STATE AID — UNITED KINGDOM

Aid C 72/03 (ex N 134/03) — Invest Northern Ireland Venture 2003

Invitation to submit comments pursuant to Article 88(2) of the EC Treaty

(2004/C 33/02)

(Text with EEA relevance)

By means of the letter dated 26 November 2003 reproduced in the authentic language on the pages following this summary, the Commission notified United Kingdom of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty concerning the abovementioned aid.

Interested parties may submit their comments within one month of the date of publication of this summary and the following letter, to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax (32-2) 296 12 42.

These comments will be communicated to United Kingdom. Confidential treatment of the identity of the interested party submitting the comments may be requested in writing, stating the reasons for the request.

SUMMARY

By letter dated 20 March 2003, registered at the Commission on 26 March 2003, the United Kingdom authorities notified, pursuant to Article 88(3) of the EC Treaty, the Invest NI Venture 2003. By letters D/53203 and D/55504 dated 15 May 2003 and 29 August 2003 the Commission requested additional information concerning the abovementioned measure. This information was submitted by the United Kingdom authorities by letters dated 24 June 2003 and 30 September 2003, registered at the Commission at 1 July 2003 and 1 October 2003.

DESCRIPTION OF THE SCHEME

The measure intends to address the gap in venture capital provision in Northern Ireland by establishing a new venture capital fund to provide risk capital to small and medium-sized enterprises in Northern Ireland. The Invest Northern Ireland Venture 2003 fund (hereafter referred to as the fund) intends to address the particular difficulties encountered by SMEs in Northern Ireland in raising finance.

Market studies provided by the United Kingdom authorities claim that the venture capital market in Northern Ireland lags considerably behind when compared to other regions of the United Kingdom. According to the United Kingdom authorities, this is attributed to the fact that Northern Ireland is physically detached from the rest of the United Kingdom and to the long lasting impact of civil unrest. The United Kingdom authorities therefore argue that, due to the unique particularities of the venture capital market in Northern Ireland, market failure in Northern Ireland extends to venture capital investments of up to GBP 1.5 million (EUR 2.1 million).

It is important to note that in 2003 the Commission approved the Small and Medium Enterprise Venture Capital and Loan Fund (1), an umbrella scheme for all United Kingdom regions including Northern Ireland. This scheme regulates the setting-up of venture capital funds specialising in equity investments in SMEs across the United Kingdom. In this decision, State aided venture capital for Article 87(3)(c) assisted areas (Northern Ireland is 87(3)(c) region) is restricted to EUR 750 000 in a single tranche. Given the exceptional problems facing the region of Northern Ireland, the United Kingdom authorities — by means of the present scheme — intend to provide SMEs with equity investment of up to GBP 1 500 000 (EUR 2.1 million) in a single tranche. All other provisions of the present scheme respect the conditions laid down in the Commission's decision on the Small and Medium Enterprise Venture Capital and Loan Fund.

STATE AID CHARACTER OF THE SCHEME

The Commission considers, at this stage of the procedure, that the measure constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

At the level of investors, the Commission considers that there is State aid within the meaning of Article 87(1) of the EC Treaty. The involvement of state resources is demonstrated by the fact that the United Kingdom authorities will provide up to a maximum of 50 % of the capital of the fund. Private investors, who may well be undertakings within the meaning of the EC Treaty, receive an advantage as the measure allows them to participate in the equity of a company or set of companies on terms more favourable than public investors. Even though no person or organisation is debarred from investing in the funds, the limited size of the funds will not safeguard that all potential investment will be accepted and the Commission therefore considers that there is selectivity. Finally, the scheme affects trade between Member States, as investment in capital is an activity that is the subject of considerable trade between Member States.

At the level of the fund, the Commission in general tends 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. Under the present scheme, the fund will be newly set up and operate as a limited partnership. The Commission therefore does not consider the fund to be a separate aid beneficiary. This principle is in line with the Commission decisions on the Viridian Growth Fund (2), the Coalfields Enterprise Fund (3) and the Community Development Venture Fund (4).

At the level of the companies invested in, the Commission considers that there is State aid within the meaning of Article 87(1) of the EC Treaty. The United Kingdom authorities themselves consider that risk capital would not be available to SMEs at these terms without the scheme. The stated objective of the scheme is to extend the opportunity to access risk capital to SMEs in Northern Ireland and the scheme is therefore considered to be selective.

PROCEDURAL CONSIDERATIONS

The United Kingdom has complied with the procedural requirements of Article 88(3) of the EC Treaty by notifying the abovementioned aid scheme before putting it into effect.

ASSESSMENT OF THE COMPATIBILITY OF THE AID MEASURE

Evidence of market failure

Point VI.5 of the SARC stipulates that the Commission will require evidence of market failure for risk capital measures. It may however be prepared to accept the case for market failure when each tranche of finance for an enterprise from risk capital measures which are wholly or partially financed through State aid will contain a maximum of EUR 750 000 in regions qualifying for assistance under Article 87(3)(c) of the EC Treaty. Taking into account that Northern Ireland has been classified as exceptional Article 87(3)(c) region based on footnote 44 of the Guidelines on national regional aid (5) in the Regional Aid Map 2000-2006 for the United Kingdom (6), and bearing in mind that the United Kingdom authorities intend to grant tranches of investment aid of up to GBP 1,5 million (EUR 2.1 million), the Commission considers that the existence of market failure cannot be taken for granted. As the intended tranche size for risk capital investments in SMEs under the present scheme significantly exceeds the thresholds outlined under the SARC, the Commission would demand provision of evidence of market failure. Once market failure is recognised, it will then go on to assess the compatibility of the measure according to the criteria (positive and negative elements) for assessing the compatibility of risk capital measures presented under point VIII of the SARC.

Provision of evidence of market failure

In order to demonstrate the existence of market failure, the United Kingdom authorities submitted the study ‘Market Failure in the Supply of Venture Capital Funds for SMEs in Northern Ireland’ from October 2002. The key finding of that study is that there exists a gap in the provision of venture capital in Northern Ireland for SMEs in the deal size range of GBP 250 000 (EUR 357 000) to GBP 1,5 million (EUR 2,1 million). The study also finds that whilst such a market failure also exists in other regional economies, it is more pronounced in Northern Ireland because of the following reasons:

— Peripherality of Northern Ireland: United Kingdom based venture capitalists are influenced by the cost and time taken to reach Northern Ireland from Great Britain. This is particularly relevant to small deals for which it is often difficult to make adequate returns. Moreover, there is an international border and foreign exchange issues between the North and South of Ireland that have historically dampened cross border business activities. In addition, many venture capital funds from the Republic of Ireland are actually precluded in their constitution from operating north of the border.

— Legacy of civil unrest: The attitude of investors to Northern Ireland is closely aligned to the level of civil unrest in Northern Ireland. It will take many years before perceptions of Northern Ireland change.

— Other ‘continuing’ factors include the size of the Northern Ireland market and its distance from the main financial centres.

(2) State aid C 46/2000.
(4) State aid N 606/01.
The study goes on to conclude that with the exception of a few larger deals, Northern Ireland cannot rely on venture capital investment from outside funds. A local supply of venture capital is thus recommended to meet the needs of smaller investments of up to GBP 1.5 million (EUR 2.1 million). The study expects that venture capital funds operating in this deal size range will continue to be viable only with continued government support. It then concludes that the permanent factors of peripherality and small market size create long term conditions that are never likely to offer sufficient returns for the private sector without underpinning by the public sector.

The Commission, after a first preliminary assessment of the measure, has doubts if the arguments presented above can sufficiently justify the granting of risk capital investment tranches considerably higher than the thresholds foreseen by the SARC. The Commission’s doubts concern the importance of the alleged barrier due to distance and border. The Commission is of the opinion that a more thorough analysis of this complex question is necessary. The Commission wishes to collect information from other interested parties, notably from potential providers of risk capital to SMEs in Northern Ireland. To do so, the Commission must, for legal reasons, open the procedure provided for in Article 88(2) of the EC Treaty. It is only with the help of such observations that the Commission can decide whether such aid is necessary and does not adversely affect trading conditions to an extent contrary to the common interest.

TEXT OF THE LETTER

The Commission wishes to inform the United Kingdom that, having examined the information supplied by your authorities on the aid measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

1. PROCEDURE

By letter dated 20 March 2003 registered at the Commission on 26 March 2003, the United Kingdom authorities notified, pursuant to Article 88(3) of the EC Treaty, the Invest NI Venture 2003. By letters D/53203 and D/55504 dated 15 May 2003 and 29 August 2003, the Commission requested additional information concerning the abovementioned measure. This information was submitted by the United Kingdom authorities by letters dated 24 June 2003 and 30 September 2003 registered at the Commission at 1 July 2003 and 1 October 2003.

2. DESCRIPTION OF THE AID MEASURE

2.1. Objective of the scheme

The measure intends to address the gap in venture capital provision in Northern Ireland by establishing a new venture capital fund to provide risk capital to small and medium-sized enterprises in Northern Ireland. The Invest Northern Ireland Venture 2003 fund (hereafter referred to as the fund) intends to address the particular difficulties encountered by SMEs in Northern Ireland in raising finance.

It is important to note that in 2003 the Commission approved the Small and Medium Enterprise Venture Capital and Loan Fund (9), an umbrella scheme for all United Kingdom regions including Northern Ireland. This scheme regulates the setting-up of venture capital funds specialising in equity investments in SMEs across the United Kingdom. In this decision, State aided venture capital for Article 87(3)(c) assisted areas (Northern Ireland is 87(3)(c) region) is restricted to EUR 750 000 in a single tranche. Given the exceptional problems facing the region of Northern Ireland, the United Kingdom authorities — by means of the present scheme — intend to provide SMEs with equity investment of up to GBP 1 500 000 (EUR 2.1 million) in a single tranche. All other provisions of the present scheme respect the conditions laid down in the Commission’s decision on the Small and Medium Enterprise Venture Capital and Loan Fund.

2.2. Legal basis of the scheme

The legal basis of the scheme is Article 7 of the Industrial Development (Northern Ireland) Order 1982.

2.3. Beneficiaries of the scheme

The scheme is exclusively aimed at small and medium-sized enterprises (8) in the manufacturing and tradable services sectors in Northern Ireland. Firms in difficulty as defined by the Community guidelines on State aid for rescuing and restructuring firms in difficulty (7) are excluded from investment. The fund will not invest in sensitive sectors under state aid restrictions nor to sectors to which the Commission Communication on State aid and risk capital (10) does not apply.

2.4. Administration of the scheme

The Department of Enterprise Trade and Investment, Northern Ireland Office will have statutory responsibility, through its non-departmental body, Invest NI. The scheme will be administered by the fund manager Crescent Capital NI Limited.


(8) The definition of small and medium-sized enterprises applied by the United Kingdom authorities for the purposes of the scheme is in line with the definition given in Annex I to Commission Regulation No 70/2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OJ L 10, 13.1.2001, p. 33).


2.5. Funding of the scheme
The United Kingdom authorities propose to establish a venture capital fund with a volume of up to GBP 20 million (approximately EUR 28 million). The fund will be created as a new fund. Funding may include a contribution from the European Investment Fund EIF. Under no circumstances will the public contribution to the fund exceed 50%.

2.6. Duration of the scheme
The fund will be set up as a ten-year limited partnership. The United Kingdom authorities intend to make commitments to the fund until 31 December 2008. There will follow a period of up to five years during which funds will be managed with the aim of successfully exiting the investment in the SMEs. The United Kingdom authorities have undertaken to comply with the relevant State aid provisions and structural funds regulations applicable at any point in time during the overall duration of the scheme.

2.7. Selection of investors under the scheme
The fund manager will select private sector investors on competitive terms. The fund manager will give private investors notice of the opportunity to invest through a private placement memorandum that will be publicly circulated. Potential private investors will be invited to offer for investment in the funds, thereby stating any required subordination of public sector funding in order to invest. The decision will therefore ensure maximum private sector investment for the minimum possible public subordination. Government contribution to the fund will never exceed 50% of the total volume of the fund.

2.8. Investment decisions
A supervisory board will be formed to represent the interests of all investors as well as to oversee the work of the fund managers. Public and private investors will be represented in the supervisory board and will jointly set the criteria for investment to be followed by the fund managers. Any change to these criteria has to be agreed upon by all investors in the funds. Investments will only be made in companies that are economically viable as demonstrated by robust business plans and will always be made upon a commercial assessment (due diligence).

2.9. Aid instruments under the scheme
The funds will provide investment in the form of equity. Investments will be made in the ordinary share capital of the targeted SMEs.

2.10. Size of investment in target companies under the scheme
The United Kingdom authorities claim that in Northern Ireland, market failure for the provision of venture capital market extends to venture capital investments of up to GBP 1.5 million (EUR 2.1 million). Consequently, the amount of aid given to any one target company will be limited to between GBP 250 000 (EUR 357 000) and GBP 1.5 million (EUR 2.1 million) in a single tranche.

The United Kingdom authorities will deliver a report on the activities of the Fund on an annual basis containing the information specified in the Commission’s instructions on standardised reports.

2.11. Selection of fund managers under the scheme
The fund manager will be selected through a competitive bidding procedure including advertising in the Official Journal of the European Union. The selection will be based upon the relevant experience of establishing and running venture capital funds, proven track record of fund raising, selection of investments and generation of a commercial return on equity, the reputation of the fund managers, as well as the capacity to provide management support to the target SMEs.

2.12. Remuneration of fund managers under the scheme
The remuneration structure of the fund manager will be in line with the remuneration of private sector driven venture capital managers. The fund manager’s remuneration will be linked to the performance of the fund.

2.13. Cumulation of aid under the scheme
The United Kingdom authorities have committed themselves to avoid cumulation of aid measures to a single enterprise.

3. ASSESSMENT OF THE SCHEME
In accordance with Article 6(1) of Council Regulation 659/1999 of 22 March 1999, the decision to initiate proceedings shall summarise the relevant issues of fact and law, shall include a preliminary assessment from the Commission as to the aid character of the proposed measure, and shall set out the doubts as to its compatibility with the common market.

3.1. Legality
By notifying the scheme, the United Kingdom authorities respected their obligations under Article 88(3) of the EC Treaty.

3.2. Existence of State aid
The Commission considers, at this stage of the procedure, that the measure constitutes State aid within the meaning of Article 87(1) of the EC Treaty. According to the provisions of the Commission Communication on State aid and risk capital (hereafter referred to as SARC) (1), the assessment of the presence of State aid must consider the possibility that a 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,
— aid to the companies invested in.

At the level of investors, the Commission considers that there is State aid within the meaning of Article 87(1) of the EC Treaty. The involvement of State resources is demonstrated by the fact that the United Kingdom authorities will provide up to a maximum of 50% of the capital of the fund. Private investors, who may well be undertakings within the meaning of the EC Treaty, receive an advantage as the measure allows them to participate in the equity of a company or set of companies on terms more favourable than public investors. Even though no person or organisation is debarred from investing in the funds, the limited size of the funds will not safeguard that all potential investment will be accepted and the Commission therefore considers that there is selectivity. Finally, the scheme affects trade between Member States, as investment in capital is an activity that is the subject of considerable trade between Member States.

At the level of the fund, the Commission in general tends 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. Under the present scheme, the fund will be newly set up and operate as a limited partnership. The Commission therefore does not consider the fund to be a separate aid beneficiary. This principle is in line with the Commission decisions on the Viridian Growth Fund (12), the Coalfields Enterprise Fund (13) and the Community Development Venture Fund (14).

At the level of the companies invested in, the Commission considers that there is State aid within the meaning of Article 87(1) of the EC Treaty. The United Kingdom authorities themselves consider that risk capital would not be available to SMEs at these terms without the scheme. The stated objective of the scheme is to extend the opportunity to access risk capital to SMEs in Northern Ireland and the scheme is therefore considered to be selective.

3.3. Preliminary assessment of conformity of the measure

3.3.1. Evidence of market failure

Point VI.5 of the SARC stipulates that the Commission will require evidence of market failure for risk capital measures. It may however be prepared to accept the case for market failure when each tranche of finance for an enterprise from risk capital measures which are wholly or partially financed through State aid will contain a maximum of EUR 750 000 in regions qualifying for assistance under Article 87(3)(c) of the EC Treaty. Taking into account that Northern Ireland has been classified as exceptional Article 87(3)(c) region based on footnote 44 of the Guidelines on national regional aid (15) in the Regional Aid Map 2000-2006 for the United Kingdom (16), and bearing in mind that the United Kingdom authorities intend to grant tranches of investment aid of up to GBP 1.5 million (EUR 2.1 million), the Commission considers that the existence of market failure cannot be taken for granted. As the intended tranche size for risk capital investments in SMEs under the present scheme significantly exceeds the thresholds outlined under the SARC, the Commission would demand provision of evidence of market failure. Once market failure is recognised, it will then go on to assess the compatibility of the measure according to the criteria (positive and negative elements) for assessing the compatibility of risk capital measures presented under point VIII of the SARC.

3.3.2. Provision of evidence of market failure

In order to demonstrate the existence of market failure, the United Kingdom authorities submitted the study ‘Market Failure in the Supply of Venture Capital Funds for SMEs in Northern Ireland’ from October 2002. The key finding of that study is that there exists a gap in the provision of venture capital in Northern Ireland for SMEs in the deal size range of GBP 250 000 (EUR 357 000) to GBP 1.5 million (EUR 2.1 million). The study also finds that whilst such a market failure also exists in other regional economies, it is more pronounced in Northern Ireland because of the following reasons:

— Peripherality of Northern Ireland: United Kingdom based venture capitalists are influenced by the cost and time taken to reach Northern Ireland from Great Britain. This is particularly relevant to small deals for which it is often difficult to make adequate returns. Moreover, there is an international border and foreign exchange issues between the North and South of Ireland that have historically dampened cross border business activities. In addition, many venture capital funds from the Republic of Ireland are actually precluded in their constitution from operating north of the border.

— Legacy of civil unrest: The attitude of investors to Northern Ireland is closely aligned to the level of civil unrest in Northern Ireland. It will take many years before perceptions of Northern Ireland change.

— Other ‘continuing’ factors include the size of the Northern Ireland market and its distance from the main financial centres.

The study goes on to conclude that with the exception of a few larger deals, Northern Ireland cannot rely on venture capital investment from outside funds. A local supply of venture capital is thus recommended to meet the needs of smaller investments of up to GBP 1.5 million (EUR 2.1 million). The study expects that venture capital funds operating in this deal size range will continue to be viable only with continued government support. It then concludes that the permanent factors of peripherality and small market size create long term conditions that are never likely to offer sufficient returns for the private sector without underpinning by the public sector.

The Commission, after a first preliminary assessment of the measure, has doubts if the arguments presented above can sufficiently justify the granting of risk capital investment tranches considerably higher than the thresholds foreseen by

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the SARC. The Commission's doubts concern the importance of the alleged barrier due to distance and border. The Commission is of the opinion that a more thorough analysis of this complex question is necessary. The Commission wishes to collect information from other interested parties, notably from potential providers of risk capital to SMEs in Northern Ireland. To do so, the Commission must, for legal reasons, open the procedure provided for in Article 88(2) of the EC Treaty. It is only with the help of such observations that the Commission can decide whether such aid is necessary and does not adversely affect trading conditions to an extent contrary to the common interest.

4. DECISION

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 88(2) of the EC Treaty, requests the United Kingdom to submit its comments and to provide all such information as may help to assess the aid scheme, within one month of the date of receipt of this letter.

The Commission wishes to remind the United Kingdom that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipients.

The Commission warns the United Kingdom that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.'