EU State Aid

EU Commission Consults on New Rules on State Aid for Companies in Difficulty

SUMMARY

On 5 November 2013, the European Commission released for public comment proposed new guidelines on state aid for rescuing and restructuring companies that operate in sectors other than financial services coal and steel. The proposed guidelines are intended to replace the Commission’s current Rescue and Restructuring Aid guidelines and will, if adopted, tighten the conditions under which rescue and restructuring aid can be granted in the EU. The proposed guidelines deal with substantive and procedural aspects. The principal changes reflected in the proposed guidelines are as follows:

**New Definition of “Undertaking in Difficulty”**

- Only “undertakings in difficulty” are legally eligible to receive rescue and restructuring aid. Consequently, the definition of an “undertaking in difficulty” is key to determining the situations in which an EU member state can grant such aid. The proposed guidelines add new elements to the definition based on the aid recipient’s credit rating, debt-to-equity ratio and earnings.

**Temporary Restructuring Support**

- The proposed guidelines introduce a new type of aid to be known as “temporary restructuring support”. It is a hybrid between (i) rescue aid (which must be limited to six months) and (ii) restructuring aid (which is of long-term nature and requires far-reaching restructuring of the aid recipient). Temporary restructuring support is intended to provide liquidity assistance for periods of either 12 or 18 months for small and medium sized enterprises.

**More Stringent Tests for Aid to be Approved by the Commission**

- To ensure that EU member states grant aid to undertakings in difficulty only when the public interest outweighs the distortive effect on competition, the proposed guidelines put forward extensive conditions that aid-granting EU states will have to meet in order for the aid to comply with EU law. These conditions aim to ensure that the aid is targeted at cases where it is really required and serves the public interest.
The proposed guidelines include new rules on “burden sharing” which require a greater contribution from shareholders and creditors of the aid recipient to the restructuring costs. The changes reflect the Commission’s extensive experience in determining “burden sharing” in its assessment of aid granted to financial institutions during the financial crisis.

The deadline for comment on the proposed guidelines is 31 December 2013. The Commission plans to adopt the new guidelines in the first half of 2014.

BACKGROUND

Rescue and restructuring aid is among the most controversial types of state aid. If granted too liberally and without sufficient control, rescue and restructuring aid props up inefficient “zombie” firms, thereby distorting competition. However, properly targeted rescue and restructuring aid can allow companies in difficulty to restructure their operations in a manner that ensures their long-term viability and with minimal distortive effects on competition.

The EU Commission’s policy and practice for analysing rescue and restructuring aid under EU state aid rules are described in its Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (the “Current R&R Guidelines”), which date from 2004. Since the Current R&R Guidelines entered into force, the Commission has significantly developed and refined its approach to the assessment of state aid. In addition, it has implemented its state aid modernisation (“SAM”) initiative to generally overhaul and update EU state aid law.

To ensure that its guidelines on rescue and restructuring aid reflect these developments, the Commission is consulting on Guidelines (the “Proposed R&R Guidelines”) to replace the Current R&R Guidelines. The Proposed R&R Guidelines do not apply to aid for companies in the financial services, coal or steel sectors. Sector-specific guidelines apply to aid for companies in those sectors.

KEY CHANGES IN THE PROPOSED R&R GUIDELINES

Revised Definition of “Undertaking in Difficulty”

In order to be eligible for (i) rescue aid, (ii) restructuring aid, and (iii) temporary restructuring support, a company must demonstrate on objective grounds that it is in difficulty. Under the Proposed R&R Guidelines, a company is considered to be “in difficulty” if, without state aid, it will go out of business in the short or medium term. The Current R&R Guidelines sets out two (illustrative) situations in which this is likely to be the case: (i) loss of more than half of its capital, with more than a quarter being lost over the preceding 12 months; and (ii) if the company is eligible under its domestic law to be subject to collective insolvency proceedings.

The Proposed R&R Guidelines explain that, in the case of a limited liability company, situation (i) arises when the deduction of accumulated losses from reserves (and other elements considered to be part of
the company’s own funds) leads to a negative result that exceeds half of the company’s subscribed share capital.

The Proposed R&R Guidelines also specify two further scenarios in which a company will be considered to be in difficulty: (a) if the company’s credit rating by at least one registered credit rating agency is equivalent to CCC+ or below and (b) if the company’s book debt-to-equity ratio is greater than 7.5 and/or its EBIT or EBITDA interest coverage ratio has been below 1.0 for the past two years.

Importantly, the Proposed R&R Guidelines state that it is only by way of exception that the Commission will consider a company that does not fit within any of these listed scenarios to be “in difficulty”. This change, if implemented, would significantly tighten the key condition for eligibility to receive rescue aid, restructuring aid and temporary restructuring support.

Temporary Restructuring Support

The Current R&R Guidelines envisage two types of aid for undertakings in difficulty: (i) rescue aid (temporary liquidity assistance limited to a six-month period to enable the recipient to formulate a restructuring plan or liquidation plan) and (ii) restructuring aid (aid to restore the long-term viability of a company on the basis of a detailed restructuring plan). The Proposed R&R Guidelines introduce a new type of liquidity assistance for undertakings in difficulty: “temporary restructuring support”, consisting of loans or guarantees. It will be available only for small and medium sized enterprises (“SMEs”), which the Commission notes, often face greater liquidity challenges than larger companies. Temporary restructuring support will be available for longer than the strict six-month period applicable to rescue aid (the Proposed R&R Guidelines envisages either 12 or 18 months). Moreover, the recipient will need to present a simplified restructuring plan rather than the more far-reaching type of restructuring plan required for the approval of restructuring aid.

Improved Targeting of Aid

A perceived shortcoming of the Current R&R Guidelines is that they do not ensure that aid is targeted at cases where the state intervention serves a real public interest. The Proposed R&R Guidelines attempt to mitigate this shortcoming by tightening the conditions under which aid can be granted (as set out above) and, in addition, require the aid granting authority to justify the aid, by providing evidence that the failure of the beneficiary would involve serious social hardship or severe market failure. The Proposed R&R Guidelines set out a non-exhaustive list of situations in which aid would be justified, including instances where (i) the unemployment rate in a specific region is higher than the EU or national average, persistent and accompanied by difficulty in creating new employment in that region; (ii) the beneficiary has an important systemic role in a particular region or sector or provides important services that are hard to replicate (e.g., a national infrastructure provider); (iii) failure or adverse incentives of credit markets could push an otherwise viable company into bankruptcy; or (iv) the failure of the beneficiary would lead to an irremediable loss of important technological knowledge.

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The Proposed R&R Guidelines also introduce an additional test which requires EU member states to present a “counterfactual” comparison between the scenario involving state aid and a credible alternative scenario without it (e.g., debt reorganisation, asset disposals, private capital raising, sale to a competitor or breakup, in each case either through an insolvency procedure, reorganisation procedure or otherwise). State aid will be considered to be in the public interest only if it can make a difference to the situation that would prevail without it. These high evidentiary requirements, if implemented, will make it more difficult for many companies to be eligible for restructuring aid.

More Burden Sharing

The Current R&R Guidelines require companies receiving restructuring aid to make a contribution to the restructuring costs from their own resources (e.g., through external financing or by selling assets that are not essential to the beneficiary’s survival). The Proposed R&R Guidelines introduce the concept of “burden sharing”, which the Commission developed when assessing state aid granted to financial institutions during the financial crisis. The concept looks not only at the amount of own contribution, but also at who is providing that contribution. In the future, adequate burden sharing may entail greater contributions from the aid beneficiary’s shareholders and creditors. The Commission proposes two alternative ways to achieve this objective:

The first, very generalised approach, requires that the contributions to be made by incumbent shareholders and creditors should be reasonable in view of the likely losses that they would have suffered in the event of the insolvency of the aid recipient. Under this approach, the contributions will normally be considered adequate if their amount is at least as high as the amount of the aid.

The second, more detailed approach, requires initially that all past losses are borne by shareholders. If this is insufficient to fully cover such losses, subordinated creditors would be required to contribute to reducing the capital shortfall by converting their debt into equity or by writing down the principal of their debt instruments. The Commission will not, however, require a contribution of senior debt holders (in particular, holders of bonds) as a mandatory component of burden sharing. Under this approach, the contributions will normally be considered adequate if they amount to at least 50% of the restructuring costs.

Both approaches considerably tighten the rules regarding the contribution to be made by shareholders as the Current R&R Guidelines differentiate between minimum own contributions for small (25%), medium (40%) and large (50%) aid recipients.

More Detailed Guidance on the Content of a Restructuring Plan

The granting of restructuring aid is conditional on the implementation of a restructuring plan. The Proposed R&R Guidelines provide more extensive guidance as to the Commission’s expectations regarding the contents of a restructuring plan, including an indicative table of contents for a restructuring plan. The restructuring plan must identify the causes of the aid beneficiary’s difficulties and own...
weaknesses, outline how the proposed restructuring measures will remedy the underlying problems (including information on the beneficiary’s business model, organisational structure, funding, corporate governance etc.) and contain a detailed timetable of actions (in principle not exceeding three years) together with a calculation of the costs of each action.

**Increased Minimum Level of Remuneration for Rescue Aid**

To incentivise aid beneficiaries to repay the rescue aid as soon as possible, the Commission proposes to increase the minimum level of remuneration for rescue aid (currently one-year IBOR plus 400 basis points) and to introduce a “step-up” system for temporary restructuring support measures, whereby the required remuneration must increase every six months by 50 basis points.

**New Measures to Limit Distortions of Competition**

To try to limit the distortive effect on competition that can result from rescue and restructuring aid, the Proposed R&R Guidelines replace the “compensatory measures” that apply under the Current R&R Guidelines (i.e., divestment of assets, reductions in capacity or market presence and reduction of entry barriers on the markets concerned) by a more detailed list of measures to limit distortions of competition. The Proposed R&R Guidelines introduce very detailed guidance on the form and calibration of measures to preserve and strengthen competition in the market, including (i) structural measures (such as divestiture of assets, reduction of capacity or market presence); (ii) behavioural measures (such as restrictions on acquiring shares in any company during the restructuring period and on publicising state support as a competitive advantage); and (iii) market opening measures aimed at promoting open and competitive markets (e.g., by favouring entry and exit, expansion of existing small competitors or cross-border activity). They also introduce three criteria for the Commission’s assessment of the extent of measures to limit distortions of competition: (i) the amount and nature of the aid and conditions and circumstances under which it was granted; (ii) the size and relative importance of the beneficiary and the characteristics of the market concerned; and (iii) the extent to which moral hazard concerns remain after the application of burden-sharing measures.

**COMMENT**

The Proposed R&R Guidelines are an additional building block in the Commission’s state aid modernisation programme. If adopted in their current form, the Proposed R&R Guidelines will significantly change the EU rules applicable to state aid for undertakings in difficulty outside the financial services, coal and steel sectors. They will give the Commission a greater say in deciding whether, and on what terms, EU states can support ailing companies.

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