Brussels, XXX
SWD(2014) 229

COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

COMMUNICATION FROM THE COMMISSION

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

{C(2014) 4606}
{SWD(2014) 228}

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1. PROBLEM DEFINITION

1.1. Policy context

State support to troubled firms imposes a number of costs:

- Rescue and restructuring (R&R) aid interferes with the market signals provided by financial distress, maintaining an inefficient allocation of resources.
- Aid has an indirect negative effect through its effects on the incentives of firms. Firms that expect to receive aid may take excessive risks, while their competitors may be deterred from investing.
- R&R aid can have a negative impact on the allocation of capital where it protects investors from losses.
- Finally, R&R aid may harm the level playing field between Member States.

On the other hand, State support to troubled firms can help relieve some of the negative social and economic consequences of financial distress, including loss of employment and output in particular areas; loss of technical knowhow and expertise; disruption to important services, including services of general economic interest (SGEI); systemic risks; and the deadweight losses of financial distress.

The Commission addresses this issue by permitting aid for rescuing and restructuring firms in difficulty only on conditions that minimise the costs of such aid, on the basis of Commission guidelines that were last amended in 2004[1] (the "2004 guidelines"). This impact assessment reviews the impact of possible changes to those guidelines.

1.2. Problem definition

Review of DG COMP's case experience, the views of stakeholders and of other members of the Impact Assessment Steering Group have not identified major problems with the overall approach of the guidelines. However, some concerns have been raised that they may not be fully consistent with the State aid modernisation ("SAM") programme. First, while SAM calls for streamlining the rules and achieving faster decision-making, the existing rules are in some respects unclear and unduly burdensome. Second, pursuant to SAM, State aid policy should facilitate well-designed aid targeted at market failures and objectives of common interest ('good aid'). Concerns have been raised that the 2004 guidelines do not ensure that aid is well designed and properly targeted, and that their scope is too narrow.

1.2.1. Unclear and burdensome rules

1.2.1.1. Definition of "firm in difficulty"

The definition of "firm in difficulty" involves both objective ("hard") criteria and more subjective ("soft") criteria. This definition is used both as an eligibility criterion under the guidelines and as an exclusion criterion under a number of other rules, including the structural funds regulations as well as most other state aid instruments. The existence of subjective elements in the definition can pose problems where the definition must be applied directly by granting authorities.

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

1.2.1.2. Application to SGEI providers

The European Union framework for State aid in the form of public service compensation[2] ("SGEI Framework") provides that aid for SGEI providers in difficulty is to be assessed under the R&R guidelines. This has caused some concern among stakeholders, since SGEI providers may not be able to comply with certain provisions of the guidelines.

1.2.1.3. Compensatory measures for medium-sized firms

Under the 2004 guidelines, firms receiving aid must take compensatory measures to minimise the adverse effects of the aid on trading conditions. However, small firms are not required to take compensatory measures. Some stakeholders have argued that this exemption should be extended to medium-sized enterprises.

1.2.2. Ineffective rules

1.2.2.1. No requirement for contributions by investors

Allocation of losses to investors when a firm is in distress is the necessary counterpart to 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. However, the 2004 guidelines do not prevent aid being used in this way.

1.2.2.2. No incentive to grant aid in less distortive forms

Liquidity aid is less distortive than other forms, but the 2004 guidelines provide little incentive to prefer liquidity aid over grants and equity injections.

1.2.2.3. Inappropriate criteria for the justification of aid

Although the 2004 guidelines set out certain circumstances in which the grant of R&R aid may be justified, they do not map well to the negative social and economic consequences of financial distress and are expressed in very general terms. As a result, notifications of R&R aid are not closely scrutinised for a satisfactory justification.

1.2.3. Problems due to restrictive scope of the rules

1.2.3.1. Exclusion of the steel sector

Steel producers are currently excluded from R&R aid. However, some stakeholders have argued that steel should be brought within the scope of the guidelines.

2. ANALYSIS OF SUBSIDIARITY

Approving State aid falls under the exclusive competence of the Commission, and guidelines on compatibility increase predictability for stakeholders.

3. OBJECTIVES

3.1. General objective

The overall objective is to contribute to successful restructuring and the return to strong, sustainable growth following the crisis, whilst avoiding market distortions.

[2] OJ C 8, 11.1.2012, p. 15.

3.2. Specific objectives

1. Provide for state aid rules that are clear and easy to apply

2. Ensure that aid is well designed and properly targeted

3. Ensure that the scope of the rules is appropriate

4. POLICY OPTIONSUNCLEAR AND BURDENSOME RULES

4.1.1. Definition of firm in difficulty

4.1.1.1. Option 1: No policy change.

The definition would continue to involve hard and soft criteria.

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

This option would seek to minimise uncertainty by removing the soft criteria and introducing additional hard criteria based on a book debt to equity ratio of 7.5 and an interest cover ratio of 1.0. Stakeholders were invited to comment on different forms of these ratios. Under Option 2, the broadest of those forms would be used, namely that the ratios would be alternative and the interest cover ratio would be linked to EBIT.

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

Option 3 differs from Option 2 in that the narrowest form of the financial ratios would be used, namely that the ratios would be cumulative and that the interest cover ratio would be linked to EBITDA

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

Option 4 would resemble Option 3, but the additional hard criteria would only apply to large firms.

4.1.2. Application to SGEI providers

4.1.2.1. Option 1: no policy change

The guidelines would apply in full to SGEI providers.

4.1.2.2. Option 2: Applying the guidelines with necessary adaptations to the situation of SGEI providers

4.1.3. Compensatory measures for medium-sized firms

4.1.4. Option 1: no policy change

Medium-sized firms would have to take compensatory measures.

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

Under Option 2, the requirement for compensatory measures would apply only to large firms.

4.2. Ineffective rules

4.2.1.1. Option 1: No policy change

No specific incentives for the use of less distortive and better targeted aid would be introduced.

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

This option would seek to address concerns related to ineffective rules in three ways.

1) A new burden sharing requirement would clarify that own contribution should be comparable in terms of effects to the aid granted. Shareholders would have to fully absorb losses, with new external capital being granted on terms leading to a reasonable share of future value gains for the State.

2) A new form of "temporary restructuring support" (TRS) would be introduced, in the form of short-term liquidity aid with a duration of up to 18 months. Less demanding conditions would apply than for restructuring aid, with only a simplified restructuring plan being required. This form of support would only apply to SMEs.

3) 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 less strict set of filters would apply to SMEs.

4.2.1.3. Option 3: Basic incentives for better targeting of aid

Option 3 would involve a more limited set of changes. Instead of introducing TRS, the maximum rescue aid period would be extended 18 months for SMEs. No new "filters" would be introduced, but the justifications currently set out in the guidelines would be applied more systematically.

4.3. Scope of the rules

4.3.1.1. Option 1: No policy change

Steel would remain excluded from the scope of the guidelines.

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

5. ASSESSMENT OF IMPACTSOPTIONS ON THE DEFINITION OF "FIRM IN DIFFICULTY"

Options 2, 3 and 4 would have strongly positive effects on the clarity and ease of application of the rules. Removing the soft criteria would make it possible to determine with certainty whether a firm was in difficulty.

Options 2, 3 and 4 would have positive effects on the risk of competition distortions, by replacing ineffective soft criteria with hard criteria that can be applied in practice. The most positive impact is expected from Option 2, followed by Option 3 and then Option 4.

Options 2, 3 and 4 should have a positive impact on administrative burden. All of them would remove the need to assess all aspects of a firm's performance in order to determine whether it is in difficulty. Option 4 would have a more positive impact, since additional hard criteria would apply to only 0.2% of firms.

Options 2, 3 and 4 would also affect administrative burden through their impact on the proportion of firms able to receive aid under the General Block Exemption

Regulation (GBER). Option 4 would have a minimal impact, Option 3 would have a slightly negative impact and Option 2 would be strongly negative.

The impact of the options on employment is linked to their impact on distortions of competition. Option 2 should be the most strongly positive, while Options 3 and 4 would have a slightly positive impact.

Since Option 4 would entirely exclude SMEs from the additional hard criteria, it would have a strongly positive impact on SMEs.

5.1. Options on SGEI providers

Option 2 would improve the clarity and ease of application of the rules. It would have a slightly negative impact on the costs of R&R aid, given that Option 1 rules out the possibility of such aid. Option 2 would have a strongly positive impact in terms of the potential benefits of R&R aid, by making it possible to avoid disruption to SGEI provision.

Option 2 would have a positive impact on employment by allowing R&R aid for SGEI providers.

5.2. Options on compensatory measures for medium-sized firms

Option 2 would allow easier access to R&R aid for medium-sized firms. However, the scale of this issue is small, as it is not particularly difficult for medium-sized firms to provide compensatory measures.

Aid to medium-sized enterprises can create significant distortions of competition, particularly in areas where such firms have an important market position. Accordingly, Option 2 could have a significantly negative effect on distortions of competition.

Whilst the administrative burden associated with the compensatory measures requirement is small, Option 2 could provide some benefits in terms of reduction of administrative burden.

Option 2 is likely to have positive impacts on employment in firms that become able to receive R&R aid, but by increasing competition distortions, it could reduce the capacity of the economy for job creation. Its overall effect should thus be negative.

5.3. Options on effective targeting of aid

Option 2 should have a significant positive effect on the costs of R&R aid, by reducing the likelihood of mismatches between the form of aid and own contribution. Moreover, under Option 2, a larger proportion of losses would be borne by incumbents, and the potential upside would be greatly increased. As Option 3 would not involve any changes to the own contribution requirement, it would be equivalent to the baseline.

Both Options 2 and 3 should reduce the costs of R&R aid by strengthening incentives for the use of liquidity aid. Option 2 should have a greater impact than Option 3.

Regarding the justification for aid, Option 2 should prevent the grant of aid in situations where it does not bring benefits. Option 3 would have a similar effect, but would be less effective.

The impact of Option 2 on mitigating social and economic harm 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.

In relation to liquidity support, both Options 2 and 3 should enhance the benefits of R&R aid, by encouraging restructuring to take place as rapidly as possible. Option 2 should have the most positive impact, since the requirement to submit a simplified restructuring plan should strengthen incentives for speedy restructuring.

As for the justification for aid, under Option 3, Member States might not be able to demonstrate an appropriate justification, and this option could therefore have a negative impact on the benefits of R&R aid.

Option 2 would have a balanced impact on administrative burden. The requirement to demonstrate compliance with the filters would involve some increased administrative burden, but the simplified restructuring plan would involve a significantly lower burden than a full restructuring plan. Option 3 would have a similar impact, but 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.

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

5.4. Options for aid to steel producers

The steel sector remains characterised by overcapacity. By enabling the least efficient firms to maintain capacity, R&R aid for steel would shift the burden of the necessary adjustment to more efficient competitors, preserving an inefficient allocation of resources.

Aid to steel producers would also have harmful effects on incentives. Producers that expected to receive aid in the event of financial difficulties might be prompted to take greater risks, while others could be deterred from improving efficiency.

R&R aid for steel could allow certain firms to maintain a greater level of production and employment. However, the overcapacity in the European steel industry could mean that such benefits would be only temporary, as R&R aid would contribute to the maintenance of overcapacity, leading to ongoing financial difficulties and imposing costs on others. Regarding the strategic role of steel, there is no indication that market exit of a firm would put at risk the supplies of steel necessary for European industry.

6. COMPARISON OF OPTIONS

Definition of "firm in difficulty"

	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: broad additional hard criteria, no soft criteria	++	++	0
Option 3: narrow additional hard criteria, no soft criteria	++	+	0
Option 4: narrow additional hard criteria, for large firms only, no soft criteria	++	+	++

SGEI providers

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

Compensatory measures for medium-sized enterprises

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

Targeting of aid

	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	+	++

Scope of the guidelines

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

7. MONITORING AND EVALUATIONANNUAL REPORTS, MONITORING AND TRANSPARENCY

All Member States that operate aid schemes covered by the guidelines must submit annual reports to the Commission. The Commission continuously monitors the implementation of state aid measures 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.

7.1. Evaluation

In connection with the SAM programme, DG Competition has introduced a requirement for systematic *ex post* evaluation of certain aid schemes. 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.

To evaluate the effectiveness of the amended guidelines, which will remain in force until 2020, the following criteria will be used:

- Whether the relevant provisions of the guidelines (in particular the definition of "firm in difficulty") are applied confidently and correctly by public authorities;
- whether the amendments to the guidelines lead to a greater proportion of less distortive aid; and
- whether the grant of aid is possible where necessary to deal with the negative social and economic consequences of financial distress.