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Undertakings in Difficulty under the General Block Exemption Regulation

Czechia, Germany, Latvia, Luxembourg, Poland, Slovakia, Spain and the Netherlands support a revision of the definition of “undertakings in difficulty” (UID). The amendments need to be aligned with the ongoing revision of the Rescue and Restructuring Guidelines. The newly proposed exceptional application of the General Block Exemption Regulation (GBER) to UID in the cases listed in article 1 (5) is a positive step and the proposed amendments address some of the current problems regarding UID.

However, these amendments do not provide a sustainable and structural solution, which also alleviates the current administrative burden caused by the definition. We, therefore, urge the Commission inter alia the following to ensure the new UID definition and its application is fit for purpose, and fully addresses the needs of SMEs and start-ups and scale-ups to create a competitive, innovative and autonomous Europe.

As these problems are urgent, the Commission is encouraged in the provision of an interim solution, such as a guidance or a statement to enable more legal certainty in retroactively applying GBER, to bridge the gap until the revised rules are fully implemented.

1 Definition of Undertakings in Difficulty

We advocate for the recognition of quasi-equity financing as own funds within the meaning of the UID Definition. The definition currently fails to adequately achieve its purpose and does not reflect modern investment practices.

One purpose of the UID definition is to identify companies which, ‘*without intervention by the State, will almost certainly be condemned to going out of business in the short or medium term*’. Representative data shows that under the current definition financially sound and viable enterprises are wrongly classified as undertakings in difficulty, since quasi-equity is not taken into account. Quasi-equity is commonly used in modern investment practices, and especially in case of highly innovative deep-tech companies it is even an indispensable part of financing in the early years, that actually improves the rating of a company. It is an effective loss buffer, stabilises a undertaking’s capital structure, and is often a strong indicator of economic potential.

We, therefore, propose not to refer in the definition to “equity” and to maintain the broader concept of “own funds”. We strongly propose the following definition of own funds:

A company's own funds consist of its equity and quasi-equity funds that are economically equivalent to equity.

The definition of quasi-equity in the GBER should fulfil the material aspects that cover various quasi-equity instruments (hybrid financing/mezzanine financing) used in Member States such as subordinated loans, including shareholder loans and convertible loans, convertible bonds, silent partnerships, profit participation rights, simple Agreements for Future Equity (SAFE), etc. Quasi-equity financing is from an economic perspective equivalent to equity if the funds are available to the undertaking for an indefinite period or on a long-term basis for at least five years and if the financing is subordinate to other creditor claims against the undertaking. To facilitate granting authorities and uniformize these material conditions, a standard subordination agreement could be included in the GBER annex or in additional guidance by the Commission.

2 Exemptions from the UiD-Definition

In addition, the exemption for SMEs, start-ups, scale-ups from the UID-test should be broadened to reflect the actual development stages of those enterprises, and to ensure the definition is fit for purpose and proportionate, by considering additional carve outs:

Enabling state aid for SMEs, Startups and Scaleups

i. **Including section 6 (aid for environmental protection) in the exemption and extending the exemption period to 15 years after registration (Art. 1 (5) sub g)**. This aid is crucial for the transition to a sustainable industry as well as maintaining and improving the open strategic autonomy of Europe. If successful, a start-up becomes a scale-up. This, however, does not mean that their financial situation is aligned with the current UID-definition. Scale-ups, especially those developing disruptive deep-tech innovations, still have a development phase ten years after registration and they, therefore, should not be excluded from receiving state aid as a result. Otherwise their previous efforts might result in failure instead of success.

ii. **Extending the current general 3-year exemption for SME (Art. 1 (5) sub. a) from the UID regulation to at least 7 years**. This to ensure effective support of young companies.

Reducing administrative burdens

iii. **Including section 5 (aid with a social objective) for social enterprises in the exemption (Art. 1 (5)).** Undertakings with a social aim are generally smaller undertakings with a different financial reality. Exempting aid to these undertakings will lower the administrative burden on these undertakings and public authorities. The risk of undue market distortion is low for these activities by these companies.

iv. **Include a Safe Harbour-exemption.** Article 1 (5) should include a carve out for all aid under EUR 300.000 for all undertakings that qualify as undertakings in difficulty under Article 2, point 32 (a) or (b). This will introduce proportionality and lessen the administrative burden on undertakings and public authorities alike.

By acting big on big and small on small, these suggestions solve the underlying problem, by enabling State aid for innovative undertakings, reducing administrative burdens, while safeguarding competition, and simplifying the GBER.