EUROPEAN COMMISSION

Brussels, 19.06.2006

K(2006)2876

Subject: State aid N 599/2005 - Poland

Aid to the creation of the funds of seed capital

Sir,

1. PROCEDURE

By letter dated 15 November 2005, registered at the Commission on 28 November 2005, the Polish authorities, having regard to Article 88 (3) EC, notified to the Commission the above-mentioned scheme.

By letter of 13 January 2006, the Commission requested additional information on the aid scheme. By letter dated 14 February 2006 the Polish authorities provided information. The Commission sent a second request for information on 6 March 2006. The Polish authorities provided the missing information by letter of 10 April 2006 and of 20 April 2006.

2. DESCRIPTION OF THE SCHEME

The aid granting scheme involves four major participants:

- private investors, who create seed capital funds;
- such funds created as separate legal entities, managed independently from the aid granting authority by mangers who , in the name of the fund, apply for the state aid;
- aid granting authority;
- potential investees (SMEs).

Seed capital funds applying for aid are subject to open competitions, in which those funds will be chosen that fulfil the criteria mentioned in the draft regulation.

The seed capital fund is obliged, in the period of realisation of the project aided by public resources, to provide all information and explanations concerning the project realisation and its effects.

2.1. *Objective of the scheme*

The aim of the scheme is to reduce the equity gap present in Poland. The gap constitutes unfavourable conditions to create supply for investment resources intended for an increased risk capital market. This measure intends to facilitate the establishment and development of venture capital funds providing funding to innovative and growth-oriented small and medium-sized enterprises ('SMEs')[1] in their early stage of development.

A SME in an early stage of its development is understood as being, shortly after its start-up, still in the stage of research or development of a product or service or a SME which has already completed that phase, but since the start up of its economic activity has not yet commenced any commercial production nor sales of the product or service concerned (i.e. has not generated profits).

2.2. *Legal basis of the scheme*

- Draft Regulation of the Minister of Economic Affairs and Labour on the financial aid granted to increase seed capital fund;
- the Act of 20 April 2004 on National Development Plan, Article 31, Journal of Laws, No 116, item 1206 and of 2005 No 90, item 759- text available on http://isip.sejm.gov.pl/prawo/index.html);
- Ordinance of the Minister of Economic Affairs and Labour of 6 August 2004 on adoption of the Programme Complement to the Sectoral Operational Programme – Improvement of the competitiveness of enterprises, years 2004-2006, OJ No 197, item 20023, of 2005 No.9 item 63, No 108, item 906 and No.206, item 1716; text available on http://isip.sejm.gov.pl/prawo/index.html

2.3. *Background of the scheme*

According to the Polish authorities private investors are not encouraged to make investments in the SMEs in an early stage of development. This is due to low tendency of the Polish banks to engage in the high risk investments, which is caused by a high supply of profitably attractive Treasury papers and legal limits concerning the necessity to ensure safety for bank assets. The same applies to pension funds. In the event of lack of capital supply, there exists an unsatisfied demand for the financial instruments, which could fill in the private capital supply by supporting the seed capital funds and by the reduction of the funds management charges for private investors.

According to the evidence provided by the Polish authorities the equity gap in Poland reaches the level between PLN (Polish zlotys) 0,1-2 million (EUR 0,02-0,5 million) and PLN 8-10 million (EUR 2 - 4.5 million) respectively, depending on the project's features and the sector in which the investees are active. This phenomenon is indicated by the statistical data that depict the changes of the market structure, a systematic decrease of the number of funds that

[1] Commission Regulation 70/2001 EC on the application of Articles 87 and 88 of the EC Treaty to state aid to small and medium-sized enterprises (OJ L 10 of 13.11.2001, p. 33) and Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (notified under document number C(2003) 1422; OJ L 124, 20.05.2003, p.36).

offer relatively small portions of capital and an increase of the average amount of a single transaction in the venture capital. Thus, obtaining financing is at the moment practically impossible due to the running out of the capital stocks of the venture capital funds that emerged in Poland in the first half of the 90s. In particular, at present private investors are not interested in carrying out investments of a relatively low value, below EUR 1 million and at the same time of relatively high investment risk, resulting from the peculiarity concerning the investment in the companies in an early stage of development and from the high cost of seed capital fund management. The programme should help to reduce funds management costs, create the atmosphere of credibility by engagement of public resources as well as promoting the development of venture capital market.

2.4. Beneficiaries of the scheme

2.4.1. SMEs

Beneficiaries are SMEs in their early development stage that have carried out business activities within the territory of the Republic of Poland for a period of a maximum of 3 years. Firms in difficulty as defined by the ‘Community guidelines on State aid for rescuing and restructuring firms in difficulty’[2] are excluded from investment.

The venture capital funds shall not invest in SMEs active in the following sectors: motor vehicles, textiles, shipbuilding, agriculture, iron and steel production, mining and querying transport service, manufacturing and trade in arms, manufacturing of alcohol beverages and tobacco, as well as manufacturing and marketing of narcotic substances.

Moreover, the aid shall not be granted for the following activities: financial services, including factoring and leasing, assets lease service, legal services, accounting services, real estate brokerage, trade or management services, wholesale and retail trade.

SMEs operate in the regions eligible for assistance under Article 87 (3) (a) EC.

2.4.2. Private investors

The Polish authorities have confirmed that private investors are to be understood as any entities except for public entrepreneurs as defined in Article 2 (14) of the Law on the Procedural Issues Concerning Public Aid. Public entrepreneurs are defined broadly as each business entity conducing business operations, which is influenced in a decisive, direct or indirect way by a public authority.

Private investors establish seed capital funds in an appropriate legal form. They have to invest in it. The participation of one investor in more than one seed capital fund is allowed.

Private investors participate in the distribution of proceeds from exiting investments on more favourable terms than public investors. In case the investment does not provide the assumed level of return private investors shall have a higher chance to regain the contributed capital as well as to obtain a minimal rate of return in comparison with the institution granting aid.

[2] OJ C 244, 01.10.2004, p.2.

Private investors cannot receive any other state aid concerning risk capital than provided in this programme. In particular, there are no other measures such as tax breaks to support the same investments.

2.5. *Administration of the scheme*

Ministry of Economic Affairs.

2.6. *Funding of the scheme*

The estimation of the total amount of funding necessary to implement the scheme concerned equals EUR 36.208 million. It comprises public and private resources – the public aid (50%) is EUR 18.104 million, out of which EUR 14.467 million will be covered from the resources of the European Regional Development Fund (ERDF) and EUR 3.637 million from the national budget. The maximum public investment per venture capital fund is limited to PLN 50 million (approx. EUR 12.5 million). The total investment made by one or more funds in the eligible SME shall not exceed an equivalent of the amount of EUR 1 million expressed in PLN.

2.7. *Duration of the scheme*

The duration of the Programme is from 1 April 2006 until 31 December 2007.

The following table provides the relevant dates:

Period of signing the aid granting agreements	Till December 31, 2007
Period of carrying out expenditure eligible for aid (investing in SMEs)	Till June 30, 2008
Period of the scheme operation (investing and reinvesting by the funds)	Date of signing the aid granting agreements + 10 years (+2 years in justified cases) At the latest on December 31, 2019
Period for payments of the financial resources into the funds by the aid granting authority	Till June 30, 2008
Dissolution of the fund (transfer of resources in accordance with paragraph 12 of the draft regulation)	At the latest on December 31, 2019

The Polish authorities have confirmed that no state aid can be granted before the decision approving the measure is taken by the European Commission.

2.8. *The role of the funds under the scheme*

The funds will be newly created and can take different legal forms. The Polish authorities have put forward a number of possible legal options. Funds may operate e.g. as investment funds, limited partnerships, limited joint-stock partnerships, limited liability companies or joint-stock companies.

Regardless of the above-mentioned legal forms, it will not be possible for investors to participate in a fund without having signed the agreement that specifies the scope of their rights and obligations. The fund must ensure the transparency of the investment activity and represent common interest of the fund's investors. There will be a civil law obligation on the fund to allocate all its resources for making investment in SMEs in their early stage of development. On the basis of an agreement with the aid granting authority the fund will have to conduct accountancy in a manner that will enable the authority to closely monitor the correctness of the use of public funds and funds' activity as a whole. According to the draft regulation the fund is prevented from diversifying into other activities than investment in SMEs. Moreover, seed capital funds will be obliged to have a separate bank account for the public money.

In most cases the funds will be tax transparent investment vehicles. The income tax will be then only levied at the level of the fund's investors.

2.8.1. *Selection of investors under the scheme*

Private investors can create more than one seed capital fund. It is also not excluded that more than one investor will participate in the creation of the fund. Of significant importance for the aid granting authority will be the rate proposed by fund managers i.e. the minimum rate of return per year that private investors accept to obtain from the carried out investment, referred to in the notification as a "hurdle rate". In case where a proposed hurdle rate is too high, the fund application may be eventually rejected by the aid granting authority due to lower rates proposed by other funds. It will automatically exclude private investors whose funds proposed too high hurdle rates. Therefore, important criteria in the application assessment are: the experience of fund mangers and the height of the hurdle rate which is proposed by the fund to the aid granting authority.

The wide accessibility of the aid scheme to all interested private investors shall be ensured through placing the call for tenders for funds capitalization at the web sites: of the Polish Agency for Enterprise Development (the Implementing Body for sub-measure 1.2.3. *Supporting the emergence of seed capital funds* of the Sectorial Operational Programme Improvement of the Competitiveness of Enterprises, 2004-2006 (SOP-ICE)); of the Ministry of Regional Development (the Managing Authority for the SPO-ICE); of the Ministry of Economy (the Intermediate Body for the SOP-ICE) as well as in the Polish press of economic profile and of nationwide scope, and in the European Union Official Journal.

2.8.2. *Investment decisions*

The investment decision will be taken by the fund management. The fund manager submits, along with the application for aid, a business plan containing a definition of the target market/s, on which the fund manager intends to make investments in the potential investee and criteria and conditions of investment in the potential investee. The final arrangements can be found in the aid granting agreement.

The fund manager, before taking the decision on making an investment in an investee financed with the aid, shall carry out an analysis of the business plan submitted by the potential investee that in principle specifies:

- organisation data of potential investee and the information concerning the scope of its operation prior to business plan submission;
- data concerning the current and future products and services provided by the enterprise;
- data concerning current and potential markets on which an investee acts or intends to act;
- data concerning current and future marketing and sales strategy;
- information concerning the management staff of the potential investee as regards education, professional experience, years of work at the managerial level as well as other qualifications;
- financial data concerning the potential investee as regards previous or forecasted periods;
- information on cash flow forecast of the potential investee with the indication of financing sources.

If the analysis of the business plan proves the viability of the investment to be made and indicates the possibility of gaining profit, the fund manager carries out a thorough legal, economic, financial and market analysis of the potential investee :

The fund manager may make investments by means of support funding into the potential investee provided that the investment is made in line with the business plan of the fund submitted by the fund manger to the aid granting authority.

The fund will be legally prevented from investing in SMEs, the shareholders or stakeholders of which were persons connected with the investor prior to the first investment by family ties, employment or management relationships. The same applies to the relationship between the fund management and a potential investee.

The fund manager must not make investment in SMEs in cases where a person of the management board of the potential investee has been convicted for crimes enumerated in the draft regulation. A potential investee cannot have any outstanding fiscal liabilities.

According to the Polish authorities it is assumed that the investors will have only partial influence on the investments by the fund. They will not influence directly the decisions by the fund manager, but they will keep control over the fund's operations, depending on the fund's legal form.

2.8.3. Participation of public and private investors under the scheme

Pursuant to the provision of the scheme, the amount of public funding must not exceed 50% of the total expenditure eligible for aid.

The aid for a seed capital fund shall not be lower than PLN 3 million and higher than PLN 50 million, which means that the minimum value of the seed capital fund supported by the aid granting authority will be 6 million PLN (PLN 3 million of public funds and PLN 3 million of private funds). The financial resources paid out in favour of an investee are each time proportional to the amount of the actual share contributed by the private investor. The same proportionality rule applies in case of reinvestment of public funds after 30 June 2008, when the deadline for making first investments in SMEs by the funds expires.

The same 50% limit of public funding applies to administrative costs when the selection of fund management is made in accordance with the public procurement rules. The costs are established in the aid granting agreement. In case where the fund management is not selected by public tender the eligible administrative expenditure cannot exceed annually on average 5% of the capital of the fund. If the fund brings losses amounting to the whole public contribution to the fund, then administrative costs could not be covered from public funding.

2.8.4. Size of investment in target companies under the scheme

The scheme envisages a global limit of investment by one or more funds into one single SME. The investment cannot exceed in total EUR 1 million expressed in PLN during the whole existence of the fund/funds. At the same time each investment in an investee cannot exceed 20% of the total declared value of the fund.

2.8.5. Profit and losses distribution under the scheme

The resources originating from the sale of investments or other way of withdrawal from the investment by the fund manager, including the repayment or the interest on the debt instruments will be divided as follows:

- first, to cover the initial capital contribution of private investors. In case there are many investors – prorate to their capital contributions;
- second, to cover private investors' minimum rate of return as stipulated in the aid granting agreement. In case there are many investors – prorate to their capital contributions;
- third, to cover the total capital contribution of the aid granting institution;
- fourth, to cover the minimum rate of return to the institution granting aid;
- fifth, to remunerate the fund mangers up to the level when the payments in favour of the latter will constitute the established percentage of all the fund payments made to private investors, the aid granting institution and the fund manager, as agreed in the agreement;
- sixth, to pay to the fund manager a motivation bonus (carried interest) calculated as a percentage of profits gained from investments made by the fund managers;
- seventh, to distribute the remaining profit, if any, pro rata to the aid granting institution and the private investors, calculated as agreed in the aid granting agreement.

The withdrawal from the investment made by a seed capital fund can take, in particular, a form of:

- introduction of a fund's portfolio company to the public stock exchange,
- sale of a fund's portfolio company to a trade investor – trade sale,
- management buy out of a portfolio company,
- leveraged buy out of a portfolio company.

The same principles of profit and losses distribution under the scheme are applicable in case of the fund's dissolution. The more precise conditions will be described in each case in the business plan attached to the application form.

2.9. The role of the fund managers under the scheme

The fund managers file the application for aid to the public authorities. They are responsible for drawing the seed capital fund's business plan and for making investment. Their investment decisions will be financially motivated in such a way that the most significant part of fund managers' remuneration will depend on the investment results of the fund (motivation bonus, i.e. carried interest).

2.9.1. Selection of fund managers under the scheme

The investor signs a contract with the fund management team. The latter may be both an internal body in the enterprise that creates a seed capital fund, as well as an external entity towards the fund, for instance being a limited liability company which is an active partner in limited partnership or limited joint-stock partnership. The management team has to have experience in investments in SMEs and in the improvement of their value together with the necessary economic and technical capacity to carry out an investment. The fund managers do not necessarily have to be chosen by a public tender. If the latter does not take place, the amount of the administrative and seed capital fund management expenditure must not exceed, on average yearly, 5% of the paid out capital of the fund.

The aid granting authority assesses the application for aid in which the list of key persons of the fund management has to be provided together with their qualifications and experience.

2.9.2. Remuneration of fund managers under the scheme

The remuneration of the fund managers consists of two parts. First part is paid on the basis of an agreement between the investor and the fund manager from the administrative expenses of the fund. Second and the most significant part is only paid out after payments to private investors and the aid granting authority are made. The second part of remuneration is paid from exiting investment proceeds. In this case the fund manager shall receive firstly remuneration up to the level when the payments in favour of it will constitute the percentage of all the fund payments made to private investors, the institution granting aid and the fund manager, as agreed in the aid granting agreement. Secondly, the fund manager shall receive the remuneration dependent on the achieved results, i.e. the relevant motivation bonus (carried interest) calculated as agreed in the aid agreement.

Therefore, it follows that the fund manager's remuneration will be linked to the disbursement of the fund resources and the performance of the fund.

2.10. Aid instruments under the scheme

The basic form of investing is the made-for-profit acquisition of stocks or newly issued shares of the SME. The acquisition of debt instruments shall not be made independently of a purchase of stock or shares and can take a form of granting a credit or a loan or acquisition of bonds. In such a case the amount of financial resources allocated by any fund to the acquisition of debt instruments may not exceed the sum invested in stocks and shares in any investee after 2 years following the day when the capital fund made the first investment in a SME .

It follows that on the level of the fund as a whole the investment in all forms of debt instruments cannot exceed the investment in equity during the period of administration of public resources by the fund

The loans granted by the fund will be at a market rate. In any case they should not be lower than the reference rate published by the European Commission in the Official Journal. In case of unsecured loans the Polish authorities will apply the reference rate increased by 400 basis points and more, if the market rate that depends on the commercial risk is higher. This will be done in accordance with the Commission Notice on the method for setting the reference and discount rates[3]

The Polish authorities have confirmed that the usage of all debt instruments will be subject to conditions fixed according to market rules.

2.11. Cumulation of aid under the scheme

Over a period of 2 years following the date of signing the investment agreement, an investee is not allowed to apply for any aid under the Regional Aid Guidelines. Moreover, the overall amount of financing by the state aided venture capital, originating from one or more funds, to one SME is not limited to EUR 1 million within 6 months, but restricted capped at this level during the whole period of funds' existence.

3. UNDERTAKINGS

The Polish authorities have committed themselves to comply with the appropriate changes concerning the status of regions as assisted areas, eligible for support on the basis of the Article 87 (3) a to Article 87 (3) c of the EC Treaty, if the status of these regions as the areas eligible for support changes under the future regional aid guidelines, years 2007-2013.

The Polish authorities have confirmed the compliance with the relevant state aid provisions and structural funds regulations applicable at any point in time. The Polish authorities undertook to adapt the scheme and accept the appropriate measures proposed by the Commission if the currently applicable rules on state aid and risk capital change.

4. ASSESSEMENT OF THE SCHEME

[3] OJ C 273, 09/09/1997.

4.1. Legality

By notifying the scheme before its implementation, the Polish authorities respected their obligations under Article 88(3) of the EC Treaty.

4. 2. Existence of State aid and compatibility with the common market

The Commission has examined the scheme in the light of Article 87(1) et *seq.* of the EC Treaty and Articles 61 et *seq*. of the EEA Agreement, and in particular on the basis of the 'Commission Communication on State Aid and Risk Capital' (hereafter referred to as 'the Communication')[4]. It has decided not to raise objections.

4.3. State aid character of the scheme

, In order for a risk capital measure to fall within the scope of Article 87(1) EC Treaty, four cumulative criteria must be met:

– the measure must involve the use of State resources;

– the measure must distort competition by conferring an advantage on the beneficiary;

– the advantage must be selective in that it is limited to certain undertakings;

– the measure must affect trade between Member States.

In line with point IV.2 of the Communication, the assessment of the presence of State aid within the meaning of the Treaty will consider the possibility that the measure may confer aid on at least three different levels:

– aid to investors;

– aid to any fund or other vehicle through which the measure operates;

– aid to the companies invested in.

4.4. Aid to investors

At the <u>*level of investors*</u>, the Commission considers that there is State aid within the meaning of Article 87(1) EC Treaty. The involvement of *State resources* is demonstrated by the fact that the public funding will be up to 50% of the paid-up capital of venture capital funds.

Moreover, a subordination of public funding *vis à vis* private funding with the aim of attracting market investors to the funds is foreseen by the Polish authorities. It is especially visible in the investment exit mechanism and the fund's dissolution when private investors' capital and their possible profits are paid off before the same applies to public authorities. An *advantage* is therefore conferred to the private investors.

Even though no person or organisation is barred from investing in the funds, first of all the investors should have at their disposal a considerable amount of capital in order to be able to participate in the scheme. Investors should pay at least the amount of PLN 3 million (750,000

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[4] OJ C 235, 21.08.2001, p. 3.

EUR) into the fund. In addition, the fund manager must confirm in the application for public support that the fund has enough financial resources in the form of cash contribution from private investors in the amount of at least 50% of the eligible expenditure. Moreover, it is not a general measure, since there is no guarantee that all investment applications that fulfil the criteria laid down in the draft regulation will be accepted, since the aid is distributed according to the first come, first served principle depending on the outstanding amount of financial. al resources to be distributed within the scheme. The Commission, therefore, considers that there is *selectivity* at the level of investors.

Finally, the scheme *affects trade between Member States*, as investment in capital is an activity that is the subject of considerable trade between Member States. Thus, State aid is present within the meaning of Article 87(1) EC Treaty at the level of investors.

4.5. Aid to an intermediary vehicle or fund

At the *level of the fund*, the Commission in general tends to the view that a fund is a vehicle for the transfer of aid to investors and/or enterprises invested in, rather than being an aid beneficiary itself pursuant to point IV.5. of the Communication. The Polish authorities assured that the funds would be newly set up as separate legal entities from investors and therefore there would be no transfers of founds in favour of existing funds with numerous and diverse investors. Funds would be prevented from diversifying into other activities than the ones intended by the scheme i.e. transferring aid to SMEs. The distribution of profits and losses in case of the fund's dissolution, described in point 2.8.5. above, insures that after the end of the scheme nothing remains on the account of the fund. It shows that the latter are only set up to transfer the aid to investees.

As far as the fund management is concerned, its choice should be made in accordance with public procurement rules. In such a case state support is provided *pari passu* and cannot exceed 50% of the eligible administrative and management expenses. Hence state resources are made available on the same terms as private resources. If there is no public tender for the selection of managers, the state support is in any event limited to 50% of eligible administrative and management expenses. Eligible expenses are in that case capped at 5% of the capital of the fund. Furthermore, if a fund incurs losses equal to public resources paid into the fund, the state ceases to support any administrative and management expenses. It follows that state resources are made available, if anything, on less advantageous terms than those of private investors, as the state's exposure to management expenses is capped.

In view of the above, the Commission considers that there is no State aid within the meaning of Article 87(1) EC Treaty neither at the level of the fund nor at the level of fund management.

4.6. Aid to enterprises invested in

Under the provisions of the scheme, public funding will be up to 50% of the capital of the funds. Thus *state resources* are involved.

Furthermore, the stated objective of the scheme is to facilitate the access to venture capital in Poland by SMEs, which would not otherwise receive sufficient capital in the same amounts and/or at the same conditions in absence of the scheme. It confers therefore an *advantage* on the beneficiary SMEs.

The measure is *selective* as it is targeted at SMEs.

Finally, the measure has at least the potential to *affect trade between Member States*, as there is the possibility that the target SMEs are engaged or will get engaged in activities involving intra-Community trade.

The Commission therefore considers that there is State aid within the meaning of Article 87(1) EC Treaty at the *level of the enterprises invested in*.

4.7. Assessment of the compatibility of the measure

As the measure involves State aid at the level of investors and at the level of the targeted SMEs, the Commission has to examine whether this State aid is compatible with the common market.

4.7.1. Evidence of market failure

Point VI.5 of the Communication provides that the Commission will require the evidence of market failure for risk capital measures. It may, however, be prepared to accept the case for market failure when each tranche of finance for an enterprise from risk capital measures, which are wholly or partially financed through State aid is limited to maximum of EUR 1 million in regions qualifying for assistance under Article 87(3)(a) EC Treaty. In the case of the notified scheme, the Commission considers that these conditions are satisfied as total aid provided by one or several funds to one SME is limited to EUR 1 million in a region qualifying for assistance under Article 87(3)(a) EC Treaty.

4.7.2. Criteria for assessing the compatibility of the measure

Point VIII of the Communication outlines a set of positive and negative elements that the Commission will assess in order to evaluate the compatibility of a risk capital measure once market failure has been established. The following summarises the position of the Commission.

Restrictions of investments

Under the provisions of the Communication, the restriction of investments to small or even micro enterprises and/or to medium-sized enterprises in their start-up or other early stages or in assisted areas will be regarded as a positive element.

The Polish authorities have confirmed that the funds will only provide funding to SMEs who fall within the definition of the Community regulations[5] and will be active only in assisted areas. Moreover, the eligible SMEs will be in their early development stage.

Focus on risk capital market failure

[5] See the definition given in Annex I to the 'Commission Regulation No 70/2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OJ L 10, 13.1.2001, p. 33)' which refers to the Commission Recommendation 96/280/EC concerning the definition of small and medium-sized enterprises (OJ L 107, 30.4.1996, p.4) and is replaced by Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36) from 1 January 2005.

The scheme focuses on risk capital market failure. The established funds will make investments by a variety of funding instruments consisting of equity, quasi-equity and debt instruments. The latter cannot be made independently of equity or quasi equity instruments The acquisition by the funds of stocks or newly issued shares of the SME in accordance with the provisions of the Communication (point VIII.3.) is to be regarded positively The application of market conditions to debt instruments which accompany equity and quasi-equity instruments has been already accepted by the Commission, in particular in case Wales Early Stage Fund[6]. It has to be stressed that on the level of each investment and each fund the investment in the form of debt instruments cannot exceed the investment in equity.

Profit-driven nature of the investment decisions

Pursuant to point VIII.3 of the Communication, a link between investment performance and the remuneration of those responsible for investment decisions will be regarded as a positive element. This will be assumed to be met by measures with significant involvement of market economy investors' capital, being invested on a commercial basis directly or indirectly in the equity of the target enterprises. In the case of funds, provision of at least 50% of the fund's capital would be taken to constitute significant involvement, or 30% in the case of measures operating in assisted areas.
According to the provisions of the present scheme, market economy investors will provide at least 50% of the capital of the funds. This is considered as the significant involvement of private investors. Moreover, as already emphasised above the scheme will operate in Poland only in regions qualifying for assistance under Article 87(3)(a) EC Treaty.

Furthermore, the Commission, in accordance with the Communication, also considers other elements of the scheme in question as positive:

– an agreement between a professional fund manager and participants in the fund, providing that the manager's remuneration is linked to performance;

– setting out the objectives of the fund and proposed timing of investments;

– the representation of private market investors in decision making;

According to the provisions of the scheme, the professional fund managers of the funds will take investment decisions on commercial grounds; they will be remunerated according to their performance. The exact degree of involvement of private investors in the investment strategy of the fund will be established in the contract between the investor(s) and the fund manager. In any case, even if the fund manger is an internal body within the structure of private investors, the requirement of fund managers' remuneration based on performance will be included in the aid granting agreement. Such agreements must also comprise setting out the objectives of the fund and timing of investments.

The investors who agree to a low hurdle rate proposed to them by the fund management and then accepted by the aid granting authority will count mainly on profits from the increase of portfolio companies' value. This indicates that the funds will be commercially managed towards the maximisation of profits.

[6] Case N 572/2003, point 4.2.2.

The present scheme includes the safeguards, mentioned in point 2.8.2 above, which prevent to finance particular enterprises known to investors or fund mangers in advance.

Minimisation of the level of distortion between investors and investment funds

The level of distortion is minimised by the selection of private investors by means of market rules. The lower minimum rate of return per year that a private investor expects to obtain from the carried out investment (hurdle rate), the higher probability that he will be selected by the aid granting authority. The selection is made on the basis of open and widely publicised competition in national and international journals.

Sectoral focus

Firms in difficulties as defined by the Community guidelines on State aid for rescuing and restructuring firms in difficulty[7] are excluded under the measure. Furthermore, SMEs in sensitive sectors as defined by section VIII.3 of the Communication will be excluded. Pursuant to the Communication, this is to be regarded positively.

Investment on the basis of business plans

Under the provisions of the scheme, all investments will be made on the basis of commercial business plans together with a variety of other standard commercial tests to ensure the viability of the project and the expected commercial return. The fund manger is obliged to carry out a detailed analysis of the business plan of the targeted SME. This is to be considered as another positive element pursuant to the Communication.

Avoidance of cumulation of aid measures to a single enterprise

According to point VIII.3 of the Communication, if a measure provides aid to the enterprises invested in, the Commission may request commitments from a Member State to assess and set limits to other forms of State aid to enterprises funded by the risk capital measure, including under authorised schemes.

The Programme excludes the cumulation with regional aid for 2 years following the date of signing the investment agreement. It has to be remembered that aid can only be given in assisted areas pursuant to Article 87(3)(a) EC Treaty and the aid granting agreements can only be signed till 31 December 2007.

All the above is to be considered positively in light of the Communication.

5. CONCLUSION

[7] OJ C 244, 01.10.2004, p.2.

In view of the positive elements of the scheme, the Commission concludes that the measure *Aid to the creation of the funds of seed capital* - Venture Capital Financing for Small and Medium-Sized Enterprises fulfils the conditions as set out in the 'Commission Communication on State Aid and Risk Capital'. It has therefore found the measure to be compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty.

DECISION

On the basis of the foregoing assessment, the Commission concludes that the measure *Aid to the creation of the funds of seed capital* - Venture Capital Financing for Small and Medium-Sized Enterprises as described above is compatible with the common market pursuant to Article 87(3)(c) EC Treaty.

The Commission reminds the Polish Government to submit an annual report on the implementation of the scheme.

The Commission further reminds the Polish Government that all plans to modify this aid scheme have to be notified to the Commission.

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax No: 32 2 2961242

Yours faithfully,
For the Commission

Neelie KROES
Member of the Commission