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Rescue and Restructuring Aid[*]

1. Economic Background

Rescue and Restructuring aid ("R&R Aid") is defined as state financial assistance to an individual firm "in difficulty" that is, when "*without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term*".[1] Rescue aid is intended to provide only short term repayable finance, while restructuring aid provides a long term injection of finance on non-commercial terms. An individual firm, as distinct from an industrial sector, may be in difficulty because it is the only firm in the industry facing an idiosyncratic problem, or there may be an industry-wide factor that is affecting firms differentially, perhaps because of their particular productivity, market niche, quality of products or nimbleness.

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1. European Commission, Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, OJ 2014 C 249/1 ("R&R Guidelines").

1.1. Why R&R aid is generally a "bad thing"[2]

State aid granted to firms in difficulty is perceived very critically by the European Commission. Interference by national governments in the competitive process to help failing firms has particularly distorting effects on competition, as such firms should usually be allowed to fail and exit the market.[3] Aid to individual firms in difficulty puts a brake on the normal process by which the most innovative and efficient firms see their market share grow because they better serve the needs of consumers, while less productive competitors or those less capable of addressing consumer needs exit the market. This insight is sometimes unpopular because it can be misrepresented as doctrinaire and even callous as closures have serious implications for individuals and their families. The short term political gain from 'defending' a local firm can therefore be significant for a national government even if it distorts competition, harms long term consumer interests and is ultimately a waste of public resources.

Recent economic research shows that much of aggregate productivity growth can be attributed to shifting market share from less productive to more productive companies. This is quantitatively more important than from improvements in the productivity of incumbent firms. Exit is thus a major source of productivity growth. Following Schumpeter, this process is often termed 'creative destruction'.[4] In the case of an industry-wide downturn in demand (or increase in costs relative to customer willingness to pay), and in the presence of some degree of economies of scale, a shrinking market will support fewer firms in the long run. The speed and order of exit depends on relative efficiencies and scale, but it is to be expected that inefficient firms exit first and if two firms have the same costs the larger one will reduce its size first.[5]

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2. Sections 1 and 2 draw heavily on Bruce Lyons, John van Reenen, Frank Verboven and Xavier Vives 'EAGCP Commentary on European Community Rescue and Restructuring Aid Guidelines' (2008) available at http://ec.europa.eu/dgs/competition/economist/eagcp.html. *See* also Maier-Rigaud, F. and Milde, C. (2015), The Rescue and Restructuring Aid Guidelines of the European Commission: An Economic Point of View, *World Competition*, 38(2), pp. 189–214.
3. Lienemeyer and Soukup, in: Mederer, W., Pesaresi, N. and van Hoof, M. (2008, eds.), *EU Competition Law*, Vol. IV, State Aid, Book two, Leuven: Claeys and Casteels, para. 4.983 et seq.
4. Research into industry dynamics shows that the key difference between the US and EU appears to be that although entry rates are similar, both post entry growth of efficient firms and exit of unproductive firms are slower in the EU than the US. Part of this could be due to greater resistance in EU Member States against creative destruction as an essential feature of progress, with consequences for the overall level of productivity.
5. For the economic theory, *see* Ghemawat, P. and Nalebuff, B. (1985), 'Exit', *RAND Journal of Economics*, 16(2), pp. 184–195; Fudenberg, D. and Tirole, J. (1986), A Theory of Exit in Duopoly, *Econometrica*, 54(6), pp. 943–960; Whinston, M.D. (1988), Exit with Multiplant Firms, *RAND Journal of Economics*, 19(4), pp. 568–588; Ghemawat, P. and Nalebuff, B. (1990), The Evolution of Declining Industries, *Quarterly Journal of Economics*, 150(1), pp. 167–186; Murto, P. (2004), Exit in Duopoly under Uncertainty, *RAND Journal of Economics* 35(1), pp. 111–127.

This process can be distorted by financial subsidies which allow either an inefficient business to survive the competitive (evolutionary) war of attrition at the expense of a more efficient one, or a larger firm to maintain its scale at the expense of a smaller one.

There are many reasons why a once-profitable firm may become loss-making, but they generally fall under two headings: increase in relative costs or loss of demand. If a firm fails to reduce its costs in line with its rivals or sees its costs grow out of line, it will eventually find itself unprofitable and in financial distress. The inability to sell at a price in excess of costs is either a sign that an inefficient senior management team is at work or a market signal that the firm's resources would be better used elsewhere. Similarly, if a particular firm's product range loses its customer appeal relative to that of its rivals, it may become unprofitable. This is also an essential market mechanism by which customer preferences drive the pattern of production. Loss making is the market signal that resources are better used elsewhere. Firms must adapt to changing tastes or they risk failure. State subsidies can undermine the market process by reducing the incentive for firms to respond speedily to innovation opportunities, cost control and changing consumer tastes.

The implications go beyond the firm receiving a subsidy. R&R aid has important externalities on rival firms. It results in a higher market share for the subsidised firm at the expense of its unsubsidized rivals. Already the expectation of R&R aid reduces the cost of capital for firms likely to receive such aid.[6] All this has an impact on productivity and the distribution of employment. In most cases, the consequence for rivals is that they will see their output and employment fall. R&R aid also affects potential entrants as the prolonged existence of firms in difficulty makes it harder for entrants to increase their market shares and thus makes entry of potentially more efficient firms less likely.[7]

Distortions of competition and the corresponding negative externalities for rival firms extend to several levels. Most commonly considered, and by its very nature, R&R aid distorts competition between firms in the same sector. Competition can also be distorted between firms from different sectors which nevertheless are competing for the same customers on the same markets. One example is R&R aid received by an airline company affecting bus or train companies. Yet another level of distortion of competition is between rivalling firms residing in different EU Member States with

6. This is a particular concern under the realistic assumption that large and/or state-owned firms have more political leverage compared to small and medium-sized firms and are therefore more likely to receive R&R aid (Maier-Rigaud and Milde, (2015)).

7. Maier-Rigaud and Milde (2015).

different capacities to extend R&R aid. So-called *'deep pocket distortions'*[8] have the potential to unlevel the playing field as, for instance, a firm receiving R&R aid is becoming more competitive vis-à-vis rival firms from EU Member States which cannot afford to extend R&R aid or decide not to.[9]

One important exception is when the failure of one firm results in a loss of consumer confidence in the market as a whole. The most important example is a bank failure, which can panic customers of other banks into withdrawing deposits and so create a generalised liquidity crisis. In more serious cases a bank's bankruptcy leads to a write-down of inter-bank debt which undermines the viability of rival firms. Such contagion is less likely outside the financial system. As the global consequences of the failure of Lehmann Brothers showed in 2008, however, the inter-connected banking system carries an inherent danger of systemic failure and so requires special consideration.[10] The prospect that a firm might receive R&R aid also has important indirect effects on the incentives faced by all firms in the market creating moral hazard issues. First, inefficient firms who anticipate a financial safety net will take greater risks. This is equally true for investors and stock-holders of such firms and will in turn precipitate more such crises. Second, efficient rivals who do not anticipate having to call on R&R aid can expect to face more reckless and inefficient rivals whose demise will be slowed down by an injection of state aid and artificially bolstered investor confidence. Consequently, an efficient firm might invest more conservatively. This anticipation effect shifts market shares from more efficient to less efficient firms even before any firm gets into difficulty. Thus, actual and prospective R&R aid can have far-reaching adverse effects on business behaviour beyond the narrow confines of the local aid decision.

8. Almunia J., 'Doing More with Less—State Aid Reform in Times of Austerity: Supporting Growth Amid Fiscal Constraints' (King's College London, London 11 January 2013) as referred to by Agnolucci, I. (2022), Will COVID-19 Make or Break EU State Aid Control? An Analysis of Commission Decisions Authorising Pandemic State Aid Measures, Journal of European Competition Law & Practice, 13(1), pp. 3-16.

9. Motta, M. and Peitz, M. (2020), State Aid Policies in response to the COVID-19 Shock: Observations and guiding principles. *Intereconomics*, 55(4), pp. 219-222. *See* also Agnolucci (2022) for an assessment of the geographical distribution of state aid during the Covid-19 pandemic and the use of R&R aid. Interestingly this distortive effect would then be mitigated if aid is given consistently throughout all EU Member States, an element typically not considered by the EC in its assessment.

10. In practice, this means a greater readiness to grant support at least in the short run. Between 1 October 2008 and 1 October 2014, the Commission authorized total aid worth 30% of annual EU GDP for guarantees on liabilities, 6% for recapitalization, 3% for short term liquidity support and 1.4% for asset relief (Lyons and Zhu, 2013). Not all of this was actually used, but it provides some perspective given that aid to non-financial firms over the same period was just over 3% of annual EU GDP. This reflects both the scale of the financial crisis and the Commission's understanding of what was necessary to restore order to the dangerously inter-connected financial system.

1.2. Is R&R aid ever justifiable?

A number of justifications can be proposed, including market failure, social hardship and specific externalities. We first consider whether a justification for R&R aid can be found in market failure in financial markets. Do creditors, including shareholders and banks, have sufficient foresight and the appropriate incentive to finance long-term viable firms which are in short term financial difficulty? The answer can depend on the details of different national liquidation and reorganisation laws (i.e. bankruptcy law). There is no space in this chapter to elaborate on national idiosyncrasies, other than to suggest that it would be unwise to build EU policy around such features.[11] Instead, we highlight some general threads of analysis.

The starting point is that firms should shut down when they can no longer cover their cost and this situation is unlikely to only be temporary. A Type 1 error arises if an efficient firm is pushed into bankruptcy too soon. A Type 2 error arises if an inefficient firm continues in business too long. Collectively, these two types of error are known as filtering failures. Additionally, there can be inefficiencies if a firm continues to invest in inefficient projects (or fails to invest in efficient ones). A particular example of inefficiency is when a firm adopts an investment strategy that is too risky. It is important not to focus on only the Type 1 error as to do so only increases the other sources of error. Good policy requires a balanced approach weighing the respective costs associated with the potential errors.

The following characteristics are common to most systems. Investment and bankruptcy decisions can be influenced by the existence of different priorities for creditors (e.g. suppliers, banks, bond holders, shareholders). There are also agency issues between creditors and managers. In the event of bankruptcy, there is usually a strict priority of creditors, with a status quo of higher priority creditors being paid in full before the next priority level until assets are exhausted (this is known as the 'absolute priority rule'). Limited liability means that shareholders can lose their entire

11. For example: 'In France, bankruptcy officials appointed to decide whether firms in bankruptcy will be liquidated or reorganised have "safeguarding the business" and saving jobs as their primary objectives. However, in the UK and Germany, bankruptcy procedures are more pro-creditor than in the US or France and reorganisation is less likely to occur"; White, M., 'Bankruptcy Law' draft chapter in: Polinsky, A.M. and Shavell, S. (2005, eds.), *Handbook of Law and Economics*, North-Holland. Also, in the US, senior managers have the right to file for bankruptcy reorganisation under Chapter 11 as an alternative to Chapter 7 bankruptcy liquidation. *See also* White, M. (1989), The Corporate Bankruptcy Decision, *Journal of Economic Perspectives*, 1989 3(2), pp. 129–151, and White, M., Economics of Corporate and Personal Bankruptcy Law, entry in *New Palgrave Dictionary* (2007). For the likely prognosis of firms in financial difficulty, *see* European Commission (2009) 'Should aid be granted to firms in difficulty? A study on counterfactual scenarios to restructuring state aid', Report prepared by Oxera.

investment in a firm, but creditors cannot claim against a shareholder's private assets. The supervisory system for managers usually aligns their incentives most closely with shareholders. Because limited liability restricts the consequences for equity holders in the event of very bad outcomes, it encourages managers to take more risks (i.e. managers do not take creditor losses fully into account).

There are several externalities between creditor types which can result in financially-induced biases in relation to exit and reorganisation. If high priority creditors perceive that the firm is in decline, though with a reasonable chance of recovery, they may still try to push the firm into bankruptcy so that they can be paid off with certainty (i.e. they do not take low priority creditors fully into account). There are, however, other biases working in the opposite direction. Managers may start taking ever increasing risks as bankruptcy looms because by this time shareholders can only retrieve their investment if a positive long shot works out. Furthermore, firms in difficulty can sometimes borrow by giving the lender the status of first creditor priority to the disadvantage of other creditors. Overall, the fact that firms often enter bankruptcy with far higher liabilities than assets suggests that the balance of these biases is to keep failing firms going longer than is efficient.

A firm in difficulty may have been caught out by surprise events and so request time and resources (i.e. state aid) to renegotiate loans. While this may be collectively beneficial if the difficulty was a genuine surprise, it can be of particular benefit to managers and shareholders. The former keep their jobs for longer and the latter can normally negotiate away from the absolute priority rule by offering creditors a partial payment that might still be more acceptable (e.g. quicker or more certain) than the alternative of liquidation. Such renegotiation subsidies tend to exacerbate any bias that delays bankruptcy, and an expectation of state subsidies further reinforces this bias that keeps failing firms in operation too long.

Sometimes there may be forces that work in the opposite direction. For example, reorganisation requires the consent of numerous creditors with differing priorities, so it is possible that there could be a coordination failure between dispersed creditors with diverging interests. The main issue here is to allow sufficient time and create sufficient incentive for creditors to agree. This should be only a very short term problem and so relates only to rescue, not restructuring aid. The prospect of the latter only reduces the cost of delayed agreement – so making disagreement more likely. Another argument is that creditors and financial markets do not have all the information that managers have as to the continuing viability of a firm. It is extremely unlikely, however, that any authority deciding on state subsidies will have better information and therefore make a better funding decision. Financial markets and creditors have a strong financial incentive to acquire and interpret information accurately.

Overall, while there are arguments that can conceivably go either way, corporate finance and bankruptcy law do not create a fundamental bias that can justify R&R aid other than in very exceptional circumstances. More generally, outside of a financial crises or in a situation free from sector-specific market failures or temporary shocks, justifications for R&R aid are unlikely to be justified. The reason is twofold. First, market failure tends to be structural and a permanent feature of the market. It is therefore unclear how such a difficulty would only affect one firm in the market while others continue to operate without difficulties. Second, R&R aid is a one-off intervention treating conditions in the affected firm and not targeting the source of the market failure and can therefore not be a suitable instrument to overcome the causes for structural difficulties of a permanent nature.[12]

We next turn to alternative economic justifications based on social hardship and externalities. Two considerations should always be kept in mind. First, as already discussed, if a firm expects R&R aid in the event of it getting into financial difficulties, this weakens its incentives to avoid such difficulties in the first place (e.g. taking undue investment risks or conceding unrealistic wage claims). Second, there are often alternative interventions that are better placed to solve the problem without so many undesirable side-effects.

The closure of a large business can have a significant local impact, particularly on employment and with knock-on effects on other local businesses.[13] This may properly be a justification for some form of aid to ease transition or preserve technical knowledge. It is unlikely, however, that R&R aid will be the best form of targeting such aid. Local workers are unlikely to benefit most from the aid, as a financial injection (e.g. a grant, tax exemption or soft loan) most immediately benefits shareholders. The aid also imposes costs on taxpayers and potential beneficiaries of social spending that is squeezed (e.g. education, state pensions). Even taking only local issues into consideration, it will normally be better to subsidise retraining, infrastructure and/or new investment in the region, and not to subsidise an ailing firm unless it is of systemic relevance to the region or under temporary distress not caused by the firm itself and also affecting its rivals. Finally, there are political economy reasons (e.g. lobbying and

12. Maier-Rigaud and Milde (2015). *See* also the following recent contribution for an assessment of R&R aid: Sonderegger, G. (2019), A Critical Analysis of Rescue and Restructuring Aid. *Eur. St. Aid LQ*, 264.

13. This knock-on, or local multiplier, effect is often overestimated, especially if there are other local firms which require similar labour skills. For example, *see* Jofre-Monseny, Sanchez-Vidal and Viladecans-Marsal 'Big plant closures and agglomeration economies', Institut d'Economia de Barcelona, working paper 2015/19.

political pressure according to where swing voters are located) which distort the allocation of aid such that it is not necessarily the most worthy firms/areas that are likely to receive R&R aid – in the absence of tightly specified rules focusing on the economic justification for aid, it is firms with the most powerful political lobby, and not those with the best economic justification, that will receive R&R aid.[14]

We have already highlighted the particular case of inter-connected financial markets that can suffer from serious contagion. This creates a negative externality on both consumers and rivals if a systemically important bank (or other major financial institution) fails, thereby providing an important justification for R&R aid. Relatedly, bank failures result in insufficient lending capacity in the banking system, which contrasts with non-bank firms which typically get into difficulty due to excess capacity in the industry. Similarly in the context of a particular region, the monopoly provider of a SGEI (Service of General Economic Interest) conveys positive externalities on firms in the locality, and its failure would have serious consequences. Further, we will discuss in more detail in the next section the case of sector-specific shocks, as for example during the Covid-19 pandemic, and possible economic justifications for R&R aid due to credit constraints for viable firms under temporary demand shifts. None of these reasons, however, justify excessive aid and the case for controlling the level of such aid and imposing conditions, as discussed below in relation to the legal framework and guidelines, is undiminished.

Another potential justification for some form of intervention arises if another country is subsidising a global competitor. There may then be an incentive for counter-subsidies if that would shift profits to a Member State's 'national champion'. There are numerous caveats to this argument, but one relevant point in the context of R&R aid is that such aid is typically given when a firm is making a loss, so that possible benefits of shifting profits are not clear. There are circumstances under which aid will clearly not be beneficial if it is given to shift demand to a loss-making local firm without affecting production cost. If external subsidies are being used in a predatory manner and would disappear in the event of exit by the European firm, there is, however, a potential justification for intervention. Nevertheless R&R aid may not be the right instrument to address the issue as Foreign Subsidies Regulation, bilateral negotiations or anti-

14. Most R&R aid cases are not in deprived areas. There are twice as many rescue cases outside assisted areas as there are in them, and 50% more restructuring cases are not in assisted areas as are in them. Note also that if the regional economy is buoyant, R&R aid adds to labour scarcity in other related sectors of the region. For more details, *see* European Commission (2004), Ex-post evaluation of the impact of rescue and restructuring aid on the international competitiveness of the sector(s) affected by such aid, Report prepared by London Economics, Table A3.1.

dumping and anti-subsidy external trade measures may be a better choice to address the concerns. These have much more attractive properties in that they can bring about a reduction or elimination of the extra-EU subsidy and they do not impose a negative externality on other EU firms. In this context, rescue aid may be justified as a short term measure to keep a firm in business pending a negotiated settlement.

Inasmuch as aid to a SME (Small and Medium-sized Enterprise) is less likely to affect cross-border trade within Europe, it is unlikely to have some of the harmful externalities described above. Nevertheless, it may delay the selection of the best from a group of SMEs competing with each other to grow and succeed in the market. Slower exit also leaves less room for innovative new entry.[15]

1.3. Good aid after economy or sector-wide shocks

Sector-wide or economy-wide shocks such as the Covid-19 pandemic call the above-mentioned economic arguments against R&R aid into question.[16] During the pandemic some markets have disappeared overnight, and some firms' assets have been rapidly depleted as a result of a combination of demand and supply shocks. Otherwise viable firms found themselves in difficulty to obtain liquidity in a temporarily uncertain economic environment. The rationale for R&R aid under these conditions is to allow otherwise viable firms to remain in the market so that no capital accumulated in these firms is destroyed.[17]

R&R aid is warranted in situations when shocks are only temporary and when the market is likely to revert back in the short run as such aid could then prevent the destruction of the accumulated capital such as know-how, equipment and machinery. Rescue aid could then avert damage to the economy arising from the bankruptcy of firms otherwise perfectly fit for survival and only temporarily in distress due, for example, to a pandemic. Rescue aid in a situation where all firms within a sector are affected by a transitory shock helps to stabilize the supply of goods and services once demand normalises again. If the destruction of the combined existing know-how, technology and machinery is not prevented, it may be much more costly to build up the industry in a particular sector afterwards than to temporarily ensure that all assets are

15. The lower entry and exit rates of small firms in Europe provides a sharp contrast with the US economy which has proved more successful in productivity growth and innovation.

16. The Covid-19 pandemic has had comprehensive effects on the whole economy with several sectors being extremely affected, such as the food, leisure and transport sectors. *See*, for example, Bloom, N., Bunn, P., Chen, S., Mizen, P. and Smietanka, P. (2020), The economic impact of coronavirus on UK businesses: Early evidence from the Decision Maker Panel. *VOX CEPR Policy Portal, 27th March.*

17. Motta and Peitz (2020).

maintained. A similar situation may be present, when the crisis affects only small firms. If only large companies survive as small and medium-sized companies are forced to exit the market, it is not clear whether new entry will be sufficient in scope and timely enough to counter the increase in concentration in the industry.[18] In addition, some of the negative effects of R&R aid tend to be less pronounced in case of unexpected sector-wide shocks. Moral hazard is less prevalent when, for example, the difficulties cannot be attributed to lack of precautionary measures of individual firms but are related to general developments.[19]

Granting R&R aid, however, can become problematic when sector-specific shocks are not temporary but transform the sector and therefore require sector-wide restructuring. That is the case if the shock profoundly transforms the industry, changes the products, or fundamentally alters supply and demand.[20] Under such conditions, granting R&R aid may interfere with the market adaptation processes. Firms may be kept alive that stick to their pre-crisis business models or are less able to adapt to the new situation.

1.4. Ex-post evaluation of the effectiveness of R&R and its effect on competition

There is a growing body of research into the effectiveness of R&R aid in achieving its most immediate objective, which is the viability of the aided firms. A number of studies have sought to evaluate the *ex-post* effectiveness of R&R aid, almost always specifically in relation to the survival of aided firms.[21] This research does not provide much insight

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18. Besides the increased concentration this also is likely to have effects on social inequality. See for example Autor, D., Dorn, D., Katz L. F., Patterson Ch. And J. Van Reenen (2020) The Fall of the Labor Share and the Rise of Superstar Firms, Querterly Journal of Economics, 135(2), 645-709.

19. The Covid-19 pandemic is a case in point. See Neven, D. J. (2020), The EU rescue and restructuring guidelines. Fit for purpose?, Journal of Antitrust Enforcement, 8(2), 290-292.

20. For example, it is still unclear whether passenger numbers in the airline industry post-Covid will recover or whether there is a lasting impact on the sector requiring more substantial structural adjustments.

21. Bolsa Ferruz, M.A. and Nicolaides, P. (2014), An economic assessment of state aid for restructuring firms in difficulty: theoretical considerations, empirical analysis and proposals for reform, *World Competition*, 37(2), pp. 207–234; Chindooroy, R., Muller, P. and Notaro, G. (2007), Company survival following rescue and restructuring state aid, *European Journal of Law and Economics* 24(2), pp. 165–186; Glowicka, E. (2006), Effectiveness of bailouts in the EU, *GESY Mannheim Discussion Paper No. 176*; London Economics (2004); Nulsch, N. (2014), Is subsidizing companies in difficulties an optimal policy? An empirical study on the effectiveness of state aid in the European Union, *IWH-Diskussionspapiere*, No. 2014-9; European Commission (2009), Should aid be granted to firms in difficulty? A study on counterfactual scenarios to restructuring aid, *Report prepared by Oxera*; European Commission (2016), Ex-post evaluation of the impact of restructuring aid decisions on the viability of aided (non-financial) firms, *Report prepared by Wifo, SPI, Ecorys, ZEW and Idea Consult*; Heim, S., Hüschelrath, K., Schmidt-

into either the market-wide effects on other firms and customers, or on employment effects. A range of statistical methods, time periods and samples are used and the wide range of industries, firm sizes and member state contexts mean that the statistical findings are unlikely to be precise when applied to specific cases.[22] Nevertheless, these studies do provide a reasonably clear picture in relation to viability. We use the findings from European Commission (2016) as illustrative of this body of research.[23] Out of 60 firms in their sample, half were still active and independent at the time of the study, a further quarter had been acquired but were still active and the remaining quarter had exited or were subject to a bankruptcy process.[24] 61% of firms improved their return on capital employed, with just over half of the 13 with a negative initial ROCE (Return On Capital Employed) moving positive in one year and the others taking up to 6 years. There is evidence that this would not have happened in the absence of the aid. As compared with a sample matched by pre-aid financial, employment, industry and member state characteristics (i.e. apparently similarly distressed firms) which did not receive R&R aid, the survival probability was 14%-18% higher for the aided firms. Other studies show that: productivity increases, more by increased sales than by reduced employment;[25] restructuring aid is more beneficial to survival than rescue aid alone;[26] the average cost of saving a job is nearly €50,000, which is 1.7 times the average wage, and average aid per worker is much higher in capital intensive industries, which apparently limits the employment benefits.[27]

Research evaluating competition and moral hazard related outcomes is available in the context of the financial crisis and corresponding bank bailouts. Banks that benefited

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Dengler, P. and Strazzeri, M. (2017), The impact of state aid on the survival and financial viability of aided firms. *European Economic Review*, 100, pp. 193-214.

22. For a helpful review, *see* Annex 1 in European Commission (2016) "Ex-post evaluation of the impact of restructuring aid decisions on the viability of aided (non-financial) firms" Report prepared by WIFO et al..

23. As in most studies, this sample has its quirks. 40% of the firms were located in Poland (four of which were for bus services), 22% in France or Italy, with the remaining cases spread thinly across 14 Member States. Two-thirds of the cases were in 2011 or 2012, with the others spread over 2003–2010. Two-thirds of cases were for firms employing fewer than 500. Over a third of firms received <€2.5m in aid and just under a third each received €5m-€50m; 8% received >€500m. 42% of aided firms received debt write-offs or other equity benefits, 40% direct grants, and 28% soft loans or guarantees.

24. This is very similar to the 77% survival after 3 years found in European Commission (2009). By way of putting this survival rate in context, it may be helpful to compare this survival rate with successful businesses that underwent the shock of a forced transfer of ownership. A study of the survival of divested businesses that were necessary to remedy the potentially anti-competitive effects of mergers, found that 94% were still operating after three to five years, 7% of which had been sold on to a new buyer. *See also* European Commission (2005) 'Merger remedies study' *Report by DG Competition*.

25. European Commission (2004).

26. Glowicka (2006), Chindooroy et al. (2007), Nulsch (2014).

27. Bolsa Ferruz and Nicolaides (2014).

from the Troubled Asset Relief Program (TARP) were found to exhibit increased market power after the intervention.[28] Already the existence of TARP distorted competition indirectly through bailout expectations.[29] With respect to moral hazard, it has been found that bailout expectations can lead to increased risk taking for banks.[30] There are also a few studies investigating the imposed measures intended to limit the distortions of competition arising from R&R aid. For instance, no price cutting rules or price leadership bans imposed as behavioural measures after bank rescues and limiting banks in setting competitive prices after receiving R&R aid have the potential of stifling competition as this encourages rivals to increase prices or facilitates collusion.[31] Whatever the economic justification, R&R aid needs to be carefully scrutinised to make sure that its negative consequences are kept to a minimum and are outweighed by the benefits of the aid.[32]

2. Legal Framework

2.1. General principles

Under Art. 107 (3) c) TFEU, the Commission can allow aid measures which "*facilitate the development of certain economic activities* […] *where such aid does not adversely affect trading conditions to an extent contrary to the common interest*". The Commission has adopted its 2014 Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty[33], which set out the criteria under which EU Member States can grant public funding to companies that are in financial difficulty in line with EU state aid rules.[34]

As a general principle, when exceptionally approving aid for a firm in difficulties, the Commission wants to ensure that the aid enables the beneficiary to return to long-term

28. Berger, A. N. and Roman, R. A. (2015), Did TARP banks get competitive advantages?. *Journal of Financial and Quantitative Analysis*, 50(6), pp. 1199-1236.

29. Koetter, M. and Noth, F. (2016), Did TARP distort competition among sound unsupported banks?. *Economic Inquiry*, 54(2), 994-1020.

30. Dam, L. and Koetter, M. (2012), Bank bailouts and moral hazard: Evidence from Germany. *The Review of Financial Studies*, 25(8), pp. 2343-2380.

31. Lyons, B. and Zhu, M. (2013), Compensating competitors or restoring competition? EU regulation of state aid for banks during the financial crisis. *Journal of Industry, Competition and Trade*, 13(1), 39-66; Dijkstra, M. and Schinkel, M. P. (2019). State-aided Price Coordination in the Dutch Mortgage Market, Amsterdam Law School Research Paper No. 2019-07.

32. There is a strong case that the negatives are, in practice and in the absence of specific industry or sector-wide effects, unlikely ever to be outweighed. For more details *see* Maier-Rigaud and Milde (2015).

33. OJ 2014 C 249/1.

34. For a short historical overview see Mamdani, G. and Ritzek-Seidl, S., in: Pesaresi, N.,van de Casteele, K., Flynn, L. and Siaterli, C. (2016, ed.), EU Competition Law Vol. IV, State Aid, Book two, Leuven: Claeys & Casteels, para. 3.821.

viability without permanent state support. R&R aid thus leads to a double benefit for the firms concerned: the beneficiaries are saved from going bankrupt, and they are even assisted (and forced) to become viable and efficient again. The detriment for other market participants is obvious. Given these immediate detrimental effects on competition and the absence of immediate counterbalancing other public policy interests, the Commission requires compensatory measures for the distortion of competition caused by the aid.

The strict conditions for aid measures can be perceived as a sort of "consideration" of the beneficiary in exchange for the Commission's lenient approach to allow R&R aid. Moreover, they are sufficiently strict and painful to ensure that only firms in acute and serious difficulties and with a genuine need of state support apply for R&R aid.

In general, although the R&R guidelines are rather detailed, the Commission enjoys considerable flexibility when applying them.[35] It is true that, in adopting such rules, the Commission imposes a limit on the exercise of its discretion[36] under Art. 107 (3) TFEU and, in principle, cannot depart from those rules, without violating general principles of law, such as equal treatment or the protection of legitimate expectations[37] . However, while the Commission, is bound by the guidelines that it issues, the adoption of such guidelines does not, relieve it of its obligation to examine the specific exceptional circumstances relied on by a Member State, in a particular case, for the purpose of requesting the direct application of Article 107(3) TFEU. This applies, especially if the Commission did not have the specific constellation in mind when it adopted the guidelines. This does not constitute a violation of the principles of equal treatment, legal certainty or the protection of legitimate expectations.[38]

2.2. The review of the R&R guidelines as a key element of SAM

The review of the R&R guidelines was a key element of the State Aid Modernisation (SAM) programme. [39] Since the previous guidelines were adopted in 2004,[40] the Commission has gained significant experience, in particular during the financial crisis.

35. General Court, Case T-79/14, Secop GmbH v Commission, ECLI:EU:T:2016:118, para. 29.
36. General Court, Cases T-115/09 and T-116/09, Electrolux AB v Commission, EU:T:2012:76, para. 40.
37. CJEU, Case C-431/14 P, Greece v Commission, EU:C:2016:145, paras 70 to 72; CJEU, Case C-526/14, EU:C:2016:570, Kotnik and Others, para. 4.
38. General Court, Case T-657/20, Ryanair v. Commission, ECLI:EU:T:2022:390, para. 77 et seq.
39. Mamdani and Ritzek-Seidl (2016), para 3.830.
40. OJ 2004 C 244/2.

Even though the financial sector is excluded from the scope of the (general) R&R guidelines,[41] they have been inspired by the “banking cases”.

The 2014 R&R guidelines, which have been extended until the end of 2023[42], are not a revolution but rather an evolution of the previous guidelines and the Commission's case law. The main changes involve:

- Different from previous guidelines, the Member State has to demonstrate positive effects, i.e. the aid should contribute to achieving an objective of common interest. The 2014 guidelines strengthen the test of whether aid has beneficial effects by introducing “filters” ensuring that the aid will bring benefits to society, for example by saving jobs and the other justifications discussed in section II above. Previous guidelines did not contain such a test.
- Based on its experience during the financial crisis, the 2014 guidelines require that the owners (including subordinated creditors) of companies that receive aid contribute to the costs of restructuring. This principle of “burden sharing” has been contained in the previous guidelines, but it has been strengthened to the effect that the firm's owners should bear any losses first, and that the state will receive a fair share of any future gains.
- In addition, the 2014 guidelines contain a concept of temporary restructuring support, which allows loans and guarantees to be granted to SMEs for up to 18 months on simplified terms.
- The 2014 guidelines include some general SAM principles, like the requirement to conduct ex post evaluations of aid >€15m and aid “containing novel characteristics”.

The revised guidelines represent a significant step towards a clearer focus on the economic effects of aid and the incentives it creates. This “refined economic approach” is in line with the Commission's general State aid policy. EU Member States will have to provide a more precise statement of the social benefits of the aid and an explanation of how the firm got into difficulty. These will be used to determine proportionality, including burden sharing and “own contribution”. The clearer requirement in relation to “burden sharing” is also an important step towards a focus on effects.

It will be difficult for EU Member States to provide a credible analysis of the social hardship that the aid is intended to prevent, especially if the granting authority is inexperienced and poorly resourced. It is also problematic that the beneficiary and

41. Para. 17 of the R&R guidelines.

42. OJ 2020 C 224/2.

Member State will be required to provide an "*assessment of the role of any flaws in the beneficiary's business model…and the extent to which the difficulties could have been avoided through appropriate and timely management action*"[43] because they will have a strong incentive to blame outside influences and the Commission may not have the resources to fully test their claims.

2.3. No block-exemption for R&R aid

Different from other categories of aid, R&R aid is not exempted from prior notification to the Commission under the GBER (General Block Exemption Regulation = Reg. (EU) No. 651/2014).[44] Although the scope of block-exempted aid has been vastly expanded over the last decades, the Commission believes that block exemptions are only appropriate in clear cut cases of "good aid". Since the assessment under the R&R guidelines looks at the whole business of the company concerned, not just one particular project, it would be too complex to be reduced to a simple set of criteria.

Given the distortive nature of R&R aid described above, it seems unlikely that the Commission's approach will change fundamentally in the future. As a result, the Commission will maintain its strong role as a competition watchdog in the field of R&R aid and there will be very limited room to delegate state aid control to EU Member States' authorities as it has been intended by the GBER.

Nevertheless, a Member State can simplify the process of granting small amounts of aid to companies in difficulty by adopting aid schemes. Once a scheme has been approved by the Commission, grants of aid to individual companies do not need to be notified for prior authorisation, provided they meet the conditions of the scheme. The 2014 guidelines make clear that such schemes are the best way to grant aid to SMEs.[45]

2.4. Scope of application

2.4.1 Sectoral scope

43. "Indicative model restructuring plan" in Annex II para. 4 of the R&R guidelines.

44. OJ 2014 L 187/1, as amended by OJ 2017 L 156/1, OJ 2020 L 215/3, OJ 2020 L 89/1 and 2021 L 270/39.

45. Para. 104 et seq. of the R&R guidelines.

The R&R guidelines apply to all sectors apart from the coal sector, the steel sector[46] and those covered by specific rules for financial institutions.[47] In the fisheries and aquaculture sector as well as in agriculture the guidelines apply in modified form.[48]

2.4.2 Material scope: Meaning of 'undertaking in difficulty'

The notion of "undertaking in difficulty" is important in two aspects. On the one hand, only firms in difficulty are subject to the R&R guidelines and can therefore receive R&R aid. On the other hand, since state aid to such firms can seriously harm the competitive environment they are only allowed to receive aid under the rescue and restructuring guidelines. They are therefore generally excluded from other aid regimes, such as for example regional aid,[49] R&D&I aid,[50] climate, energy and environmental aid,[51] as well as others.[52] Specific exceptions from this general ban applied, however, during the Covid 19 crisis.[53]

As a general rule, an undertaking ('firm') is considered to be in difficulty when, without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term.[54] The definition of a "company in difficulty" has been subject to many discussions, in particular whether this qualification should be based on "hard" criteria (referring to key financial data of the company) or "soft" criteria (based on future expectations). Compared with the previous guidelines the definition has been significantly simplified, by removing any "subjective" elements and replacing them by new, objective criteria linked to financial indices that are frequently used by analysts to assess the health of a company, in particular whether its burden of debt is sustainable and whether it generates enough profits to cover its interest payments.[55]

46. Mamdani and Ritzek-Seidl (2016), para 3.841.
47. Under the 2014 R&R guidelines the special treatment of the financial sector remains in place, that is, the relevant provisions will not be integrated into the general guidelines for the time being.
48. Para. 104 et seq. of the R&R guidelines.
49. Guidelines on regional State aid, OJ 2021 C 153/1, para. 17.
50. Framework for State aid for research and development and innovation, OJ 2014 C 198/01, para. 10.
51. Guidelines on State aid for climate, environmental protection and energy 2022, OJ 2022 C 80/1, para. 14.
52. *P*ara. 24 of the R&R guidelines which provides that, if the term 'undertakings in difficulty' or 'firms in difficulty' is contained in other frameworks or guidelines, it should be interpreted in line with the definition in para. 20 of the R&R guidelines.
53. OJ 2020 C 224/2 and OJ 2020 L 215/3.
54. Para. 20 of the R&R guidelines.
55. Other criteria, for example the specifics of the business model of professional soccer clubs, are not to be taken into account, see General Court, Case T-732/16, Valencia Club de Fútbol v. Commission, ECLI:EU:T:2020:98, para. 77.

Under this "objective" test, a firm is considered to be in difficulty if at least one of the following circumstances occurs:[56]

(a) In the case of a limited liability company, where more than half of its subscribed share capital[57] has disappeared as a result of accumulated losses.
(b) In the case of a company where at least some members have unlimited liability, where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses.
(c) Where the firm is subject to collective insolvency proceedings[58] or fulfils the criteria under its domestic law for being placed in collective insolvency proceedings[59].
(d) In the case of an undertaking that is not an SME, where, for the past two years:
  (i) the firm's book debt to equity ratio has been greater than 7.5 and
  (ii) the firm's EBITDA interest coverage ratio has been below 1.0.

This test is, compared with the previous guidelines, relatively straightforward and therefore usually provides legal certainty.[60] In the past, i.e. under the previous guidelines, the test of an "undertaking in difficulty" was less straightforward which often led to protracted discussions on whether a firm could, mainly based on the "soft criteria", be considered as not (yet) being in difficulty (which was usually more advantageous given that it could benefit from "other types of aid").

Companies belonging to a larger business group[61] are normally not eligible for R&R aid[62], unless it can be demonstrated that the company's difficulties are intrinsic and are not the result of an arbitrary allocation of costs within the group[63], and that the

56. Para. 20 of the R&R guidelines.
57. The expression 'subscribed share capital' includes all contributions which current or future members or shareholders of a company have made or have irrevocably undertaken to make, *see* CJEU, Case C-347/20, *Zinātnes parks*, ECLI:EU:C:2022:59.
58. This covers all collective insolvency proceedings under national law, whether they are opened by the national administrative or judicial authorities of their own motion or on the initiative of the aid recipient, *see* CJEU, Case 245/16, *Nerea S.p.A.*, ECLI:EU:C:2017:521, para. 21 et seq.
59. The fact that an undertaking satisfies the conditions for being subject to collective insolvency proceedings under to national law is sufficient. However, the undertaking is not considered to be in difficulty solely on the ground that it became subject to collective insolvency proceedings after the aid was granted to it, *see* CJEU, Case 245/16, *Nerea S.p.A.*, ECLI:EU:C:2017:521, para. 30 et seq.
60. Mamdani and Ritzek-Seidl (2016), para 3.850.
61. On public undertakings *see* Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, para. 159 – *Complexul*.
62. Commission Decision of 2 March 2005, N 386/2005. Paras. 118 et seq. – *Fret SNCF*.
63. Commission Decision of 16 May 2020, N 726/2009, paras. 168ff. – *Fret SNCB*.

difficulties are too serious to be dealt with by the group itself.[64] Those (cumulative) conditions aim at preventing a group of undertakings from being able to have the State bear the cost of a rescue operation for one of the undertakings belonging to the group, when that undertaking is in difficulty and the group itself has created those difficulties or has the means to deal with them.[65] The pooling of cash is as such no indication that the difficulties have been caused by the group. Cash pooling is a common and widespread practice within groups of companies, which is intended to facilitate financing of the group while enabling companies in that group to make savings in respect of financing costs.[66] It is therefore of crucial importance to identify the aid recipient, which can be difficult in cases where the aid is being granted within the framework of a change of ownership.[67]

Where a company in difficulty creates a subsidiary, the subsidiary, together with the company in difficulty controlling it, will be regarded as a group and may receive aid under the conditions mentioned above.[68]

As under the previous guidelines, specific rules apply to newly created firms, which are generally not eligible for R&R aid even if their initial financial position is insecure.[69] This is the case, for instance, where a new undertaking emerges from the liquidation of a previous undertaking or merely takes over that undertaking's assets. An undertaking will in principle be considered as newly created for the first three years following the start of operations. Only after that period will it become eligible for aid under these guidelines, provided that:

(a) it qualifies as an undertaking in difficulty, and (b) it does not form part of a larger business group except under the conditions laid down above.[70] The aim of this ban of R&R aid to newly created players is to prevent the creation of unviable firms or loss-making activities, which, from the moment they are created, are dependent on State support.[71]

The guidelines also acknowledge that in some exceptional cases, it may be necessary to give liquidity support to companies that are not "technically" in difficulty, but that

64. Para. 22 of the R&R guidelines.; see also Commission Decision of 22 January 2018, Case SA.49619- *Uljanik Shipyard*.

65. General Court, Case, T-465/20, *Ryanair v Commission (TAP)*, ECLI:EU:T:2021:284, para. 36 et seq. and General Court, Case T- 577/20, *Ryanair v Commission*, ECLI:EU:T:2022:301, para. 45.

66. General Court, Case T- 577/20, Ryanair v Commission, ECLI:EU:T:2022:301, para. 51.

67. General Court, Case, T-511/09, *Niki Luftfahrt v Commission*, ECLI:EU:T:2015:284, para. 121 et seq.

68. Para. 21 of the R&R guidelines.

69. General Court, Case T-79/14, *Secop GmbH v Commission*,ECLI:EU:T:2016:118, paras. 30 et seq.

70. Para. 21 of the R&R guidelines.

71. General Court, Case T-79/14, *Secop v Commission*, ECLI:EU:T:2016:118, para. 32.

are facing a liquidity crisis through no fault of their own. Where such a financing crisis is genuinely driven by market conditions and not by poor management, rescue aid or temporary restructuring support could be provided to bridge the gap.[72]

These criteria for defining a firm in difficulty embrace firms which are not necessarily on the brink of bankruptcy but are in sharp decline. It is possible that this facilitates a smaller injection of aid in a timely fashion, but it is also possible that it provides an opportunity for such firms to lobby for aid they do not strictly need.[73]

2.5. Aid to cover the social costs of restructuring

The R&R guidelines also contain some special provisions on aid for the social costs of restructuring.[74] These are measures which are mainly targeted at the employees of an ailing firm. The whole section is a bit "out of place" in the R&R guidelines because it addresses, different from the rest of the R&R guidelines, primarily the question under which circumstances State measures have to be considered as State aid within the meaning of Article 107 (1) TFEU, whereas the other sections deal with the question of approval under Article 107 (3) c) TFEU. However, in practice such schemes to cover the social costs of restructuring often go hand in hand with classical R&R aid.

Restructuring normally entails workforce reductions. The R&R guidelines make it clear that EU Member States' labour legislation may include general social security schemes under which certain benefits are paid directly to redundant employees. Such schemes are not to be regarded as State aid.[75]

In addition, general social support schemes frequently provide for the government to cover the cost of benefits which an undertaking grants to redundant workers and which go beyond its statutory or contractual obligations. Where such schemes are available generally without sectoral limitations to any worker meeting predefined and automatic eligibility conditions, they are not deemed to involve State aid. On the other hand, if the schemes are used to support restructuring in particular industries, they may well involve aid because of the selective way in which they are used.[76]

The obligations of a company in difficulties to provide certain benefits to redundant workers, such as redundancy payments or measures to increase their employability, are part of the normal costs of business Therefore, any contribution by the State to those

72. Para. 19 of the R&R guidelines.

73. Para. 30f. of the R&R guidelines.

74 Mamdani and Ritzek-Seidl (2016), para 3.984.

75. Para. 31 et seq. of the R&R guidelines.

76. Para. 32 et seq. of the R&R guidelines.

costs are usually qualified as aid. This applies regardless of whether the payments are made directly to the undertaking or are administered through a government agency to the employees. However, the Commission would generally approve such support rather generously.[77]

Apart from these direct financial support measures, aid is often provided in connection with a particular restructuring scheme for training, counselling and practical help with finding alternative employment, assistance with relocation, and professional training and assistance for employees wishing to start new businesses. The Commission takes a favourable view of such measures, when it is granted to undertakings in difficulty.[78]

Aid to cover the social costs of restructuring of the type must be clearly identified in the restructuring plan.[79]

3. Rescue Aid

As a principle, the R&R guidelines cover two different types of aid: rescue aid and restructuring aid. This section will deal with rescue measures.

3.1. "Traditional" rescue aid

Rescue aid can be granted to keep a firm afloat over a short period of time to overcome sudden difficulties, and to give the company time to work out a restructuring plan which sets out how difficulties will be overcome.[80] As under the previous guidelines, rescue aid can be granted for a period of up to 6 months. Beyond this period the aid must either be reimbursed or a restructuring plan must be notified to the Commission for the aid to be approved as "restructuring aid".[81]

Given the limited admissible time for the use of rescue aid, it can in principle only consist of measures which are easily reversible. Thus, rescue aid essentially consists of liquidity support for an ailing firm and usually excludes irreversible structural measures such as capital injections.[82] The repayment conditions must be comparable to the conditions applying to healthy firms under normal market conditions.

77. Para. 34 et seq. of the R&R guidelines.
78. Para. 35 et seq. of the R&R guidelines.
79. Para. 93 of the R&R guidelines.
80 Mamdani and Ritzek-Seidl (2016), para 3.885.
81. Para. 55 of the R&R guidelines; Commission Decision of 10 September 2021, O.J. 2022 L 141/53, para. 370 – *Alitalia*.
82. Para. 55 of the R&R guidelines.

The R&R guidelines provide a "formula for calculation of the maximum amount of rescue aid or temporary restructuring support per six-month period".[83] Any aid exceeding the result of that calculation will only be authorised if it is duly justified by the provision of a liquidity plan setting out the beneficiary's liquidity needs for the coming six months.

In most cases, the full repayment of the aid within six months is not possible. Thus, the granting of rescue aid usually entails the necessity to submit a restructuring plan for the beneficiary firm. If the Member State fails to submit a restructuring plan, or if the submitted restructuring plan is clearly insufficient to enable the beneficiary firm to return to viability, the Commission will open a formal procedure.[84] In such a case, the rescue aid becomes illegal ex nunc after expiry of the initial six months deadline.[85] If, on the other hand, the Member State submits a restructuring plan which is prima facie in line with the requirements of the R&R Guidelines, the obligation to terminate the rescue aid is suspended until the Commission has assessed the restructuring plan.

The General Court made it clear that the procedural requirements for rescue aid are to be taken seriously. This applies, in particular, to the requirement that after the six months period, the aid must either be repaid or a restructuring plan must be notified.[86] In *Siremar v Commission*[87] the General Court had argued that, although there was no formal notification of a restructuring plan, the Commission had been regularly informed about the privatisation process, including through the parallel procedure under the European Merger Regulation. According to the applicant the restructuring plan had been drawn up before the expiry of the six-month period, which was apparently indicated on the company's website. Moreover, the aid had been repaid later (after the six-month period had expired). This was however not sufficient for the General Court (and the Commission), which was hardly surprising. In particular, the reference on the website was not equivalent to the formal submission of a restructuring plan. In the General Court's view, the Member State's approach also contradicted the nature of rescue aid as temporary and reversible aid.

The short term nature of rescue aid and the need for it to be repaid mean that it is much less likely to have negative economic effects than restructuring aid, so it is much less problematic for competition and general economic incentives. As a result, up to now, getting approval for rescue aid has always been relatively "unproblematic", i.e. the

83. Annex I of the R&R guidelines.

84. *See* also Commission Decision of 10 September 2021, O.J. 2022 L 141/53, paras. 370 et seq. – *Alitalia*.

85. Commission Decision of 24 April 2007, O.J. 2007 C 120 /12, para. 36 et seq. – *New Interline*.

86. Commission Decision of 10 September 2021, O.J. 2022 L 141/53, para. 371 – *Alitalia*.

87. General Court, Case T-668/21, *Siremar v Commission*, ECLI:EU:T:2022:677.

Commission usually adopted rescue very quickly and without any in depth assessment. Some impressive examples in the banking sector during the financial crisis are *Northern Rock*, [88] *Bradford & Bingley* [89] *and Hypo Real Estate* [90] where rescue aid was approved within a few days. However, recent Commission decision-making practice, even under the old guidelines, suggests a tougher stance. This change of policy can be highlighted by the famous Nürburgring case where the Commission refused to authorize rescue aid immediately, choosing to open a formal investigation which led to the bankruptcy of the company.[91] This more restrictive approach vis-à-vis rescue aid can also be seen from the decisions on *Adria Airways* [92] and *airBaltic*.[93].[94]

3.2. A new tool for SMEs: “temporary restructuring support”

Not to be confused with rescue aid is the new tool of “temporary restructuring support” to SMEs for a period of 18 months.[95] Measures falling under this category are targeted at SMEs (which often suffer from lack of appropriate access to credit) and consist of liquidity support (loans and guarantees) which are considered less harmful and less distortive types of aid. [96] In the case of temporary restructuring support the company does not have any obligation to provide a contribution from its own resources or to take measures to limit distortions to competition, but has only to produce a simplified restructuring plan explaining what it will do to restore its long-term viability.[97]

Temporary restructuring support seems most suitable for relatively straightforward cases. Where a company's problems go beyond pure liquidity difficulties, or where there is a complex business to restructure, temporary restructuring support is unlikely to be the appropriate choice. In any case, it is available only to SMEs.

4. Restructuring Aid

88. Commission Press Release of 5 December 2007 IP/07/1859, State aid: Commission approves rescue aid package for Northern Rock.
89. Commission Decision of 1 October 2008, Case NN 41/2008 – *Bradford & Bingley*.
90. Commission Decision of 2 October 2008, Case NN 44/2008 – *Hypo Real Estate Holding*.
91. Commission Decision of 21 March 2012 and of 7 August 201, Case SA.31550 and SA.34890 – Nürburgring. This case was also particularly interesting because the aid recipient was a public undertaking indirectly owned by a German Land.
92. Commission Decision of 20 November 2012, Case SA.32715 – Adria Airways.
93. Commission Decision of 20 November 2012, Case SA.39191 – airBaltic.
94 Lienemeyer and Soukup (2008), para. 4.1073.
95. Para. 13 and 29 of the R&R guidelines.
96. Mamdani and Ritzek-Seidl (2016), para 3.894.
97. For details *see* para. 114 et seq. of the R&R guidelines.

Apart from the immediate rescue aid for a period of maximum six months (and "temporary restructuring support"), any other aid is assessed as "restructuring aid", the second type of aid covered by the R&R guidelines. This includes cases in which the original rescue aid measure is maintained over the initial six months period mentioned above, i.e. during the time of the Commission's assessment of the restructuring plan. Restructuring aid can also consist of irreversible measures, provided they are an appropriate means to restore the viability of the beneficiary.

The Commission has a wide discretion when it comes to the approval of restructuring aid.[98] As under the 2004 guidelines, the basic conditions for approval are based on three pillars, under which the Commission approves restructuring aid only if it is ensured that

(i) the aid actually makes the beneficiary viable again ("return to viability"),
(ii) the aid is kept to the minimum necessary to achieve this objective and the aid recipient provides an "own contribution", and
(iii) any distortions of competition resulting from the aid are "compensated" by appropriate measures of the firm concerned.[99]

These conditions are the major challenge in R&R aid cases are considered in more detail in the following:

4.1. Return to viability (restructuring plan)

First, the restructuring plan that the company must submit has to show how its long-term viability will be restored without further state support.[100] This must be a feasible, coherent and far-reaching restructuring plan which may involve the reorganisation and rationalisation of the beneficiary's activities on to a more efficient basis, typically involving withdrawal from loss-making activities, restructuring of those existing activities that can be made competitive again and, possibly, diversification towards new and viable activities. It typically also involves financial restructuring in the form

98. General Court, Case, T-511/09, *Niki Luftfahrt v Commission*, ECLI:EU:T:2015:284, para. 144 et seq.; General Court, Case T-499/12, *HSH Investment Holdings Coinvest-C Sàrl, HSH Investment Holdings FSO Sàrl v Commission*. ECLI:EU:T:2015:840.

99. In addition the "one time, last time" principle has to be complied with (see below).

100. See, for example, Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, paras. 176 et seq. – Complexul.

of capital injections by new or existing shareholders and debt reduction by existing creditors.[101]

In a nutshell the restructuring plan serves to show to the Commission the feasibility of restoring viability.[102] The plan must identify and disclose the firm's problems and set out in detail how the firm will address them (based on best and worst case scenarios). To this end, it *inter alia* requires the firm to withdraw from activities which would continue to make losses even after successful implementation of the restructuring plan. It has to be used to tackle the problems causing the losses of the beneficiary, not only to cover the losses resulting from these problems. Restructuring aid must be designed in a way that sets the right incentives for the beneficiary to change its behaviour.[103]

The restructuring plan must provide information on the business model of the beneficiary, which should include, in particular, information on the beneficiary's organisational structure, funding, corporate governance[104] and all other relevant aspects. The restructuring plan should assess whether the beneficiary's difficulties could have been avoided through appropriate and timely management action and, where that is the case, should demonstrate that appropriate management changes have been made.[105]

The plan should include a “counterfactual”, i.e., a baseline scenario as well as a pessimistic (or worst-case) scenario. [106] It should take account, inter alia, of the current state and future prospects of supply and demand on the relevant product market and the main cost drivers of the industry, reflecting baseline and adverse scenario assumptions, as well as the beneficiary's specific strengths and weaknesses. Assumptions should be compared with appropriate sector-wide benchmarks and should, where appropriate, be adapted to cater for country- and sector-specific circumstances. The beneficiary should provide a market survey and a sensitivity analysis identifying the driving parameters of the beneficiary's performance and the main risk factors going forward.[107]

The beneficiary has to withdraw from activities which would remain structurally loss-making in the medium term. The return to viability must not be dependent on overly optimistic assumptions about external factors and it must not be linked to the

101. Para. 45 of the R&R guidelines.
102. Commission Decision of 16 May 2020, N 726/2009, paras. 193ff. – Fret SNCB.
103. See also Commission Decision of 2 March 2005, N 386/2005, paras. 156 et seq. – Fret SNCF.
104. Mamdani and Ritzek-Seidl (2016), para 3.914.
105. Para. 49 of the R&R guidelines.
106. Commission Decision of 10 January 2017, SA.44727- *Areva*, paras. 230 et seq.
107. Para. 50 of the R&R guidelines.

beneficiary outperforming the market and its competitors or entering and expanding into new activities where it has no experience and track record. [108] In the end, long-term viability is achieved when an undertaking is able to provide an appropriate projected return on capital after having covered all its costs including depreciation and financial charges.[109] The overall goal is that the restructured undertaking should be able to compete in the marketplace on its own merits. [110]

In practice the restructuring plan is usually drawn up by an independent advisor with a view to restoring sustainable profitability in the long term. [111] This means that there must be a prospect that the firm will be able to bear its entire costs alone on a permanent basis and generate an appropriate capital yield once the restructuring has been carried out in accordance with the plan submitted. Restructuring plans contain a far-reaching disclosure of the firm's status and its problems, as well as "painful" measures within the firm (modernization of production and development, access to new know-how, new selling methods, new distribution network, abandoning business areas in deficit, concentration on profitable core business, etc.). In particular, departments with structural deficits are to be closed down, including personnel reduction.[112] The restructuring period should be as short as possible; the Commission would usually accept a period of three years and, in exceptional cases, up to five years.[113] Changes to the restructuring plan after the Commission's decision during the restructuring phase are possible, but are subject to separate assessment and approval by the Commission.[114]

For the first time outside the financial sector the Commission has in its 2014 guidelines provided an "Indicative model restructuring plan" in Annex II of the R&R guidelines. The Commission usually insists that this structure is strictly complied with.

108. Para. 51 of the R&R guidelines.

109. Mamdani and Ritzek-Seidl (2016), para 3.920.

110. Para. 52 of the R&R guidelines.

111. A sales and liquidation plan set up by an administrator cannot be considered to be a restructuring plan, Commission Decision of 10 September 2021, O.J. 2022 L 141/53, para. 376 – *Alitalia*.

112. European Commission (2016) analysed restructuring plans and found that 50% included personnel reductions, 48% promised to focus on core business, 45% to cut costs and 45% to make new investments. Other frequent elements to the plans included training, asset sales and financial consolidation. Less frequent were plans for capacity reduction (15%) and plant closure (13%). A production cap and privatisation were each promised in 5% of the 60 cases reviewed. The representativeness of these figures should be treated with caution given the nature of the sample as described in footnote 22.

113. *See* para. 7 of the "Indicative model restructuring plan" in Annex II of the R&R guidelines. This would be a tightening of practice. In the Wifo et al. (2016) sample, only a quarter of plans were for 2 or 3 years. A further quarter were for 4 years and the most popular duration of plan was 30% at 5 years. The remainder were for 6 or 7 years. They also find that the financial projections of most plans tended to be over-optimistic.

114. R&R Guidelines, para. 52; Case T-140/95, *Ryanair v Commission*, 1998 ECR II 3327, paras. 85 et seq.

There are a number of advisors who have experience with the setting-up of such plans; some of them are specialized in certain sectors. Plans which have been made "in house" are sometimes viewed with scepticism by the Commission. Given the pivotal importance of the restructuring plan and the credibility of its authors it is advisable to discuss with the Commission beforehand whether they have any objections or concerns against the advisor which has been chosen. Even though this is not a formal requirement, it might facilitate discussions. The plan has to contain, inter alia, a market survey, an analysis of different scenarios and possible solutions. In its practice the Commission examines restructuring plans very closely, often with the help of external industry experts.[115]

Under relatively narrow circumstances, the Commission allows the subsequent amendment of a restructuring plan.[116] This usually requires a formal decision.[117]

In some cases the Commission can be flexible where the parties come up with creative solutions. One example is the inclusion of a "review" mechanism in the PSA case, i.e. if the results envisaged by the plan turn out to be below the plan scenario, corrective action has to be taken by the aid recipient.[118]

The aim of the plan is to restore the long-term viability of the aid recipient. However, this objective can come into conflict with requirements for own contribution/burden sharing and the compensatory measures which may weaken the aid recipient (see below).[119]

4.2. Own contribution and burden sharing

The company, its owners or external investors have to contribute to the costs of restructuring.[120] A beneficiary and its shareholders are required by the Commission to bear as much of the restructuring costs as possible on their own. In other words, the Commission requires a significant own contribution to the restructuring costs by the firm itself and its owners.[121] Normally the own contribution will be considered to be adequate if it amounts to at least 50% of the restructuring costs. In exceptional circumstances, the Commission may accept a contribution that does not reach 50% if

115. *See* for example Commission Decision of 19 September 2012, Case SA.30908, OJ 2013 L 92/16 – *Czech Airlines*; Commission Decision of 29 July 2013, SA.35611 – *PSA Peugeot Citroën SA*.
116. Mamdani and Ritzek-Seidl (2016), para 3.968.
117. Para. 124 of the R&R Guidelines.
118. *See*, for example, Commission Decision of 29 July 2013, SA.35611 – *PSA Peugeot Citroën SA*.
119. Lienemeyer and Soukup (2008) para. 4.1083.
120. This is a key requirement, *see* Commission Decision of 10 September 2021, O.J. 2022 L 141/53, para. 378 – *Alitalia*.
121. R&R Guidelines, para. 62 et seq. *See also* (for the financial sector) CJEU, Case C-526/14, *Kotnik*, ECLI:EU:C:2016:570.

the contribution remains significant and the Member State demonstrates the existence of exceptional circumstances or particular hardship.[122]

The objective of the requirement is to maximize the contribution of the firm in difficulty and minimize the aid element of a restructuring plan. This has at least three economic benefits: reducing the burden on taxpayers; greater incentive for firms not to get in difficulty in the first place as it is more costly (*ex ante* moral hazard); and an incentive to limit the amount of aid requested (*ex post* moral hazard). In some cases, burden sharing may even eliminate the need for aid altogether, since investors are more likely to agree to support a private workout of the company's debts if they do not expect to be fully bailed out by the State. In general, it would be reasonable to expect that investors in a troubled company - particularly shareholders, who receive the highest returns when the company performs well - bear a fair share of the restructuring costs.[123]

The guidelines make a distinction between "burden sharing" and "own contribution". "Burden sharing" refers to the new requirement for shareholders and, where necessary, subordinated creditors to absorb all previous losses.[124] In effect, the aid cannot be backdated but it does mean that R&R aid cannot go to a firm with positive equity value if past losses have not yet wiped out pre-aid value. Also, no dividends can be paid out during the restructuring period unless legally required or necessary to attract new equity.

"Own contribution" refers to the funding of the restructuring plan. This must normally be at least 50% from the beneficiary in the form of, for example, new shareholder funding, debt write-downs or converting debt to equity. The sale of profitable assets is no longer considered a suitable own contribution. Furthermore, aid that enhances shareholder value should no longer be provided in the form of a direct grant. It should instead provide the state with "a reasonable share of future gains in the value of the beneficiary".[125]

The own contribution should in principle be as high as possible. It may consist of the sale of assets or the divestiture of business units which are not essential for the firm's

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122. R&R Guidelines, para. 64. *See also*, for example, Commission Decision of 16 July 2021, SA. 60165- *TAP SGPS,* para.82 et seq.

123. Commission Decision of 10 January 2017, SA.44727- Areva, paras. 290 et seq.

124. It is not at all clear how this will work in the context of state ownership prior to the firm getting into difficulty. Is a write-down of the value of state ownership burden sharing or state aid?

125. The guidelines discuss this in relation to burden sharing but seems more appropriate in relation to own contribution.

return to viability, but also in external debt financing at market conditions.[126] The own contribution must be real, i.e. it cannot stem from expected future profits, and it must not in itself be financed by state support.[127] In case of the sale of business units, strategic partnerships or other framework agreements for commercial cooperation between the company and the divested part are generally forbidden.[128] An own contribution can also consist in the coverage of transaction costs incurred in the framework of the restructuring process as well as the assumption of future operating losses.[129] In the Commission's past practice, this requirement existed mainly on paper. Ultimately, there was a fundamental problem with all restructuring cases in this regard, since "firms in difficulties" are by definition only those firms that can no longer obtain sufficient funds on the private capital markets. Therefore, as a rule, it was highly unlikely that an own contribution would be possible on the scale demanded by the R&R guidelines. Under the 2014 R&R guidelines, companies that are restructured have to meet a reasonable share of the costs of restructuring from their own resources[130] (at least half, for support outside of schemes).[131] For providers of services of general economic interest (SGEI; i.e. economic activities that carry a public service obligation), these requirements are slightly softened.[132]

Measures to limit distortions of competition as required under the Guidelines[133], may lead to proceeds from sales, but cannot necessarily be taken into account for the own contribution.[134]

Compared to the previous version, the 2014 guidelines also place a greater emphasis on the form in which the own contribution is made, requiring, in principle, that the own contribution should be in a form that has a comparable effect as the aid provided. Therefore, if the State provides an equity injection, the owners should do the same. The

126. The divestment of an asset can only count as a real contribution if the divestment has already taken place under the restructuring plan, or, if it has not yet been completed, on condition that there are no serious impediments that would prevent it from taking place before the restructuring period ends, see Commission Decision of 10 January 2017, SA.44727- Areva, para. 308.

127. R&R Guidelines, para. 63. See General Court, Case T-1/12, France v Commission, ECLI:EU:T:2015:17; Strievi EStAL 2015, 417. Confirmed by Commission Decision of 10 January 2017, SA.44727- Areva : The Commission did not include that part of the restructuring costs of 4.5 billion, which was to be provided through the sale of shareholdings.

128. Commission Decision of 10 January 2017, SA.44727- Areva, para. 365.

129. General Court, Case, T-511/09, Niki Luftfahrt v Commission, ECLI:EU:T:2015:284, para. 164 et seq.

130. On public undertakings *see* Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, para. 216 – *Complexul*.

131. R&R Guidelines, para. 64.

132. R&R Guidelines, para. 101.

133. R&R Guidelines, para. 76 et seq.

134. Commission Decision of 10 January 2017, SA.44727- *Areva*, para. 191.

2014 guidelines also pay great attention to the fact that losses already incurred by the company are fully allocated to existing shareholders and subordinated creditors (who are, in the Commission's view, in a comparable position to shareholders). In addition, any gains must also be shared fairly with taxpayers: a company that received state support must return a reasonable share of its future profits to the State.

The greater detail on burden sharing and own contribution provide a helpful step towards providing more appropriate incentives. Such measures may, however, weaken the aid recipient, which can sometimes clash with the objective of the restructuring plan, i.e. to restore the long-term viability of the aid recipient (see above). With this in mind, the Commission has sometimes accepted creative solutions; for example, a mechanism leading to an increase of the own contribution depending on the market share of the aid recipient.[135]

4.3. Measures to limit distortions of competition

4.3.1 General background

In addition, the company must take measures to limit the distortions of competition created by the state support, for example by selling off profitable parts of its business.[136] The underlying idea is that the advantages resulting from a firm's survival should somehow outweigh the distortions of competition, and that there is sufficient compensation for the distortions of competition resulting from restructuring aid. Thus, the firm has to adopt measures which counterbalance the distortions of competition resulting from its state-supported survival in the market.[137] Such measures must have a real effect on the market.[138] Compensatory measures can be implemented even before the aid is authorised by the Commission.

The extent of the required compensatory measures should reflect the influence of the aid on market competition and on any remaining moral hazard after the own contribution and burden sharing. It must be proportionate to the scale of the aid, the firm's market position and the amount and effects of the aid.[139] This assessment will also take into account the amount of its own contribution, and its responsibility for the difficulties it finds itself in.

135. Commission Decision of 29 July 2013, SA.35611 – *PSA Peugeot Citroën SA*.

136. This is an indispensable requirement for R&R aid, *see* Commission Decision of 10 September 2021, O.J. 2022 L 141/53, para. 381 – *Alitalia*.

137. R&R Guidelines, para. 76 et seq.

138. General Court, Cases T-115/09 and T-116/09, *Electrolux AB v Commission*, EU:T:2012:76, para. 58.

139. Commission Decision of 16 May 2020, N 726/2009, paras. 230ff. – *Fret SNCB*.

4.3.2 Structural measures

As in EU merger control, the Commission has a clear preference for structural commitments. Any measures to limit distortions of competition "will usually take the form of structural measures". Only in exceptional cases, the Commission accepts behavioural measures.[140]

Structural measures can consist of structural divestitures[141] or downsizing of profitable business branches[142] (i. e. by way of capacity reductions[143]), the reduction of the market presence,[144] or by the lowering of entry barriers in markets where the firm will have a significant market position post-restructuring. These compensatory measures must – at least in theory – not only consist of such measures which would be contained in the restructuring plan anyway (in order to become viable again), but they should go beyond that.[145] Compensatory measures should ideally be adopted in markets where the firm concerned will retain a strong position post-restructuring.[146] Divestments to limit distortions of competition should take place without undue delay, taking into account the type of asset being divested and any obstacles to its disposal, and in any case within the duration of the restructuring plan.[147] In a nutshell, compensatory measures therefore require the firm to make certain "sacrifices" in favour of its competitors. For providers of services in the general economic interest (SGEI), these requirements are slightly softened.[148]

Divestments, write-offs and closure of loss-making activities which would be carried anyway to restore long-term viability will generally not be considered sufficient.[149] In line with general Commission competition policy, they should favour "the entry of new competitors, the expansion of existing small competitors or cross-border activity. Retrenchment within national borders and fragmentation of the internal market should be avoided".[150] Such measures must also not undermine the beneficiary's

140. R&R Guidelines, para. 77.
141. Commission Decision of 16 May 2020, N 726/2009, paras. 174ff. – *Fret SNCB.*
142. Commission Decision of 2 March 2005, N 386/2005. Paras. 170 et seq. – *Fret SNCF.*
143. Commission Decision of 16 May 2020, N 726/2009, paras. 230ff. – *Fret SNCB;* Mamdani and Ritzek-Seidl (2016), para 3.956.
144. I.e. the withdrawal from certain markets/temporary prohibition of activities, which is similar like a non-compete obligation, *see* Commission Decision of 25 July 2012, SA.23839 (C 44/2007), para 101 – *FagorBrandt.*
145. *See* para. 40 of the previous guidelines. This principle is, however, not contained in the new R&R Guidelines which suggests that the Commission will be more flexible in this regard.
146. R&R Guidelines, para. 78.
147. R&R Guidelines, para. 78.
148. R&R Guidelines, para. 102.
149. R&R Guidelines, para. 78.
150. R&R Guidelines, para. 79.

prospect of restoring viability[151] and they must not lead to competition concerns in themselves[152].

In line with its practice under EU merger control, the Commission takes the view that, in order to prevent a deterioration in the structure of the market, structural measures should normally take the form of divestments on a going concern basis of viable stand-alone businesses that, if operated by a suitable purchaser, can compete effectively in the long term. In the event that such an entity is not available, the beneficiary could carve out and subsequently divest an existing and appropriately funded activity, creating a new and viable entity that should be able to compete in the market.[153] In addition, as in its practice under EU merger control, the Commission usually requires that the beneficiary facilitates divestitures, for example through ring-fencing of activities and by agreeing not to solicit clients of the divested business.[154] In situations where it is difficult to find a buyer for the divestment package, the Commission requires to identify alternative divestments or measures to be taken if the primary divestment fails ("crown jewel commitment").[155]

In the past, the Commission's practice has not always been consistent. Whereas in most cases the Commission had required radical and painful "downsizing" of the aid recipient's business (examples are the cases of *Bankgesellschaft Berlin* (reduction by 30%),[156] *Crédit Foncier de France* (reduction by 25%),[157] *Societé Marseillaise de Crédit* (by 20%),[158] *Banco di Napoli* (43%)[159] and *Crédit Lyonnais* (ca. one-third)[160]), some other decisions were surprisingly generous and do not require such far-reaching "sacrifices" at all.[161] This is not always easy to reconcile with the principle of equal treatment. It will, of course, depend on the Commission's future practice whether the outcome of the 'commitment packages' will be more coherent.

The revised guidelines take a useful step away from the practice of compensating competitors in the direction of preserving or even enhancing competition (which is more likely to beneficial to consumers). The focus, if not the effect, has shifted from

151. Commission Decision of 10 January 2017, SA.44727- *Areva*, para. 330.
152. Commission Decision of 10 January 2017, SA.44727- *Areva*, para. 367.
153. R&R Guidelines, para. 80.
154. R&R Guidelines, para. 81.
155. R&R Guidelines, para. 82.
156. Commission Decision of 18 February 2004, Case C 28/2002 – *Bankgesellschaft Berlin AG*, OJ 2005 L 116/1.
157. Commission Decision of 23 June 1999, OJ 2001 L 34/36.
158. Commission Decision of 14 October 1998, OJ 1999 L 198/1.
159. Commission Decision of 29 July 1998, OJ 1999. L 116/36.
160. Commission Decision of 20 May 1998, OJ 1998 L 221/28.
161. *See*, for example, Commission Decision of 29 July 2013, SA.35611 – *PSA Peugeot Citroën SA*.

punishing the struggling firm towards creating viable stand-alone businesses.[162] This belatedly catches up with the experience of divestitures in the context of EU merger control, where it has been appreciated for at least fifteen years that carved out assets provide ineffective competitors. The aim will be to create a viable new competitor or to strengthen a smaller rival. Of course, it will often be very difficult to find a suitable buyer when the market has contributed to the struggling firm's difficulties.

4.3.3 Behavioural measures

As explained above, the Commission has a clear preference for structural commitments. Therefore, only in exceptional cases, the Commission accepts behavioural measures.[163] These can be a useful tool to ensure that “aid is used only to finance the restoration of long-term viability and that it is not abused to prolong serious and persistent market structure distortions or to shield the beneficiary from healthy competition”.[164]

In this regard, a popular tool is a requirement to open up or liberalise the market (e.g. if the firm owns a bottleneck facility or benefits from a particular regulation).[165] This can involve legislative measures by the respective Member State.[166] In *Bank of Ireland* the aid recipient had to offer certain services to new entrants or to small banks already active in Ireland to reduce the cost for competitors to develop business in Ireland. This comprised, inter alia, a “customer mobility package” to help other banks to reduce the costs of acquiring new customers. In addition, the Irish authorities committed to a number of market opening measures in order to enhance competition in the Irish banking market by facilitating the entry and expansion of competitors.[167]

One of the new behavioural measures raises a concern, even though it is to be used only under exceptional circumstances. This is that the Commission may “*require beneficiaries to refrain from engaging in commercial behaviour aimed at rapid expansion of their market share*”.[168] This concept is not entirely new. It was used during the financial crisis when the Commission imposed so-called “(non)-price leadership commitments”. These prohibited the aid recipient from offering more favourable terms and conditions for

162. *See* Commission Decision of 16 May 2020, N 726/2009, paras. 168ff., 230ff. – *Fret SNCB.*
163. R&R Guidelines, para. 77; Mamdani and Ritzek-Seidl (2016), para 3.961.
164. R&R Guidelines, para. 83.
165. R&R Guidelines, para. 86.
166. Lienemeyer and Soukup (2008), para. 4.1073.
167. Commission Decision of 15 July 2012, N 546/2009 – *Bank of Ireland*.
168. R&R Guidelines, para. 85.

certain products than their most competitive rivals on the relevant markets.[169] The aim is understandable – to prevent a subsidized firm from undercutting unsubsidized rivals. However, this limitation on competitive behaviour may create conditions suitable for tacit coordination.[170] Such a "non-price-leadership commitment" as required by the Commission can also stifle price competition, can harm consumers and thus contains an anti-competitive element. In addition, non-price leadership commitments can involve substantial application problems which has become apparent in current cases. It is very difficult in the "standardised private customer business" to establish whether a price has been undercut. For it is hardly possible, in view of thousands of transactions being concluded each day, to rule out that an employee of a branch – unknowingly – offers somewhat more favourable terms and conditions than the competitors in an individual case.

Less controversially, and also found in the Commission's practice during the financial crisis, there is a prohibition on new acquisitions for a time period (acquisition ban).[171] This has become somewhat of a standard clause which "must be applied in all cases, to avoid undermining the effects of structural measures, and should in principle be imposed for the duration of the restructuring plan"[172] The (legitimate) purpose of such prohibition is to prevent the company from using state aid to fund an aggressive expansion strategy at the expense of competitors (shopping tour). State aid should be "used to restore viability and not to fund investments or to expand the beneficiary's presence in existing or new markets". However, the respective clauses usually provide that exceptions may be authorised by the Commission in specific cases ("where indispensable to ensure the long-term viability of the beneficiary").[173]

In addition, the Commission usually insists on a prohibition for the beneficiary to advertise State support as a competitive advantage when marketing its products and

169. Cf. e.g. Commission Decision of 07 May 2009 N 244/2009, para. 111 – *Commerzbank*; Commission Decision of 03 December 2008, NN42/2008, NN46/2008, NN53/A/2008 para. 94 – *Fortis*.

170. A controversial example relates to the Dutch mortgage market in 2009. Three of the four large mortgage providers got into difficulty in the midst of the financial crisis and required aid. One of the conditions imposed by the Commission was that subsidised banks must not undercut rivals. This offered the single unsubsidised large mortgage provider the opportunity to lead prices up. In May 2009, there was a sharp rise in mortgage rates against a downward trend. The controversy relates to the exact timing of the rise in relation to the behavioural measure. For a thorough analysis of this case, *see* the special issue introduced by *Dijkstra, Randag and Schinkel* 'High Mortgage Rates in the Low Countries: an introduction' (2014), Journal of Competition Law and Economics, 10(4), 773–777.

171. Commission Demission of 07 May 2009, N 244/2009, paras. 69 et seqq. – *Commerzbank*.

172. R&R Guidelines, para. 84.

173. R&R Guidelines, para. 84 (a).

services.[174] This has become a "must", which is usually not too painful for the beneficiary.

In the field of behavioural commitments the Commission has been rather innovative, in particular in cases during the financial crisis. For example, in *ABN AMRO* the Commission has imposed a requirement to achieve certain margin profit levels in the private banking sector.[175] Equally, in *Hypo Alpe Adria* requested a very tight set of rules ("new business restrictions") which precisely defined all business parameters for the commercial lending business (rating of customers, interest rates, margins, etc.).[176]

The Commission's practice also includes the prohibition of certain activities. In *Areva* the Commission forbid to increase the production capacity of one of its Uranium enrichment plants.[177]

4.3.4 Extent of measures ("Calibration")

In section 3.6.2.2, the R&R Guidelines strongly aim to create the impression that measures to limit distortions of competition are based on objective factors and "tailored to market characteristics "[178]. Such elements include the amount of aid (both in absolute terms and in relation to the beneficiary's assets and the size of the market as a whole[179]); the conditions and circumstances under which it was granted; the size of the beneficiary and its market position (both before and after restructuring[180]); the characteristics of the market concerned; the risk of moral hazard; the degree of own contribution and burden sharing[181]; the question whether the measures help to ensure that national markets remain open and contestable[182]; and whether the measures could compromise the prospects of the beneficiary's return to viability (if a measure is very costly or would come at the expense of consumers and competition[183]).

However, it is clear that determining the extent of measures to limit distortions is not an arithmetical exercise. There is no mathematic formula which would allow the beneficiary to calculate the scope of such measures in advance. The Commission has

174. R&R Guidelines, para. 84 (b).
175. Commission Decision of 5 April 2012, SA.26674 – *Restructuring aid to ABN AMRO*.
176. Commission Decision of 5 December 2012, SA.32554 – *Hypo Alpe Adria*.
177. Commission Decision of 10 January 2017, SA.44727- *Areva,* para. 380.
178. R&R Guidelines, paras. 87ff.
179. R&R Guidelines, para. 88.
180. R&R Guidelines, para. 89.
181. R&R Guidelines, para. 90.
182. R&R Guidelines, para. 91.
183. R&R Guidelines, para. 92.

wide discretion when it comes to the approval of restructuring aid[184] and uses this freedom in particular when it comes to the imposition of such measures.

Aid to cover the social costs of restructuring[185] has to be clearly identified in the restructuring plan, because it is disregarded for the purposes of determining the extent of measures to limit distortions of competition.[186]

4.4. Process issues

4.4.1 The "negotiations" on commitments

The Commission procedure on restructuring aid often consists of intense discussions and negotiations between the beneficiary, the Member State and the Commission until a consensus is reached on the scope of the necessary restructuring measures, namely divestments, downsizing of activities and/or balance sheets, etc.

Since the survival of the beneficiary in this phase entirely depends upon obtaining a clearance decision of the Commission, the Commission is in a very strong bargaining position and is able to substantially shape the future business of the beneficiary. This "inequality of arms" has been depicted rather accurately by the General Court in the ING case.[187]

4.4.2 Questions of implementation

In practice it has proven to be difficult to implement and check compliance with behavioural commitments. The monitoring of the commitment packages places an enormous administrative burden on the Commission. In this regard the Commission will have to solve difficult problems of interpretation that will necessarily arise out of commitment packages applying for a long term which are, however, formulated in brief and vague terms (and were regularly negotiated under considerable time pressure).

In the meantime it appears that the Commission increasingly seeks to delegate the supervision of compliance with the commitments to independent trustees (which raises the general questions to which extent such a delegation of power to private bodies is compatible with the EU institutional system).

4.4.3 Legal consequences of a breach of a commitment

184. General Court, Case T-79/14, Secop GmbH v Commission, ECLI:EU:T:2016:118, para. 29.

185. R&R Guidelines, paras. 32 ff.

186. R&R Guidelines, para. 93.

187. *See* the description of the factual background in Cases T-29/10 and T-33/10 *Netherlands and ING v Commission*, ECLI:EU:T:2012:98, para. 147 to 159.

One important issue which occurs in practice rather often is the question of the legal consequences of a violation of a commitment by the aid recipient. According to the Courts' case-law, the Commission may not ignore a failure to comply with a commitment but is generally obliged to issue a formal decision in such case.[188] If the Commission considers that the non-compliance is merely a *minor* deviation from the original condition, it can directly (i.e. without any further formal procedural steps, in "phase 1") adopt a decision by which it grants an explicit exception from the condition in question.[189] If, however, the failure to comply with a condition relates to a *material* part of the package of conditions and accordingly raises doubts about whether the aid is (still) compatible with the common market, the Commission must actually open a *formal examination* on the "misuse of aid" (Article 20 in conjunction with Article 1 g), Article 4 (4) of Regulation No. 1589/2015[190] and carry out a comprehensive assessment on whether such aid is (still) compatible with the common market.[191] In its final decision, the Commission may even issue a negative decision pursuant to Article 20 in conjunction with Article 16 of Regulation No. 1589/2015 which may result in a recovery order.[192]

It is unclear whether a certain degree of "seriousness of the infringement" has to be established in order to justify the repayment of the aid, i.e. whether also "minor" infringements too may result in such a recovery order (failure to comply with conditions which are less significant in economic terms, small degree of delay, etc.). In the Commission's own practice, decisions to recover aid that were ordered due to a failure to comply with conditions have so far been rarely issued.[193] However, the Courts have so far not required such "particular seriousness of the infringement"; rather, it is deemed to be sufficient for a request for repayment that merely "part of the aid" has been misused by the beneficiary.[194] In its practice, the Commission regularly refrains from carrying out such a "particular degree of seriousness test".[195] In contrast, according

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188. Case T-140/95, *Ryanair* [1998], ECR II-3327, paras. 85 et seqq.; Case T-68/03, *Olympic Airways*, [2007], ECR II-2911, para. 92.

189. For an example of such (generous) alteration of conditions due to non-feasibility, *see* Commission Decision of 26 April 2006, N 46/2006 – *Bankgesellschaft Berlin*. For the question of an amendment of commitments, *see also* Decision of the European Commission of 9 July 2013, SA.36784 – *Bank of Ireland*.

190. R&R Guidelines, para. 122.

191. Case T-68/03, *Olympic Airways*, [2007], ECR II-2911, para. 92.

192. Cases T-111/01 et al., *Saxonia Edelmetalle* [2005] ECR II-1579, paras. 86, 111 et seqq.

193. However, the number of cases seems to increase, *see*, for example Commission Decision of 18 December 2012, Case SA.35062, OJ 2013 C 116/13 – *Caixa Geral de Depositos*.

194. Cases T-111/01 et al., *Saxonia Edelmetalle* [2005] ECR II-1579, paras. 86 et seqq. *See also* Case T-68/03, *Olympic Airways*, [2007], ECR II-2911, para. 275.

195. Cf. e.g. Commission Decision of 02 July 2008, C 16/2004 – *Hellenic Shipyards*.

to individual statements made by Commission officials it should be decisive whether a particularly serious infringement has occurred, i.e. whether the respective condition was essential when the approval was granted, for instance because certain obstacles to an approval being granted were eliminated by such condition.[196] However, it is unclear whether this opinion will come to prevail. It must therefore be assumed that in principle any failure to comply with conditions which is not merely of a minor nature may trigger a recovery order.

Some DG COMP officials are even considering that the effect of the approval decision will automatically lapse in case of a failure to comply with a condition. They argue that in such case the granting of the aid is no longer covered by the previous approval and is consequently *ipso iure* null and void.[197] This extremely strict approach is based on the premise that, as a result of the failure to comply with a condition, the basis underlying the previous approval no longer exists and the aid therefore becomes subsequently "unlawful aid". However, this far-reaching opinion has so far not been confirmed either by the Commission's practice or by European case-law. The wording of Regulation No. 1589/2015 also seems to suggest that a failure to comply with conditions does not "automatically" result in illegality: If the aid recipient fails to comply with conditions the procedure to be applied is Article 20 in conjunction with Article 1 g), Article 4 (4) of Regulation No. 1589/2015 ("misuse" of an aid), not, however, the procedure on "unlawful aid" in terms of Article 12 et seqq. of Regulation No. 1589/2015. Therefore, in its own decision making practice the Commission, also in cases of serious infringements of conditions, always has applied the procedural rules for "misuse of aid".[198] Moreover, if an "automated procedure" in the aforementioned sense were applicable, even very small infringements would already result in the approval lapsing subsequently, the consequence being a legal uncertainty that would be barely tolerable.

5. "One Time, Last Time"

An important further limitation of the possibility to grant rescue and restructuring aid is the so-called "one time, last time principle":[199] R&R aid can in principle only be granted once, or at least only once in ten years.[200] The relevant point of time for the start

196. In this sense, *Grespan* in *Mederer/Pesaresi/Van Hoof* (2008,ed.) EU Competition Law Vol. IV, State aid, Book One, Leuven: Claeys& Casteels, para. 3.117.

197. Cf. *Köster* in Münchener Kommentar zum Europäischen und Deutschen Wettbewerbsrecht, Band 3, Art. 9 VO 659/1999 VO, 4th edition 2022, para. 22.

198. Cf. e.g. Commission Decision of 02 July 2008, C 16/2004 – *Hellenic Shipyards*.

199. R&R Guidelines, para. 70 et seq.

200. General Court, Case T-79/14, *Secop GmbH v Commission*, ECLI:EU:T:2016:118, para. 45.

of the ten-year period is the granting of the aid. The aid must be deemed to be granted, from the moment at which the right to receive support through State resources is conferred on the beneficiary under the applicable national legislation, with the result that the actual transfer of the resources in question is not decisive. In particular, the period during which the restructuring *measures* are implemented is in principle different from the period during which the restructuring *aid* itself is implemented.[201]

This is based on the principle that R&R aid should enable a firm in difficulty to make a "fresh start" after successful restructuring. If this restructuring fails to make the firm viable again, a further restructuring attempt with state support will usually not be allowed by the Commission. The underlying idea is that repeated aid merely delays the "inevitable end" and shifts the problems to more efficient manufacturers.[202]

However, it has been difficult for the Commission to commit to this principle in the past, and the guidelines still allows an exception to the rule "*in exceptional and unforeseeable circumstances for which the beneficiary is not responsible*".[203] Those exceptions have not been applied recently.[204] It remains to be seen how liberally it interprets the non-responsibility of the subsidized firm.[205] Recent case law seems to suggest that the Commission will become stricter in this regard[206], but there are also decisions, which seem to point in a different direction[207].

The "one time, last time principle" applies to both rescue aid and restructuring aid, but does not apply to "other" types of aid that were granted in the past (R&D&I, regional, environmental, etc.).[208] It does not, of course, apply to previous State measures which did not constitute aid in the first place, in particular to measures that pass the "private investor test".[209]

6. New "Filters"

A real innovation of the new guidelines is the introduction of a new test which aims to balance the good effects (preserving jobs, industrial knowhow or essential services)

201. Cf. General Court, Case T-718/20, *Wizz Air Hungary v Commission*, ECLI:EU:T:2022:276, para. 83 et seq.
202. Cf. General Court, Case T-79/14, *Secop v Commission*, ECLI:EU:T:2016:118, para. 47 et seq.
203. R&R Guidelines, para. 72(c).
204. Mamdani and Ritzek-Seidl (2016), para 3.870.
205. For the case law under the previous guidelines *see* Mamdani and Ritzek-Seidl (2016), para 3.870.
206. Case SA.31550 and SA.34890 – *Nürburgring*, Commission Decision of 21 March 2012 and of 7 August 2012. *See also* Commission Decision of 9 January 2012, SA.30584, OJ 2013 L 92/1 – *Málev Hungarian Airlines*.
207. Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, paras. 223 et seq. – *Complexul*; *see* also *Ziegler* EStAL 2022, 181.
208. Mamdani and Ritzek-Seidl (2016), para 3.865.
209. Commission Decision of 27 June 2012, SA.33015, OJ 2012 L 301/29 – *Air Malta*.

and bad effects (distortion of competition) of R&R aid. [210] This new “filter” should improve targeting of State aid that is to ensure that State aid measures really do serve the common interest. Such a “material” test, by which a firm's eligibility for State aid is ultimately judged, is a novelty in the R&R aid context. [211]

There are two aspects to the test.[212] First, to ensure that aid is only granted where it is necessary to achieve an objective of common interest[213], aid-granting authorities have to show special circumstances, such as social hardship, market failure, etc., in order to justify aid being granted.[214] The R&R guidelines set out a list[215] of situations in which aid would be justified, for example where the unemployment level in the region concerned is above the national or EU average, persistent and accompanied by difficulty in creating new employment in the region concerned or where there is a risk of disruption to an important service which is hard to replicate and where it would be difficult for any competitor simply to step in. For a service to be regarded as important, it is not necessary, that the undertaking providing that service play a systematic role which is important for the economy of a region of the Member State concerned; it is neither necessary that it be entrusted with a service of general economic interest or with a service that is of national importance.[216] Even an airline travel to holiday destinations can be an important service in the sense of the guidelines.[217] In *Wizzair v. Commission*, the General Court recently decided that regional connectivity by means of domestic air routes and international connectivity provided by a Romanian airline constitutes an important service, the absence of which could lead to social hardship or market failure. The Court argued that there were no valid alternatives to the services by the airline due to the poor condition of Romanian road and rail infrastructure and the unlikelihood that a competitor airline would step in and cover those routes. Therefore, the airline has a decisive role in ensuring regional connectivity within Romania.[218] Furthermore, the court decided that the aid-granting authority is not required to demonstrate that, in the absence of the aid measure, certain negative consequences would necessarily arise, but

210. Paras. 43 et seq. of the R&R Guidelines.
211. See also Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, paras. 144 et seq. – Complexul; Ziegler EStAL 2022, 181, on the question to which extent environmental objectives can be taken into account.
212. Sections 3.1.1 and 3.1.2 of the R&R Guidelines.
213. Commission Decision of 10 January 2017, SA.44727- Areva, para. 216.
214. Commission Decision of 26 January 2022, Case SA.59974, OJ 2022 L 263/21, paras. 165 et seq. – Complexul.
215. Para. 44 of the R&R Guidelines.
216. General Court, Case T- 577/20, Ryanair v Commission, ECLI:EU:T:2022:301, para. 75.
217. General Court, Case T- 577/20, Ryanair v Commission, ECLI:EU:T:2022:301, para. 78.
218. Cf. General Court, Case T-718/20, *Wizz Air Hungary v Commission*, ECLI:EU:T:2022:276, para 49.

only that such consequences might arise.[219] A separate provision for SMEs applies a less strict standard and identifies situations that are more relevant to the position of SMEs.[220]

Second, the granting of aid must make a positive difference, as compared to the situation without aid. In order to demonstrate this, aid grantors have to present a comparison (counterfactual scenario) with a credible alternative scenario not involving aid. In practice, it is always difficult to construct a robust counterfactual as it is never observed (unless the aid is not granted). We have already discussed the difficulty also with credible estimates of social hardship, especially for grantors with very limited resources. While well motivated and in principle the right thing to do, it remains to be seen how this test will work in practice.[221] In principle, it would require a full market analysis of the consequences of insolvency, including who would likely buy the assets of the firm and how the assets would be used. This raises difficult questions such as: would capacity continue in the market, or be switched to other markets, or would it be scrapped? In principle, this sort of counterfactual analysis is similar to the economic analysis that is applied in a merger (i.e. “would the market be less competitive in the event that one firm is removed from the market?”), but there are some crucial differences. Most obviously, for merger analysis the counterfactual is usually that the merging parties would continue independently in the market in the absence of the merger, and that competition in the market would continue in much the same way as currently observed. However, for R&R aid analysis the counterfactual will usually be that the firm would exit, which requires an answer to the above question as to what would happen to capacity, and the future will have a restructured firm that enjoys new benefits of aid but which has been subject to structural changes. Neither the expected future nor the counterfactual are observed, which doubles the challenge. We have already discussed the need for an impartial assessment given that the analysis is to be provided to the Commission by the firm and Member State.

7. Conclusion and Outlook

The R&R Guidelines clearly show that the Commission is committed to apply a strict State aid discipline when it comes to public support for ailing firms. This approach is based on sound economic principles. The European Commission wants to avoid

219. Cf. General Court, Case T-718/20, *Wizz Air Hungary v Commission*, ECLI:EU:T:2022:276, para 40; similar arguments in General Court, Case T- 577/20, Ryanair v Commission, ECLI:EU:T:2022:301, para. 79 et seq.

220. *P*ara. 107 et seq. of the R&R Guidelines.

221. For a critical assessment *see* Petzold, H. (2014), Rescue and Restructuring (R&R) Guidelines – Thoughts and Comments on the Commission's Draft, *European State Aid Law Quarterly*, 2014 13(2), p. 291.

inefficient firms remaining in the market ("zombie economy") and wants to minimise "moral hazard" issues, i.e. the promotion of reckless behaviour because companies count on being rescued by the state.

During recent years the Commission has benefitted from its vast experience during the financial crisis and the new R&R Guidelines are clearly influenced by the decision-making practice in the banking sector. In its recent Fitness Check, the Commission conducted a comprehensive evaluation of the State aid modernisation. Given the limited case practice under the R&R Guidelines since the 2014 modifications, the evaluation of the R&R Guidelines was narrowed down to the aspect of the modified definition of undertakings in difficulty. The mid- to long-term effects on the application of R&R aid of the COVID-19 crisis and Russia's war against the Ukraine remain to be seen. The EU reacted to these crises by establishing temporary frameworks stipulating the rules for the use of State aid measures.[222] The lower thresholds to apply aid under these temporary frameworks might also explain the relatively low amount of R&R aid recently. This could change once the temporary frameworks are no longer in place and lead to an increasing need for R&R aid.[223] The R&R Guidelines provide a very solid basis for future decisions but will remain difficult to enforce. An equally strict application of the R&R Guidelines is desirable. There should be no (political) compromises diluting the achievement of these important aims.

222. OJ 2020 C 091/1 - Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, OJ 2022 C 131/1 - Temporary Crisis Framework to support the economy following aggression against Ukraine by Russia, and OJ 2023 C 101/03 - Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia.

223. Commission Staff Working Document, Fitness Check of the 2012 State aid modernisation package, railways guidelines and short term export credit insurance, 30.10.2020.