

II

(Acts adopted under the EC Treaty/Euratom Treaty whose publication is not obligatory)

DECISIONS

COMMISSION

COMMISSION DECISION

of 8 October 2008

on the measure (C 33/07 (ex N 339/06 and N 729/06)) which Germany is planning to implement through the IBG Beteiligungsgesellschaft Sachsen-Anhalt mbH

(notified under document number C(2008) 5581)

(Only the German text is authentic)

(Text with EEA relevance)

(2009/364/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 those provisions ⁽¹⁾,

Having regard to those comments,

Whereas:

(2) By letter dated 22 June 2006, the Commission requested additional information. The German authorities replied by letter dated 13 July 2006. The Commission requested supplementary information by letter dated 31 August 2006 and the German authorities replied by letter dated 22 September 2006. The Commission asked for further information on 11 October 2006 and the German authorities replied by letter dated 6 November 2006.

(3) By letter dated 9 November 2006, received by the Commission on the same day, the German authorities notified the second part of the measure, which the Commission registered as State aid case N 729/06. Owing to the overlap between the two notifications (N 339/06 and N 729/06), in a letter dated 6 December 2006 the Commission proposed to merge the cases and treat all correspondence as being relating to both, and also asked for additional information relating to both cases. The German authorities replied by letter dated 23 January 2007.

1. PROCEDURE

(1) By letter dated 30 May 2006, received by the Commission on the same day, the German authorities notified the Commission under Article 88(3) of the EC Treaty of the first part of the measure, which the Commission registered as State aid case N 339/06.

(4) The Commission requested further information on 28 February 2007. Following an extension of the deadline, the German authorities replied by letter dated 11 April 2007. The Commission requested additional information on 4 May 2007. Following an extension of the deadline, the German authorities replied by letter dated 29 June 2007.

⁽¹⁾ OJ C 246, 20.10.2007, p. 20.

- (5) By letter dated 30 August 2007, the Commission informed Germany that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid (hereinafter the opening decision). The opening decision was published in the *Official Journal of the European Union* ⁽²⁾. The Commission called on the German authorities and interested parties to submit their comments.
- (6) The German authorities submitted comments on the opening decision by letter dated 19 October 2007. Following an extension of the deadline, the Commission received observations from an interested party, namely IBG Beteiligungsgesellschaft Sachsen-Anhalt mbH (hereinafter the IBG Fund) by letter dated 10 December 2007. By letter dated 21 January 2008, the Commission forwarded these observations to the German authorities. In response to the observations, the German authorities replied by letter dated 14 February 2008.
- (7) The Commission requested further information by letter dated 18 April 2008 and by e-mails dated 28 April 2008 and 11 June 2008. The German authorities submitted additional information by letter dated 5 June 2008 and e-mail dated 13 June 2008.

2. DESCRIPTION OF THE MEASURE

- (8) The IBG Fund is a public venture capital fund, established and funded by the *Land* of Saxony-Anhalt. The objective of the IBG Fund is to provide risk capital to technology-oriented innovative SMEs in Saxony-Anhalt in their early and growth stages of development. Saxony-Anhalt is a region eligible for assistance under Article 87(3)(a) EC Treaty ⁽³⁾.
- (9) Since 1 July 2007, the IBG Fund has been managed by the management company Goodvent Beteiligungsmanagement GmbH & Co. KG (hereinafter the Fund manager), selected in an open and non-discriminatory public tender procedure. The total size of the public funding is approximately EUR 130 million. The measure is applicable until 31 December 2013.
- (10) The IBG Fund provides the following investments:
- (a) ordinary equity holdings of up to EUR 1,5 million per SME per 12-month period, with at least 30 % of the funding being provided by private independent investors on the same terms as the IBG Fund;
- (b) ordinary equity holdings (*offene Beteiligungen*) of up to EUR 10 million per SME, including conversion options, such as convertible bonds (*Wandelanleihen*) and bonds with warrants (*Optionsanleihen*), effected with private investors in equal amounts, on the same terms and with the same risks (*pari passu*);
- (c) silent participations (*stille Beteiligungen*) (hereinafter IBG Fund silent participations) of up to EUR 5 million per enterprise, effected by the IBG Fund on its own, independently of private investors, and held for up to 10 years;
- (d) conversion of existing IBG Fund silent participations into ordinary equity holdings effected *pari passu* with private investors.
- (11) In respect of the ordinary equity holdings and the conversion measures, the Commission concluded in the opening decision that there was no State aid within the meaning of Article 87(1) of the EC Treaty either to the investors ⁽⁴⁾ or to the IBG Fund management ⁽⁵⁾. There might be State aid within the meaning of Article 87(1) of the EC Treaty to the IBG Fund ⁽⁶⁾ or to the target enterprises. However, the Commission found the measure to be in line with the Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises ⁽⁷⁾ (hereinafter the guidelines) and compatible with the common market under Article 87(3)(c) of the EC Treaty.
- (12) In the opening decision, the IBG Fund silent participations were assessed separately, because the German authorities considered them to be debt instruments in line with market conditions, which thus did not constitute State aid within the meaning of Article 87(1) of the EC Treaty, while the Commission had doubts as to whether in economic terms they should be classified as debt instruments or as equity instruments.

⁽²⁾ See footnote 1.

⁽³⁾ N 459/06 — Guidelines on national regional aid for 2007-2013 — National regional State aid map: Germany (OJ C 295, 5.12.2006, p. 6).

⁽⁴⁾ The Commission explained that this was because the IBG Fund and private investors share the same upside and downside risks and rewards and hold the same level of subordination; in the case of a conversion into ordinary equity, the IBG equity holdings would be properly valued by converting the total remuneration (the nominal value, the fixed and variable interest due and the exit remuneration) into ordinary equity holdings.

⁽⁵⁾ The Commission explained that this was because a separate management company was selected through an open tender procedure.

⁽⁶⁾ The Commission considered the IBG Fund to be a State-owned undertaking, likely to raise its capital on terms that would not be available on the private market.

⁽⁷⁾ OJ C 194, 18.8.2006, p. 2.

3. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

(13) The Commission initiated the formal investigation procedure on the issue of whether the IBG Fund silent participations should, in economic terms, be classified as debt instruments, as claimed by the German authorities, or as equity instruments. If the IBG Fund silent participations did qualify as debt instruments, the Commission notice on the method for setting the reference and discount rates ⁽⁸⁾ (hereinafter the 1997 notice), which is to be used as an indicator of the market rate, would have to be applied to determine whether they entailed State aid to the target enterprises within the meaning of Article 87(1) of the EC Treaty ⁽⁹⁾.

(14) In its opening decision, the Commission considered that, if the IBG Fund silent participations were classifiable as debt instruments, they would not constitute an advantage to the recipient companies within the meaning of Article 87(1) of the EC Treaty as they would be in line with market conditions according to the 1997 notice. On the other hand, if the IBG Fund silent participations were classifiable as equity, State aid to the target enterprises could not be ruled out, as the measure might be addressing a market failure in the venture capital market.

(15) To establish whether the IBG Fund silent participations should be classified as debt instruments or equity instruments, the opening decision examined the economic substance of the instruments in line with point 4.3.3 of the guidelines, taking into account the degree of risk and potential losses borne by the investor, whether profit-dependant remuneration or fixed remuneration was predominant, the level of subordination in the event of bankruptcy and the treatment of the investment instrument under the applicable domestic legal, regulatory, financial, and accounting rules.

(16) Having examined the economic nature of the IBG Fund silent participations, the Commission identified the following possible differences between standard debt instruments and the IBG Fund silent participations:

(a) *Subordination*: In the case of bankruptcy of a target enterprise, the IBG Fund silent participations are senior to equity but subordinated to loans and other liabilities.

(b) *Security*: The IBG Fund silent participations are partly secured (minimum 10 %), although this security is far from the level which would be required for debt financing.

(c) *Repayment*: The IBG Fund silent participations are repaid twice a year, while on standard debt instruments the principal and the interest are normally repaid on a monthly basis.

(d) *Information and control rights*: There appeared to be differences between the IBG Fund silent participations and standard debt instruments in terms of information and control rights, although ownership and change-of-control clauses are sometimes included in standard credit contracts.

(e) *Termination of contract*: There appeared to be differences between the IBG Fund silent participations and standard debt instruments as concerns the termination of contracts.

(f) *Remuneration*: In view of the profit-linked one-off exit remuneration (*Exitvergütung*) component, it could not be established with 100 % certainty that the fixed remuneration was the predominant remuneration component.

(17) The Commission therefore had doubts as to whether the IBG Fund silent participations should be classified as debt instruments, and asked interested parties to provide comments on these points.

4. COMMENTS FROM INTERESTED PARTIES

(18) Pursuant to Article 20(2) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽¹⁰⁾ and in response to the notice published in the Official Journal ⁽¹¹⁾, the Commission received comments from one interested party, namely the IBG Fund, which provided detailed arguments to demonstrate that the IBG Fund silent participations should be classified as debt instruments.

⁽⁸⁾ OJ C 273, 9.9.1997, p. 3.

⁽⁹⁾ This reasoning was also applied in previous Commission decisions: State aid N 344/06 — Germany (OJ C 157, 10.7.2007, p. 8); State aid N 104/05 — Germany: Regio MIT Risk Capital Fund Hessen (OJ C 295, 26.11.2005, p. 8); State aid N 212/04 — Germany: ERDF Risk Capital Fund Berlin (OJ C 95, 20.4.2005, p. 8); State aid N 213/04 — Germany: ERDF Risk Capital Fund Schleswig-Holstein (OJ C 72, 24.3.2006, p. 2); State aid N 266/04 — Germany: ERDF Risk Capital Fund Thüringen (OJ C 95, 20.4.2005, p. 9); State aid N 310/04 — Germany: ERDF Risk Capital Fund Brandenburg (OJ C 79, 1.4.2006, p. 25).

⁽¹⁰⁾ OJ L 83, 27.3.1999, p. 1.

⁽¹¹⁾ See footnote 1.

(a) Subordination

- (19) The IBG Fund explained the subordinated status of the silent participations. It said that subordination is agreed on a voluntary basis and is not legally required. It is not unusual to place debt instruments in different rankings. In the field of acquisition financing for example, it is virtually always the case that debts are grouped into senior debts and junior debts. In its comments, the IBG Fund emphasised that while the silent participations may be subordinated to other loans and liabilities, they are always senior to equity and never participate in the losses of the target enterprises.

(b) Security

- (20) The IBG Fund explained that between 10 % and 30 % of the value of the silent participations is secured by guarantees given by the shareholders of the target enterprises. The precise amount of collateral depends on the individual case, and in particular on the assets the shareholders have previously transferred to the enterprise, e.g. in the form of equity or intellectual property rights. According to the IBG Fund, debt instruments can take different forms, depending on the individual case. In practice, there is even 0 % collateral, and the loan is unsecured; and this does not automatically turn a debt instrument into an equity instrument.

(c) Repayment

- (21) According to the IBG Fund, the repayment procedures for its silent participations are similar to those of debt instruments. In the case of standard loans, depending on a company's liquidity position, the principal and interest are not necessarily (re)paid on a monthly basis. Repayments on a six-monthly or three-monthly basis are just as common as monthly payments. The German Civil Code provides for an interest payment at the end of each year, but other arrangements can be agreed.
- (22) As regards the repayment of the principal, the IBG Fund points out that the German Civil Code stipulates that the principal becomes due when the loan contract is terminated unless the contract provides otherwise. According to the IBG Fund, its silent participations are compatible with the provisions of the German Civil Code without the need for any contractual provision departing from the general rule.

(d) Information and control rights

- (23) The IBG Fund presents further arguments to demonstrate similarities between the information and ownership and change-of-control clauses of the IBG Fund silent partici-

pations and those of debt instruments. According to the IBG Fund, it is usual to agree on ownership and change-of-control clauses for debt instruments. Creditors insist on them particularly in the case of commercial loans and project and acquisition financing. These types of credit have in common with the IBG Fund silent participations that they are often long-term loans which become repayable only upon their termination. In return, the creditors request extensive covenants which entitle them to terminate the credit contract earlier in the case of breach of the covenant by the debtor.

- (24) As regards commercial loans, the umbrella organisation of German private banks, the Bundesverband Deutscher Banken, has designed a special model contract which contains an extensive ownership and change-of-control clause. As regards project and acquisition financing, the IBG Fund refers to several relevant German commentaries which discuss and acknowledge extensive control clauses for the benefit of the creditor.

(e) Termination of contract

- (25) The IBG Fund provides further arguments to demonstrate similarities between its silent participations and loans as regards the conditions for terminating the contract. In the case of breach of contract, non-compliance with agreed conditions, incorrect information or change of control, both the target enterprise and the IBG Fund are entitled to terminate the contract. Where the specific contract termination terminology of the IBG Fund silent participations is different from that for standard loans, it only reflects the specific nature of the instrument as compared to a standard loan.

(f) Remuneration

- (26) The IBG Fund explains the remuneration structure of its silent participations, in order to demonstrate that fixed remuneration is the dominant component of the total annual remuneration of 13 %. The total remuneration is composed of the fixed interest rate component, determined on the basis of the credit-risk rating of each target enterprise and payable irrespective of the profitability of the investment, and the profit-linked component, payable if certain profitability benchmarks are exceeded. According to the IBG Fund, the profit-linked component is always at least 250 basis points lower than the fixed interest rate. A fixed one-off exit remuneration is paid in addition to the total 13 % annual remuneration. This is calculated as a percentage of the nominal amount of the silent participation and does not depend on the profitability of the investment.

(g) Accounting and tax treatment

- (27) The IBG Fund provides detailed information to demonstrate that under German law (civil law, accounting law and tax law) and international accounting rules (IFRS and IAS) its silent participations are considered to be typical silent participations and thus debt instruments.

5. COMMENTS FROM GERMANY

5.1. Comments on the opening decision

- (28) Pursuant to Article 20(2) of Regulation (EC) No 659/1999 and in response to the notice published in the Official Journal⁽¹²⁾, the Commission received comments from the German authorities. The German authorities argued that the IBG Fund silent participations are typical silent participations and thus should be classified as debt instruments, for the following reasons:

(a) Under civil law, accounting law and tax law, these investment instruments are treated as borrowed capital (*Fremdkapital*).

(b) The information and control rights, as well as the provisions on termination of investments, are similar to those for debt instruments.

(c) As in the case of debt instruments, full repayment of principal and interest is required at the end of the holding.

(d) The fixed interest component is the predominant component of remuneration, which indicates that the IBG Fund silent participations should be treated as debt instruments.

(e) The subordination of the IBG Fund silent participations to other loans and liabilities is necessary to avoid immediate accounting insolvency because of the weak credit position of the borrower.

(f) Banks and credit institutions typically treat mezzanine capital as a debt instrument, even when it is unsecured.

5.2. Observations on the interested party's comments

- (29) In their observations on the interested party's comments, the German authorities expressed their agreement, and

reiterated the conclusions presented in their own original comments on the opening decision. Moreover, the German authorities emphasised that the IBG Fund silent participations are granted on market terms and do not entail State aid as they are in compliance with the communication from the Commission on the revision of the method for setting the reference and discount rates⁽¹³⁾ (hereinafter the 2008 communication).

- (30) In further correspondence with the Commission, the German authorities explained the IBG Fund credit rating system, which has been examined by Price Waterhouse Coopers and classifies the target enterprises between 'very good' (AAA) and 'bad/financial difficulties' (CCC)¹; CCC companies are excluded from receiving financing. The low collateralisation and the ranking of the IBG Fund silent participations is taken into account when assessing the credit risk of the target enterprises.

- (31) The rating system provides the basis for establishing the risk-adjusted interest rates. The silent participations are always remunerated at a fixed interest rate composed of IBOR plus an appropriate margin. The latter can vary between 100 and 650 basis points, depending on the rating of the enterprise. In the case of target enterprises that can not be classified using the IBG Fund rating system, a margin of at least 400 basis points is applied, which can never be lower than the one which would be applicable to the parent company.

6. ASSESSMENT

6.1. Legality

- (32) The German authorities have fulfilled their obligation under Article 88(3) of the EC Treaty by notifying the measure before its implementation. The measure's entry into force is subject to the Commission's approval.

6.2. Legal basis for the assessment

6.2.1. Economic classification of the IBG Fund silent participations

- (33) To classify the IBG Fund silent participations as debt instruments or equity instruments in economic terms, they had to be assessed under the guidelines. Point 2.2 of the guidelines provides the following definitions of quasi-equity and debt investment instruments:

⁽¹²⁾ See footnote 1.

⁽¹³⁾ OJ C 14, 19.1.2008, p. 6.

— ‘quasi-equity investment instruments’ means instruments whose return for the holder (investor/lender) is predominantly based on the profits or losses of the underlying target company, and which are unsecured in the event of default. This definition is based on a substance over form approach,

— ‘debt investment instruments’ means loans and other funding instruments which provide the lender/investor with a predominant component of fixed minimum remuneration and are at least partly secured. This definition is based on a substance over form approach.

(34) Point 4.3.3 of the guidelines stipulates that ‘the Commission will have regard to the economic substance of the instrument rather than to its name and the qualification attributed to it by the investors ... [taking] into account the degree of risk in the target company’s venture borne by the investor, the potential losses borne by the investor, the predominance of profit-dependent remuneration versus fixed remuneration, and the level of subordination of the investor in the event of the company’s bankruptcy ... [and] the treatment applicable to the investment instrument under the prevalent domestic legal, regulatory, financial, and accounting rules, if these are consistent and relevant for the qualification.’

(35) After examination of the arguments from the German authorities and the information received from the interested party (the IBG Fund) in response to the opening decision, the following conclusions have been reached:

(a) Investor risk

(36) In line with the guidelines, the Commission assessed the degree of risk and potential losses borne by the IBG Fund. Account was taken of the fact that the IBG Fund silent participations, similarly to debt instruments, do not bear the full exit risk as do equity investors⁽¹⁴⁾. The IBG Fund silent participations never participate in the losses of the target enterprises, as happens with equity investments; this criterion for distinguishing between equity and debt is explicitly mentioned in point 4.3.3 of the guidelines. Similarly to debt instruments, the

contractual terms of the IBG Fund silent participations require the principal and interest, including the profit-linked component, to be repaid from the company’s cash flow. As regards the degree of risk and potential losses borne by the investor, the IBG Fund silent participations can therefore be classified as debt investment instruments.

(b) Subordination

(37) In accordance with the guidelines, the level of subordination in the event of bankruptcy had to be considered. The IBG Fund silent participations are subordinated to loans and other liabilities, but are senior to equity and never participate in the losses of the target enterprises; this is a typical feature of debt instruments. Subordination of unsecured or partially secured debt to the claims of senior creditors is standard practice. While the subordinated IBG Fund silent participations are indeed more risky than unsubordinated debt, this is reflected in the risk-adjusted interest rate. For these reasons the subordination to other creditors does not in itself lead to classification of the IBG Fund silent participations as quasi-equity instruments.

(c) Security

(38) The Guidelines require that a debt instrument, in order to qualify as such, must be at least partly secured. The fact that between 10 % and 30 % of the value of the IBG Fund silent participations is secured by guarantees given by the target enterprise shareholders must be taken into consideration. The low collateralisation requirements are largely explained by the fact that fast-growing technology SMEs do not have sufficient high-value collateral. Moreover, the partial security would seem to be adequate, considering the lower ranking of the IBG Fund silent participations. The subordinated and partially secured nature of the IBG Fund silent participations is appropriately reflected in the level of remuneration. It can therefore be concluded that the IBG Fund silent participations are partially secured, as required by the guidelines.

(d) Remuneration

(39) The Guidelines require that a debt instrument, in order to qualify as such, must have a predominant component of fixed remuneration. The profit-linked remuneration component of the IBG Fund silent participations is always at least 250 basis points lower than the fixed interest rate component. Besides, the fact that an additional fixed one-off exit remuneration can be added to the total remuneration of 13 % increases the predominance of the fixed remuneration in the total remuneration. The fixed interest rate component of the IBG Fund silent participations is thus the predominant remuneration component, as required by the guidelines.

⁽¹⁴⁾ Equity providers usually make capital available for the long term, with no right to repayment and no security. In return, they receive a share of the equity and obtain their return by exiting from the investment at the end of the investment period.

(e) Ownership change-of-control clauses

- (40) Having assessed the detailed information provided by the interested party, the Commission has concluded that the information and ownership and change-of-control clauses of the IBG Fund silent participations appear to be similar to those of unsecured or partially secured subordinated debt instruments, which usually require intensive monitoring and detailed and prompt information on the economic progress of the companies, and define specific financial indicators or covenants which the company must observe. In terms of the information and ownership and change-of-control clauses of the IBG Fund silent participations, therefore, these instruments can be classified as debt instruments.

(f) Termination of contract

- (41) In the opening decision, the Commission acknowledged that the IBG Fund conditions for terminating a silent participation contract seem to be similar to those of debt instruments in that the investments can be terminated in case of breach of contract, non-compliance with agreed conditions, incorrect information and change of control. The Commission has taken into consideration that the differences in the terminology merely reflect the specific nature of the IBG Fund silent participations as compared to standard debt instruments. Therefore, apart from the differences in terminology, the termination provisions of the IBG Fund silent participations are in principle similar to those of standard debt instruments.

(g) Legal, accounting and tax treatment

- (42) The Commission finds that the German authorities and the IBG Fund have demonstrated that the IBG Fund silent participations are typical silent participations and are therefore considered to be debt instruments under the relevant German legislation (civil law, accounting law and tax law) and under the International Accounting Standards (IAS).

(h) Conclusion

- (43) After examination of the economic nature of the IBG Fund silent participations, and taking account of the legal, accounting and tax treatment of these instruments, the Commission finds that in economic terms the IBG Fund silent participations can be classified as debt instruments.

6.2.2. State aid status of the IBG Fund silent participations

- (44) The Commission has examined the IBG Fund silent participations in the light of Article 87 of the EC Treaty. Article 87(1) of the EC Treaty provides that 'any aid granted by a Member State or through State resources

in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market'. In order for a measure to fall within the scope of Article 87(1) of the EC Treaty, four criteria must be met:

- (a) the measure must involve the use of State resources;
- (b) the measure must distort or threaten to distort competition by conferring an advantage on the recipient;
- (c) the advantage must be selective in that it is limited to certain undertakings or sectors;
- (d) the measure must affect trade between Member States.

- (45) In its opening decision, the Commission concluded that, provided the IBG Fund silent participations could be classified as debt instruments, they would be considered debt instruments in line with market conditions under the 1997 notice. The instrument is also in line with market conditions under the 2008 communication, as the IBG Fund assesses the credit risks of each enterprise, including the level of subordination and collateralisation, and applies risk-adjusted interest rates.

- (46) It can therefore be concluded that the IBG Fund silent participations do not constitute State aid to the target enterprises within the meaning of Article 87(1) of the EC Treaty,

HAS ADOPTED THIS DECISION:

Article 1

The measure which Germany is planning to implement through IBG Beteiligungsgesellschaft Sachsen-Anhalt mbH, is not, as regards the silent participations, aid within the meaning of Article 87(1) of the EC Treaty.

Article 2

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 8 October 2008.

For the Commission
Neelie KROES
Member of the Commission
