DECISION OF THE EFTA SURVEILLANCE AUTHORITY

No 78/00/COL

of 12 April 2000

revising the guidelines on the application of the EEA State aid provisions to State guarantees and to guarantees given to public enterprises in the manufacturing sector, and amending for the twenty-seventh 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), and in particular 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), and in particular Article 24 and Article 1 of Protocol 3 thereto,

Whereas under Article 24 of the Surveillance and Court Agreement the EFTA Surveillance Authority shall give effect to the provisions 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(4), in particular the provisions contained in Chapter 17 (aid in the form of State guarantees) and paragraph 7(2) of Chapter 20 (guarantees to public enterprises in the manufacturing sector) thereof;

Whereas the European Commission issued on 24 November 1999 a notice to the Member States on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ C 71, 11.3.2000, p. 14);

Whereas this notice is of relevance also 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 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,

(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.
(4) Initially published in OJ L 231 of 3.9.1994 and in the EEA Supplement No 32 of the same date, last amendment (26th) adopted by Decision No 72/00/COL of 5.4.2000 (see page 26 of this Official Journal).
HAS ADOPTED THIS DECISION:

1. The State Aid Guidelines shall be amended by replacing the existing Chapter 17 and paragraph 7(2)(1) of Chapter 20 with a new Chapter 17 'State guarantees', contained in Annex I to this Decision.

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 to 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, 12 April 2000.

*For the EFTA Surveillance Authority*

*The President*

Knut ALMESTAD
ANNEX I

17. STATE GUARANTEES (1)

17.1. Introduction

1. This chapter outlines the EFTA Surveillance authority's approach to State aid granted in the form of guarantees. Guarantees are usually associated with a loan or other financial obligation to be contracted by a borrower with a lender. However, this chapter covers all forms of guarantees, irrespective of their legal basis and the transaction covered. Guarantees may be granted as individual guarantees or within guarantee schemes. If aid is involved, this aid in most cases benefits the borrower. However, in certain circumstances, there may also be an aid to the lender.

2. This chapter applies without prejudice to Article 125 of the EEA Agreement and thus does not prejudice the rules in the EFTA States governing the system of property ownership. The EFTA Surveillance Authority is neutral as regards public or private ownership. This notice does not apply to export credit guarantees.

3. The EFTA Surveillance Authority adopted in 1994 guidelines concerning State guarantees (2), which stipulated that the EFTA Surveillance Authority would regard all guarantees given by the State, either directly or by delegation through financial institutions, as falling within the scope of Article 61(1) of the EEA Agreement. According to these guidelines, the EFTA Surveillance Authority should be notified of any plans to establish guarantee schemes or grant guarantees outside a scheme. The guidelines adopted by the EFTA Surveillance Authority in 1994 on the application of State aid provisions to public enterprises in the manufacturing sector (3) also addressed the subject of guarantees.

4. Experience gained in the mean time suggests that the policy pursued by the EFTA Surveillance Authority in this area should be reviewed. This chapter replaces the existing Chapter 17 on State guarantees and Chapter 20, point 20.7.2(1). Its purpose is to give the EFTA States more detailed explanations about the principles on which the EFTA Surveillance Authority intends to base its interpretation of Articles 61 and 62 of the EEA Agreement, as well as Protocol 3 to the Surveillance and Court Agreement, and their application to State guarantees. The EFTA Surveillance Authority intends in this way to make its policy in this area as transparent as possible, thereby ensuring that its decisions are predictable and that equal treatment is guaranteed.

17.2. Applicability of Article 61(1) of the EEA Agreement

17.2.1. Aid to the borrower

1. Usually, the aid beneficiary is the borrower. The State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower can obtain lower rates and/or offer less security. In some cases, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms. State guarantees may thus facilitate the creation of new businesses and enable certain undertakings to raise money in order to pursue new activities or simply remain active instead of being eliminated or restructured, thereby creating distortions of competition. State guarantees thus generally fall within the scope of Article 61(1) of the EEA Agreement, if trade between the Contracting Parties is affected and no market premium is paid.

2. The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. This carrying of a risk by the State should normally be remunerated by an appropriate premium. Where the State forgoes such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under Article 61(1) of the EEA Agreement. The aid is granted at the moment when the guarantee is given, not the moment at which the guarantee is invoked or the moment at which payments are made under the guarantees.

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(1) This chapter corresponds to the Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ C 71, 11.3.2000, p. 14).
(3) Chapter 20 of these guidelines. Guarantees are addressed in section 20.7.2 thereof.
3. The EFTA Surveillance Authority also regards as aid in the form of a guarantee the more favourable funding terms obtained by enterprises whose legal form rules out bankruptcy or other insolvency procedures or provides an explicit State guarantee or coverage of losses by the State. The same applies to the acquisition by a State of a holding in an enterprise if unlimited liability is accepted instead of the usual limited liability (4).

4. Article 61(1) of the EEA Agreement covers aid granted by EFTA States or through State resources. Therefore, in the same way as other forms of potential aid, guarantees given by the State directly, namely by central, regional or local authorities, as well as guarantees given by undertakings under the dominant influence of public authorities, may constitute State aid.

17.2.2. Aid to the lender

1. Even if usually the aid beneficiary is the borrower it cannot be ruled out that under certain circumstances the lender, too, will benefit from the aid. In such a case the EFTA Surveillance Authority will certainly pursue the matter accordingly.

2. In particular, for example, if a State guarantee is given _ex post_ in respect of a loan or other financial obligation already entered into without the terms of this loan or financial obligation being adjusted, or if one guaranteed loan is used to pay back another, non-guaranteed loan to the same credit institution, then there may also be an aid to the lender, in so far as the security of the loans is increased. Such aid is capable of favouring the lender and distorting competition, and generally falls within the scope of Article 61(1) of the EEA Agreement, if trade between contracting parties is affected.

17.3. Amount of the aid

1. In the case of an individual State guarantee, the aid element must be assessed by reference to the details of the guarantee and loan (or other financial obligation). The relevant factors include in particular the duration and amount of the guarantee and loan, the risk of default by the borrower, the price paid by the borrower for the guarantee, the nature of any security given, how and when the State could be called upon to pay a debt and the means (e.g. declaration of bankruptcy) to be used by the State to recover amounts owed by the borrower once the guarantee has been invoked.

2. The cash grant equivalent of a loan guarantee in a given year can be:
   - calculated in the same way as the grant equivalent of a soft loan, the interest subsidy representing the difference between the market rate and the rate obtained thanks to the State guarantee after any premiums paid have been deducted, or
   - taken to be the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor (the probability of default) and (b) any premium paid, i.e. (guaranteed sum × risk) – premium, or
   - calculated by any other objectively justifiable and generally accepted method.

For individual guarantees, the first method should in principle be the standard form of calculation, for guarantee schemes the second one.

The risk factor should be based on the past experience of defaults on loans given in similar circumstances (sector, size of firm, level of general economic activity). The yearly grant equivalents should be discounted to their present value using the reference rate, then added up to obtain the total grant equivalent.

3. Where, at the time the loan is granted, there is a strong probability that the borrower will default, e.g. because he is in financial difficulty, the value of the guarantee may be as high as the amount effectively covered by that guarantee.

(4) See Chapter 20 of these guidelines, points 20.7.2(2) and 20.7.2(3).
4. If a financial obligation is wholly covered by a State guarantee, the lender has less incentive to assess properly, secure and minimise the risk arising from the lending operation, and in particular to assess properly the borrower’s creditworthiness. Such risk assessment might also not always be taken over by the guarantor, for lack of means. This lack of incentive to minimise the risk of non-repayment of the loan might encourage lenders to contract loans with a greater than normal commercial risk and could thus increase the amount of higher-risk guarantees in the State’s portfolio.

5. The EFTA Surveillance Authority considers that a percentage of at least 20% not covered by a State guarantee will serve as an appropriate limit for inducing the lender to properly assess the creditworthiness of the borrower (1), to properly secure its loans and to minimise the risk associated with the transaction (2). The EFTA Surveillance Authority will therefore, in general, examine critically any guarantees covering the entirety (or nearly the entirety) of a financial transaction.

6. In the case of State guarantee schemes, the specific features of the individual cases may not be known at the time when the scheme is to be assessed. In these circumstances, the aid element must be assessed by reference to the provisions of the scheme concerning amongst others the maximum amount and duration of loans, the category of enterprise and type of project eligible, the security required from the borrowers, the premium to be paid and the interest rates obtained by them.

17.4. **Conditions excluding the existence of aid**

1. An individual guarantee or a guarantee scheme entered into by the State will be outside the scope of Article 61(1) of the EEA Agreement when there is no aid which favours certain undertakings or the production of certain goods. In such cases, notification by the EFTA State is not necessary. Also, a guarantee does not constitute State aid under Article 61(1) of the EEA Agreement when the measure does not affect trade between contracting parties.

2. The EFTA Surveillance Authority considers that the fulfilment of all the following conditions ensures that an individual State guarantee does not constitute State aid under Article 61(1) of the EEA Agreement:

   (a) the borrower is not in financial difficulty;
   
   (b) the borrower would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;
   
   (c) the guarantee is linked to a specific financial transaction, is for a fixed maximum amount, does not cover more than 80% of the outstanding loan or other financial obligation (except for bonds and similar instruments) and is not open-ended;
   
   (d) the market price for the guarantee is paid (which reflects, amongst others, the amount and duration of the guarantee, the security given by the borrower, the borrower’s financial position, the sector of activity and the prospects, the rates of default, and other economic conditions).

3. The EFTA Surveillance Authority considers that the fulfilment of all the following conditions ensures that a State guarantee scheme does not constitute State aid under Article 61(1) of the EEA Agreement:

   (a) the scheme does not allow guarantees to be granted to borrowers who are in financial difficulty;
   
   (b) the borrowers would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;
   
   (c) the guarantees are linked to a specific financial transaction, are for a fixed maximum amount, do not cover more than 80% of each outstanding loan or other financial obligation (except for bonds and similar instruments) and are not open-ended;

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(1) This is under the assumption that the same level of security is provided by the company to the State and the credit institution.

(2) The answers to a questionnaire on State guarantees in the EFTA States show that this principle is being applied only to a certain extent. Most of the guarantees cover the full amount of the underlying financial operation, thereby exempting the lending institution from the necessity to access properly the creditworthiness of the beneficiary in its own interest.
(d) the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiary enterprises make it, in all probability, self-financing;

(e) the scheme provides for the terms on which future guarantees are granted and the overall financing of the scheme to be reviewed at least once a year;

(f) the premiums cover both the normal risks associated with granting the guarantee and the administrative costs of the scheme, including, where the State provides the initial capital for the start-up of the scheme, a normal return on that capital.

4. Failure to comply with any one of the above conditions set out in point 17.4(2) and (3) does not mean that such guarantee or guarantee scheme is automatically regarded as State aid. If there is any doubt as to whether a planned guarantee or scheme does constitute State aid, it should be notified.

5. There may be circumstances in which it is planned to use State guarantees to enable enterprises, and in particular small and medium-sized enterprises, to obtain loans that the market would not supply. The enterprises may be starting up, expanding fast or be small and hence unable to furnish the necessary security to secure a loan or obtain a guarantee. They may fall into the category of high-risk enterprises (expected to move into profitability only in the long term and/or having a particularly high failure rate). This may be the case, for example, with projects concerning new, innovative products or processes. The EFTA Surveillance Authority considers that such circumstances will generally not take State guarantees outside the scope of Article 61(1) of the EEA Agreement. State guarantees given in such circumstances should therefore be notified to the EFTA Surveillance Authority in sufficient time, in the same way as State guarantees given in other circumstances.

17.5. **Compatibility of State aid in the form of guarantees with the functioning of the EEA Agreement**

1. State guarantees within the scope of Article 61(1) of the EEA Agreement must be examined by the EFTA Surveillance Authority with a view to determining whether or not they are compatible with the functioning of the Agreement. Before such assessment of compatibility can be made, the beneficiary of the aid must be identified. As has been explained in point 17.2, this can be either the borrower, or the lender, or both.

2. In most cases the guarantee contains aid to the borrower (point 17.2.1). Whether or not this aid is compatible with the functioning of the EEA Agreement will be examined by the EFTA Surveillance Authority according to the same rules as are applied to aid measures taking other forms. The concrete criteria for the compatibility assessment can be seen from the chapters of these guidelines covering horizontal, regional and sectoral aid. The examination will take into account, in particular, the aid intensity, the characteristics of the beneficiaries and the objectives pursued.

3. The EFTA Surveillance Authority will accept guarantees only if their mobilisation is contractually linked to specific conditions which may go as far as the compulsory declaration of bankruptcy of the beneficiary undertaking, or any similar procedure. These conditions will have to be agreed at the initial examination by the EFTA Surveillance Authority of the proposed guarantee within the normal procedures of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, at the stage when it is granted. In the event that an EFTA State wants to mobilise the guarantee under conditions other than those initially agreed at the granting stage, then the EFTA Surveillance Authority will regard the mobilisation of the guarantee as creating a new aid which has to be notified under Article 1(3) of Protocol 3 to the Surveillance and Court Agreement.

4. Where the guarantee contains aid to the lender (point 17.2.2), attention should be drawn to the fact that such aid might, in principle, constitute operating aid.

17.6. **Consequences of infringement of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement**

1. Where an EFTA State does not observe the obligations of prior notification and suspension laid down in Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, the aid element of the guarantee is to be qualified as unlawful in accordance with Chapter 6 of these guidelines. As to the consequences of infringement of the third sentence of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, various distinctions should be drawn. In the following the position of the aid beneficiary and that of lenders not being a beneficiary will be examined in turn.
2. First, where aid has been illegally granted, the beneficiaries of the aid contained in the guarantee will run a risk. The EFTA Surveillance Authority may take interim measures in accordance with Chapter 6, point 6.2.1, of these guidelines, pending the outcome of the examination as to the compatibility of the aid. If, after this examination, the EFTA Surveillance Authority finds that the State aid is incompatible with the functioning of the EEA Agreement, it will as a rule order the State to recover the aid from the beneficiary in accordance with Chapter 6, point 6.2.3, of these guidelines, even if this means the declaration of bankruptcy of the enterprise.

3. Moreover, aid beneficiaries also run a risk at national level, inasmuch as the national courts' role is to safeguard rights which individuals enjoy as a result of the prohibition laid down in the "standstill provision" of the last sentence of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, which has been accordingly implemented into the national legal order of the EFTA States. The fact that the last sentence of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement has been incorporated in the national legal order of the EFTA States, gives national courts sufficient powers to ensure that the "standstill provision" will be complied with (7). National courts in the EFTA States have to draw all the appropriate conclusions from the illegality of State aid granted in breach of the procedural rules of the Surveillance and Court Agreement. If a national court is requested to order recovery of the unlawful aid, it must normally grant that application (8).

4. Secondly, guarantees differ from other State aid measures, such as grants or tax exemptions, in the sense that in the case of a guarantee the State also enters into a legal relation with the lender. Therefore, consideration has to be given to whether the fact that a State aid has been illegally granted also has consequences for third parties. In the case of State guarantees for loans, this concerns mainly the financial lending institutions. In the case of guarantees for bonds issued to obtain financing for undertakings, this concerns the financial institutions involved in the issuance of the bonds.

5. The question whether the illegality of the aid affects the legal relations between the State and third parties is a matter which has to be examined under national law. National courts may have to examine whether national law prevents the guarantee contracts from being honoured, and in that assessment the EFTA Surveillance Authority considers that they should take account of the breach of EEA law. Accordingly, lenders may have an interest in verifying, as a standard precaution, that the EEA rules on State aid have been observed, whenever guarantees are granted. The EFTA State should be able to provide a case number issued by the EFTA Surveillance Authority for an individual case or a scheme and eventually a non-confidential copy of the EFTA Surveillance Authority's decision together with the relevant reference to the EEA section of the Official Journal of the European Communities and the EEA Supplement thereto. The EFTA Surveillance Authority for its part will do its utmost to make available in a transparent manner information on cases and schemes approved by it.

17.7. **Reports to be submitted to the EFTA Surveillance Authority by the EFTA States**

1. As there may be new developments on the financial markets and as the value of State guarantees is difficult to assess, the constant review pursuant to Article 62(1) of the EEA Agreement of State guarantee schemes approved by the EFTA Surveillance Authority is of particular importance. In addition to the usual data on expenditure, the reports to be presented annually to the EFTA Surveillance Authority should give (for schemes and individual guarantees as well) data on the total amount of State guarantees outstanding, the total amount paid in the preceding year by the State to defaulting debtors (net of any funds recovered), and the premiums paid for State guarantees in the same year. This information will help in calculating the rate of default and will be used to reassess the value of future guarantees and, if necessary, the premium to be paid in the future.

2. The EFTA Surveillance Authority does not intend to use information supplied in the abovementioned reports and not known or foreseeable when it took an earlier decision, in order to revise its initial conclusions concerning the existence or scale of aid contained in State guarantee schemes. The EFTA Surveillance Authority may, however, use such information to propose appropriate measures to an EFTA State under Article 1(1) of Protocol 3 to the Surveillance and Court Agreement, in order to alter an existing State guarantee scheme.‘

\(^{7}\) See in this context also Chapter 9A of these guidelines (On cooperation between national courts and the EFTA Surveillance Authority in the State aid field).

\(^{8}\) See Case C-39/94 Syndicat Français de l'Express International (SFEI) and others v La Poste and others [1996] ECR I-3547.