II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 13 February 2001
on the aid scheme 'Viridian Growth Fund' notified by the United Kingdom

(notified under document number C(2001) 334)

(Only the English text is authentic)

(Text with EEA relevance)

(2001/406/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above [1],

Whereas:

I. PROCEDURE

(1) By letter dated 14 September 1999 the United Kingdom authorities notified aid linked to the setting up and operation of the Viridian Growth Fund, a venture capital fund.

(2) The Commission asked for additional information on 12 November 1999 and sent a reminder on 22 December 1999. The United Kingdom authorities replied by letter dated 14 January 2000. However, they still did not supply all the information asked for on 12 November 1999. The Commission therefore sent a second reminder on 10 March 2000 to which the United Kingdom authorities replied by letter dated 28 March 2000. The Commission requested further additional information on 12 May 2000. The United Kingdom authorities replied by letter dated 14 June 2000.

(3) By letter of 8 August 2000 [2], the Commission informed the United Kingdom authorities of its decision to initiate the procedure pursuant to Article 88(2) of the EC Treaty in relation to the Viridian Growth Fund.

(4) The decision to open the procedure was published in the *Official Journal of the European Communities* [3]. The Commission invited interested parties to present comments on the aid scheme concerned.

(5) The Commission did not receive comments from interested parties.

(6) The official response of the United Kingdom authorities arrived by letter dated 8 September 2000.

(7) On 19 September 2000, the Commission sent a request for certain clarifications and a meeting discussing the Commission queries was held between the services of the Commission and the United Kingdom authorities on 8 November 2000.

(8) The United Kingdom authorities formally replied to the Commission queries on 15 December 2000.

II. DETAILED DESCRIPTION OF THE SCHEME

The objective of the scheme

(9) The objective of the scheme as notified and as amended by the United Kingdom authorities under the procedure is to address perceived gaps in the provision of venture capital funding for small enterprises (SEs) in Northern

[1] OJ C 266, 16.9.2000, p. 9.

[2] Reference: SG (2000) D/106067.

[3] OJ C 266, 16.9.2000, p. 9.

Ireland, as defined in accordance with the recommendation for SMEs) [1]. The Fund will invest in SEs in the manufacturing and commercial services sector, these enterprises have difficulty in raising finance from existing financial sources.

(10) In order to attract institutional investors to this market, which is heavily under-represented in Northern Ireland and which is perceived as very risky, the United Kingdom authorities consider that they have to provide certain incentives and thus contribute to the development of a regional venture capital Fund called the Viridian Growth Fund.

Legal basis

(11) The legal basis for the scheme is Article 7 of the Industrial Development (Northern Ireland) Order 1982, as well as the Fund contract and the operating guidelines.

Status of the Fund and the partnership structure

(12) The Fund is to be set up as a partnership, namely a limited partnership, registered under the Limited Partnerships Act 1907, as amended from time to time, under the name of Viridian Growth Fund LP. The partnership has a General Partner who is responsible for the conduct and management of the Partnership's business, and has the ability to appoint a manager. The fund manager was selected through a competitive bidding procedure. The Fund will have capital totalling GBP 10 million. To establish the Fund the public sector finance [2] of GBP 3,34 million is provided alongside finance from the private sector and finance provided by the European Investment Bank (EIB), GBP 3,3 million. The non-public sector finance is provided by the Viridian Group plc (the private sector supplier of electricity in Northern Ireland), GBP 2 million, the Northern Ireland Local Government Officers Superannuation Scheme, GBP 1 million, and Abbey National, GBP 0,33 million.

(13) However, the United Kingdom authorities are prepared to seek further private sector investors in relevant publications across Europe. They are presently considering advertisements in the international edition of the *Financial Times* and the monthly publication produced by the European Venture Capital Association.

Duration

(14) The investment phase of the Fund will be completed by the end of December 2004, as stated by the United Kingdom authorities by letter dated 14 January 2000.

Terms of investment and remuneration of the Fund as notified and amended by the United Kingdom authorities

(15) Finance will be drawn down into the Fund over a period of time to match approximately the annual rate of investment by the Fund into SEs. To cover the five-year investment period, five tranches of investment by the Fund shareholders were envisaged. Each tranche of funds drawn down from the investors in the Fund will take place in proportion to the participation in the fund. It is also the intention that the Fund is managed both to return all the capital invested by the private and public sectors, and to pay an acceptable rate of return on the invested capital.

(16) The income achieved by the Fund will be redistributed to the investors in four phases. In a first phase, all private sector investors and the EIB will be reimbursed until that sector and the EIB have realised a total return of their investment. In a second phase they will receive an internal rate of return of 10 % a year. In a third phase, further realisations from the portfolio will be made preferentially to the public sector investment until its initial GBP 3,34 million investment has been returned and in a fourth phase the public sector will receive an internal rate of return of 2,2 % a year.

(17) If the Fund should produce losses, the allocation of net income losses and net capital Losses (if any) will first be borne by the Department of Enterprise, Trade and Investment (DETI). This will be done until such time as the full amount of its investment in the Fund has been reduced to zero by reason of such allocation. Any further net income losses and net capital losses will be allocated amongst the remaining Investors pro rata to their participation.

(18) It is the intention of the United Kingdom authorities that the General Partner will receive an administrative fee partly based on the performance of the Fund.

It can be concluded that the DETI takes both a higher risk and a lower rate of return than the other investors do.

[1] OJ L 107, 30.4.1996, p. 4.
[2] The public sector finance made available by DETI and partially refinanced by the ERDF.

Investment in SEs by the Fund

(19) The Fund will operate under certain limitations as notified by the United Kingdom authorities. The Fund will have the ability to invest up to GBP 600 000 in an individual SE by means of loans and shareholdings:

— *Loans*: a loan (subordinated, unsecured loan) will be given at an interest rate which is 1 % to 3 % higher than the interest rate charged by the commercial banking sector for a secured loan

— *ordinary share capital*: the SEs will give up a portion of their equity in return for capital investment.

(20) The Fund will not invest in companies in difficulties as defined by the Community Guidelines on State aid for rescuing and restructuring aid [1].

(21) The Fund will not invest in companies active in the production, processing or marketing of products listed in Annex I to the Treaty. It will be excluded from investing in companies active in the sensitive sectors for which special Community rules governing State aid have been laid down.

(22) According to the United Kingdom authorities, the Fund will only invest in companies that will undertake a programme of expansion that will include investment in fixed assets or intangible assets similar to that described in point 4.4 of the Guidelines on national regional aid [2].

(23) The financial aid from the Fund will be separate from other regional or national programmes, but if they are used together the United Kingdom authorities have undertaken to limit the total aid to the aid ceiling laid down in accordance with the current aid status of Northern Ireland (40 %).

III. OPENING OF THE PROCEDURE PURSUANT TO ARTICLE 88(2) OF THE EC TREATY

(24) In its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty concerning the Viridian Growth Fund [3], the Commission expressed several doubts regarding the compatibility of the notified aid measure with the Community's State aid rules:

(a) first, the United Kingdom authorities justified the preferential treatment of the private investors of the Fund as being necessary in order to attract their participation in the Fund. In its decision to open the procedure, the Commission expressed doubts as to whether the underwriting of a considerable proportion of the private investors' risk, and giving them the benefit of the differing drawdown provisions were linked to any expenditure which can be considered to constitute eligible costs under any of the communications and frameworks of the Commission under which State aid can be authorised;

(b) second, the Commission also questioned whether the aid to the companies invested in was linked to initial investment in the sense of either the former Community Guidelines on State aid for small and medium-sized enterprise [4] or the Guidelines on national regional aid [5] or to any other expenditure constituting eligible costs under any other of the Commission's communications and frameworks.

(25) In its decision to initiate the procedure pursuant to Article 88(2) of the EC Treaty, the Commission also indicated that it would consider whether the limited partnership, which is the vehicle for the Fund's operation, should also be considered to be an undertaking that is a beneficiary of the aid.

IV. COMMENTS FROM THE UNITED KINGDOM

(26) By letter of 8 September 2000, the United Kingdom submitted comments on the Commission's decision to initiate the procedure pursuant to Article 88(2) of the EC Treaty, regarding the Fund. These comments can be summarised as follows:

(a) it is because potential investors do not wish to invest at the proposed level of the Fund that the Government brought the Fund proposal forward. The proposal seeks to address a real market failure, which places targeted companies in Northern Ireland at a disadvantage;

(b) the companies in question cannot find or attract equity capital to Northern Ireland at the GBP 50 000 to GBP 300 000 level. The issue of whether they can afford it does not apply - at the present time it is not an available option, and therefore they do not get funded;

(c) the United Kingdom authorities pointed out that an interest rate of between 1 % and 3 % higher than that charged by banks is significant in the Northern Ireland context where banks compete to make secured loans at low margins;

(d) the scheme has to be selective, given that there are limited funds and the demand is potentially large, so the Fund Manager has to take discretionary decisions

[1] OJ C 288, 9. 10. 1999.
[2] OJ C 74, 10.3.1998, p. 9.
[3] OJ C 266, 16.9.2000, p. 9.
[4] OJ C 213, 23.7.1996, p. 4.
[5] OJ C 74, 10.3.1998, p. 9.

(e) the assistance provided to the private investors of the Fund is limited to the minimum necessary to secure private sector involvement. The Fund will make sources of risk capital available to companies in Northern Ireland, addressing the market failure rather than excessively distorting competition;

(f) the United Kingdom authorities do not accept that the existence of the Fund would reduce the number or attractiveness of investment opportunities available to other potential investors who might be interested in serving the same market. All potential institutional investors were approached about supporting the Fund and all had the opportunity of participating. Further, no fund currently addressed the investment needs of the target range of companies and therefore it would seem that these enterprises have no attractiveness to investors. Potential investors will continue to find attractive opportunities for investment not targeted by the Fund;

(g) the purpose of the investment assistance is to enable targeted companies to rapidly expand their operations, not to reduce their current expenses. The proposed investments from the Fund cannot therefore be construed as operating aid;

(h) a limited partnership is an arrangement whereby people and organisations agree to carry on business in common with a view to profit. The Limited Partnership Agreement regulates the operation of the partnership. A limited partnership is not a legal person distinct from its partners. Also, in a partnership the tax authorities treat the individual partners (investors in the partnership or fund in this case) as if the partners themselves had made investments directly into the underlying portfolio of companies. In other words, limited partners are assessed individually on their tax liabilities arising from income and capital gains in the partnership or fund. The limited partners are not taxed twice, first as a partnership then as individual partners. The United Kingdom contends that if aid is judged to have been derived by individual partners it would be double counting and incorrect to attribute aid to the limited partnership.

(27) A meeting was held on 8 November 2000 between the services of the Commission and the United Kingdom authorities and a formal letter dated 15 December 2000 was sent to the Commission in which certain amendments were provided. These amendments are integrated in the description of the scheme in Section II.

V. ASSESSMENT OF THE SCHEME

As to the existence of aid

(28) The legal person, which constitutes the Fund, is a limited partnership, which under United Kingdom tax legislation is not deemed to be a legal person distinct from its partners. Therefore, for the purpose of the present case, the Commission considers the Fund and the investors therein to be one and the same level.

(29) The Commission notes that the terms for the investors in the Fund have been modified under the procedure. Furthermore, the United Kingdom authorities have committed themselves to seek further private investors to the Fund on a European-wide level. However, differences in remuneration remain between the DETI and the other investors in the fund at the cost of the DETI. The stake from the DETI in the Fund stems from State resources. Notwithstanding its stated policy to promote access to risk capital, the Commission can therefore not exclude that, given its particularities, the scheme may involve aid to the investors/Fund and to the enterprises in which the Fund will invest.

(30) Such aid to the investors/Fund and to the enterprises in which the Fund will invest could distort or threaten to distort competition and affect trade between Member States within the meaning of Article 87(1) of the EC Treaty in view of the fact that there is a high level of competition in the financial market, which is at least European-wide and because the small enterprises in Northern Ireland, in which the Fund will invest, will have a considerably enhanced capability of competing with undertakings in other Member States.

(31) The scheme was notified in advance in accordance with Article 88(3) of the EC Treaty.

As to the compatibility of the aid:

(32) Having established that the Fund may involve State aid for the purposes of Article 87(1) of the EC Treaty, the Commission has examined the compatibility thereof with one of the derogations provided under Article 87(2) and 87(3).

(33) The Commission considers that the exemptions provided for in Article 87(2) of the EC Treaty do not apply, since the aid measure does not pursue any of the objectives listed in that article of the Treaty, nor has the United Kingdom argued that this would be the case.

(34) Article 87(3)(a) of the EC Treaty does not apply, since no part of Northern Ireland qualifies for regional aid under Article 87(3)(a) [1].

[1] The United Kingdom regional aid map for the period 2000 to 2006, approved by the Commission under State aid number N 265/2000 (Approval letter No SG (2000) D/1006293 of 17 August 2000), indicates that Northern Ireland is an Article 87(3)(c)region and that it is an exceptional region based on footnote 44 of the Guidelines on national regtional aid (OJ C 74, 10.3.1998, p. 9).

(35) Aid under the scheme is not intended to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State, nor is it intended to promote culture or heritage conservation. The Commission therefore considers that neither Article 87(3)(b) nor Article 87(3)(d) of the EC Treaty is applicable to the Fund.

(36) In view of the above, the Commission determined that the only possible basis on which the measure could be found compatible with the common market is Article 87(3)(c) of the EC Treaty.

(37) The Commission notes that Northern Ireland is an assisted area according to footnote 44 of the Guidelines on national regional aid [1]. The Commission recalls its well-established view that SMEs suffer from a number of handicaps that can slow down their development. One of the main such handicaps is the difficulty in obtaining capital and credit, the chief causes of which are imperfect information, the risk-shy nature of financial markets and the limited guarantees that SMEs are in a position to offer. The Commission also recalls that the Community has a stated policy as set out, for example, in the conclusion of the Lisbon European Council, '…to redirect funding towards support for business start-ups, high-tech firms and micro-enterprises, as well as other risk-capital initiatives proposed by the EIB' [2]. The Commission furthermore notes that:

(a) the most comprehensive research study into the financing of SMEs in Northern Ireland, undertaken by the Ulster Society of Chartered Accountants, shows that a market failure exists at the lower end of the risk capital market. Furthermore, the public intervention is decisive for the creation of the Fund; no private investor would invest in the Fund on the same terms as the public sector. Thus, without the intervention of the State there would be no Fund;

(b) as an amendment to the terms originally notified to the Commission, the Fund will invest only when the investee company (the SE) undertakes a programme of expansion as set out in a supporting business plan. The investment decisions will focus on the nature of the product, the market, the development plan, the quality and the know-how of the management team and the availability of key personnel;

(c) as a further amendment to the terms originally notified to the Commission the United Kingdom authorities will revise the present limited partnership in order to ensure that, on each tranche of investment made by the Fund, funds from each investor in the Fund will be drawn down in proportion to their commitment to the Fund. Thus the only advantages to the private partners concern the distribution of returns and not the drawdown of funds. This means that the private investors (and the EIB, which invests on the same terms) are required to put funds at risk well before the first returns are made;

(d) the total funds invested by the private investors are 33 %, which can be regarded as substantial, and the total funds invested on the same terms are 66 % (both private investors and the EIB). This provides assurance that commercial considerations will play a key role in the Fund's investment decisions, which should additionally limit the distortion of competition created by the aid to the investee companies;

(e) it is the stated intention of the United Kingdom authorities that the Fund be managed both to return all the capital invested by the private and public sectors, and to pay an acceptable rate of return on the invested capital;

(f) the Fund Manager was selected from an open call for tender published in the *Official Journal of the European Communities* [3] and his/her remuneration is partially based on its performance. This fact too should enhance the commerciality of the Fund;

(g) the Commission finally notes the United Kingdom authorities' commitment to keep interventions by the Fund separate from other regional or national programmes, but if they are used together the United Kingdom authorities have undertaken to limit the total aid to the aid ceiling laid down in accordance with the current aid status of Northern Ireland (40 %). However, due to the problems concerning calculation of aid intensities in equity participation this can only be done in regard to the loans.

(38) Under these conditions the Commission concludes that, in so far as aid could be involved in the establishment and the operation of the Fund, it is limited to the minimum necessary and will not adversely affect trading conditions to an extent contrary to the common interest.

[1] OJ C 74, 10.3.1998, p. 9.
[2] Lisbon European Council, Presidency Conclusions on 35 March 2000.
[3] OJ C 136, 17.7.1998, p. 215.

(39) The above conclusions are supported by the fact that no observations were made by interested parties under the formal investigation.

(40) The Commission notes the commitment of the United Kingdom authorities to notify any application of the Fund not authorised by the present Decision or by Commission Regulation (EC) No 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid [1], Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid [2] or Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises [3].

(41) On the basis of the foregoing, the Commission takes the view that the amended Viridian Growth Fund, in so far as it involves aid, would qualify for derogation under Article 87(3)(c) EC. The Commission therefore concludes that the scheme is compatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The Viridian Growth Fund, as amended, is compatible with the common market. That scheme may, therefore, be implemented.

Article 2

The United Kingdom authorities shall submit to the Commission, in addition to the information on any plan to continue funding or to extend or amend the scheme referred to in Article 1 which they are required to provide pursuant to Article 88(3) of the EC Treaty, an annual report providing detailed information that allows the Commission to evaluate the scheme's performance and whether the positive effects of the scheme continue to outweigh any distortion of competition.

Article 3

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

Done at Brussels, 13 February 2001.

For the Commission

Mario MONTI

Member of the Commission

[1] OJ L 10, 13.1.2001, p. 20.
[2] OJ L 10, 13.1.2001, p. 30.
[3] OJ L 10, 13.1.2001, p. 33.