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Accompanying the document

COMMUNICATION FROM THE COMMISSION

Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty

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Executive Summary Sheet
Impact assessment on the review of the Community guidelines on State aid for rescuing and restructuring firms in difficulty
A. Need for action
Why? What is the problem being addressed?
Rescue and restructuring (R&R) aid can bring certain benefits that justify the approval of such aid under Article 107(3)(c) of the Treaty. However, those benefits must be set against the substantial costs of R&R aid in terms of distortions of competition. Since 1994, the Commission has addressed this issue through guidelines that set out the conditions for approval of R&R aid. The current guidelines, dating from 2004, are now being reviewed. The main problems to be addressed in relate to some unclear, ineffective and burdensome rules under the existing guidelines, particularly that the definition of "firms in difficulty" leaves too much room for interpretation, that the rules cannot be applied easily to SGEI providers, that they contain no incentives to grant less distortive forms of aid, contain no requirements for contributions by investors, and no mechanism to ensure that the aid is justified. The scope may also be too narrow. The review of the guidelines seeks to remedy these aspects of the regime, which otherwise appears to function well.
What is this initiative expected to achieve?
The overall purpose is to contribute to successful restructuring and the return to strong, sustainable growth in the aftermath of the financial and economic crisis, and align the guidelines with the objectives of the State aid modernisation (SAM) programme, including the streamlining and clarifying of rules and ensuring good targeting of aid.
What is the value added of action at the EU level?
Approving State aid falls under the exclusive competence of the Commission. Guidelines on how the Commission intends to perform its compatibility assessment for a specific instrument or sector increase predictability and hence ease the administrative procedure between Member States and the Commission. The revision of the guidelines forms part of SAM and its objective of a simpler, clearer legal framework for aid that is supportive of economic growth.
B. Solutions
What legislative and non-legislative policy options have been considered? Is there a preferred choice or not? Why?
In relation to the definition of "firm in difficulty", four options have been considered: (1) the current provision, with both "hard" (objective) and "soft" (more subjective) criteria; or replacing the soft criteria with (2) broad additional hard criteria, (3) narrow additional hard criteria, or (4) narrow additional hard criteria for SMEs only. Of these, Option 4 is preferred, as it would reduce distortions of competition while limiting burdens on SMEs. On SGEI providers, the options are (1) applying the R&R rules in full or (2) allowing certain adjustments for SGEI providers. Option 2 is the preferred option, as it would allow SGEI providers to receive R&R aid and would support the role of SGEI in the European social model. On compensatory measures, the options are: (1) to exempt medium-sized enterprises from providing compensatory measures, or (2) to remain with the status quo where only small enterprises are exempt. The preferred option is the status quo, since the first option would create distortions of competition that would outweigh the gains in terms of rescuing SMEs more easily. On targeting of aid, three options have been considered: (1) the existing rules, with minimal provisions to ensure aid is well targeted, (2) creating strong incentives for better targeting and (3) creating basic incentives for better targeting. Of those options, the second is preferred, since it would make a major contribution to reducing the distortive effects of aid. On the scope of the guidelines, there are two options: (1) to maintain the exclusion of steel firms from the guidelines or (2) to allow R&R aid to the steel sector.
Who supports which option?

On the definition of "firm in difficulty", stakeholders generally support the second and third options. On SGEI providers, there is strong support among stakeholders for Option 2. In relation to targeting of aid, the third option combines proposals that are supported by Member States and industry. The few stakeholders, mostly Member States, that have expressed a view on the options for SMEs support the first option. On targeting of aid, there is strong support from stakeholders for the second option. On the scope of the guidelines, industry generally prefers the first option, although some Member States support the second.

C. Impacts of the preferred option

What are the benefits of the preferred option (if any, otherwise main ones)?

The preferred option on the definition of "firm in difficulty" should improve the clarity and ease of application of the rules, reduce competition distortions and limit burdens on SMEs. The preferred option on SGEI providers should bring benefits for SGEI provision and employment by allowing SGEI providers to receive R&R aid. The preferred option on compensatory measures should limit distortions of competition. On targeting of aid, the preferred option should greatly reduce the distortive effects of aid. The preferred option on the scope of the guidelines would avoid the creation of serious competition distortions. No significant direct environmental benefits are expected.

What are the costs of the preferred option (if any, otherwise main ones)?

The preferred option on the definition of "firm in difficulty" may have a small negative effect by reducing the degree of control of competition distortions caused by aid to SMEs. The preferred option on SGEI providers may have a small negative effect due to the fact that by allowing R&R aid to SGEI providers, it opens the door to possible competition distortions in this field. The preferred option on compensatory measures means that some medium-sized firms may not be able to obtain R&R aid. On targeting of aid and the scope of the guidelines, the preferred options should have no significant negative impacts. No significant direct negative environmental impacts are expected.

How will businesses, SMEs and micro-enterprises be affected?

The preferred option on the definition of "firm in difficulty" will reduce the burden on SMEs by removing the soft criteria without putting additional hard criteria in their place. The options on compensatory measures affect only medium-sized firms. The preferred option on targeting of aid would have a positive impact on SMEs through the introduction of a new form of liquidity support for SMEs only. The preferred options on SGEI providers and on the scope of the guidelines are not expected to have any specific impact on SMEs.

Will there be significant impacts on national budgets and administrations?

The preferred option on targeting of aid is expected to lead to direct budgetary savings from the provision of aid in forms that are less costly to the State. However, it is for Member States to decide whether or not to grant aid in any given case, provided that it meets the conditions set out in the guidelines.

Will there be other significant impacts?

As noted above, the preferred options on the definition of "firm in difficulty", compensatory measures, targeting of aid and the scope of the guidelines are expected to have a positive impact on competition in the internal market.

D. Follow up

When will the policy be reviewed?

The revised guidelines will be reviewed towards the end of their period of application, expected to be at the end of 2020.

1. INTRODUCTION: THE SCOPE OF THE IMPACT ASSESSMENT

The rescue and restructuring guidelines[1] (the "2004 guidelines") came into force on 10 October 2004. They contain guidance on how the Commission will assess and may authorise State aid for the benefit of firms in difficulty. This Impact Assessment will explore the need and options for reviewing the 2004 guidelines.

The rules were initially due to expire on 9 October 2009, but were extended twice, first until 9 October 2012[2] and subsequently until their replacement by new rules[3] in line with the reform programme set out in the Commission Communication of 8 May 2012 on EU State aid modernisation ("SAM")[4].

In that Communication, the Commission set out an ambitious State aid reform programme, whose objectives include:

- to foster sustainable, smart and inclusive growth in a competitive internal market; and
- to streamline the rules and provide for faster decisions.

The review of the 2004 guidelines is guided by the common approach developed in the context of the SAM programme, which seeks to support sustainable growth and contribute to the quality of public spending by discouraging aid that does not bring real added value and distorts competition, and envisages a simplification and clarification of the State aid legal framework.

2. PROCEDURAL ISSUES AND RESULTS FROM CONSULTATION OF INTERESTED PARTIES

2.1. Consultation of interested parties

A first public consultation took place between December 2010 and February 2011. The intention of this public consultation[5] was in particular to receive feedback from Member States and stakeholders on their recent experience of rescue and restructuring of both industrial and financial institutions, especially in the light of the economic crisis. That first public consultation received replies from 29 stakeholders. This impact assessment refers to that consultation where there is a particular need or justification to do so. The consultation was followed by a workshop with Member States on 15 November 2011.

1 Community guidelines on State aid for rescuing and restructuring firms in difficulty. OJ C 244, 1.10.2004, p.2.

2 OJ C 156, 9.7.2009, p. 3.

3 OJ C 296, 2.10.2012, p. 3.

4 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on EU State aid modernisation (SAM), COM(2012) 209 final.

5 The questionnaire was published on http://ec.europa.eu/competition/consultations/2010_restructuring_aid/index.html

A second public consultation from 5 November to 31 December 2013 invited stakeholders to comment on new draft guidelines[6]. The consultation received comments from 45 stakeholders, which are summarised in Annex 1. A multilateral meeting with Member States on the draft guidelines took place on 16 December 2013.

2.2. External studies

A study on "Counterfactual scenarios to restructuring state aid"[7] was commissioned by DG Competition and prepared by the economic consultant Oxera. The presentation of the findings of the report took place on 16 November 2009. In addition, the Economic Advisory Group on Competition Policy (EAGCP) reported in February 2008 on the 2004 guidelines[8].

2.3. Impact Assessment Steering Group

The Legal Service, SG, AGRI, ECFIN, ENTR, EMPL, ENV, MARE, MARKT, MOVE, and REGIO were invited to be part of the Steering Group for this Impact Assessment and actively participated at several meetings. The group met on 11 January 2011, 24 March 2011, 27 January 2012, 2 July 2012, 27 June 2013, 6 February 2014 and 24 February 2014.

2.4. Impact Assessment Board review and opinion

The draft Impact Assessment Report was presented to the Impact Assessment Board on 26 March 2014. The Board issued its opinion on 28 March.

In line with the positive opinion of the Impact Assessment Board, the report has streamlined the problem description, explaining that overall the 2004 guidelins have worked well, but that there were some aspects that have raised concerns and are not consistent with the objectives of the State aid modernisation programme ("SAM"). Correspondingly, the problems and options have been grouped in the categories of unclear, ineffective and burdensome rules. On this basis, the description of the objectives of the review has been revised, and now focuses more clearly on the overall aims of SAM.

The report has also been revisited regarding the options, providing more details on their content, in particular as regards those relating to the definition of "firm in difficulty" and to burden sharing. As for the former, the report has identified a different set of options which makes it possible to better assess their impact.

The Impact Assessment Board also recommended strengthening the assessment of impacts, in particular regarding burden-sharing and the definition of "firm in difficulty". In this regard, the analysis performed by DG COMP has been significantly deepened. The section on the definition is now based on an extensive

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6 http://ec.europa.eu/competition/consultations/2013_state_aid_rescue_restructuring/index_en.html

7 Oxera, A study on counterfactual scenarios to restructuring state aid. Should aid be granted to firms in difficulty? , http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.html

8 Lyons et al, *EAGCP Commentary on European Community Rescue & Restructuring Aid Guidelines*, 6 February 2008.

testing of the various options considered against a large database of European firms; the burden-sharing part now sets out in greater detail the expected consequences. The section on the assessment of impacts has been significantly amended and, *inter alia*, now devotes more attention to the impact of the options on SMEs.

Finally, a number of more technical comments provided directly to DG COMP have also been taken into account in this Report.

3. POLICY CONTEXT, PROBLEM DEFINITION, AND SUBSIDIARITY

3.1. Policy context

3.1.1. Impacts of financial distress

Financial distress is a hazard faced by many firms at some point in their existence. More than 200 000 EU companies became insolvent in 2012, with an average in Western Europe of 70 corporate insolvencies per 10 000 companies[9]. These figures are likely to significantly understate the prevalence of financial distress, which also affects firms that undergo a period of financial difficulty but succeed in avoiding insolvency.

Financial distress can have a number of impacts, including abandonment of unprofitable activities, transfer of profitable activities (with associated assets/employment) to other firms, and losses to investors.

3.1.2. Support for firms in distress and state aid

Article 107(3)(c) of the Treaty allows the Commission to approve State aid "to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest."

Applying this provision to rescue and restructuring ("R&R") aid requires an assessment of the costs and benefits of providing aid. This section summarises the main costs and benefits that need to be taken into account.

3.1.2.1. Costs

By reallocating resources towards more productive uses, restructuring acts as a key driver of productivity growth. The importance of restructuring and market exit in this respect is demonstrated by empirical studies. According to one study, "external" restructuring (exit, entry and market share change), as distinct from "internal" restructuring (improvements by incumbents) accounts for 50% of establishment labour productivity growth and 80-90% of total factor productivity growth[10].

9 Creditreform, *Corporate Insolvencies in Europe 2012/13*. "Western Europe", within the meaning of that document, covers the EU-15 together with Norway and Switzerland.

10 Disney, Haskel and Heden (2003) "Restructuring and productivity growth in UK manufacturing", *The Economic Journal*, July Vol. 113.

By demonstrating that a firm is not making optimal use of resources and that restructuring is needed, financial distress plays an important signalling role[11].In this context, State support for troubled firms can impose a number of costs:

- R&R aid directly interferes with the market signals provided by financial distress. By preventing the exit of the recipient firm, it maintains an inefficient allocation of resources.

- Aid also has an indirect negative effect through the incentives of firms. Firms that anticipate that they will receive aid if they face financial distress may be willing to take an excessive level of risk, on the basis that they will benefit if the outcome is positive, but that the state will bear the burden if the risk does not pay off (the problem of moral hazard). Meanwhile, firms that anticipate that their rivals will receive aid will be deterred from investing by the awareness that greater efficiency and innovation on their part may not be rewarded by an increase in market share[12].

- R&R aid can have a negative impact on the allocation of capital. A perception that a particular firm or sector is likely to receive aid in the case of financial distress will draw capital away from other, more productive uses.

- Member States may be tempted to use aid to ensure the continuation of domestic production, shifting the burden of adjustment to production facilities in other Member States. Such a concern is particularly important in times of crisis and budgetary consolidation, when the very different fiscal circumstances of the Member States have the capacity to create severe imbalances between them.

3.1.2.2. Benefits

R&R aid can also bring benefits, by relieving the negative social and economic consequences of financial distress. Those negative consequences include:

- Unemployment and loss of output in particular areas. While in general the effect of restructuring on growth and jobs across the EU should be positive, this may translate into losses of employment and output on a local basis. This is particularly profound where unemployed workers cannot easily be re-employed, due to weaknesses in the local economy or a mismatch between workers' skills and available employment opportunities.

- Loss of technical knowhow and expertise.

- Disruption to important services, including services of general economic interest (SGEI).

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[11] See Lyons et al, *EAGCP Commentary on European Community Rescue & Restructuring Aid Guidelines*, 6 February 2008, p. 1.

[12] See EAGCP, p. 2.

- Systemic risks. In financial markets, for example, the failure of a firm can go so far as to threaten the stability of the financial system[13].

- Deadweight losses caused by the insolvency process, such as the loss of customer relationships, the foregoing of profitable investment opportunities[14] or the reduction in the value of assets sold following liquidation, compared to their going concern value[15].

3.1.3. *The rescue and restructuring guidelines*

The Commission has sought to balance the costs and benefits of R&R aid by permitting aid for rescuing and restructuring firms in difficulty, but only on conditions that minimise the costs. This approach, developed by the Commission on a case-by-case basis during the 1970s[16], has since 1994 been set out in Commission guidelines that aim to provide transparency and legal certainty. The current rules are the third version of those guidelines.

This section summarises the key provisions of the 2004 guidelines. The full text of the guidelines is set out for reference in Annex 2.

3.1.3.1. Eligibility

Under the 2004 guidelines, R&R aid can only be granted to "firms in difficulty", meaning firms that are unable, whether through their own resources or with the funds they are able to obtain from their owners/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn them to going out of business in the short or medium term.

This general definition is made operational through two further provisions. First, the 2004 guidelines set out "hard", i.e. objective, criteria. Under these criteria, a firm is considered to be in difficulty if it has lost half of its capital, with one-quarter of that capital having been lost over the preceding 12 months, or if it fulfils the criteria under its domestic law for being the subject of insolvency proceedings. Second, even when the hard criteria are not satisfied, the guidelines provide that a firm "may" be considered to be in difficulty where the "usual signs of a firm being in difficulty are present". The guidelines then provide a non-exhaustive list of usual signs of difficulty, the so-called "soft criteria", including increasing losses, diminishing turnover and mounting debt. Applying these soft criteria inevitably confers a degree of discretion on the authorities that judge whether a firm is in difficulty.

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13 According to the EAGCP, "We can think of no other significant set of markets [i.e. other than financial markets] where this argument is likely to be valid". EAGCP, p. 6.

14 See e.g. the summary in Teixeira, "The Impact of Capital Structure on the Decision to Outsource With Long Term Contracts", CEEAplA WP No. 21/2011, p. 3.

15 See Bank of International Settlements contact group on the legal and institutional underpinnings of the international financial system: Insolvency Arrangements and Contract Enforceability, September 2002, p. D1.

16 See Commission Decision 72/34/EEC of 15 December 1971 on the abolition, pursuant to Article 93 (2) of the EEC Treaty, of Belgian aid to undertakings in difficulty (OJ L 10, 13.1.1972, p. 22) and European Commission, *Eighth Report on Competition Policy* (April 1979), pp. 157-160.

The 2004 guidelines also provide that aid may only be regarded as legitimate subject to certain conditions. The same point then sets out a non-exhaustive list of possible justifications, namely social or regional policy considerations, the beneficial role played by small and medium-sized enterprises (SMEs) in the economy or, exceptionally, the desirability of maintaining a competitive market structure when the demise of firms could lead to a monopoly or to a tight oligopolistic situation.

The 2004 guidelines apply to firms in all sectors, except to those operating in the coal or steel sector.

3.1.3.2. Rescue aid

The 2004 guidelines distinguish between rescue aid and restructuring aid. Rescue aid is defined as temporary and reversible assistance, the aim of which is to afford the firm the breathing space in which to work out a restructuring or liquidation plan. Rescue aid is limited to a duration of six months, and must be in the form of loans or loan guarantees. The loan must in each case be granted at an interest rate at least comparable to those observed for healthy firms.

3.1.3.3. Restructuring aid

Unlike rescue aid, restructuring aid is not subject to any limitations on its form (whether loans, guarantees, or other forms of aid) or duration. It must, however, be based on a "feasible, coherent and far-reaching" restructuring plan, which complies with the conditions set out in the guidelines as to return to viability, own contribution and compensatory measures.

The requirement for return to viability means that the restructuring plan must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions.

To limit the amount of aid to the minimum necessary, the own contribution provision requires that beneficiaries make a significant contribution to the restructuring costs (ranging from 50% in the case of large firms to 25% for small enterprises) from their own resources. "Own resources" for this purpose can include sale of assets that are not essential for the firm's survival and external financing at market conditions.

Finally, compensatory measures aim to ensure that the adverse effects of the aid on trading conditions are minimised. These measures typically involve divestments of assets, reductions in capacity or market presence and reduction of entry barriers on the markets concerned. Small enterprises are not required to take compensatory measures.

3.1.4. The impact of the economic and financial crisis

3.1.4.1. Responses to the crisis

In the context of the crisis, the Commission adopted specific rules to assess R&R aid for banks. Those rules drew on the conceptual framework of the 2004 guidelines, but with adaptations to take account of the severity of the crisis and the particular issues that have arisen in the context of aid to banks.

In the review of the rescue and restructuring guidelines, DG Competition has considered to what extent the rules applied to banks during the crisis provide examples of best practice that can be transferred, with the necessary adaptations, to the non-financial context. In terms of the issues covered in this impact assessment, a particularly valuable example has been the concept of "burden sharing".

This concept was derived from the own contribution requirement set out in the 2004 guidelines. Unlike the own contribution requirement, however, it addressed not only the amount of contribution made, but also the source of that contribution. In so doing, it sought not only to limit the amount of aid needed, but also to limit distortions of competition and address moral hazard[17].

From an early stage of the crisis, the Commission required that losses be borne by those who invested in the bank, by absorbing losses with available capital and paying an adequate remuneration for State interventions[18]. The most recent set of rules takes this requirement further, by requiring all capital generating measures including the conversion of junior debt to be exhausted before restructuring aid can be granted[19].

3.1.4.2. Restructuring in the context of the crisis

The crisis has led to a significant increase in the prevalence of financial distress[20]. At a more fundamental level, however, it has also exposed weaknesses in the structure of the economy that require substantial restructuring and reallocation of assets to the most productive uses. As the Commission notes in its latest Annual Growth Survey, recovery in Europe "does not mean getting back to 'business-as-usual'; it means finding new sources of growth and competitiveness for the longer term, with knowledge-intensive and high-productivity activities for our economy"[21].

That means that, in the context of recovery from the crisis, it is particularly important that the market signal provided by financial distress not be muted by an inappropriate use of R&R aid. Financial distress and entry/exit dynamics will have a key role to play in reallocating resources to the development of new enterprises and more efficient and productive uses for sustainable growth and jobs.

3.2. Problem definition

This section sets out the main problems that have been experienced with the 2004 guidelines. These problems have been identified on the basis of a number of sources. DG COMP has drawn on its own experience in applying the guidelines, and has also

17 See Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (OJ C 195, 19.8.2009, p. 9), point 22.
18 *Ibid.*, point 24.
19 See point 15 of the Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), OJ C 216, 30.7.2013, p. 1
20 See Creditreform, *Corporate Insolvencies in Europe 2012/13.*
21 Communication from the Commission: Annual Growth Survey 2014 (COM(2013) 800 final), p. 9.

sought the views of stakeholders (including by way of the two public consultations referred to in section 2.1 above) and of other members of the Impact Assessment Steering Group.

This section concentrates on problems relating to the design of the rules that are expected to have a significant impact. As a result, certain issues of clarification raised by stakeholders in the context of the 2013 public consultation (such as those related to the concept of a newly created undertaking and to the exceptions to the "one time, last time" principle), and certain other issues on which only a limited number of comments were received (such as those related to remuneration and the content of restructuring plans) have not been considered further here.

This process has not identified major problems with the overall approach under the guidelines. In particular, the 2010 consultation showed strong support for the distinction between rescue and restructuring aid, and for the three main requirements for compatibility of restructuring aid (as briefly described in section 3.1.3.3 above).

However, in some respects, concerns have been raised that the 2004 guidelines may not be fully consistent with the principles of the SAM programme. In particular:

- The SAM programme calls for streamlining the state aid rules and achieving faster decision-making. That requires that the rules be clear and easy to apply. In certain respects, however, the existing rules are unclear and unduly burdensome (section 3.2.1).
- In accordance with the SAM programme, State aid policy should concentrate on facilitating well-designed aid targeted at market failures and objectives of common European interest ('good aid'). Concerns have been raised that the 2004 guidelines do not contain the appropriate provisions to ensure that aid is well designed and properly targeted (section 3.2.2) and that the scope of the guidelines is too narrow, excluding some potential "good aid" (section 3.2.3).

3.2.1. Unclear and burdensome rules

3.2.1.1. Definition of "firm in difficulty"

A significant source of uncertainty and of difficulty in applying the rules is found in the definition of "firm in difficulty". This definition is used not only as an eligibility criterion under the R&R guidelines, as noted in section 3.1.3.1 above, but also as an exclusion criterion under a number of other rules, including the structural funds regulations as well as most other state aid regulations and guidelines[22]. That means that in many cases, granting authorities in the Member States are required to determine, as a condition of eligibility for the support in question, that the firm does not meet the definition of "firm in difficulty".

[22] See, for example, Article 3(3)(d) of Regulation (EU) No 1301/2013 of the European Parliament and of the Council of 17 December 2013 on the European Regional Development Fund and on specific provisions concerning the Investment for growth and jobs goal and repealing Regulation (EC) No 1080/2006, (OJ L 347, 20.12.2013, p. 289); Point 18 of the guidelines on regional State aid for 2014-2020 (OJ C 209, 23.7.2013, p.1.

Failure to apply the definition correctly may have serious consequences. Under the structural funds regulations, granting funds to firms in difficulty may lead to the imposition of a "financial correction". Under state aid rules, it may mean that the Member State is required to recover the aid from the beneficiary, an action that can have a major impact on a firm that has arranged its business affairs on the basis that it will be able to retain the aid,

Because of these serious consequences, it is important that the definition of "firm in difficulty" is designed in such a way as to allow Member States and beneficiaries to be certain that a given firm is not in difficulty. That is the case with the "hard criteria", which are a matter of objective assessment. It is, however, very complex in relation to the application of the soft criteria.

The difficulties in applying the soft criteria as an exclusion criterion include the following:

- The criteria given are defined in terms of trends (such as increasing losses and diminishing turnover). No indication is given as to how large or well-established the trend is required to be. For example, it is not clear whether a firm is to be considered in difficulty as soon as its turnover in a given year is marginally below that of the year before, or whether the trend should be more than marginal and should be maintained for a number of years.

- The 2004 guidelines list eight criteria, which may not necessarily point in the same direction. For example, interest charges may be rising at the same time that turnover is also increasing. In cases where the criteria point in different directions, the 2004 guidelines give no weighting or order of priority that could be used to decide which criteria to rely on.

- The criteria listed are given only as examples of "usual signs of difficulty". Therefore, even if a Member State has considered all the criteria given and concluded that none of them shows a negative trend, it cannot be ruled out that other signs of difficulty might exist. There is no guidance in the 2004 guidelines as to what those other signs of difficulty might be.

Member States can deal with these problems either by attempting to interpret the soft criteria themselves, with the risk that they may still make errors, or by ignoring the soft criteria in practice. DG COMP monitoring has revealed that aid has been granted under the regional aid guidelines without systematic review of whether the beneficiaries were in difficulty in accordance with the soft criteria. In addition, DG COMP has been informed by DG REGIO of difficulties in the context of the audit of structural fund audit concerning the attempt to define precisely how the soft criteria should be applied.

For reasons such as these, a number of respondents to the 2013 consultation expressed the view that using only hard criteria for the purposes of exclusion would make it easier to assess whether firms were in difficulty[23].

23 See the responses of Poland, Italy, Finland, Slovenia and the Association of German Chambers of Commerce and Industry to the 2013 consultation.

3.2.1.2. Application to providers of services of general economic interest

The European Union framework for State aid in the form of public service compensation[24] ("SGEI Framework") sets out the conditions on which the Commission will assess the compatibility of state aid to compensate for the costs of providing services of general economic interest (SGEI). Point 9 of the SGEI Framework provides that aid for SGEI providers in difficulty is to be assessed under the R&R guidelines. This provision, which had no equivalent in the previous version of the SGEI Framework that applied between 2005 and 2012[25], has caused some concern among stakeholders, since SGEI providers may face difficulties in complying with certain provisions of the 2004 guidelines[26]. Those difficulties include the following:

- Point 36 of the 2004 guidelines requires, as a condition of viability, that the firm be able to "stand on its own feet" at the conclusion of the restructuring. That may be understood as requiring that the firm must be viable without any State support. However, an SGEI provider may not be able to provide a credible restructuring plan that does not involve continuing State aid, in the form of SGEI compensation, after the end of the restructuring period.

- Compensatory measures commonly require that the beneficiary of R&R aid divest certain assets. However, that may not be feasible in the case of an SGEI provider whose assets are largely or wholly required in order to provide the SGEI.

- The normal outcome, if a putative beneficiary of aid is unable to comply with the R&R guidelines, is that aid cannot be granted to that beneficiary. The consequence may be that the firm in question exits the market. In the case of an SGEI provider, however, that may mean that the SGEI is no longer provided, at least for the period needed to reattribute the service in question to a new provider.

3.2.1.3. Compensatory measures for medium-sized firms

As noted in section 3.1.3.3 above, small enterprises are generally not required to provide compensatory measures under the 2004 guidelines. Some stakeholders have argued that this exemption from the obligation to provide compensatory measures should be extended to medium-sized enterprises[27][28]. Such a change would avoid the

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24 OJ C 8, 11.1.2012, p. 15.

25 Community framework for State aid in the form of public service compensation, OJ C 297, 29.11.2005, p. 4.

26 Point 19 of the opinion of the Committee of the Regions on 'EU Guidelines on State aid for rescuing and restructuring firms in difficulty', OJ C139, 17.5.2013, p. 17. See also Schütte, "Revising the rescue and restructuring aid guidelines for the real economy – a practitioner's wishlist", European State Aid Law Quarterly (2012) No. 4, p. 813.

27 See the responses of Poland, France, Germany, the Association of French Regions and the Federal Association of German Public Banks to the 2013 consultation.

28 For the purposes of the 2004 guidelines, and in this impact assessment report, "small enterprise" and "medium-sized enterprise" are used with the meanings given to them in Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36), except where otherwise stated.

need for such firms to devise suitable compensatory measures and might therefore make it possible for some medium-sized enterprises that would not be able to comply with the requirements of the 2004 guidelines to obtain R&R aid in the future.

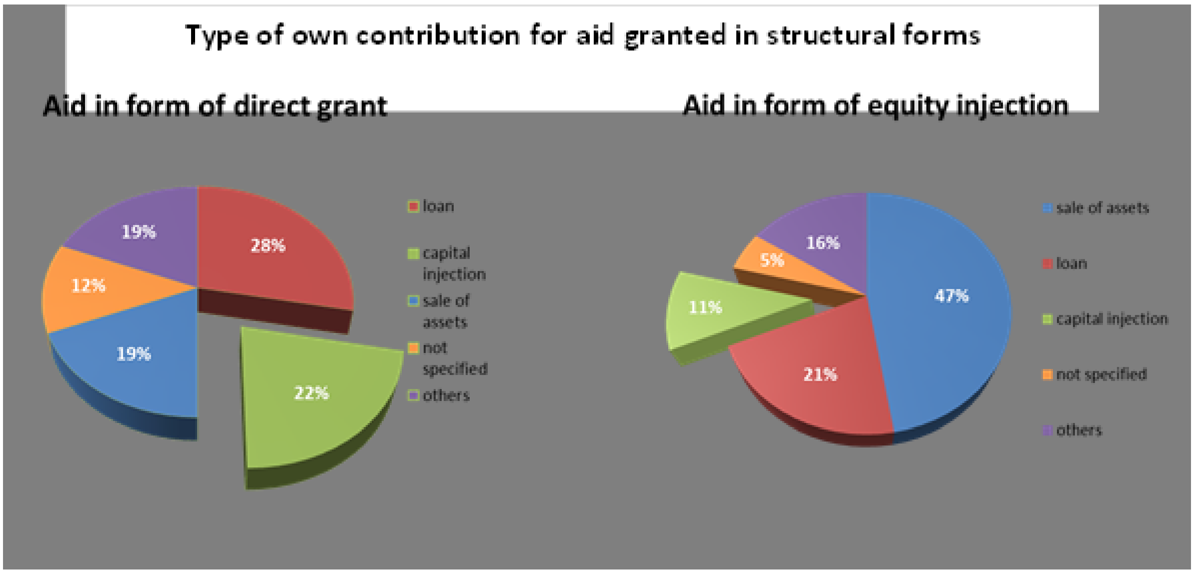
3.2.2. *Ineffective rules*

3.2.2.1. No requirement for contribution by shareholders and creditors

As noted in section 3.1.1 above, a common consequence of financial distress is that losses are allocated to investors in the distressed firm. Such allocation of losses is not among the negative consequences of distress which R&R aid should seek to prevent. On the contrary, the allocation of losses to investors in the case of distress is the necessary counterpart to such investors' right to receive a return on their investment if the firm performs well. In principle, therefore, aid that protects investors from losses is not justified, since it does not contribute to resolving market failures or pursuing objectives of common European interest.

As outlined in section 3.1.3.3 above, the 2004 guidelines require aided firms to contribute from their own resources to the costs of restructuring. However, there is no requirement that such "own contribution" be provided in a form that involves a contribution by investors. As a result, as shown in Figure 1 below, it is not only possible but common for the State to provide aid that enhances the firm's equity position (such as direct grants or equity injections), while own contribution is provided in a way that does not require any commitment from investors, such as external loans or sale of assets.

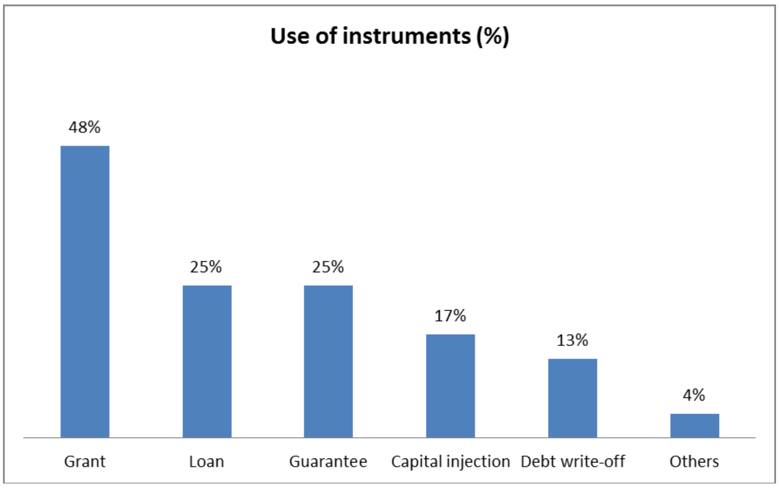
Figure 1



Source: DG COMP

A large proportion of all R&R cases dealt with by DG COMP are affected by this issue. As shown in Figure 2 below, the scale of the issue can be illustrated by reference to a study of past rescue and restructuring cases[29], which shows that a majority of such cases entailed equity aid (grants, capital injections and debt write-offs).

Figure 2



Source: Ferruz and Nicolaides, *The Economics of State Aid for the Rescue and Restructuring of Firms in Difficulty: Theoretical Considerations, Empirical Analysis and Proposals for Reform*, Bruges European Economic Research Papers 27/2013.

3.2.2.2. No incentive to grant aid in less distortive forms

In line with the objectives of the SAM programme, well designed aid should ensure that the distortions caused by aid are no greater than required to achieve the purposes of the aid. The distortions caused by R&R aid are closely linked to the form in which the aid is granted, particularly whether it is in the form of liquidity (loans and guarantees) or in the form of direct grants or equity. There are concerns in this respect that the 2004 guidelines do not contain sufficient incentives to encourage Member States to grant aid in less distortive forms.

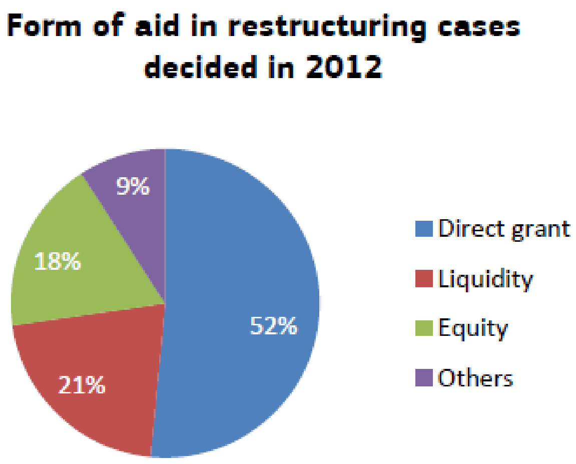
Aid in the form of liquidity is available for a limited time and bears interest for as long as the beneficiary is in receipt of such aid. Both the restricted duration and the remuneration for the aid are capable of limiting its distortive effects. By contrast, aid in the form of direct grants or equity injections remains at the disposal of the beneficiary indefinitely. It is remunerated only if the firm makes profits (or, in most cases of direct grants, not at all).

The 2004 guidelines provide very little incentive to minimise distortions by granting aid in the form of liquidity rather than grants or equity injections. While rescue aid must be in the form of liquidity, it is granted for a very short period and on terms that assume that it will be replaced by restructuring aid if the firm enters a state-supported restructuring. Restructuring aid is subject to no restrictions on the form of aid that can be granted. It is therefore unsurprising to find, as the Figure 3 below shows, that

29 Ferruz and Nicolaides, *The Economics of State Aid for the Rescue and Restructuring of Firms in Difficulty: Theoretical Considerations, Empirical Analysis and Proposals for Reform*, Bruges European Economic Research Papers 27/2013.

liquidity measures are used in only a minority of restructuring aid cases, far behind the number of cases in which direct grants are used.

Figure 3



Source: DG COMP

3.2.2.3. Inappropriate criteria for the justification of aid

As noted in section 3.1.3.1 above, the 2004 guidelines set out circumstances in which the grant of R&R aid may be justified. However, those justifications do not map well to the true negative social and economic consequences of financial distress, as outlined in section 3.1.2.2. Some of the circumstances set out in the 2004 guidelines are excessively broad (for example, the reference to "social or regional policy considerations"), and therefore do not allow for a detailed assessment of whether aid is appropriate in a particular situation. At the same time, certain important negative consequences of financial distress (such as disruption to the provision of an SGEI) are not covered at all.

3.2.3.

Because the existing criteria for the justification of aid are not appropriate, notifications of R&R aid are not closely scrutinised for whether a satisfactory justification is given. In the context of the SAM programme and its objective of facilitating well-designed aid targeted at market failures and objectives of common European interest, this is a cause for concern. It means that there is no review of whether aid granted under the 2004 guidelines is targeted at an objective of common interest. Problems due to restrictive scope of the rules

3.2.3.1. The steel sector is excluded from receiving R&R aid

Steel producers have been excluded from access to R&R aid since 1993, when the Council and the Commission agreed (under the terms of the ECSC Treaty) that no further rescue aid would be made available to steel firms[30]. Steel producers are therefore excluded from the scope of the 2004 guidelines.

However, some stakeholders have argued that steel should be brought within the scope of the guidelines[31]. This implies that the prohibition on aid to steel producers may be preventing the use of aid in cases where it can mitigate social and economic harm.

3.2.4. Problems and drivers

Problem	**Drivers**
Unclear and burdensome rules	Definition of "firm in difficulty" leaves too much room for interpretation
	Difficulty of applying the rules to SGEI providers
	Compensatory measures required of medium-sized as well as large firms
Ineffective rules	No incentives to grant aid in less distortive forms
	No requirement for contribution by incumbent shareholders and creditors
	No real assessment of the justification for aid
Problems with the scope of the rules	The steel sector is excluded from receiving R&R aid

3.3. Baseline scenario

The baseline scenario is the continuation of the existing policy with no change. In the case of the R&R guidelines, that would imply that the 2004 guidelines would remain in force without amendment.

In such a scenario, it can be expected that the problems identified above would persist and would, if anything increase. Both the demand for R&R aid and the ability of Member States to provide it are likely to develop in such a way as to enhance the negative effects of such aid.

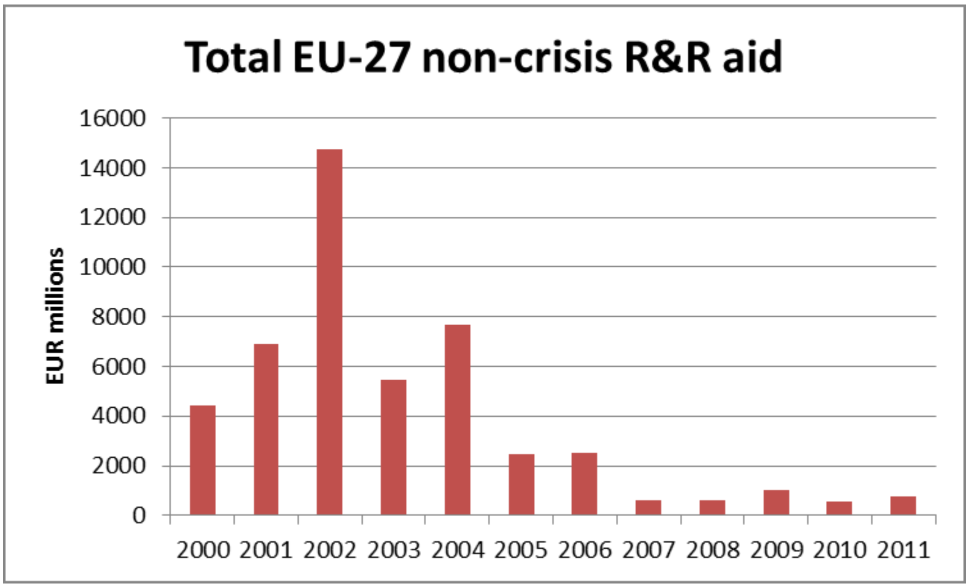
30 See the Commission Communication on rescue and restructuring aid and closure aid for the steel sector, OJ C 70, 19.3.2002, p. 21.

31 See the responses of France, Latvia and the European Affairs Committee of the French National Assembly to the 2013 consultation.

Experience of past recessions indicates that corporate insolvencies do not reach a peak for some time following the exit from recession. For example, the insolvency practitioners' association R3 has found, in connection with the UK recession of 1980-1981, that the rate of corporate insolvencies did not peak until 1985, four years after the end of the recession[32]. This implies that the coming years may see further increases in insolvencies, possibly resulting in increased demand for R&R aid.

At the same time, Member States' budgetary positions are recovering at an uneven rate. For some Member States, the growing number of corporate insolvencies is likely to coincide with improving public finances, enhancing not only the demand for R&R aid but also the capacity to satisfy that demand. That may lead to a situation similar to that following the economic slowdown of the early 2000s, which saw a peak in the amount of R&R aid granted towards the end of the slowdown in 2002, as shown in Figure 4.

Figure 4



Source: Data reported to DG COMP by Member States (aid element).

From a broader perspective, a significant reallocation of resources is needed to return the European economy to strong growth, by addressing the weaknesses revealed by the crisis. R&R aid has the capacity to hamper that reallocation process. It is therefore likely that the economy will be particularly sensitive in the coming years to the distortions caused by R&R aid.

3.4. Is the EU action justified on the basis of subsidiarity?

Approving State aid falls under the exclusive competence of the Commission. Guidelines on how the Commission intends to perform its compatibility assessment for a specific instrument or sector increase predictability and hence ease the administrative procedure between Member States and the Commission. The revision

[32] R3, "The “insolvency lag”: risks for 2010".

of the guidelines forms part of SAM and its objective to bring about a simpler, clearer legal framework for aid that is supportive of economic growth.

4. OBJECTIVES

4.1. General objective

The overall objective of EU policy for rescue and restructuring aid to the non-financial sector is to contribute to successful restructuring and the return to strong and sustainable economic growth in the EU in the aftermath of the financial and economic crisis, whilst avoiding market distortions.

4.2. Specific objectives

Given the problems outlined in section 3.2 above and the general objective set out in section 4.1, the specific objectives for the new rules on rescue and restructuring aid are the following:

1. Provide for state aid rules that are clear and easy to apply, including in particular a definition of "firm in difficulty" that can be applied with certainty by Member States in the context of block exemption regulations and the structural funds, in line with the SAM objective of streamlining the state aid rules and achieving faster decision-making.

2. Ensure that aid is well designed and properly targeted, in accordance with the SAM objective of concentrating state aid policy on facilitating well-designed aid targeted at market failures and objectives of common European interest ('good aid').

3. Ensure that the scope of the rules is appropriate and does not exclude potential "good aid", in accordance with the SAM objective of concentrating state aid policy on facilitating well-designed aid targeted at market failures and objectives of common European interest.

4.3. Operational objectives

1. Reports from stakeholders (Member States, auditors of structural funds) and results of the Commission's own monitoring of schemes that the relevant provisions of the guidelines (in particular the definition of "firm in difficulty") are applied confidently and correctly by public authorities.

2. Increase in the proportion of less distortive aid, particularly aid granted in the form of liquidity assistance (loans and guarantees) and equity-enhancing aid (particularly direct grants and equity injections) for which equivalent own contribution is provided.

3. Reports from stakeholders (Member States and public authorities) that the grant of aid is possible where necessary to deal with the negative social and economic consequences of financial distress.

5. POLICY OPTIONS

5.1. Unclear and burdensome rules

5.1.1. Definition of "firm in difficulty"

5.1.1.1. Option 1: No policy change (baseline)

Under this option, the definition of "firm in difficulty" would continue to involve the same hard and soft criteria that are used in the 2004 guidelines.

5.1.1.2. Option 2: Broad additional hard criteria, no soft criteria

This option would seek to minimise legal uncertainty by removing the soft criteria and introducing additional hard criteria in their place.

As explained in more detail in Annex 5, the services of DG COMP carried out an analysis aimed at identifying a limited set of simple financial ratios that could be used to determine whether or not a firm was in difficulty. The analysis focused on ratios that could be easily applied by public authorities on the basis of widely available financial data.

DG COMP's analysis found that a book debt to equity ratio of 7.5 and an interest cover ratio of 1.0 appeared *prima facie* to perform well in capturing the most distressed firms. These ratios are among those commonly recommended by academics and practitioners as ways of identifying distressed firms[33].

The 2013 consultation invited stakeholders to comment on different forms in which these ratios could be implemented (see Annex 5 for more detail). Under Option 2, the broadest of those forms would be used, namely:

- The debt to equity and interest cover ratios would be alternative (breaching either threshold would mean that a firm was in difficulty)
- The interest cover ratio would be linked to EBIT (earnings before interest and tax).
- The ratios would be applied to two years' data (the threshold would need to be breached in two consecutive years for a firm to be in difficulty).

5.1.1.3. Option 3: Narrow additional hard criteria, no soft criteria

As with Option 2, this option would seek to minimise legal uncertainty by removing the soft criteria and introducing additional hard criteria in their place.

[33] See Cambell et al "In Search of Distress Risk", The Journal of Finance, Vol LXIII, No 6, December 2008; Oxera, *Should aid be granted to firms in difficulty*, December 2009 and Standard & Poor's, *2011 Industrial Comparative Ratio Analysis, LT Debt – EMEA* (30.08.2012), *2007 Industrial Comparative Ratio Analysis, Long-Term Debt – U.S.* (28.08.2008) and *Industrial Comparative Ratio Analysis, LT Debt* (8.9.2003).

Option 3 differs from Option 2 in that the narrowest form of implementing the financial ratios would be used, namely:

- The debt to equity and interest cover ratios would be cumulative (both thresholds would need to be breached for a firm to be in difficulty)
- The interest cover ratio would be linked to EBITDA (earnings before interest, tax, depreciation and amortisation).
- As with Option 2, the ratios would be applied to two years' data (the threshold would need to be breached in two consecutive years for a firm to be in difficulty).

5.1.1.4. Option 4: Narrow additional hard criteria for large firms only, no soft criteria

As with Option 3, this option would seek to minimise legal uncertainty by removing the soft criteria and introducing additional hard criteria in their place. The narrow version of the hard criteria set out under Option 3 would also apply under Option 4.

Some stakeholders raised concerns in the context of the 2013 consultation that additional hard criteria based on financial ratios might impose an excessive administrative burden on SMEs. Concerns were also raised that the specific circumstances of SMEs, particularly the fact that they are commonly less well capitalised than large firms, would mean that a test based on financial ratios would identify a large proportion of SMEs as being in difficulty and would therefore not be capable of identifying those in genuine need of R&R aid[34].

Option 4 would address this concern by providing that the additional hard criteria would apply only to large firms.

5.1.2. Application to providers of SGEIs

5.1.2.1. Option 1: no policy change (baseline)

Under this option, the guidelines would apply in full to SGEI providers, with no adaptations. That would imply that an SGEI provider that was not able to comply with the guidelines, whether for reasons linked to its nature as an SGEI provider or otherwise, could not receive R&R aid.

5.1.2.2. Option 2: Applying the guidelines with necessary adaptations

Under this option, the guidelines would be adapted to the specific situation of SGEI providers, including:

- A general provision that, in assessing State aid to SGEI providers in difficulty, the Commission will take account of the specific nature of SGEI.

[34] See the responses of Croatia, Latvia and Ireland to the 2013 consultation.

- Confirmation that long-term viability may be based on the assumption that any compatible public service compensation will continue to be available after the end of the restructuring period.

- Confirmation that compatible public service compensation will not be taken into account for the purposes of assessing the amount of own contribution required.

- Clarification that, where it is not practicable to require the divestment of assets by way of compensatory measures, the Commission may instead require alternative measures to ensure that competition is not distorted to an extent contrary to the common interest.

- A further general provision that, where aid to an SGEI provider is found not to be compatible, the Commission may authorise the payment of such aid as is strictly necessary to ensure continuity of the SGEI until the service can be entrusted to a new provider.

5.1.3. Compensatory measures for medium-sized firms

5.1.3.1. Option 1: no policy change (baseline)

Under this option, medium-sized as well as large firms would be required to provide compensatory measures.

5.1.3.2. Option 2: extend the exemption from compensatory measures to all SMEs

Under Option 2, the requirement to provide compensatory measures would apply only to large firms. All SMEs would be exempt from the requirement.

5.2. Ineffective rules

5.2.1. Option 1: No policy change (baseline)

Under this option, no specific incentives for the use of less distortive and better targeted forms of aid would be introduced.

It would remain possible for the State to provide aid that absorbs losses (such as direct grants or equity injections), while own contribution is provided in a way that does not require any commitment from investors, such as external loans or sale of assets. In addition, there would be no incentive for Member States to provide support in the form of liquidity only, and there would continue to be no review of whether R&R aid was targeted at an objective of common interest.

5.2.2. Option 2: Strong incentives for better targeting of aid

This option would seek to address the concerns identified in section 3.2.2 regarding the targeting of aid in three ways: by introducing a requirement for burden sharing by investors; by introducing a new procedure allowing aid to support restructuring on less demanding conditions, provided that the aid was in the form of liquidity support only; and by introducing a new filtering system to ensure that aid was only granted where it could be shown that it was targeted at an objective of common interest.

The burden sharing requirement would draw on the Commission's experience during the crisis with the application of burden-sharing requirements to banks. Those requirements proved to be effective in ensuring that losses were borne by shareholders and subordinated creditors rather than taxpayers, without prejudicing either the viability of particular aided banks or the stability of the financial system as a whole.

While banks' business models have some specific features that differentiate them from firms in other sectors, the basic concern that the burden-sharing requirement seeks to address is the same in the case of all sectors, namely that aid should support the maintenance of employment and productive activity in the economy, rather than being used to protect investors from the consequences of their investment decisions.

Under this option, the existing requirement for the own contribution to be at least 50% of the restructuring costs would be retained, but the guidelines would clarify that the own contribution should be comparable in terms of effects on the solvency or liquidity position of the beneficiary to the aid granted. Shareholders would have to fully absorb losses, and following such loss absorption, new private capital should be granted on terms leading to a reasonable share of future value gains for the State, in view of its contribution.

To incentivise the use of liquidity support, Option 2 would involve introducing a new form of "temporary restructuring support" as an alternative to restructuring aid. This support would have to be in the form of short-term liquidity aid (loans or guarantees with a duration of not more than 18 months). The incentive would be created by applying less demanding conditions than for restructuring aid, with no requirement for burden sharing or compensatory measures and with only a simplified restructuring plan being required.

Given the fact that aid to large firms creates greater risks of distortions of competition and requires a more detailed assessment, such a simplified approach would only be applied to SMEs. This would also be in line with the fact that it is smaller undertakings that face the greatest difficulty in securing credit from banks[35] and that are therefore the most likely to face financial distress purely because of liquidity problems.

Finally, under Option 2 a list of criteria would be drawn up to identify situations where the failure of a firm would cause serious social or economic harm. Member States would be required to demonstrate that one of those "filters" applied. A proposed list of filters was set out in the draft guidelines published for consultation in November 2013, including:

- the fact that the unemployment rate in the region(s) concerned is higher than average, persistent and accompanied by the difficulty of creating new employment in the region(s) concerned;

[35] http://ec.europa.eu/enterprise/policies/finance/files/2013-safe-analytical-report_en.pdf

- the risk of disruption to an important service which is hard to replicate and where it would be difficult for any competitor simply to step in (e.g. a national infrastructure provider);
- the potential negative consequences of the exit of an undertaking with an important systemic role in a particular region or sector (for example as a supplier of an important input);
- the risk of interruption to the continuity of provision of an SGEI;
- the failure or adverse incentives of credit markets that would push an otherwise viable undertaking into bankruptcy;
- where the exit of the undertaking concerned from the market would lead to an irremediable loss of important technical knowledge or expertise; or
- similar situations of severe hardship.

Given the greater concern that temporary liquidity shortages could lead to serious loss of value within SMEs, a less strict set of filters would be appropriate to SMEs. In this respect, the draft guidelines proposed that the filters for SMEs should only involve a requirement to show that the failure of the firm would cause social or economic harm, including:

- the potential negative consequences of the exit of innovative SMEs or SMEs with high growth potential;
- the potential negative consequences of the exit of an undertaking with extensive links to other local or regional undertakings, particularly other SMEs
- the failure or adverse incentives of credit markets that would push an otherwise viable undertaking into bankruptcy; or
- similar situations of hardship.

5.2.3. *Option 3: Basic incentives for better targeting of aid*

Option 3 would involve a more limited set of changes to the guidelines, with the aim of introducing incentives for the use of better targeted aid, without requiring the introduction of new concepts.

Under Option 3, instead of introducing a new form of temporary restructuring support, incentives for greater use of liquidity support would be created by extending the maximum rescue aid period from 6 to 18 months. A number of stakeholders have called for such an extension[36]. This extension would make it possible to carry out a restructuring process using only rescue aid and would allow the less demanding

[36] See the responses of Bulgaria, France, Germany and Latvia to the 2010 consultation and point 23 of the opinion of the Committee of the Regions on 'EU Guidelines on State aid for rescuing and restructuring firms in difficulty'.

conditions that apply to rescue aid (in particular, the absence of any requirement for burden sharing or compensatory measures or for the submission of a restructuring plan) to operate as an incentive for the State not to grant restructuring aid and therefore to provide only liquidity assistance to the beneficiary of aid. Given the fact that aid to large firms creates greater risks of distortions of competition and requires a more detailed assessment, this extended period would only be available to SMEs.

In relation to the justification of aid, no new "filters" would be introduced, but the justifications currently allowed for in the guidelines would be applied more systematically, by way of a requirement for Member States granting aid to provide evidence that the aid was required due to social or regional policy considerations, the need to take into account the beneficial role played by SMEs in the economy or, exceptionally, the desirability of maintaining a competitive market structure when the demise of firms could lead to a monopoly or to a tight oligopolistic situation

Under Option 3, no change would be made to the existing own contribution requirement (and, in particular, no requirement for burden sharing would be introduced).

5.3. Scope of the rules

5.3.1. Options for aid to steel producers

5.3.1.1. Option 1: No policy change (baseline)

Under this option, steel would remain excluded from the scope of the guidelines.

5.3.1.2. Option 2: Bring steel producers within the scope of the R&R guidelines

This option would remove the exclusion of steel producers from the scope of the R&R guidelines.

6. ANALYSIS OF IMPACTS

This section sets out the conclusions of the assessment of the likely positive and negative impacts of the options described in the previous chapter. This analysis focuses on the social and economic impacts of those options, including the likely impacts on competition. No significant direct environmental impacts are expected.

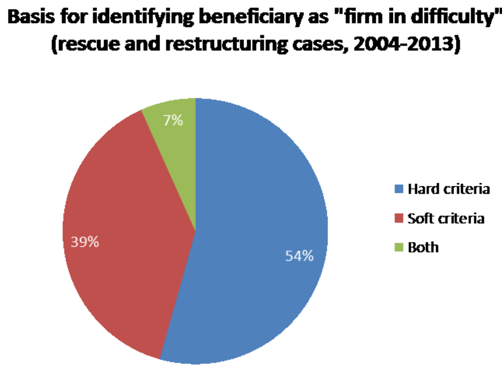
6.1. Impacts of options related to the definition of "firm in difficulty"

6.1.1. Impact on clarity and ease of application of the state aid rules

Compared to the baseline, Options 2, 3 and 4 would have strongly positive effects on the clarity and ease of application of the rules. The removal of the soft criteria, and the introduction in their place of additional hard criteria based on simple financial ratios, would make it possible for firms, granting authorities and auditors to determine with certainty, based on a firm's financial statements, whether or not the firm was in difficulty. This approach was welcomed by a number of responses to the 2013 public consultation[37].

The reduction of legal uncertainty could bring significant benefits. As Figure 5 below shows, soft criteria alone were the basis for identifying a firm as being in difficulty in 39% of rescue and restructuring cases between 2004 and 2013, and were used jointly with hard criteria in a further 7% of cases. This indicates that the scope of the soft criteria is very significant in comparison with the hard criteria, meaning that uncertainty could be significantly reduced by removing the soft criteria.

Figure 5



Source: DG COMP

The costs of uncertainty can be significant. Firms that receive aid to which they are not entitled, as a result of misapplication of the definition of "firm in difficulty", may be required to repay the aid. To avoid such a circumstance, firms are likely to incur substantial advice costs.

6.1.2. *Impact on the economic benefits of R&R aid*

Effective targeting of aid requires that the criteria used to define the notion of "firm in difficulty" accurately identify those firms that, without State intervention, will almost certainly be condemned to go out of business in the short or medium term[38].

The definition of “firm in difficulty” is not expected to have any direct impact on the benefits of aid. That is because, even if the definition is so narrow as to exclude some firms facing severe financial distress from the benefit of R&R aid, such firms would not by that token be excluded from other forms of aid.

37 See the responses of Poland, Italy, Finland, Slovenia and the Association of German Chambers of Commerce and Industry to the 2013 consultation.

38 See the general definition of "firm in difficulty" in point 9 of the guidelines.

6.1.3. *Impact on the costs of R&R aid*

If the definition of "firm in difficulty" is too narrow, so that it excludes some firms facing severe financial distress, that would create a risk of competition distortions. That is because, as set out in section 3.1.2.1 above, aid to firms in difficulty can have a negative impact on the allocation of resources and on incentives where it is not accompanied by appropriate conditions to minimise distortions, such as the requirements on viability, own contribution and compensatory measures that apply under the 2004 guidelines.

In this respect, Options 2, 3 and 4 would all have positive effects in comparison to the baseline. Since the complexity of the soft criteria means that they are used erratically, if at all, in practice, they do not operate as an effective means to reduce s of competition caused by the grant of aid to firms in financial distress. Therefore, replacing the soft criteria with hard criteria is expected to lead to improvements in this respect.

The most positive impact is expected from Option 2, which involves the broadest form of hard criteria. The narrower form of hard criteria under Option 3 would capture a smaller proportion of firms and therefore have a less positive impact In terms of reducing distortions of competition. Option 4 would have the least positive impact as it would capture only those distortions of competition caused by R&R aid to large firms.

To understand the scale of the impact, DG COMP has carried out a detailed analysis of the proportion of firms that would be covered by the definition, based on a large database of financial data for European firms of all sizes. As Table 1 below shows, that analysis leads to the conclusion that there would be a significant difference between Options 2 and 3 in terms of the proportion of firms covered, which would be around 15-20% in the case of Option 2 and less than 5% in the case of Option 3.

Table 1

Averages of ratios over 5 years (2008 – 2012)

	Germany		Italy		France	
D/E > 7.5	4.3%		3.9%		6.9%	
	EBIT	*EBITDA*	*EBIT*	*EBITDA*	*EBIT*	*EBITDA*
IC < 1 (1Y)	23.4%	20.6%	24.4%	13.2%	28.5%	20.5%
D/E > 7.5 or IC < 1 (2Y)	15.8%	16.7%	18.4%	10.7%	21%	15.5%
D/E > 7.5 and IC < 1 (2Y)	1.9%	1.3%	0.6%	0.2%	4.5%	3.6%

Source: DG COMP analysis

As regards the impact of Option 4, it should be noted that large firms make up only 0.2% of all EU firms, as shown in Table 2. Taking the highest figure shown in Table 1 for the proportion of firms caught under Option 3 (3.6%), and on the assumption that the proportion o large firms caught by the definition is no higher or lower than the average, this would mean that under Option 4, less than 0.01% of EU firms would be caught by the definition (although these would be the largest firms, the grant of R&R aid to which would potentially cause the greatest distortions of competition).

Table 2

	Micro	Small	Medium	SME	Large	Total
Number of Enterprises						
Num ber	18,786,480	1,349,730	222,628	20,355,839	43,454	20,399,291
%	92.1%	6.6%	1.1%	99.8%	0.2%	100%
Employment						
Num ber	37,494,458	26,704,352	22,615,906	86,814,717	43,787,013	130,601,730
%	28.7%	20.5%	18.3%	57.6%	42.4%	100%

Source: A Recovery on the Horizon? Annual Report on European SMEs 2012/2013

6.1.4. *Impact on administrative burden*

Overall, Options 2, 3 and 4 should all have a positive impact on administrative burden, compared to the baseline. All of them would remove the need for public authorities to assess all aspects of a firm's performance in order to determine whether it is in difficulty, as required by the soft criteria. Instead, all that would be required would be to review data included in a firm's financial statements.

The impact of Options 2 and 3 would be the same in this respect, since the tests proposed under those two options would require the same amount of data. Option 4 would have a significantly more positive impact, since the requirement to check financial data would apply to only 0.2% of all EU firms (as explained in more detail in section 6.1.3).

Options 2, 3 and 4 would also have an effect on administrative burden through their impact on the proportion of firms able to receive aid under the General Block Exemption Regulation (GBER). The GBER allows aid to be granted without prior notification to the Commission, provided that it meets certain conditions designed to ensure that the aid is well designed and targeted at market failures and objectives of common European interest ('good aid'). However, the GBER does not apply (with certain very limited exceptions) to firms in difficulty.

Too broad a definition of "firms in difficulty" could therefore have a negative impact on administrative burden, by preventing Member States from granting aid to such firms by way of the GBER (and therefore without prior notification)[39].

In this respect, Option 4 would have a minimal impact, since (as explained in section 6.1.3) it would exclude less than 0.01% of EU firms from the benefit of the GBER. Option 3 (which would exclude less than 5% of firms) would have a slightly negative

39 See, for example, the response of Finland to the 2013 consultation.

impact and Option 2 (which would exclude 15-20% of firm) would have a strongly negative impact.

6.1.5. *Social impacts*

As explained in section 3.1.2.1, R&R aid can maintain an inefficient allocation of resources and can shift the burden of structural adjustment (including job losses) onto other Member States. Therefore, while preservation of employment is a common aim of R&R aid, it should be borne in mind that uncontrolled R&R aid is likely to lead to long-term problems of productivity and competitiveness that will reduce the capacity of the economy to create jobs.

In this context, the impact of the options on employment will be linked to their impact on distortions of competition. Options 2, 3 and 4 are therefore all expected to have positive impacts on employment as compared to the baseline. The impact of Option 2 should be the most strongly positive, since it would bring the largest proportion of firms under the discipline of the R&R guidelines. Options 3 and 4 would have a slightly positive impact. It is not expected that Option 4 would have a significantly less positive impact than Option 3, even though Option 4 would exclude all but 0.2% of firms from the possibility of being in difficulty under the additional hard criteria. That is because, as Table 2 shows, large firms account for 42.4% of employment in the EU and a definition that is focused only on large firms would therefore remain very significant from an employment perspective.

6.1.6. *Impacts on SMEs*

The only respect in which a specific impact on SMEs is expected is in relation to administrative burden (see section 6.1.4). Since Option 4 would entirely exclude SMEs from the application of the additional hard criteria, that option would have a particularly positive impact on SMEs in terms of administrative burden.

6.2. Impacts of options related to SGEI providers

6.2.1. *Impact on clarity and ease of application of the state aid rules*

Compared to the baseline, Option 2 would lead to an improvement in the clarity and ease of application of the rules. As explained in section 3.2.1.2, the current problems are caused by the fact that it is not practically possible to apply the current rules to SGEI providers. Option 2 would address this issue by adapting the rules where necessary to the specific situation of SGEI providers, and is therefore expected to have a strongly positive effect.

This assessment is supported by the views of stakeholders, who gave a strongly positive response to Option 2 in the context of the 2013 consultation[40].

[40] See the responses of Italy, the United Kingdom, the Czech Republic, Belgium, Germany, Business Europe, the Catalan Regional Government, the European Competition Lawyers Forum and the *Association des Avocats Pratiquant le Droit de la Concurrence* to the 2013 consultation.

6.2.2. *Impact on the costs of R&R aid*

Option 2 would have a slightly negative impact on the costs imposed by R&R aid as compared to the baseline. That is because Option 1, by making it close to impossible for SGEI providers to receive R&R aid, would rule out the possibility of such aid imposing costs. Nevertheless, since the principles of the R&R guidelines would continue to apply to SGEI providers under Option 2, with only those amendments necessary to take account of their specific nature, the negative impact should be limited.

6.2.3. *Impact on the benefits of R&R aid*

As noted in section 3.1.2.2 above, one of the key potential benefits of R&R aid is the avoidance of disruption to SGEI provision. That benefit is not available under Option 1, since SGEI providers would find it close to impossible to qualify for R&R aid under that option. As a result, Option 2 would have a strongly positive impact in terms of achieving the potential benefits of R&R aid.

6.2.4. *Impact on administrative burden*

Option 2 would involve a slightly increased administrative burden as compared to the baseline. That is because, by effectively excluding SGEI providers in difficulty from access to R&R aid, Option 1 makes a detailed assessment of the situation of such firms unnecessary.

6.2.5. *Social impacts*

Option 2 would have a positive impact on employment as compared to the baseline. That is because, by making it close to impossible for SGEI providers to comply with the conditions of the guidelines, Option 1 prevents R&R aid being granted to preserve employment in such firms. Option 2 would allow aid to be granted, but by maintaining the basic principle of the R&R guidelines, it would ensure that such aid did not distort the allocation of resources and hold back job creation in the longer term.

6.2.6. *Impacts on SMEs*

No particular impact is expected on SMEs. Since the SGEI Framework applies essentially to SGEI providers receiving compensation exceeding EUR 15m annually for services outside the social services field, the issue identified in section 3.2.1.2 is of little relevance to SMEs.

6.3. **Impacts of options on compensatory measures for medium-sized firms**

6.3.1. *Impact on clarity and ease of application of the state aid rules and on the benefits of R&R aid*

Compared to the baseline, Option 2 would allow easier access to R&R aid by medium-sized firms in difficulty, by allowing even firms that were not able to offer compensatory measures to obtain aid. As indicated by certain stakeholder responses to the public consultation[41], therefore, Option 2 should improve access to R&R aid and therefore the ability to achieve the benefits that can be provided by such aid.

However, on the basis of a review of past case practice by DG COMP, it appears likely that the scale of that effect would be small. Between 2004 and 2012, the Commission adopted three positive decisions on restructuring aid to medium-sized companies, and two negative ones[42]. It appears from these decisions that in none of these five cases did the beneficiary encounter any particular difficulty in committing to compensatory measures.

In the three positive decisions, the compensatory measures mainly comprised structural measures, such as the divestment of certain divisions, the closure or sale of subsidiaries and the sale of a production line. In a further 14 cases of firms that were deemed large due to State ownership, the compensatory measures consisted of similar structural measures and of limited capacity reductions. This would indicate that it does not pose particular difficulties for medium-sized companies to provide compensatory measures, such that Option 2 would not remove a significant obstacle to such companies receiving R&R aid.

6.3.2. *Impact on the costs of R&R aid*

Aid granted to medium-sized enterprises can impose all of the costs identified in section 3.1.2.1 above. It can be argued that the scale of those costs is small, given the limited size of the firms concerned. However, aid to medium-sized enterprises can still create significant distortions of competition, particularly in areas where such firms have an important market position. In this context, Option 2 could have a significantly negative effect by increasing distortions of competition.

For example, in the machine equipment sector, there are, according to a study[43], 1 500 world market leaders of which 1 300 qualify as medium-sized companies. Granting restructuring aid to such companies, without any compensatory measures, could have a significant negative effect on resource allocation and could seriously weaken the incentives of similar-sized or smaller competitors to grow and innovate.

The Commission's case practice illustrates this point further. One of the medium-sized enterprises for which the Commission has approved restructuring aid is active in a sector in which micro-firms hold 70% of the market share. The Commission characterises this market as one where these small firms are increasingly under pressure from larger competitors, including the recipient of the aid. In this case, the Commission considered the compensatory measures (which included the closure of two subsidiaries, the closure of two production lines and stopping the production of certain products) as adequate.

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41 See the responses of Poland, France, Germany, the Association of French Regions and the Federal Association of German Public Banks to the 2013 consultation.

42 This very small number is likely to be because most rescue and restructuring aid to SMEs is granted through approved aid schemes. No information is available as to the compensatory measures imposed in such cases.

43 http://www.berndvenohr.de/download/vortraege/GermanMidSizedGiants_080615.pdf

6.3.3. *Impact on administrative burden*

The administrative burden associated with the compensatory measures requirement is relatively small. Since compensatory measures are only required in the context of restructuring aid, the firms that could be affected by this requirement would need to submit a restructuring plan in any event. The additional administrative burden imposed on firms by the compensatory measures requirement consists in the need to identify suitable measures. However, this must be seen in the context of a restructuring process in which the firm will in any case have made an inventory of its assets and its commercial prospects in order to complete the restructuring plan. While Option 2 could provide some benefits in terms of the reduction of administrative burdens, therefore, this effect is expected to be small.

6.3.4. *Social impacts*

Option 2 is likely to have positive impacts on employment in firms that become able to receive R&R aid. However, because that aid will be received without compensatory measures, its effect will be to shift the burden of adjustment to other firms, and therefore to reduce employment in the competitors of the aided firms. Through the negative impact of R&R aid on the allocation of resources, Option 2 is also likely to reduce the capacity of the economy for job creation. Its overall effect is therefore expected to be negative compared to the baseline.

6.3.5. *Impacts on SMEs*

This set of options relates only to medium-sized firms.

6.4. Impacts of options on the effective targeting of aid

6.4.1. *Impacts on the costs of R&R aid*

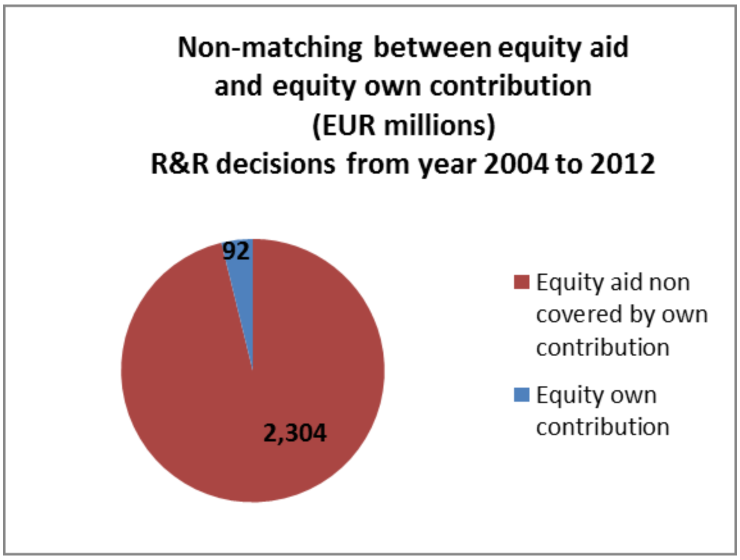
Option 2 is expected to have a significant positive effect, compared to the baseline, in terms of reducing the costs of R&R aid.

6.4.1.1. Burden sharing

As noted in section 3.1.2.1 above, where aid is used to protect investors from losses, it can lead to misallocation of capital by reducing the cost of capital for firms that are considered likely to benefit from bail-outs in the event of financial difficulty. It can also encourage excessive risk-taking behaviour, since shareholders stand to gain if the risks pay off, but will expect to be bailed out if they do not. That is particularly the case when aid that enhances the firm's equity position (as explained in section 3.2.2.1 above) is given without any matching contribution being required from investors. By reducing the likelihood of such mismatches, Option 2 should mitigate those costs. In the 2013 consultation, a number of stakeholders expressed their support for burden sharing as a way to ensure that state aid is not used to bail out shareholders[44].

A closer analysis by DG COMP[45] of 47 restructuring cases shows that in most instances equity aid was granted, but that own contribution in comparable form was only provided in a small number of those cases (9), meaning that there was a mismatch in 38 cases. In this sub-sample of 38 cases, the amount of equivalent contribution was small:

Figure 6



Source: DG COMP

This implies that the benefits of burden sharing would be substantial. To quantify the likely effect, we can note that, as the chart above shows, the total "equity" needed in the sub-sample of cases amounted to EUR 2 396 million. If the burden had instead been shared equally by Member States and investors, with each providing half of this sum, that would have meant that the equity aid necessary to achieve the same goals would have been reduced by EUR 1 106 million.

Option 2 would also make the provision of R&R aid more efficient by reducing the cost to State budgets of restructuring a firm. That effect would be enhanced by the fact that the contribution by incumbent investors to the coverage of losses would improve the financial conditions of the State's remaining equity contribution. It is likely that most of the past aid analysed provided little or no return to the State, particularly because any equity absorbed losses. Under Option 2, a larger proportion

44 See the responses of Italy, the United Kingdom, France, Finland, the Association of German Chambers of Industry and Commerce, the European Competition Lawyers Forum and the Austrian Chamber of Labour to the 2013 consultation.

45 The analysis looks at 47 positive decisions during the period 2004-2012. In principle, all positive decisions outside the financial sector have been reviewed, with the exception of a small number which do not clearly state the amounts of aid and own contribution.

of such losses would be borne by incumbents, and hence the potential upside (i.e. the likelihood that the contribution made would produce a positive return, for example on sale by the State of its shareholding in a restructured firm) would be greatly increased. Option 2 could thus have provided, in addition to the reduction of equity aid necessary, up to another EUR 1 198 million in saved public resources.

As Option 3 would not involve any changes to the existing own contribution requirement, it would be equivalent to the baseline in this respect.

6.4.1.2. Temporary restructuring support / extended rescue aid

Both Options 2 and 3 should reduce the costs of R&R aid by strengthening incentives for the use of liquidity aid. Use of liquidity aid should encourage restructuring, through the incentives created by the need to pay interest and repay the loan, and should avoid the distortions of competition created by the fact that aid in forms such as direct grants and equity injections benefits the recipient not only during the restructuring period, but also indefinitely thereafter. Option 2 is expected to have a greater impact than Option 3. In this context, a large number of respondents to the public consultation supported the proposal to introduce temporary restructuring support[46].

In the case of Option 3, this effect should result from the extension of the rescue aid period. While the existence of more stringent conditions for the grant of restructuring aid than for rescue aid already create some incentives for a firm to attempt to restructure with rescue aid only, these incentives are weak because this is not likely to be possible within the six-month rescue aid period. Corporate turnaround experts consider that the return to sustainable viability usually takes at least 18 months and is unlikely to be possible in less than a year[47]. A similar assessment emerges from the response of stakeholders to the 2013 consultation, which asked for comments on two options related to temporary restructuring support, a 12-month period and an 18-month period. Stakeholders overwhelming favoured the longer period[48], with only one stakeholder calling for a shorter period (of 9 months)[49].

The difference between Options 2 and 3 lies in the strength of the incentives provided. Under Option 3, firms would have an incentive to complete restructuring during the rescue aid period and so avoid the more stringent conditions applicable to restructuring aid. However, since firms would not be required to submit any form of restructuring plan during that period, the strength of this incentive would be limited. Under Option 2, firms receiving temporary restructuring support would face much

46 See the responses of Croatia, Portugal, Italy, Estonia, the United Kingdom, Latvia, Finland, Belgium, Germany, the Czech Republic, the German Chambers of Commerce, the Austrian Federal Chamber of Labour, the Catalan Regional Government, the Federal Association of German Public Banks and the German Farmers' Association to the 2013 consultation.

47 See Slatter, *Corporate Turnaround: Managing Companies in Distress* (Penguin Business, 1999) and Vance, *Corporate Restructuring: From Cause Analysis to Execution* (Springer, 2009).

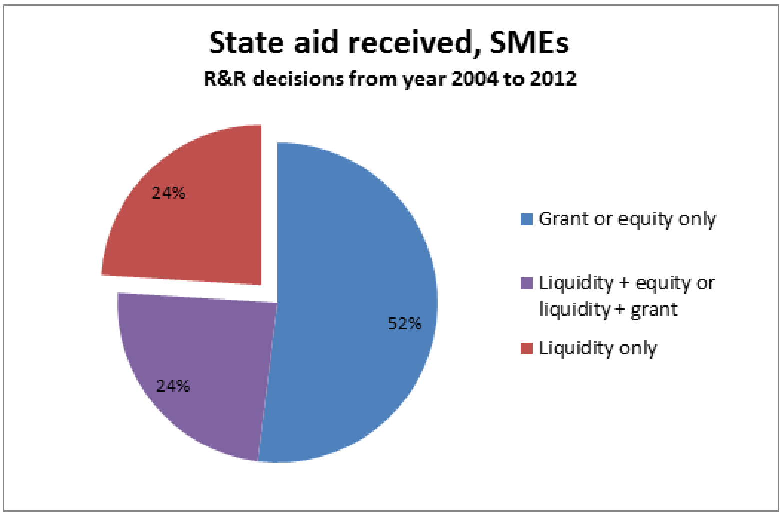
48 See the responses of Poland, Croatia, Italy, Hungary, the United Kingdom, France, Latvia, Finland, Romania, Slovakia, the Czech Republic, Belgium, the European Affairs Committee of the French National Assembly, the German Chambers of Commerce, the Confederation of Industry of the Czech Republic, the Austrian Federal Chamber of Labour, the Federal Association of German Public Banks and the German Farmers' Association to the 2013 consultation.

49 See the response of Business Europe to the 2013 consultation.

stronger incentives to complete restructuring within the period given, since the requirement to submit a simplified restructuring plan would ensure that firms drew up a strategy for carrying out restructuring early in the period.

In terms of the scale of the likely impact, as Figure 7 below shows, in only 24% of cases where the Commission approved restructuring aid to SMEs[50] in the period 2004-2012 was that aid wholly in the form of liquidity assistance. In terms of absolute amounts, as shown in Figure 8, less than half of the nominal amount of aid (EUR 23 million of a total of EUR 57 million) was in the form of liquidity assistance.

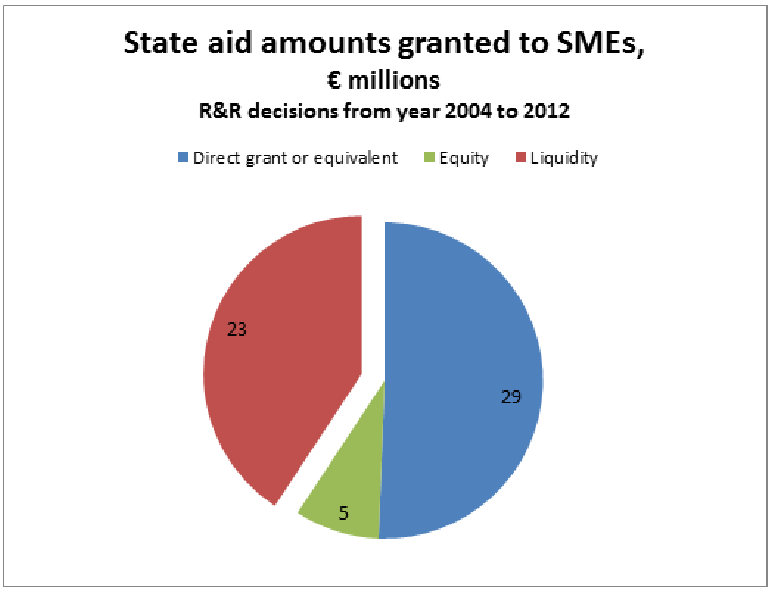
Figure 7



Source: DG COMP

Figure 8

50 For the purposes of these figures, to ensure a sample of sufficient size to allow for analysis, "SMEs" include firms that would qualify as SMEs according to the size thresholds set out in Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36), but which are excluded from this definition by virtue of the fact that 25% or more of their capital or voting rights are controlled by one or more public bodies.



Source: DG COMP

These figures underestimate the amount of aid granted to SMEs in the form of equity and direct grants. They do not include restructuring aid awarded to SMEs under approved aid schemes, since Member States are not required to notify details of individual awards under those schemes. However, Member States' reporting on the total amount of aid granted under R&R aid schemes shows that a total of EUR 400 million was granted under such schemes between 2005 and 2011. The distribution of that aid between liquidity assistance and other forms of aid is not reported, but if the distribution was the same as for notified cases, that would imply that some EUR 240 million of aid had been granted in the form of equity injections and direct grants.

As a result, incentivising a shift in the form of aid to SMEs from direct grants and equity injections to liquidity assistance could have a substantial impact in terms of reducing distortions of competition. Options 2 and 3 would also make the provision of R&R aid more efficient by reducing the cost to State budgets of restructuring a firm. Rather than granting aid with no possibility of return, Member States would be able to recover the amount of the loan, together with interest.

6.4.1.3. Justification for aid

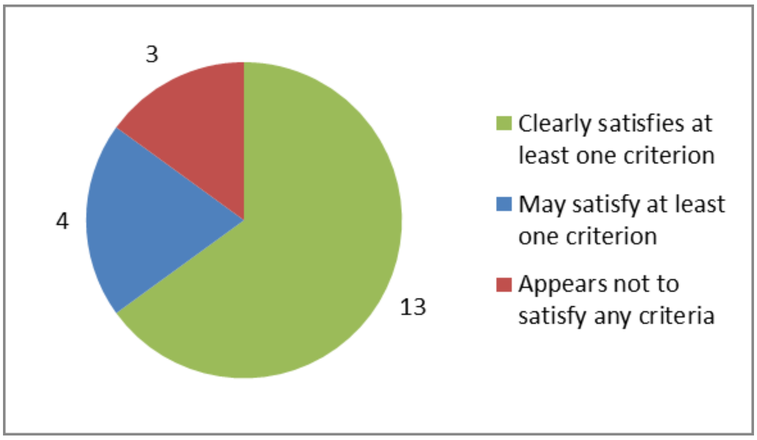
Aid granted where it is not necessary (i.e. where it is not targeted at cases where it is needed in order to achieve an objective of common interest) can impose all of the costs identified in section 3.1.2.1 above, without any corresponding benefits. Option 2 should prevent the grant of aid in those situations, and therefore reduce such costs. Certain stakeholders expressed support for this option in the 2013 consultation[51].

[51] See the responses of Italy, the United Kingdom, the Association of German Chambers of Industry and Commerce, the Catalan Regional Government and International Airlines Group to the 2013 consultation.

For the purposes of testing the impact of the options, a sample of 20 past cases has been analysed to obtain an indication of the differences that Option 2 would have made in practice as compared to the baseline.

As shown in Figure 9 below, 13 out of the 20 cases analysed would clearly have been eligible for R&R aid, and a further four cases might have been able to receive such aid. For three cases, however, it appears that the filters would have excluded R&R aid[52]. This suggests that the filters contribute to a better targeting of aid, and that hence that Option 2 would have a positive impact by avoiding the provision of aid in cases where it is not necessary.

Figure 9: Satisfaction of proposed filters in past cases



Source: DG COMP

Option 3 would have a similar effect in principle, by requiring a demonstration that the justifications for aid already set out in the 2004 guidelines were present in individual cases. However, it would be less effective, because the justifications used are not well designed. For example, it would be possible to justify any aid to SMEs on the basis of "the need to take into account the beneficial role played by small and medium-sized enterprises (SMEs) in the economy"[53], without explaining why aid to the particular SME in question would be more beneficial than allowing the normal market process of exit to function.

6.4.2. *Impacts on the benefits of R&R aid*

6.4.2.1. Burden sharing

The direct impact of Option 2 on mitigating social and economic harm caused by financial distress should be minimal, since it would only affect the use of aid to bail out investors, not its use to preserve economic activity and employment.

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52 In this context it should be borne in mind, however, that the Commission did not require Member States to submit detailed justifications for the granting of rescue and restructuring aid in the past, and it therefore cannot be ruled out that this analysis has been performed on the basis of incomplete information as regards the other criteria.

53 Point 8 of the 2004 guidelines.

For large firms, some of which are perceived to enjoy the backing of the State, such as certain State-owned enterprises, Option 2 could decrease this implicit guarantee and marginally increase funding costs[54]. However, the likelihood of a particular firm receiving R&R aid remains small. For example, in 2012, the Commission took decisions on R&R aid in 23 cases. That compares to a total of 239 437 corporate insolvencies in Europe in the same year[55]. On this basis, the reliance of investors on state aid in individual cases is likely to be minimal, meaning that the introduction of burden sharing should have little impact on the cost of capital.

Option 2 could also introduce obstacles to achieving the benefits of R&R aid if investors are unwilling or unable to provide the necessary own contribution. This concern was raised by certain stakeholders in the 2013 consultation[56]. However, the requirement to absorb past losses could in many cases be complied with through a dilution of ownership of existing owners in situation in which he incumbents do not contribute fresh funds. Other elements of own contribution could come from new investors rather than from incumbents. Provided that the firm is indeed expected to be viable (which is itself a requirement for the approval of R&R aid), there is no reason to believe that such external investment would not be available.

6.4.2.2. Temporary restructuring support / extended rescue aid

Both Options 2 and 3 should enhance the benefits expected from the provision of R&R aid, by encouraging restructuring to take place as rapidly as possible. As noted in section 6.4.1.2 above, while such an effect could also in principle have occurred with Option 1, in practice the very short period for which rescue aid is available under that option would make it impracticable to complete restructuring in that time.

Avoiding unnecessary delays in restructuring should improve outcomes, by bringing beneficiary firms back to growth as quickly as possible and avoiding the deadweight costs imposed in the interim by uncertainty over the firm's future. Economic modelling suggests that while faster restructuring means that short-run output losses are more concentrated, it also hastens the pickup in aggregate output[57].

Option 2 should have the most strongly positive impact in this respect, since the requirement to submit a simplified restructuring plan should strengthen incentives for firms to carry out restructuring without delay.

6.4.2.3. Justification for aid

It is evident that firms that did not meet the eligibility criteria of Option 2 would be negatively affected. However, this should have no impact on the effectiveness of aid in preventing social and economic harm, since the filters would be designed precisely to identify situations in which such harm could be expected.

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54 See e.g. Capobianco, A. and H. Christiansen (2011), “Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options”, OECD Corporate Governance Working Papers, No. 1, OECD Publishing, p. 5. http://dx.doi.org/10.1787/5kg9xfgjdhg6-en

55 Creditreform, *Corporate Insolvencies in Europe, 2012/13*. Figures are for EU-27 less Cyprus and Malta.

56 See the responses of Poland, Estonia and the Catalan Regional Government to the 2013 consultation.

57 Kim, "Macro Effects of Corporate Restructuring in Japan", IMF Staff Papers Vol. 51, No. 3 (2004).

In the case of Option 3, because the justifications in the 2004 guidelines do not map well to the positive effects of R&R aid as set out in section 3.1.2.2, it is possible that Member States might not be able to demonstrate that those justifications were present, even in cases where such aid would be beneficial for an objective of common interest (for example, where it could prevent the disruption of provision of an SGEI). Therefore, this option would be expected to have a negative impact on the benefits of R&R aid.

6.4.3. *Impact on administrative burden*

Option 2 would have a balanced impact on administrative burden, compared to the baseline. On the one hand, the requirement to demonstrate compliance with the filters would involve some increased administrative burden on firms that seek R&R aid[58]. On the other hand, the simplified restructuring plan required to obtain temporary restructuring support would involve a significantly lower burden than the submission of a full restructuring plan for the purposes of obtaining restructuring aid. It is expected that the overall impact would be positive, since the information required to demonstrate compliance with the filters should in any event be available. Certain filters, such as those linked to the local employment rate, would be simple to demonstrate on the basis of publicly available information. Other filters, such as the risk of loss of important technical knowledge or expertise, should be capable of demonstration on the basis of information already in the possession of the firm and which, in many cases, will be required by the granting authority in order to assess whether the aid is in the public interest.

Option 3 would have a similar impact. The absence of any requirement for a restructuring plan would mean that the impact on administrative burden would be slightly more positive than under Option 2.

6.4.4. *Social impacts*

No significant impacts on employment are expected. While Option 2 would reduce the amount of aid granted, it would do so in a targeted way by preventing the bail-out of shareholders while allowing the productive activity and employment of the beneficiary to continue. As for the justifications for aid, both Option 2 and Option 3 would include employment concerns as a justification, meaning that there would be no reduction in the aid available in cases where it was genuinely needed to preserve employment.

6.4.5. *Impacts on SMEs*

Since either temporary restructuring support or the extension of the rescue period would apply only to SMEs, both Options 2 and 3 would provide particular benefits to SMEs.

Option 3 would also have less negative effects for SMEs than for large firms in relation to the application of filters, since the concern discussed in section 6.4.2.2 that firms might not be able to demonstrate a suitable justification for aid from

[58] See the responses of Poland, France and Germany to the 2013 consultation.

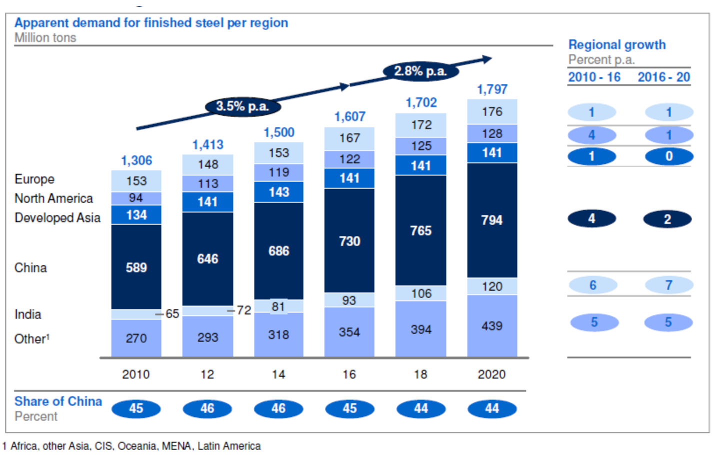
among the list included in the 2004 guidelines would not apply to SMEs, for which there is a general justification for aid. Option 2 would have the same effect on SMEs as on large firms, as a result of the introduction of specific filters for SMEs.

6.5. Impacts of options for aid to steel producers

6.5.1. Impact on the costs of R&R aid

The capacity of aid for steel producers to maintain an inefficient allocation of resources, by preventing exit in response to financial distress, is of particular concern in view of the substantial overcapacity in the steel sector. The European steel industry association Eurofer estimates overcapacity in Europe at 27 million tonnes, 14% of total realistic effective capacity of 192 million tonnes. There are strong indications that demand for steel is in secular decline and that further capacity closures will be needed in response. As the research institute RWI notes, most EU countries have exceeded the income levels up to which *per capita* steel sales continue to rise, meaning that the steel capacities required by the economy are on a downward trend[59]. This coincides with predictions for a slowdown in world steel demand growth in the period 2016-2020 as compared to 2010-2016[60] (see chart below) and with the observation that current steel demand is in line with expectations, given the long-term downward trend in steel consumption in Europe[61].

Figure 10: Apparent demand for finished steel per region



Source: McKinsey & Company, "Overcapacities in the steel industry"

In such a situation of overcapacity, financial difficulties would normally lead to the least economic capacity exiting the market[62]. By enabling the least efficient firms to

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59 Rheinisch-Westfälisches Institut für Wirtschaftsforschung, *RWI Konjunkturbericht: Die wirtschaftliche Entwicklung im Frühsommer 2013*, Jahrgang 64 (2013) Heft 2, p. 26.

60 See McKinsey & Company, "Overcapacities in the steel industry", presentation to the OECD Steel Committee 74th Session, 2 July 2013.

61 See SteelConsult International, "Realities of Survival for European Steel – Is there a future for Steel in Europe?", presentation to Platts 9th Steel Markets Europe Conference 2013, 23 May 2013.

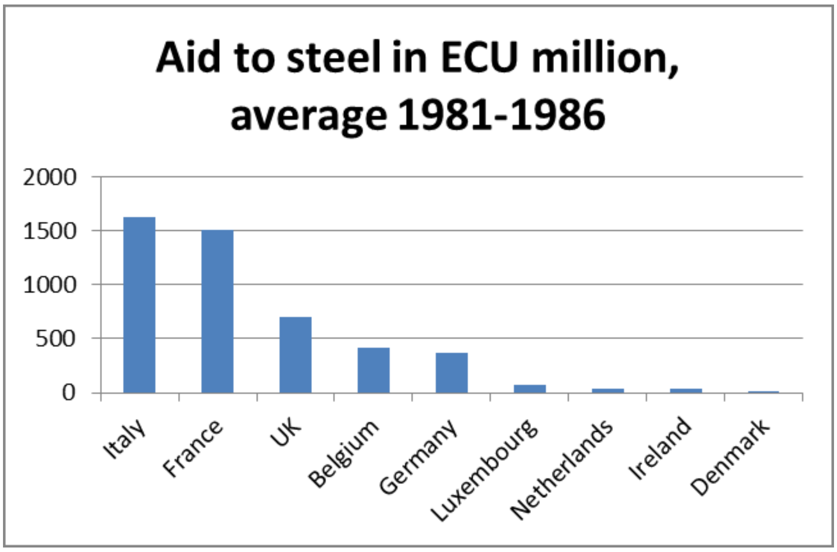
62 In the absence of state intervention, efficient firms will usually be the first to exit in a case where the cause of difficulties is a lack of demand on an industry-wide basis: see Ghemawat and Nalebuff (1985)

maintain capacity, R&R aid for steel would shift the burden of the necessary adjustment to more efficient competitors. That would imply the preservation of an inefficient allocation of resources, and the loss of the gains in productivity that could be achieved if capacity reductions were focused on the least efficient firms.

Aid to steel producers would also have harmful effects on incentives. On the one hand, producers that expected to receive aid in the event of financial difficulties might be prompted to take greater risks, for example by maintaining excess capacity in the hope of an increase in demand[63]. Other producers could be deterred from improving efficiency by the belief that such improvements would not be rewarded with an increase in market share, given the expectation that R&R aid would keep their less efficient rivals on the market despite losses.

The issue of R&R aid to the steel industry is particularly complex in view of the history of aid to the steel industry, involving the grant of large amounts of aid to support struggling firms. For example, the prohibition of state aid to the steel industry in 1993 followed the approval by the Council of aid totalling up to EUR 6.97 billion for restructuring or privatisation of six companies from four Member States[64]. In the early 1980s, meanwhile, as shown in the charts below, annual aid to steel exceeded ECU 500 million in three Member States and was more than 50% of gross value added in steel in four Member States.

Figure 11



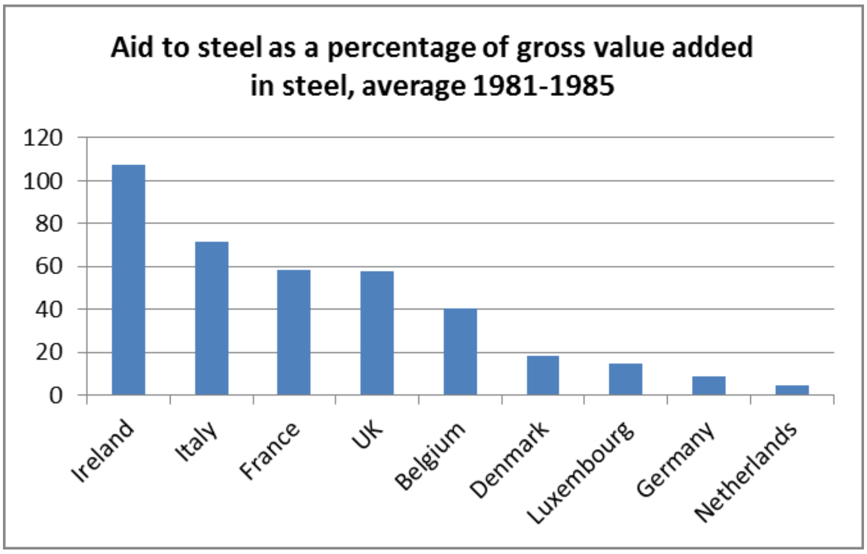
'Exit' *RAND Journal of Economics*; Fudenberg and Tirole (1986) 'A theory of exit in duopoly' *Econometrica*; Whinston (1986) 'Exit with multiplant firms' *RAND Journal of Economics*; Ghemawat and Nalebuff (1990) 'The evolution of declining industries' *Quarterly Journal of Economics*; Murto (2004) 'Exit in duopoly under uncertainty' *RAND Journal of Economics*.

63 Assessing global steel overcapacity in 2012, Ernst & Young notes that "Producers have retained loss-making excess capacity in the hope of either a large increase in demand or more likely the provision of economic assistance from host governments". Ernst & Young, *Global Steel 2013: A new world, a new strategy*, p. 14.

64 Schouw,"European Policy and Specific Sectors" in Darmer and Kuyper (eds.), *Industry and the European Union: Analysing Policies for Business* (Edward Elgar, 2000), p. 323.

Source: Commission of the European Communities, *First Survey on State Aids in the European Community* (1989).

Figure 12



Source: Commission of the European Communities, *First Survey on State Aids in the European Community* (1989).

Given that the industry as a whole is facing financial difficulties, and that "the pressure to restructure and reduce production capacity will remain one of the main challenges for this industry in the foreseeable future"[65], there are good reasons to believe that aid could be made available on a scale that would lead to significant distortions of competition.

This assessment of the costs of R&R aid to steel producers is in line with the views expressed by the steel industry. In its position paper on the EU Steel Action Plan, Eurofer noted that any aid leading to maintaining business operations "would hamper the current restructuring and lead to market distortions within the sector". Eurofer concluded from this that "the vast majority" of the industry would not support access to R&R aid. This point was also raised in the responses of the industry to the 2013 public consultation, which expressed concern (based on experience from the period in which state aid for the rescue and restructuring of steel producers was permitted under the ECSC Treaty) that aid could delay restructuring and keep uneconomic production on the market[66].

66 See the responses of the German Steel Federation and Salzgitter AG to the 2013 consultation.

6.5.2. Impact on the benefits of R&R aid

On an individual-firm basis, it can be expected that R&R aid for steel would allow certain firms to maintain a greater level of production than would be the case under Option 1.

However, the overcapacity in the European steel industry could mean that such benefits would be only temporary. By preventing the removal of capacity from the market, R&R aid would contribute to the maintenance of overcapacity, leading to ongoing financial difficulties and imposing pressure even on aided firms.

The other main benefit of R&R aid identified by respondents to the 2013 public consultation was the strategic role of steel, either in relation to high-tech industries[67] or to the defence industry[68]. However, in the current situation of overcapacity, there is no indication that market exit would put at risk the supplies of steel necessary for European industry, whether generally or in relation to the specific industries mentioned.

6.5.3. Impact on administrative burden

Option 2 would lead to an increase in the administrative burden on Member States and potential beneficiaries of aid compared to the baseline, in which there are no administrative requirements for R&R aid to steel producers because such aid cannot be granted.

6.5.4. Social impacts

On an individual-firm basis, by allowing more capacity to remain in production, R&R aid for steel could allow certain firms to maintain a higher level of employment than would be the case under Option 1. This issue is identified in the response from Latvia to the 2013 public consultation, which notes that the number of employees working in the metal processing sector represents an average of 10 % of all of those employed in the processing industry.

However, this would also have the effect of shifting the burden of structural adjustment to other, non-aided firms. It would therefore not lead to overall benefits in terms of employment. In addition, by delaying the adjustment of the whole industry, R&R aid would reduce the capacity of the European industry to compete and therefore to sustain jobs. The overall impact of Option 2 on employment is therefore expected to be negative.

6.5.5. Impact on SMEs

No specific impact is expected on SMEs, since aid to the steel industry under Option 2 would be likely to concentrate on larger firms.

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67 See the response of France to the 2013 consultation .

68 See the response of the European Affairs Committee of the French National Assembly to the 2013 consultation.

7. COMPARING THE OPTIONS

The impact of each option can be assessed in terms of its effect on the key variables of effectiveness, efficiency and coherence. Effectiveness refers to the extent to which options achieve the objective. Efficiency refers to the extent to which the objective can be achieved at least cost (cost-effectiveness). Coherence refers to the extent to which options are coherent with the overarching objectives of EU policy.

In this case, the impacts of the various options on the targeting of aid are considered from the point of view both of effectiveness and of efficiency. Impacts that relate to the ability of R&R aid to achieve its aims of limiting the social and economic harm caused by financial distress are addressed under "effectiveness", while impacts that relate to the attempt to limit the costs of R&R aid are addressed under "efficiency".

The tables below show the effect of each option on each of these key variables. Options with a positive effect are shown with a "+" and those with a strongly positive effect with "++". Similarly, options with a negative impact are shown with a "-" and those with a strongly negative impact with a "--". Options that are neutral as compared to the baseline are shown with a "0".

7.1. Options related to the definition of "firm in difficulty"

As regards effectiveness, Options 2, 3 and 4 would all have equally strong positive effects in terms of improving the clarity and ease of application of the state aid rules.

In terms of efficiency, Option 2 would have the most strongly positive effect on reducing the distortions of competition caused by aid to firms facing financial distress. Options 3 and 4 would have a less marked positive effect. While Option 4 would capture far fewer firms than Option 3, those firms covered would be those most likely to cause significant distortions of competition. For the purposes of the table below, therefore, Options 3 and 4 are both considered to have a slightly positive effect.

In terms of coherence, Option 4 would have a strongly positive impact on coherence with policies aimed at reducing administrative burdens on SMEs, since the soft criteria would be removed for SMEs and would not be replaced by additional hard criteria. The other options would be neutral in this respect.

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: broad additional hard criteria, no soft criteria	++	++	0
Option 3: narrow	++	+	0

additional hard criteria, no soft criteria			
Option 4: narrow additional hard criteria, for large firms only, no soft criteria	++	+	++

7.2. Options for providers of SGEIs

As regards effectiveness, Option 2 would have a strongly positive effect on the clarity and ease of application of the state aid rules, by making it possible for SGEI providers to comply with the rules. As a result of that, it would also have strongly positive effects on the achievement of the potential benefits of state aid, including the benefits for employment. Option 2 would therefore be strongly positive overall in relation to effectiveness.

As regards efficiency, Option 2 would have a slightly negative effect. That is because the possibility of granting R&R aid to SGEI providers would introduce some risk of possible distortions of competition.

Option 2 would also have a strongly positive effect on coherence. It would support the value of SGEI to the European social model by making it easier for Member States to guarantee the continuity of service provision even in the event of financial difficulty for the provider.

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: applying the guidelines with necessary adaptations	++	-	++

7.3. Options related to compensatory measures for medium-sized firms

As regards effectiveness, Option 2 could have a slightly positive impact, to the extent that medium-sized enterprises would be able to obtain R&R aid even if they were not in a position to offer compensatory measures.

As regards efficiency, the distortions of competition involved in allowing aid to medium-sized enterprises would make Option 2 strongly negative. This effect would remain even after the small potential benefits of Option 2 in relation to the reduction of administrative burden were taken into account. As regards coherence, Option 2 would be neutral.

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: extend the exemption from compensatory measures to all SMEs	+	--	0

7.4. Options related to the effective targeting of aid

As regards effectiveness, Option 2 should have a strongly positive impact from the introduction of temporary restructuring support, and a neutral impact from the introduction of filters and burden sharing. The extension of the rescue aid period would give Option 3 a slightly positive impact, but the enforcement of the justifications for aid set out in the 2004 guideline would have a slightly negative impact, making Option 3 neutral overall.

As regards efficiency, Option 2 should have a strongly positive impact from the introduction of burden sharing, temporary restructuring support and filters. Option 3 should have a slightly positive impact from the extension of the rescue aid period and the enforcement of the justifications for aid.

In terms of coherence as regards the reduction of burdens on SMEs, Option 2 would have a slightly positive impact from the easier availability of liquidity assistance. Option 3 would also have a slightly positive impact in this respect, but would also have a slightly positive impact from the existence of a justification based simply on the SME status of the beneficiary, giving it a strongly positive impact overall.

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: strong incentives for better targeting of aid	++	++	+
Option 3: basic incentives for better targeting of aid	0	+	++

7.5. Impacts of options for aid to steel producers

As regards effectiveness, Option 2 would have a slightly negative impact, since short-term gains in employment and production would be outweighed by longer-term losses. As regards efficiency, the significant competitive distortions expected should make Option 2 strongly negative. As regards coherence, Option 2 would have a neutral impact, since the Commission's Steel Action Plan did not call for bringing steel producers within the scope of the rescue and restructuring guidelines.

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: bring steel producers within the scope of the guidelines	-	--	0

8. MONITORING AND EVALUATION

8.1. Annual reports, monitoring and transparency

In accordance with Article 21 of the Procedural Regulation that applies in the field of State aid[69], all Member States that operate aid schemes covered by the guidelines must submit annual reports covering those schemes to the Commission.

The Commission continuously monitors the implementation of state aid measures by Member States through the monitoring exercise run by DG Competition. This ex-post monitoring exercise involves a check of the legal basis and the list of beneficiaries and an evaluation of the implementation of the scheme for a sample of beneficiaries. It allows detection and correction of irregularities in the implementation of schemes by Member States.

In addition, under the instruments that form part of the SAM programme, Member States are required to publish information on all aids granted. The draft R&R guidelines apply this requirement by requiring Member States to publish at least the following information on notified State aid schemes: the full text of the aid scheme and its implementing provisions, the granting authority, the names of the beneficiaries, the form (in particular the aid instrument) and amount of aid granted to

[69] Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 [(now Art.88)] of the EC Treaty, OJ L 83, 27.03.1999, p. 1, as last amended by Council Regulation (EU) No 734/2013 of 22 July 2013 amending Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 204, 31.07.2013, p. 15.

each beneficiary, the region in which the beneficiary is located and the principal economic sector in which the beneficiary has its activities. These requirements also apply *mutatis mutandis* to ad hoc aid. Such information must be kept for at least 10 years and must be available to the general public without restrictions.

8.2. Evaluation

In connection with the SAM programme, DG Competition is introducing a requirement for systematic *ex post* evaluation of certain aid schemes. This complements the reporting and monitoring provisions referred to in section 8.1 above (which focus, respectively, on data on the ongoing implementation of schemes and compliance with legal requirements) by assessing the effectiveness and efficiency of an aid measure and suggesting improvements and lessons to be learnt.

Evaluation under the draft R&R guidelines will be required for schemes where there is a risk of significant restrictions of competition if their implementation is not reviewed in due time. The evaluation must be carried out by an expert independent from the State aid granting authority, on the basis of a common methodology, and must be made public. The evaluation must be submitted to the Commission in due time to allow for the assessment of the possible extension of the aid scheme and in any case upon expiry of the scheme. The precise scope of the evaluation and how it is to be carried out will be defined in the decision approving the aid measure. Any subsequent aid measure with a similar objective must take into account the results of the evaluation.

As for the evaluation of the effectiveness of the amended guidelines, which will remain in force until 2020, the following criteria will be used, which will then, in addition to results from the evaluation of schemes, underpin the Commission's assessment of the need for a future reform of the guidelines:

- Whether, by relying on reports from stakeholders (Member States, auditors of structural funds) and on the results of the Commission's own monitoring of schemes, the relevant provisions of the guidelines (in particular the definition of “firm in difficulty”) are applied confidently and correctly by public authorities; and

- whether the amendments to the guidelines lead to an increase in the proportion of less distortive aid, particularly aid granted in the form of liquidity assistance (loans and guarantees) and equity-enhancing aid (particularly direct grants and equity injections), for which equivalent own contribution is provided; and

- whether, based on reports from stakeholders (Member States and public authorities), the grant of aid is possible where necessary to deal with the negative social and economic consequences of financial distress.

List of annexes

- Annex 1 – Summary of replies to the public consultation
- Annex 2 – Full text of the 2004 guidelines (this Annex can be found at http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52004XC1001(01))
- Annex 3 – Firms in difficulty

Annex 1 – Summary of replies to the public consultation

45 stakeholders provided input in the public consultation.

The following Member States replied: the Czech Republic (CZ), Finland (FI), France (FR), Germany (DE), Estonia (EE), Italy (IT), Latvia (LV), Lithuania (LT), Hungary (HU), the Netherlands (NL), Poland (PL), Slovakia (SK), the United Kingdom (UK), Portugal (PT), Croatia (HR), Romania (RO), Belgium (BE), Ireland (IE), Denmark (DK), Slovenia (SI). A reply was also received from the European Affairs Committee of the French National Assembly (FR – AN)

In addition, other responses came from: the Association of German Chambers of Industry and Commerce (Deutscher Industrie- und Handelskammertag – DIHK), the Confederation of Industry of the Czech Republic (Svaz průmyslu a dopravy České republiky - SPCR), Business Europe, Network of European Financial Institutions for SMEs (NEFI), the Spanish Business Confederation of Social Economy (Confederación Empresarial Española de la Economía Social - CEPES), the Federation of Very Small Enterprises of French Guiana (Fédération des très petites entreprises de Guyane - FTPE), Salzgitter AG, International Airlines Group (IAG), Confindustria, the Association of Lawyers Practising Competition Law (Association des Avocats Pratiquant le Droit de la Concurrence – AAPDC), Ryanair, the European Competition Lawyers Forum (ECLF) and the Competition Law Committee of the City of London Law Society, the Catalan Regional Government (CRG), COMPER Fornalczyk & Partners General Partnership, the European Trade Union Confederation (ETUC) and industriALL, the European Association of Public Banks (EAPB), the Federation of German Industries (Bundesverband der Deutschen Industrie - BDI), the German Steel Federation (Wirtschaftsvereinigung Stahl), the German Farmers' Association (Deutscher Bauernverband e.V. - DBV), the Federal Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands - VÖB), the German Banking Industry Committee (Deutsche Kreditwirtschaft - DKW), the Luxembourg Employees' Association (Chambre des salariés du Luxembourg), the Association des Régions de France (ARF) and the Austrian Chamber of Labour (Bundesarbeitskammer - BAK).

These responses are summarised below.

Agriculture

The guidelines apply in full to the agricultural sector, with some limited exceptions (Point 18 of the draft guidelines)

FI calls for the specific chapter on aid to agricultural producers, included in the 2004 guidelines, to be retained.

The steel sector

The steel sector is currently excluded from the scope of the Guidelines. (18)

Some responses (Salzgitter, Wirtschaftsvereinigung Stahl, DE) support the continued exclusion of the steel sector exclusion, while others (FR, LV, FR-AN, ETUC) call for steel to be included in the scope of the Guidelines.

Undertaking in difficulty

New hard criteria are introduced in the definition of undertakings in difficulty, with the soft criteria being reduced to a residual category (21-22).

While some stakeholders consider that the use of hard criteria will make it easier to assess whether firms are in difficulty (PL, DIHK, IT, FI, SI), a number express concern that the proposed definition may wrongly capture firms that are not in difficulty (HU, UK, FR, NL, FI, BE, DE, DIHK, Business Europa, Confindustria, BDI, DBV, SI) or may both capture some firms that are not in difficulty and miss others that are (PT, PL). Several stakeholders consider that the proposed hard criteria would cover too large a proportion of firms (DIHK, PT, IT, EE, HU, UK, FR, LV, NL, SPCR, FI, ARF, NEFI, Confindustria, EAPB, CZ, VÖB, DKW, DBV, DE). A number of respondents also consider that the use of individual indicators does not capture the full picture of a firm's performance (PL, DIHK, PT, FR, NL, Business Europe, NEFI, DK, Confindustria, BDI, DKW, BE, DE) or argue that the ratios may vary between sectors (PL, DIHK, PT, HU, FR, NL, Business Europe, FI, NEFI, DK, SK, Confindustria, EAPB, VÖB, DKW, BE, DE, SI).

On the options set out in the draft guidelines, a number of stakeholders express a preference for the leverage and interest cover conditions to be cumulative (PT, FR, LV, Business Europe, Confindustria, FI, VÖB). Most stakeholders that express a preference consider that EBITDA should be used for the interest cover ratio (HU, FR, LV, FI, SK, Confindustria, COMPER, EAPB, VÖB, BE), while PT and BAK prefer EBIT.

As regards the credit rating criterion, a number of stakeholders note that many firms are not rated (PL, HR, DIHK, PT, FR, LV, LT, SK, EAPB, VÖB, DKW, BE, DBV, DE); some propose that it should be possible to use bank or government ratings (HR, DIHK, LV, RO, EAPB, VÖB, DE).

On the criterion related to loss of capital, some stakeholders call for the reinstatement of the requirement that 25% of the firm's capital has been lost within the previous year (PL, DIHK, PT, HU, EAPB, VÖB, DKW, BE, DBV, DE).

A number of stakeholders raise concerns about the application of the criteria in particular circumstances. Some (PL, LV, LT, NEFI, EAPB, VÖB, DKW, DBV, SI) observe that not all entities keep accounts that can be used to test the ratios. Others consider that the proposed ratios are not appropriate for high-growth firms or those that invest heavily in R&D (PL, FR, FI, ARF), or that different criteria should be applied to SMEs (HR, LV, IE).

Some stakeholders express a preference for soft criteria. ECLF and AAPDC argued that the existing, broad soft criteria should be kept, and other stakeholders (IT, RO, Confindustria) propose that the ratios be used as an element of the soft criteria rather than as hard criteria or that Member States be allowed to request that the Commission approve their own methodologies based on soft criteria (FI). Some stakeholders (FR, IE, BE) observe that the need to check financial data will involve a disproportionate administrative burden.

Newly created undertaking

According to the Draft R&R Guidelines, "an undertaking will in principle be considered as newly created for the first three years following the start of operations in the relevant field of activity." (25).

Some replies (PL, LV, SK, EAPB, VÖB, DE) call for clarification on the date on which the three-year period starts to run, while others (EE, FI, NEFI, BE) propose to extend the period for which a firm is considered to be in difficulty to at least five years.

Demonstration of the need for aid to avoid social or economic harm ("Filters")

"Member States must demonstrate that the failure of the beneficiary would be likely to involve serious social hardship or severe market failure" (45)

Some respondents specifically support this provision (IT, UK, DIHK, CRG, IAG). On the other hand, some submissions (PL, FR, DE) argue that compliance with the filters is too complex and costly to demonstrate.

Some contributions (IAG and Ryanair) consider the proposed filters too broad, while others (ECLF, AAPDC) question the need for filters.

Some stakeholders call for simpler filters (or none at all) for SMEs (VÖB, DBV, DE), while one respondent (DIHK) welcomes the inclusion of specific SME-targeted filters.

Specific discussion of the proposed filters is limited. Some respondents argue that the employment criterion is discriminatory (VÖB, DBV, DE) or that social hardship of a region cannot be assessed solely by means of the average unemployment rate (FR). Some respondents call for specific additional filters to be added (IT, FI, AN, FR, AAPDC, BAK).

Viability

"In the case of restructuring aid, (...) the Commission will require that the Member State concerned submit a feasible, coherent and far-reaching restructuring plan to restore the beneficiary's long-term viability" (47).

A number of stakeholders (DIHK, IT, ECLF, IAG, DE) express approval of the greater clarity given on the content of the restructuring plan, although some consider the requirements too complex (FR, FR-AN). DIHK suggests that there should be lower requirements for SMEs.

Restructuring period

"The restructuring period should be as short as possible and should not in principle exceed three years" (49).

Some respondents (PL, FR, ECLF, AAPDC, VÖB, DBV, DE) call for a longer restructuring period to be allowed where necessary, thus providing more flexibility.

Need for State intervention

Member States that intend to grant restructuring aid must present a comparison with a credible alternative scenario not involving State aid (55).

This criterion is welcomed by DIHK and UK; in particular, the latter considers that the comparison would not be difficult to demonstrate.

Other contributions (PL, DIHK, FR, ARF, AAPDC, DE) claim that it would be very complex and hard to demonstrate and that it should be applied to a lesser extent (or not at all) to SMEs (DIHK, VÖB, DBV, DE).

Use of rescue aid

Structural measures, such as acquisition or sale of significant businesses or assets, must not be implemented with rescue aid unless they require immediate action. (57)

ECLF and ARF call for structural measures to be allowed to be undertaken using rescue aid.

Temporary Restructuring Support (TRS)

This would introduce (for SMEs exclusively) a new form of temporary restructuring support on the basis of a simplified restructuring plan. The draft guidelines invite comments on whether the maximum duration should be 12 or 18 months. (59)

Many stakeholders welcome the introduction of this option (HR, PT, IT, EE, UK, LV, FI, BE, DE, CRG, CZ, BAK, DIHK, VÖB, DBV), while only a few oppose it (DK, AAPDC).

The majority of respondents favour the 18-month duration (PL, HR, IT, HU, UK, FR, LV, FI, RO, AN, SK, CZ, DIHK, SPCR, BAK, VÖB, BE, DBV), while Business Europe, SI and DE suggest this period to be fixed at 9, 24 an30 months respectively.

Some contributions (PL, IT, HU, FR, ECLF, SK, BAK) suggest allowing TRS not only for SMEs, but also for large firms. UK in particular asks the Commission to provide for firms exiting the TRS period.

Finally, according to IT, TRS should not be treated as restructuring aid.

Remuneration

Rescue aid and TRS should bear remuneration at the rate applicable to weak firms under the reference rate communication (60)

Some respondents express concern that the rate may be too high (PL, EE) or object to the use of step-ups for TRS (IT, EE).

Limitation of the amount of rescue aid and TRS

Unless duly justified, the amount of rescue aid or TRS must not exceed the amount calculated in accordance with Annex I, based on past liquidity needs (62, 72, Annex I)

Some stakeholders (FR, AAPDC, VÖB, DBV) believe that the formula is too rigid,

Burden sharing

Investors in an undertaking in difficulty are expected to contribute to the costs of restructuring the undertaking. Comments are invited on two options, of which Option 1 requires a reasonable amount of burden sharing in view of likely losses on insolvency, while Option 2 requires losses to be borne first by shareholders and then by subordinated creditors (64-71).

A number of respondents support the burden sharing concept (DIHK, IT, UK, FR, FI, ECLF, BAK) although some express concern that investors may not be willing or able to share the burden (PL, EE, CRG).

Preferences for Option 1 (PL, IT, UK, RO, VÖB, DE) and Option 2 (DIHK, FI, DK, Confindustria, AAPDC, BAK, SI) are almost equally distributed, and some stakeholders (CZ, SPCR) express a preference for having the possibility of choosing between the two options on a case-by-case basis. IT considers that banks should be required to contribute if an undertaking is already in insolvency.

Some stakeholders (PL, HR, DIHK, EE, FR, FI, VÖB, DBV, DE) call for a lower own contribution threshold for SMEs and PT for lower own contribution to be permitted in the outermost regions.

Lastly, some stakeholders (PL, EE, HU, FR, ECLF, AAPDC) call for contributions by the state as shareholder to be recognised as own contribution.

"One time, last time" principle

"In order to reduce moral hazard, excessive risk-taking incentives and potential competitive distortions, rescue aid, restructuring aid and temporary restructuring support should be granted in respect of only one restructuring operation" (73).

PT and EE ask the Commission to give more detail on the exceptions to this general principle. FR-AN calls for exceptions to the principle, for example for start-ups. However, IAG and Ryanair argue that the exceptions should not be expanded.

FR calls for the period during which aid can be granted only once to be reduced from 10 to 5 years.

Competition measures

"In order to ensure that adverse effects on trading conditions are minimised as much as possible, (...) measures to limit distortions of competition must be taken" (79).

DK argues that the exemption from competition measures for small enterprises should be used cautiously, while others (PL, FR, ARF, VÖB, DE) call for all SMEs (medium-sized as well as small enterprises) to be exempted. BAK proposes to exempt early-stage firms and important technology companies from the duty to provide compensatory measures.

Regarding specific measures, Business Europe supports behavioural measures while PT and DE are against them. ARF considers that behavioural measures should not be imposed when the firm's difficulties were caused by problems in the market as a whole.

Services of general economic interest (SGEI)

"In assessing State aid to SGEI providers in difficulty, the Commission will take account of the specific nature of SGEI and, in particular, of the need to ensure continuity of service provision in accordance with Article 106(2) of the Treaty" (104).

Overall, stakeholders express appreciation for the specific provisions concerning SGEI (IT, UK, Business Europe, ECLF, CRG, AAPDC, CZ, BE, DE). BAK argues that the assessment of aid to SGEI providers should be the responsibility of Member States, and PT calls for transitional aid to SGEI providers to be allowed for 6 years where Member States can show there is no alternative provider.

State owned firms

Firms that do not qualify as SMEs only because they are more than 25% state-owned can nevertheless receive aid under schemes (109)

Some stakeholders support this provision (HU, DK, DE, SI, CRG), while IT opposes it. PL considers that all provisions that apply to SMEs should be extended to firms that do not qualify as SMEs only because they are more than 25% state-owned.

Schemes

"The Commission may authorise schemes for providing limited amounts of rescue aid, restructuring aid or temporary restructuring support to SMEs or smaller State-owned undertakings (109)".

A number of stakeholders express concern about the reduction of the maximum amount of aid that can be granted to any one undertaking under a scheme from EUR 10m to EUR 5m (DIHK, HU, FR, ARF, CRG, AAPDC, VÖB, DE, SI), while IT supports the reduction.

PL and AAPDC argue that firms that are in difficulty according to the soft criteria should be eligible for aid under schemes. FR proposes that entreprises de taille intermédiaire should be eligible.

Annex 3 – Firms in difficulty

Provisions of the 2004 guidelines

The 2004 guidelines explain the meaning of "firm in difficulty" as follows.

9. There is no Community definition of what constitutes ‘a firm in difficulty’. However, for the purposes of these Guidelines, the Commission regards a firm as being in difficulty where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term.

10. In particular, a firm is, in principle and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines in the following circumstances:

(a) in the case of a limited liability company [1], where more than half of its registered capital has disappeared [2] and more than one quarter of that capital has been lost over the preceding 12 months;

(b) in the case of a company where at least some members have unlimited liability for the debt of the company [3], where more than half of its capital as shown in the company accounts has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;

(c) whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings.

11. Even when none of the circumstances set out in point 10 are present, a firm may still be considered to be in difficulties, in particular where the usual signs of a firm being in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value. In acute cases the firm may already have become insolvent or may be the subject of collective insolvency proceedings brought under domestic law. In the latter case, these Guidelines apply to any aid granted in the context of such proceedings which leads to the firm's continuing in business. In any event, a firm in difficulty is eligible only where, demonstrably, it cannot recover through its own resources or with the funds it obtains from its owners/shareholders or from market sources.

[1] This refers in particular to the types of company mentioned in the first subparagraph of Article 1(1) of Council Directive 78/660/EEC (OJ L 222, 14.8.1978, p. 11) as last amended by Directive 2003/51/EC of the European Parliament and of the Council (OJ L 178, 17.7.2003, p. 16).

[2] By analogy with the provisions of Article 17 of Council Directive 77/91/EEC (OJ L 26, 30.1.1977, p. 1) as last amended by the 2003 Act of Accession.

[3] This refers in particular to the types of company mentioned in the second subparagraph of Article 1(1) of Council Directive 78/660/EEC.

Provisions of the draft rescue and restructuring guidelines

The draft rescue and restructuring guidelines published for consultation on 5 November 2013 propose the following definition of an "undertaking in difficulty"[70].

20. For the purposes of these guidelines, an undertaking is considered to be in difficulty when, without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term. Therefore, an undertaking is considered to be in difficulty if at least one of the following circumstances occurs:

(a) In the case of a limited liability company[1], where more than half of its subscribed share capital[2] has disappeared as a result of accumulated losses. This is the case when deduction of accumulated losses from reserves (and all other elements generally considered as part of the own funds of the company) leads to a negative result that exceeds half of the subscribed share capital.

(b) In the case of a company where at least some members have unlimited liability for the debt of the company[3], where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses.

(c) Where the undertaking is subject to collective insolvency proceedings or fulfils the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors.

(d) In the case of an undertaking that is not an SME, where, for the past two years:

(1) the undertaking’s book debt to equity ratio is greater than 7.5and

(2) the undertaking's EBITDA interest coverage ratio has been below 1.0.

[1] This refers in particular to the types of company mentioned in Annex I of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

[2] Where relevant, ‘share capital’ includes any share premium.

[3] This refers in particular to the types of company mentioned in Annex II of Directive 2013/34/EU.

[70] The term "undertaking" replaces "firm" for greater consistency with other EU legal instruments, but is not intended to change the scope of the definition.