2. Compatibility assessment

6.2.1. MMC

(40) From the information provided by the UK authorities, the Commission understands that LPA's terms of MMC (namely the subordination conditions)

---

\(^{19}\) A buy and build strategy is typically deployed by private equity to generate value and increase their returns. It entails buying a platform company with established management and systems, and leveraging off this company to acquire subsequent tuck-in acquisitions. The buy and build approach entails significant change, and therefore management teams capable of building cohesive teams and further developing a scalable structure are a must.

\(^{20}\) Two other investments were considered but were withdrawn.
were agreed before the end of the transition period for taking appropriate measures under the RCGs of 2006.

(41) Until its official creation (that is to say, signature of the LPA), a fund cannot be involved in any transaction because it does not have any legal personality. However, while the specificities of the venture capital industry and the particularities of the ECFs scheme meant that the conditions of the LPA were established long before the date of signature of the LPA, MMC could not operate on the market or carry out transactions of any kind before the signature of the LPA. Therefore, the fact that the launch process started during the transitional period is irrelevant for the case at issue.

(42) It follows that the Commission cannot retain the argument of the United Kingdom with respect to the date of the creation of the fund. The investment should therefore be assessed on the basis of Chapter 4 of the RCGs of 2006.

(43) As regards the investment made by MMC in Reevoo, Article 2(2) of the Commission Recommendation of 6 May 2003, concerning the definition of micro, small and medium-sized enterprises, sets the conditions under which an undertaking qualifies as a small enterprise. In addition, Article 4(2) of that Recommendation states the conditions under which an enterprise changes status.

(44) The United Kingdom informed the Commission that, in March 2010, Reevoo employed 26 persons, in March 2011 it employed 28 persons, and in March 2012 it employed 39 persons. The investment by MMC took place in July 2012. Therefore, on the basis of the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, Reevoo was a small enterprise at the moment of the investment.

(45) Since the company did not exceed the limit of 50 persons over two consecutive accounting periods, in March 2012 the company was a small enterprise and was entitled to receive State aid up to the expansion phase (see point (24)).

(46) Therefore, having regard to the fact that the thresholds relating to turnover and balance sheet totals were respected it is concluded that the investment received from MMC was compatible with the RCGs of 2006.

21 The process of raising money from private investors is long and involves a fair amount of complex legal documents; the conditions of the LPA are set up long before the moment of its the official creation of the fund that is to say, the date of the signature of the LPA.

22 The Commission notes that conditions agreed by MMC at the moment of the bid were similar to those of the LPA signed on 01.07.2008

23 Article 2(2): “A small enterprise is that enterprise that employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million.”

24 Article 4(2): “[...] where, at the date of closure of the accounts, an enterprise finds that, on an annual basis, it has exceeded [...] the headcount or financial ceilings stated in Article 2, this will not result in the [...] acquisition of the status of medium-sized [...] unless those ceilings are exceeded over two consecutive accounting periods.”
(47) As regards the investment made by MMC in Interactive Investor, the Commission understands that Interactive Investor was acquired for GBP 1 in 2004 by Capital Accumulation Limited and that the MMC investment of 2010 enabled the company to enter a new market following a full overhaul of its business strategy. In particular, the acquisition led to important transformations, including a change of business model, withdrawal from its previous markets, divestments to generate cash and layoffs/hiring of personnel. Therefore the investment made by MMC in 2010 was, in substance, an early stage venture investment as Interactive Investor faced the same difficulties as regards access to capital as an SME in its start-up phase.

(48) Therefore, it is concluded that the investment in Interactive Investor complied with the RCGs of 2006.

6.2.2. Panoramic investment

(49) From the information provided by the UK authorities, the Commission understands that Panoramic invested directly in STL, a buy and build platform, which was subsequently to operate as an aggregator/consolidator in the travel/tour operator market.

(50) The establishment of buy and build platforms by investment funds is a common practice in the venture capital industry: such platforms enable economies of scale and synergies between the companies operating under the platform (scouting costs, management fees, procurement, cross-sales, etc.).

(51) Furthermore, it is also common practice for subsequent investments to be made by the initial investees. In fact, it is difficult to control the stream of further investments because (a) a fund would eventually dilute its participation and control in the subsequent investees and (b) subsequent investments in general take opportunistic approaches and forms (direct investment or acquisition of shares). The initial investment in such platforms is a direct investment (that is to say, the platform is directly capitalized), while subsequent investments of the initial investee could be executed either through direct investments (issuing of new shares) or capital replacement transactions (acquisition of existing shares) on opportunistic conditions.

(52) The ECFs scheme did not prevent investments of any type from funds' initial investees (that is to say, direct investment or acquisitions). Thus, at the level of STL, Panoramic's investment complied fully with the State aid rules, since the fund invested through a direct investment. At the level of Andante Travels, the transaction involved elements of a capital replacement operation. While the ECFs scheme does not allow direct capital replacement transactions because such transactions do not face a market failure, subsequent investments by ECFs' initial investees follow a more commercial/opportunistic approach. That strategy was followed by STL which invested in Andante Travels and another company, as well as considering other potential investees, in the tour operator market.
(53) Therefore, it is concluded that the investment made by Panoramic complies with the RCGs of 2006.

7. CONCLUSION

(54) In the light of the foregoing, the investments that MMC and Panoramic undertook in Reevoo, Interactive Investor and Andante Travels are compatible with the internal market,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which the United Kingdom has granted to Reevoo, Interactive Investor, and Andante Travels during the period of implementation of the Enterprise Capital Funds scheme is compatible with the internal market within the meaning of Article 107(3)(c) of the Treaty.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 09.03.2015

For the Commission

[Signature]

For the Commission

Jordi AVET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION

Margrethe VESTAGER
Member of the Commission
Notice

If the decision contains confidential information which should not be published, 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 publication of the full text of the decision. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
1049 Brussels
Belgium

Fax No: +32 2 29 61242