EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION
No 308/2000/COL
of 30 October 2001
introducing new Guidelines on the application of the EEA State aid provisions to State aid and risk capital, and amending for the 29th time the Procedural and Substantive Rules in the Field of State Aid

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area ([1]), in particular to Articles 61 to 63 thereof,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice ([2]), in particular to Article 24 and Article 1 of Protocol 3 thereof,

Whereas under Article 24 of the Surveillance and Court Agreement, the EFTA Surveillance Authority shall give effect to the provisions of the EEA Agreement concerning State aid.

Whereas under Article 5(2)(b) of the Surveillance and Court Agreement, the EFTA Surveillance Authority shall issue notices or guidelines on matters dealt with in the EEA Agreement, if that Agreement or the Surveillance and Court Agreement expressly so provides or if the EFTA Surveillance Authority considers it necessary.

Recalling the Procedural and Substantive Rules in the Field of State Aid ([3]) adopted on 19 January 1994 by the EFTA Surveillance Authority (OJ L 231, 3.9.1994, EEA Supplement No 32).

Whereas on 23 May 2001, the European Commission adopted a Communication on State aid and risk capital (OJ C 235, 21.8.2001, p. 3).

Whereas this Communication is also of relevance for the European Economic Area.

Whereas a uniform application of the EEA State aid rules is to be ensured throughout the European Economic Area.

Whereas, according to point II under the heading 'GENERAL' at the end of Annex XV to the EEA Agreement, the EFTA Surveillance Authority is to adopt, after consultation with the Commission, acts corresponding to those adopted by the EC Commission, in order to maintain equal conditions of competition.

Having consulted the European Commission.

Recalling that the EFTA Surveillance Authority has consulted the EFTA States in a multilateral meeting on the subject,

HAS ADOPTED THIS DECISION:

1. The State Aid Guidelines shall be amended by adding a new Chapter 10A, State aid and risk capital, contained in Annex I to this Decision.

([1]) Hereinafter referred to as the EEA Agreement.
([2]) Hereinafter referred to as the Surveillance and Court Agreement.
([3]) Hereinafter referred to as the State Aid Guidelines.

2. The Decision, including Annex I, shall be published in the EEA Section of and the EEA Supplement to the *Official Journal of the European Communities*.
3. The EFTA States shall be informed by means of a copy of the Decision, including Annex I.
4. The European Commission shall be informed, in accordance with point (d) of Protocol 27 of the EEA Agreement, by means of a copy of this Decision, including Annex I.
5. The Decision shall be authentic in the English language.

Done at Brussels, 30 October 2001.

For the EFTA Surveillance Authority

The President

Knut ALMESTAD

ANNEX I

'10A. STATE AID AND RISK CAPITAL [1]

10A.1. ***Introduction***

(1) In the Communication on State aid and risk capital [2] the European Commission sets out how it will apply the State aid rules to measures designed to promote risk capital. The Commission has previously expressed a general policy in favour of promoting risk capital [3] in the Community. It has, for example, expressed concern about the risk of Community enterprises being overdependent on debt finance [4], and emphasised the potential for growth and job creation which an increase in risk capital markets would have [5]. The Commission believes that certain types of enterprises, or enterprises at certain stages of their existence, may be better served by equity or near-equity finance than by loan finance alone, given the costs of servicing debt and the risk-averse nature of many lending institutions.

(2) In the view of the Commission an equity gap, implying that there is a persistent capital market imperfection preventing supply from meeting demand at a price acceptable to both sides, affects negatively European small and medium-sized enterprises (SMEs) compared with similar companies in North America. The gap concerns, on one hand, high-tech innovative and mostly young firms with high growth potential and, on the other hand, a wide range of firms of different ages and sectors with smaller growth potential that cannot find financing for their expansion projects without external risk capital.

(3) The Commission also point out that risk capital provision is essentially a commercial activity involving commercial decisions. Economic and budgetary conditions are such that public funds on their own will not be able, and should not attempt, to provide the whole of the increase in risk capital activity. The key challenge is to provide the conditions under which the large reserves of private capital which exist in Europe will be used for such investment. This challenge concerns as much the development of the demand for capital by entrepreneurs as the supply of capital by investors. In addition the Commission has recognised a role for public funding of risk capital measures limited to addressing identified market failures [6].

(4) The Authority concurs with the view expressed by the Commission. Public funding of risk capital measures will, however, inevitably raise the question of the compatibility with the State aid rules of the EEA Agreement.

10A.2. ***Aim and scope of these Guidelines and relation to other guidelines***

(1) These Guidelines have two principal aims:

— to set out how the Authority will apply the State aid definition in Article 61(1) of the EEA Agreement to measures designed to provide or promote risk capital (risk capital measures),

— to provide new criteria under which the Authority may authorise such measures which do constitute State aid, even if they are not compatible with the other guidelines of the Authority's State Aid Guidelines.

(2) In addition these Guidelines aim to explain why State aid control in this area is necessary, to explain the difficulties in applying current guidelines to such measures, and to justify why the Authority considers that the new compatibility criteria are both necessary and appropriate.

(3) Nothing in these Guidelines should be taken to call into question the compatibility of State aid measures, which meet the criteria of any other guidelines of the present State Aid Guidelines.

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(1) This chapter corresponds in substance to the Commission Communication on State aid and risk capital (OJ C 235, 21.8.2001, p. 3). The Commission had taken a number of decisions on State aid and risk capital before its adoption of the Communication on State aid and risk capital. The Authority refers, in these Guidelines, to the same decisions as in the Commission Communication.
(2) OJ C 235, 21.8.2001, p. 3.
(3) In its paper "Risk capital: a key to job creation in the European Union" (SEC(1998) 552 final, 31 March 1998) the European Commission defined risk capital as equity financing to companies in their start-up and development phases, and the phrase is used with that sense in the present guideline. The term "venture capital" refers essentially to risk capital provided by investment fund (venture capital funds) established for that purpose. Such funds provide a mix of equity, mezzanine and subordinated loan finance and the term "venture capital" refers to the totality of this finance.
(4) "Economic reform: report on the functioning of Community product and capital markets", COM (1999) 10, 20 January 1999.
(5) "Risk capital, a key to job creation in the European Union", SEC(1998) 552 final, 31 March 1998.
(6) Progress report on the risk capital action plan, COM(2000) 658 final, 18 October 2000, section 3.4.

(4) This document in no way derogates from the provisions of the present State Aid Guidelines on State aid for rescuing and restructuring firms in difficulty.

(5) The Authority will pay particular attention to the need to prevent the use of these guidelines to circumvent the principles laid down in existing Chapters of the present State Aid Guidelines.

10A.3. *Reasons for controlling public funding to risk capital measures*

(1) Aside from the fact that the EEA Agreement and the Surveillance and Court Agreement impose on the Authority the requirement to control State aid within the EFTA States, and in common with other forms of public intervention, national authorities, when deciding whether to commit or to authorise public funds for measures designed to promote risk capital, should reduce as far as possible the following three distinct though connected categories of risk:

— the risk that advantages to the beneficiaries (whether investors or enterprises) create an undue distortion of competition relative to their competitors in the European Economic Area,

— the risk of "deadweight", or lack of incentive effect. Some enterprises funded through publicly supported measures may have obtained finance on the same terms in any case. There is evidence of this happening though this is inevitably anecdotal. In that event public resources are being used unnecessarily,

— the risk of "crowding out". The presence of publicly supported measures may actually discourage other potential investors from providing capital.

(2) Not all public measures carried out in favour of risk capital schemes fall within the definition of State aid in Article 61(1) of the EEA Agreement and therefore under the Authority's State aid control. The next section of these Guidelines therefore provides guidance as to how the Authority interprets the definition of State aid as it concerns risk capital measures.

10A.4. *Applicability of Article 61(1) to risk capital measures*

(1) In the case of a measure in the form of a grant or loan, it is normally obvious which enterprise is potentially the beneficiary for the purpose of assessing whether State aid is involved. However, certain constructions devised to promote risk capital are more complex because the public authorities create incentives for one set of economic operators (investors) in order to provide finance to another set (for example, smaller enterprises). Depending on the design of the measure, and even if the intention of the public authorities may be only to provide benefits to the latter group ([7]), enterprises at either or both "levels" may be beneficiaries of State aid. Moreover, in some cases the measure provides for the creation of a fund or other investment vehicle which has an existence separate from investors and the enterprises invested in. In such cases it is also necessary to consider whether the fund or vehicle can be considered to be an enterprise benefiting from State aid.

(2) When assessing risk capital measures the Authority will therefore have to consider the possibility that the measure may confer aid on at least three different levels:

— aid to investors,

— aid to any fund or other vehicle through which the measure operates (in the case of a "fund of funds" there may be more than one such level),

— aid to the companies invested in.

(3) In order for a measure to fall within the scope of Article 61(1) of the EEA Agreement, four cumulative criteria must be met:

— the measure must involve the use of State resources; in the case of the direct financial participation of public authorities in risk capital measures, or tax incentives for investors, this is usually self-evident,

— the measure must distort competition by conferring an advantage on the beneficiary; in accordance with case law of the Court of Justice of the European Communities, the Authority must assume that State aid is likely to be present whenever State resources are contributed in a manner which would not be acceptable to a private investor operating under normal market economy conditions. Where by contrast the public authorities invest on terms that would be acceptable to such an investor, no advantage is conferred and

([7]) The Court of Justice of the European Communities has held that Article 87 of the EC Treaty does not distinguish between the measure of State intervention concerned by reference to their causes or aims but defines them in relation to their effects (Case 173/73 *Italy* v. *Commission* [1974] ECR 709).

there is therefore no State aid ([8]). It follows that where State resources are made available on the same terms as those applying to private investors (*pari passu*) it will normally be possible to conclude that the measure does not confer an advantage. However, if the State resources are made available on more favourable terms, then an advantage will normally be present,

— that advantage must be selective, in that it is limited to certain undertakings; if a measure applies without limitation or sectoral or geographical distinction to all enterprises throughout the territory of a EFTA State, then it is not selective ([9]). However, any measure which, because of its nature, can only apply to a limited number of enterprises, is selective. Likewise, a measure is selective if it provides for investments to be made only in certain enterprises, for example limited by sector or by region. It should be noted that a measure which is general as regards investors (that is, it is available to all investors) may nonetheless be selective at the level of companies invested in ([10]),

— the measure must affect trade between Contracting Parties to the EEA Agreement. Since investment of capital is an activity which is the subject of very large trade between the Contracting Parties to the EEA Agreement, and since any measure providing an advantage to investors has the declared aim of affecting their investment decisions, the Authority will normally consider that this criterion is met by risk capital measures in favour of investors. In assessing any effect on trade, the Authority needs to consider the effects across capital markets more generally, not merely on investors who may or may not have been previously operating in the market for providing equity capital to the enterprises targeted by the measure. Similarly, unless it can be shown that all investments will be made in enterprises engaged in activities which are not the subject of trade between the Contracting Parties to the EEA Agreement, the Authority will regard this criterion as met at all the levels for which the other criteria are fulfilled ([11]).

(4) There are also other Chapters of the present State Aid Guidelines which provide interpretation on whether individual measures fall within the definition of State aid and which may be relevant to risk capital measures. These include the chapters on Public authorities' holdings, on the application of the State aid rules to measures relating to direct business taxation and on State guarantees ([12]). The Authority will continue to apply these texts when assessing whether risk capital measures constitute State aid.

(5) In accordance with the principles set out above, the Authority will take the following factors into account in determining whether State aid is present at each of the different levels.

(I) Aid to investors

Where a measure allows investors to participate in the equity of a company or set of companies on terms more favourable than public investors, or than if they had undertaken such investments in the absence of the measure, then those investors receive an advantage ([13]). This remains the case even if the investor is persuaded by the measure to confer an advantage on the company or companies concerned. The fact that owing to the existence of a market failure no investors would otherwise make such investments, is not of itself sufficient to rebut the presumption of advantage. In effect, the investors are being offered more advantageous terms to compensate them for the factors which cause market failure, and the Authority considers that such compensation must be considered as an advantage, which will constitute aid if the investors are enterprises and if the other conditions described above, notably selectivity, are met. Provided, however, that the advantage is limited to the amount necessary to overcome the factors which cause market failure, it may be considered compatible with the EEA Agreement, where it meets the principles described in section 10A.8. because of its limited effect.

(II) Aid to an intermediary vehicle or fund

In general, the Authority would tend to the view that a fund is a vehicle for the transfer of aid to investors and/or enterprises invested in, rather than being an aid beneficiary itself. However, in certain cases, notably measures involving transfers in favour of existing funds with numerous and diverse investors, the fund may have the character of an independent enterprise. In that case aid will usually be present unless the investment is made on terms which would be acceptable to a normal economic operator in a market economy and therefore provides no advantage to the beneficiary.

([8]) See Commission Decision of 4 October 2000 in Case N 172/2000 (Ireland) Seed and Venture Capital Found Scheme (OJ C 37, 3.2.2001, p. 48).

([9]) This could be the case, for example, of a tax measure promoting investment in a certain class of financial instrument.

([10]) See for example the judgment by the Court of Justice of the European Communities in Case C-156/98 *Germany* v. *Commission* [2000] ECR I-6857.

([11]) In this connection the Court of Justice of the European Communities has held that: "In the case of an *aid programme* the Commission *may confine* itself to examining the characteristics of the programme in question in order to determine whether, by reasons of the high amounts or percentages of aid, the nature of investments for which aid is granted or other terms of the programme, it gives an appreciable advantage to recipients in relation to their competitors and is likely to benefit undertakings engaged in trade between Member States" Case 248/84 *Germany* v. *Commission* [1987] ECR 4013, at paragraph 18 (emphasis added).

([12]) It should, however, be noted that guarantees granted by the State in favour of investment in risk capital are more likely to include an element of aid to the investor than is the case with traditional loan guarantees, which are normally considered to constitute aid to the borrower rather than to the lender.

([13]) This may be the case of measures providing finance to investors for investment in such participations, where this provision is made on conditions more favourable than market terms.

(III) **Aid to the enterprises invested in**

Once again the main test is whether the enterprise has received the investment on terms which would be acceptable to a private investor in a market economy. This test can, as an example, be met when the investment made through the risk capital measures is made *pari passu* with such an investor or investors. Where this is not the case, the fact that investment decisions are being taken by commercial managers of risk capital funds, or by representatives of investors, with an interest to ensure a maximum return for the fund is an important indicator, but it is not of itself conclusive. The Authority must also take into account the possibility that any advantages accorded to investors in the funds are passed on to the enterprises invested in, when the investments are not made by the fund *pari passu* with a private investor in a market economy. If a risk capital measure has reduced the risks and/or increased the rewards which investors will obtain from making a particular investment, then they may be said no longer to be operating as a normal economic operator ([14]).

(6) Whether a measure provides aid, and at what level, will depend on its design. Some measures might for example be general measures at the level of investors but provides State aid at the level of individual enterprises ([15]), other measures could provide State aid to investors but not to the enterprises invested in, through application of the *pari passu* principle described above ([16]), and some measures could provide State aid at more than one level ([17]).

(7) Where all aid provided to beneficiaries is *de minimis* in the sense of the *de minimis* rule and its application, then it is deemed not to meet all the criteria of Article 61(1) of the EEA Agreement. In risk capital measures the application of the *de minimis* rule is handicapped by difficulties of calculation (see also section 10A.5) and also by the fact that measures may provide aid not only to the target enterprises but also to other investors. Where these difficulties can be overcome, however, it remains applicable. If a scheme provides public capital of EUR 100 000 or less to each enterprise over a three year period then it is certain that any aid to these enterprises is within the limits set by the *de minimis* provisions of the Guidelines.

10A.5. *Assessment of the compatibility of risk capital measures under the State aid rules: application of existing texts*

(1) Where measures constitute State aid, the Authority is called to assess whether they can be found compatible with the functioning of the EEA Agreement under Article 61(2) and (3). Most risk capital measures could be found to be compatible only under paragraph 3(a) (for measures applying solely in regions eligible for the derogation in that paragraph), or paragraph 3(c).

(2) The immediate objectives of risk capital measures are likely to include the promotion of SMEs, in particular new or innovative firms, or firms with high growth potential, and/or the promotion of the development of a particular region. The Authority has already adopted texts under which State aid with such objectives can be authorised under paragraphs 61(3)(a) or (c) ([18]). The public authority devising the measure may also have the objective of encouraging more investors to become involved in the provision of this type of finance. No text on State aid in this area exists, and indeed it has not been explicitly recognised up to now as an objective capable in itself of justifying State aid. However, this does not in any way preclude the compatibility of a measure which meets the terms of other frameworks or guidelines.

(3) One characteristic of existing guidelines authorising State aid under paragraphs 61(3)(a) or (c) is that aid is authorised up to a level representing a “grant equivalent” of a fixed percentage of certain of the beneficiary enterprise's costs. These “eligible costs” are principally fixed investments in land, buildings, new productive equipment and intangible assets (patents, know-how etc) labour costs linked to fixed asset investment, and the costs of consultancy services. Experience has shown, however, that risk capital measures can frequently not be found compatible under these rules, for some or all of the following reasons:

([14]) See, for example, Commission decision 98/476/EC (OJ L 212, 30.7.1998, p. 50). This case was the subject of the judgment in Case C-156/98 referred to in footnote 10.
([15]) See footnote 14.
([16]) See, for example, Commission decision in case N 705/99, United Kingdom High Technology Fund.
([17]) See Commission Decision 2001/406/EC in Case C 46/2000 Viridian Growth Fund (Northern Ireland) (OJ L 144, 30.5.2001, p. 23).
([18]) See the present State Aid Guidelines on Aid to Small and Medium-sized Enterprises and on National Regional Aid.

— the difficulty of establishing a "grant equivalent" of equity capital. While the Authority has established rules for determining such equivalents for loans and guarantees [19], it has no such formula for equity capital. Against that, the Authority believes that a technical difficulty of calculation cannot of itself suffice to make a measure incompatible with the functioning of the EEA Agreement. It is examining the options for a possible methodology in this respect, and in the meantime will be open to proposed calculation methods accompanying notifications of risk capital measures [20],

— the difficulty of establishing a link with eligible costs, in particular under measures which provide incentives to investors, and notably under measures in the form of funds. Such a link is not easily reconcilable with the commercial fund management which will be required by investors participating in funds and may raise verification and enforcement difficulties,

— for measures providing aid at the level of investors, the fact that no current text provides any basis for authorising such aid.

(4) The Authority believes that in general there are good reasons for the "eligible costs" approach. The approach provides certainty, predictability and a basis for limiting aid and for ensuring equal treatment between regions and EEA States. It has served well in the past and is likely to be the basis of most State aid control in the future. The Authority believes that good reasons are needed for departing from it.

(5) In particular, the risk of departing from the principle is that State aid may be authorised which is merely "operating aid", that is, aid to cover normal current expenses of a business. The Authority believes that such aid, which may isolate the beneficiary from the effects of commercial non-viability, is among the most distortive types of State aid and is authorised only in limited circumstances.

(6) However, the Authority also believes that the fact that risk capital measures cannot be found compatible on the basis of existing guidelines, and in particular the difficulties listed above, are not in themselves a justification for finding the measures incompatible with the common market. With regard to the difficulties listed in the paragraphs above the Authority has noted that:

— the costs regarded as eligible under existing frameworks are of less importance to many young or innovative enterprises. In any case, such costs will more often be capable of being financed by loan capital; the need for equity capital is generally linked not only to assets but also to the need for working capital during an enterprise's start-up or expansion phase,

— the lack of a link to eligible costs as defined in current texts is not necessarily evidence of operating aid, understood as aid which defrays an enterprise's normal operating expenses, and has no effect other than to keep it running. Aid with a clear incentive effect to an enterprise's start-up or expansion cannot be held to constitute operating aid in this sense, and could therefore be accepted under certain circumstances,

— as regards aid to investors, a measure cannot be considered incompatible solely because, by involving private sector or market investors, it constitutes a State aid to them as well as to the enterprises invested in. In general, where a transfer made by the State would be compatible with the State aid rules, the Authority believes that a measure which provides a minimum incentive to other economic operators to make that same transfer should also be authorised, even if technically an aid to those operators is involved.

10A.6. ***Basis for authorising risk capital measures under Article 61(3)(a) and (c) of the EEA Agreement***

(1) The principal basis on which the Authority may authorise risk capital measures even though they fall outside the scope of existing rules is that one of the main handicaps suffered by SMEs, and in particular small enterprises and start-ups, is the difficulty in obtaining capital and credit. The chief causes of this are imperfect information, the risk-averse nature of investors and lending institutions and the limited guarantees that SMEs are in a position to offer [21]. A particular obstacle to the provision of equity capital can be the high transaction and "due diligence" costs relative to the amount of capital being provided.

(19) For example the present State Aid Guidelines on *de minimis*, on State Guarantees and on National Regional Aid.
(20) This might include a methodology based on the cost of providing a particular guarantee. See Commission decision of 28 February 2001 in Case N 551/2000 (Germany): BTU — Beteiligungskapital für kleine Technologieunternehmen (OJ C 117, 21.4.2001, p. 17).
(21) See the chapter of the present State Aid Guidelines on Aid to Small and Medium-sized Enterprises (SMEs).

(2) The Authority recognise a role for public funding of risk capital measures limited to addressing identifiable market failures. A market failure can be defined as a situation in which economic efficiency is not achieved owing to imperfections in the market mechanism. A market failure may manifest itself either in the inability of the system to produce goods which are wanted (in this case a risk capital market), or by a misallocation of resources, which could be improved in such a way that some consumers would be better off and none worse off. The externalities involved in training and research and development activity result in a market failure which justifies State aid in those areas.

(3) As economic theory predicts that markets will usually fail in some sense except under conditions of perfect competition, the term market failure is reserved for cases where it is believed that a serious misallocation of resources has occurred. There are two main sources of market failure relevant to risk capital markets which particularly affect access to capital by SMEs and companies at the early stages of their development and which may justify public intervention:

— *imperfect or asymmetric information*: potential investors face more difficulties in gathering reliable information on the business prospects of an SME or a new company. Particularly if these are involved in highly innovative projects or risky projects, imperfect information will aggravate problems related to difficulties in the assessment of risk,

— *transaction costs*: small deals are less attractive to investment funds due to relatively high costs for investment appraisal and other transaction costs.

(4) The Authority believes that these factors can cause a market failure which would justify State aid. However, caution is needed. The fact that requests for finance, both debt and equity, have been turned down is not in itself an indication of market failure. Indeed, the Authority believes that there is no general risk capital market failure in the European Economic Area. It does, however, accept that there are market gaps for some types of investments, at certain stages of enterprises' lives. It also recognises that there are particular difficulties in regions qualifying for assistance under Articles 61(3)(a) and (c) ("assisted areas"). These gaps and difficulties are to some extent already recognised in existing State aid frameworks, and where these can be applied to risk capital measures the Authority will be prepared to continue to do so.

(5) The Authority will therefore require provision of evidence of market failure before being prepared to authorise risk capital measures which fall outside the scope of existing rules. It may however be prepared to accept this is the case where each tranche of finance for an enterprise from risk capital measures which are in turn wholly or partially financed through State aid will contain a maximum of EUR 500 000, or EUR 750 000 in regions qualifying for assistance under Article 61(3)(c) or EUR 1 million in regions qualifying for assistance under Article 61(3)(a) ([22]). This is because for small transactions the argument that market failure exists through high transaction costs is more persuasive. The fact that a market failure is recognised does not however alter the aid character of a particular measure, nor the need to assess its compatibility, in particular under the provisions of section 10A.8.

(6) Where it is recognised that there is a market failure, the Authority will examine whether any State aid measure is proportionate to the presumed market failure it is devised to meet, and will seek to ensure that any distortion is minimised. It believes that this can best be achieved by measures which are just sufficient to ensure that market investors provide capital and which result in investment decisions being taken on a commercial basis and on terms as close as possible to those which would prevail in the normal economy.

(7) The diversity of possible models for risk capital measures, and the relative novelty of some of the constructions being devised by EFTA States, mean that the Authority is not in a position to define rigid criteria by which to determine whether to authorise such measures. It has, however, identified certain elements which it will regard as positive, and others which it will regard as negative, in their assessment. These are set out in section 10A.8. The fact that the criteria are devised in this way reinforces the importance of all risk capital measures which constitute or which may constitute State aid being notified to the Authority under Article 1(3) of Protocol 3 to the Surveillance and Court Agreement before being put into effect, unless they are exempted from notification through an exemption like that cited at 10A.4(7). Where the Authority is in possession of a complete notification which shows that a measure contains numerous positive elements, and no negative elements, the Authority will aim to make a rapid assessment of it within the deadlines laid down in the procedural part of the present State Aid Guidelines.

([22]) Separate injection of capital within six months of each other would be considered to be part of the same tranche, as would different injections, even over a longer period, to which a commitment is made as part of a single transaction.

10A.7. ***Form of aid measure***

(1) The Authority believes that the choice of form of an aid measure lies in general with the EFTA State. This applies equally to risk capital measures. However, and as further explained at section 10A.8, the Authority's assessment of such measures will include whether they encourage market investors to provide risk capital to the “target enterprises” and are likely to result in decisions to invest being taken on a commercial (that is, a profit-maximising) basis. The Authority believes that forms of incentives to such investors capable of producing this result, and therefore of being viewed positively under the criteria set out in section 10A.8. where they constitute State aid, include the following:

— constitution of *investment funds* (“venture capital funds”) in which the State is a partner, investor or participant, even if on less advantageous terms than other investors,

— *grants* to venture capital funds to cover part of their administrative and management costs,

— *other financial instruments* in favour of risk capital investors or of venture capital funds to provide extra capital for investment,

— *guarantees* to risk capital investors or to venture capital funds against a proportion of investment losses, or guarantees given in respect of loans to investors/funds for investment in risk capital ([23]),

— *fiscal incentives* to investors to undertake risk capital investment.

(2) The Authority does not intend to use the criteria in the following section to authorise measures which may provide capital to an enterprise *solely* in the form of loans (including subordinated loans and “equity loans”) or other instruments which provide the investor/lender with a fixed minimum return, whether through funds or through other means. Such capital provision is not “risk capital” in the sense of the definition in footnote 3, and the Authority regards existing rules, covering notably the calculation of any aid element and the link to eligible costs, as adequate to assess such measures.

(3) The Authority does not intend to use the criteria in the following section to authorise an ad-hoc measure providing capital to an individual enterprise.

10A.8. ***Criteria for assessing compatibility***

(1) As already explained in section 10A.6, the criteria are expressed in the form of “positive and negative elements”. Not all the elements have equal weight, and in the following list the most important elements are listed first. No single element is essential, nor can any set of them be regarded as sufficient on its own to ensure compatibility. In some cases their applicability, and the weight attached to them, may depend on the form of the measure. The Authority's assessment will take account of the regional specificity of any measure and will be subject to an overall test of proportionality.

Measures will be assessed at each level. In cases where the provision of risk capital to an enterprise is linked to costs which are eligible for aid under an existing guideline, that guideline may be applied as an alternative to the principles below for assessing the aid to that enterprise, in line with paragraphs 10A.2(3) and 10A.5(2). Where the measure concerned also provides aid at the level of investors, however, such aid will still need to be assessed in accordance with the principles below.

(2) Where the ceilings for transaction sizes set out in 10A.6(5) are met, and when only investors (or an investment vehicle) are beneficiaries of State aid under the measure, such State aid is compatible to the extent that it is proportional to the cost disadvantages addressed, such as the higher relative costs of analysis and management of small investments. The provisions of 10A.8(3) below will be used to assess whether this is so.

The Authority will require provision of evidence of market failure where the ceilings for transaction sizes set out in paragraph 10A.6(5) are exceeded.

(3) Once market failure has been established, the Authority will examine the following elements in the assessment of a risk capital measure under the State aid provisions of the EEA Agreement:

([23]) The second alternative is one means of intervention of the US Small Business Administration in favour of small business investment companies.

Restriction of investments, or failing that of a majority of funds invested:

— to small [24] or even “micro” enterprises, and/or

— to medium-sized enterprises in their start-up or other early stages [25] or in assisted areas;

will be regarded as a positive element. Access to finance for medium-sized enterprises beyond their start-up or early stages should be subject to a limit per enterprise on total funding through the measure. Restriction to smaller transaction sizes (that is to say, below EUR 500 000 or EUR 750 000 in regions qualifying for assistance under Article 61(3)(c) or EUR 1 million in regions qualifying for assistance under Article 61(3)(a)) or to a given level of demonstrated market failure will also be regarded as a positive element.

Measures should be focused on risk capital market failure. If a measure provides for the delivery of the finance to enterprises principally in the form of equity or quasi-equity then this will be regarded positively. Where measures provide significant amounts of finance in other forms, or appear not to have a significant incentive effect (that is, where it will support risk capital investments which would have happened even in the absence of the measure) this will be regarded negatively. This could be the case of measures providing further finance to an enterprise which has already received one aided injection of capital.

Decisions to invest should be profit-driven. A link between investment performance and the remuneration of those responsible for investment decisions will be a positive element. This would be assumed to be met:

— by measures under which all the capital invested in the target enterprises is provided by market economy investors, who also make the investment decision, with the aid being solely an incentive for them to do so, and

— by other measures with significant involvement of market economy investors' capital, being invested on a commercial basis (that is, only for profit) directly or indirectly [26] in the equity of the “target enterprises”.

In the case of funds, and while each measure will be regarded on its merits and other aspects will have a bearing on the Authority's assessment, provision of at least 50 % of the funds capital would be taken to constitute “significant involvement”, or 30 % in the case of measures operating in assisted areas. Further positive elements would be:

— an agreement between a professional fund manager and participants in the fund, providing that the manager's remuneration is linked to performance and setting out the objectives of the fund and proposed timing of investments,

— the representation of market investors in decision-making, and

— the application of best practice and regulatory supervision in the management of funds.

Where no such element is present to indicate that investment decisions will be commercially driven, then this will be regarded negatively. This will be taken to be the case of measures which are so small in size as to be focussed on only a few projects, and which are not economically viable, or of measures set up solely or principally to provide finance to a particular enterprise known in advance.

The level of distortion of competition between investors and between investment funds should be minimised. The Authority will regard positively a call for tender for the establishment of any “preferential terms” given to investors, or the availability of any such terms to other investors. This availability might take the form of a public invitation to investors at the launch of an investment fund, or might take the form of a scheme (such as a guarantee scheme) which remained open to new entrants over an extended period. The means by which this positive element could be achieved will necessarily depend on the form of the measure in question. However the absence of any such check against overcompensation to investors, or a measure where the risk of losses is borne entirely by the public sector and/or where the benefits flow entirely to the other investors will be considered as a negative element.

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[24] Following the Authority's definition set out in the chapter on Aid to Small and Medium-sized Enterprises (SMEs) of the present State Aid Guidelines.

[25] The European Venture Capital Association defines start-up financing as “financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold their products commercially”, and other early-stage as “financing to companies still in the stages of research and product development or that have completed the product development stage and require further funds to initiate commercial manufacturing and sales. They will not yet be generating a profit”.

[26] “Indirectly” should be taken to mean investment via funds or other investment vehicles.

Sectoral focus. To the extent that many private sector funds focus on specific innovative technologies or even sectors (such as health, information technology, culture) the Authority can accept a sectoral focus where this has a commercial as well as a public policy logic. In line, however, with the Authority's consistently less favourable view of sectoral State aid measures, in particular in sensitive sectors suffering from overcapacity, measures should specifically exclude the provision of aid to enterprises in the shipbuilding and ECSC sectors.

Investment on the basis of business plans. The existence for each investment of a business plan containing details of product, sales and profitability development and establishing the *ex ante* viability of the project is standard commercial practice in professional fund management and will be positively regarded. Measures providing no "exit mechanism" for the State's direct or indirect involvement in individual enterprises would be regarded negatively.

Avoidance of cumulation of aid measures to a single enterprise. If a measure provides aid to the enterprises invested in, then the Authority may request commitments from an EFTA State to assess and set limits to other forms of State aid to enterprises funded by the risk capital measure, including under authorised schemes. For such measures, and unless the EFTA State undertakes that these enterprises will receive no other State aid than *de minimis* aid, the EFTA State should propose to the Authority for examination and approval a reasonable evaluation of the aid element of the measure which will be used for applying the cumulation rules. Where capital provided to an enterprise under such a risk capital measure is used to finance initial investment, research and development costs or other costs eligible for aid under other frameworks, the EFTA State should include the aid element in the risk capital measure in applying the relevant aid ceilings.

10A.9. ***Final observations***

The Authority intends to apply the terms of these Guidelines for five years. However, given that the approach of these Guidelines represents a departure from previous methods of State aid control, and that it deals with an area of rapid development in the economy of the European Economic Area, it reserves the right to adjust its approach in the light of experience. Where this would be helpful it may also provide further clarifications of its approach to particular issues.'