Case No: 73095
Event No: 656487
Dec. No: 104/13/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 13 March 2013

not to raise objections to the National Seed Capital scheme

(Norway)

The EFTA Surveillance Authority ("the Authority")

HAVING REGARD to the Agreement on the European Economic Area ("the EEA Agreement"), in particular to Articles 61 to 63 and Protocol 26 thereof,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ("the Surveillance and Court Agreement"), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement ("Protocol 3"), in particular to Article 1(3) of Part I and Article 4(3) of Part II,

HAVING REGARD TO the Authority's Guidelines[1] on the application and interpretation of Articles 61 and 62 of the EEA Agreement, and in particular on State Aid to promote Risk Capital Investments in Small and Medium-Sized Enterprises ("the Risk Capital Guidelines") in Part III;

Whereas:

I. FACTS

1. Procedure

(1) The Norwegian authorities notified the National Seed Capital scheme pursuant to Article 1(3) of Part I of Protocol 3 by letter received and registered by the Authority on 16 January 2013 (Events No 659632 and 659635).

2. Description of the proposed measure

2.1 The objective of the National Seed Capital scheme

(2) The primary objective of the National Seed Capital scheme is to increase the supply of risk capital. The Norwegian authorities discern a shortage in private capital that affects innovative young enterprises with a high-growth and international potential at their seed

[1] Procedural and Substantive Rules in the Field of State Aid (State Aid Guidelines), adopted and issued by the EFTA Surveillance Authority on 19 January 1994, published in OJ 1994 L 231, as amended by Decision 313/06/COL. The State Aid Guidelines are available on the Authority's website: http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/.

and start-up stages, as well as for their further development. This shortage has increased since the beginning of the financial crisis.

(3) The Norwegian authorities submitted a study commissioned from the independent consultancy MENON about the situation of the provision of early stage risk capital (including seed capital) in Norway.[2] They also submitted a report by the Norwegian Venture Capital & Private Equity Association (NVCA) that covers the fund-raising activities of private funds with regards to risk capital investments.[3]

(4) The Norwegian authorities argue that these recent studies demonstrate a market failure for early stage risk capital in Norway: whilst there is very little seed and start-up capital available from private sources, that limited supply has been further reduced due to the financial crisis. Under the current market conditions, private funds generally tend not to make investments at the seed stage into companies based in Norway. This is primarily due to the high risks and relatively low returns generated from seed stage investments. There is also a lack of available risk capital at later development stages. At the same time, a market survey quoted in the MENON study indicates that market participants expect demand for risk capital to increase in the coming years.[4]

(5) According to the Norwegian authorities, this shows that there is a severe equity gap for risk capital to innovative young enterprises. The MENON study estimates that the median size of investments at the seed stage amount to EUR 1.7 million, and at later development stages to EUR 2.8 million.[5] The Norwegian authorities argue that this provides an estimate for the respective equity gaps.

2.2 The National Seed Capital scheme

(6) The National Seed Capital scheme builds on the experience from the previous Norwegian national seed capital scheme, as approved by the Authority.[6]

2.2.1 The funds and their management

(7) The notified scheme covers a total of six funds with an investment volume of up to NOK 500 million each (NOK 3 billion in total). The minimum fund size is NOK 350 million, which the Norwegian authorities consider to be sufficient to ensure the robust and professional management of a fund. The funds will be set up for a maximum of 15 years.

(8) The fund management will be chosen by way of an open, transparent and non-discriminatory tender procedure with objective selection criteria including track record, competence, ability to attract investors and price, respecting the applicable EEA rules and Norwegian legislation. The managers' remuneration will be market-based and linked to performance. The best practice standards of the NVCA will apply to the management. Furthermore, each fund will establish an advisory committee to assist the management in its investment decisions.

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[2] MENON Business Economics, "The need for government supported capital measures in the market for early stage risk capital in Norway", MENON publication no. 18/2011, available at http://en.menon.no/publications.

[3] "NVCA Activity Report H1 2012 – Private Equity Funds in Norway, Seed – Venture – Buy Out", also available at http://en.menon.no/publications.

[4] MENON publication no. 18/2011, page 34.

[5] MENON publication no. 18/2011, page 48.

[6] See Dec. No. 181/05/COL and 61/06/COL, which are available at http://www.eftasurv.int/state-aid/state-aid-register/norway/.

(9) The detailed arrangement of the fund management, including remuneration of the fund managers, the funds' governance as well as the conditions for investments will be laid down in a Seed Capital Framework Agreement that is currently been discussed with certain stakeholders who have experience with investments in early stage ventures and know the behaviour of potential investors who may invest private capital in the notified scheme.

(10) The notified scheme does not prescribe any sector focus for the funds. However, fund managers and investors can decide to specialise if they consider it commercially advantageous.

(11) Investments into enterprises in difficulty as defined in the Authority's State Aid Guidelines, enterprises in the shipbuilding, coal and steel sectors, real estate and financial industries will not be allowed. The Norwegian authorities further confirm that any aid under the notified scheme will neither be directly linked to the quantities exported, to the establishment and operation of a distribution network or to other current expenditure linked to export activity, nor to aid contingent upon the use of domestic in preference to imported goods. However, some of the target enterprises may export goods or services, especially in later development stages.

2.2.2 The funds' investments

(12) The funds' investment decisions will be profit-driven and based on a business plan. An exit strategy will be established for each investment.

(13) Investments by the funds can take the form of equity or quasi-equity, i.e. any instruments the return on which is based on the profits and losses of the target company and that are unsecured in case of default.

(14) The funds can only make initial investments into young enterprises that have reached a maximum of five years from incorporation. These will be either micro or small enterprises[7] in the seed or start-up phase and based in Norway. Investments in Norway-based subsidiaries of foreign firms are not excluded from the notified scheme.

(15) Any initial investment is limited to a maximum of EUR 1.5 million. Thereafter, the funds will be allowed to make follow-on investments (even beyond the expansion stage and irrespective of company size) up to a maximum of EUR 2.5 million in any 12-month period. Funds will not invest more that 15% of their respective capital in any single company. The funds will not make revolving investments, i.e. the result of divestments will not be reinvested.

(16) The funds' cumulative shareholding in a company will normally be limited to 49%.

2.2.3 The investors

(17) At least half of the funds' capital will be contributed from external investors, which will be attracted to the funds by way of open invitations. There will be no specific restrictions on foreign investors. The minimum investment per investor in each fund will be NOK 2.5 million to ensure that investors have a sufficient financial interest to be willing to invest time and competence in addition to capital. The maximum share per investor in each fund is set at 25% (i.e. a maximum of NOK 125 million in a NOK 500 million fund).

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[7] As defined in the State Aid Guidelines on aid to micro, small and medium-sized enterprises in Part III, which refer to Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p. 36.

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(18) Investors will be approved by Innovation Norway[8] according to the following criteria:

- First priority will be given to entirely private investors. These include business angels, family businesses, other private companies and the European Investment Fund. If there is an oversubscription of private investors, "business angels"[9] will receive preference as they are likely to possess relevant expertise they can contribute to the funds.

- Second priority will be given to partly publicly owned investors listed on stock exchanges.

- Third priority will be given to partly publicly owned investors not listed on stock exchanges.

- Fourth priority will be given to fully publicly owned investors operating commercially according to their strategy and that have more than one (public) owner. The criterion for more than one owner is established because this means that any departure from the company's official commercial strategy would be harder to implement than in case of a single public owner.

- Fully publicly owned companies with a single owner are excluded from investing in the funds unless they comply with the state ownership policies for commercial enterprises, which include additional safeguards.[10]

(19) For all publicly owned companies, Innovation Norway will make an assessment to ensure that they are acting on a commercial basis.

(20) According to the Norwegian authorities, the scheme cannot exclude commercially run public companies from investing, as this would carry a substantial risk that the funds would not be able to attract sufficient capital to be established.

(21) The Norwegian authorities point out that the Norwegian economy has a particularly high share of publicly owned companies, with a public ownership of about 35% of the equity on the Oslo Stock Exchange and an estimated 33% of the total market value of all Norwegian businesses.[11] This importance of publicly owned enterprises in Norway is mainly due to the Norwegian policy of securing public ownership in natural resources, especially in sectors such as hydropower and petroleum. In the hydropower sector, Norwegian legislation lays down the principle of public ownership of hydropower resources. However, the public companies exploiting these resources compete on the energy market and act on a commercial basis. A similar situation arises in the petroleum sector, where Statoil ASA is under majority state ownership, but is listed on stock exchanges both in Norway and in New York and must thus comply with their rules.

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[8] Innovation Norway is an entity wholly owned by the Norwegian State whose objective is to promote innovation and business development in Norway. Its financial tools are equity capital, low risk loans, venture capital loans, grants and guarantees.

[9] "Business angels" (or "angel investors") are individuals who provide seed or start-up finance to entrepreneurs in return for equity. Business angels usually contribute more than pure cash – they often have industry knowledge and contacts that they can pass on to entrepreneurs.

[10] See White Paper "Active ownership – Norwegian State ownership in a global economy", Meld. St. 13 (2010–2011), section 5, available at: http://www.regjeringen.no/en/dep/nhd/documents/government-propositions-and-reports/reports-to-the-storting-white-papers/2010-2011/meld-st-13-20102011.html.

[11] *Ibid*., section 2.

(22) The prevalence of publicly owned enterprises (including in these sectors) is also reflected in the investor mix in the previous seed capital scheme. Of the about NOK 683 million invested in the four nationwide seed funds established from 2006, about NOK 200 million came from partly state-owned enterprises listed on the Oslo Stock Exchange. A further NOK 100 million came from fully publicly owned enterprises operating commercially. The total investment capital from wholly or partly publicly owned investors was therefore about NOK 300 million, or 44% of the total invested capital.

2.2.4 The state's participation in the funds

(23) The Norwegian state will participate with equity in each fund up to maximum of 50%. This participation includes a support element to investors, as 15% of the capital injected by the state will be allocated to the other investors as additional shares in the fund, thus increasing their shareholdings. On a basis of a 50% participation by the state in the equity of a fund, the resulting shareholding will be 42.5% for the state and 57.5% for the other investors.

(24) Apart from this support element, the state will invest at the same conditions (*pari passu*) as the other investors.

2.3 National legal basis for the aid measure

(25) The following Norwegian legal instruments form the basis for the notified scheme:

- Prop. 111 S (2011-2012) Tilleggsbevilgninger og omprioriteringer i statsbudsjettet 2012;[12]
- St. Meld. (2011-2012) Verktøy for vekst – Om Innovasjon Norge og SIVA SF;[13] and
- Entrustment letter to Innovation Norway.[14]

2.4 Budget and duration

(26) The notified scheme has a maximum budget allowance of NOK 1.5 billion for the establishment of up to six funds. As a first step, NOK 500 million were allocated in the 2013 budget to enable the setting up of the first two funds. However, the first funds will only be set up once the scheme is authorised by the Authority. The Norwegian authorities expect that the last funds will be established by 2017.

(27) The funds in the scheme have a maximum lifetime of 15 years. The Norwegian authorities estimate that it will take about a year for funds to become operational, and that the active investment period for each fund will be about five years.

(28) The Norwegian authorities consider that this lifetime of the funds is indispensable to achieve the objectives of the notified scheme. They point out that risk capital is "patient" capital, and follow-on investments are frequently necessary to achieve good returns from investments. The funds must have a sufficient lifetime to be able to follow target companies from the initial investment until exit in order to offer an attractive investment prospect to private investors.

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[12] Available at: http://www.regjeringen.no/pages/37884048/prop_omf_2012.pdf.

[13] Available at: http://www.regjeringen.no/pages/37862379/PDFS/STM201120120022000DDDPDFS.pdf.

[14] Letter from the Norwegian Ministry of Trade and Industry to Innovation Norway dated 2.7.2012, "Oppdragsbrev til Innovasjon Norge med oppdrag om å opprette nye landsdekkende Såkornfond".

3. Comments by the Norwegian authorities

(29) The Norwegian authorities argue that the National Seed Capital scheme is compatible with the EEA Agreement pursuant to Article 61(3)(c) and the Risk Capital Guidelines.

(30) They consider that the scheme does not contain any state aid in favour of the funds or their fund management, and that the state aid element in favour of investors and enterprises the funds invest in are necessary and proportionate.

(31) The notified scheme contains a moderate incentive to investors, who will receive a total aid element of up to 15% of their committed capital. To illustrate the effect of the aid, the Norwegian authorities explain that over a 15 year life-span, and based on the presumption that investors have all their capital in the funds all the time, the added annual return to investors from the aid, given otherwise a 0% pooled internal rate of return (IRR), is 0.94%. However, as the committed capital is drawn down in tranches and paid back in tranches, it is more likely that only half the capital on average is paid out to the funds. This would increase the added annual IRR to 1.76%. The Norwegian authorities point out that this level of support is lower than in the previous seed capital scheme.[15]

(32) Regarding the application of the Risk Capital Guidelines, the Norwegian authorities comment in particular on the following issues:

- Pursuant to Article 125 of the EEA Agreement and in application of the market economy investor principle, the Authority should not distinguish between private undertakings and public undertakings that act on a commercial basis when applying the Risk Capital Guidelines.

- The experience from the previous scheme shows that it was difficult to attract investors, mainly because of low profitability caused in particular by the strict limitations on follow-on investments.[16] The new funds will be able to invest up to 15% of their capital into a single company, which should enable them to avoid dilution at later stages of development and to increase returns for investors. Early-stage investment funds tend to invest in a large number of companies, of which only a handful succeed. The profitability – and thus the attractiveness for investors – of a fund therefore depends not only on selecting the best companies at the stage of the initial investment, but also on its ability to make follow-on investments in the successful ventures throughout all stages of development and irrespective of the size of the company. The Norwegian authorities argue that without the possibility to undertake such follow-on investments, there is a risk that the funds will not create sufficient investor interest, or that investors will require a higher support element from the state. In any event, the maximum level of each follow-on investment tranche will be EUR 2.5 million in any 12-month period, in line with the Risk Capital Guidelines and within the estimated equity gap.

- The risk of the notified scheme crowding out private investments is very limited, given that there is a lack of risk capital in the market. Furthermore, the funds will

[15] The Norwegian authorities have calculated that given the same assumptions, the previous scheme resulted in an added annual IRR for investors of 1.5% and 2.74% respectively.

[16] MENON publication no. 18/2011, pages 61-62. MENON identifies three core criteria for success: the ability to follow the ventures all the way to exit, the possibility of attracting professional private co-investors, and the competence of the investment team. The Norwegian authorities also submitted a detailed report on the results of the funds established under the previous national seed capital scheme.

normally only hold up to 49% in a single company, which provides sufficient opportunities for co-investments by private investors.

- The notified scheme respects the cumulation rules. All enterprises invested in will be made aware that they have received risk capital aid under the National Seed Capital scheme. It will be their obligation to notify any other aid providers that they have received aid. In addition, Innovation Norway will establish a register over all companies invested in through the funds to provide a further safeguard. The cumulation restrictions will apply three years from the last capital injection. There will be no cumulation rules regarding other aid received before the initial first risk investment through the funds. There will be no cumulation restrictions regarding aid for research, development and innovation.

- The funds must comply with industry reporting standards and reporting obligations under Norwegian law. In addition, annual and bi-annual aggregated reports for the funds will be prepared by Innovation Norway as part of its ordinary reporting procedure. These reports will, as a minimum, contain details on size of tranches, the size of companies invested in, the development stage (for initial investments), sector, deal flow and the management of the funds, in accordance with the Risk Capital Guidelines.

II. ASSESSEMENT

1. Existence of state aid within the meaning of Article 61(1) of the EEA Agreement

(33) The Authority has examined the notified scheme in light of Article 61 of the EEA Agreement, and in particular on the basis of its Risk Capital Guidelines.

(34) Article 61(1) of the EEA Agreement reads as follows: "Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement."

(35) The following conditions must be met for a measure to constitute state aid within the meaning of Article 61(1) of the EEA Agreement:

- The measure must involve the use of State resources;

- The measure must distort or threaten to 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 EEA States.

(36) State resources are present in that 50% of the capital base under the scheme will be provided by the state out of its budget.

(37) In line with section 3.2 of the Risk Capital Guidelines, in the assessment of whether state aid is present within the meaning of the EEA Agreement, the Authority will consider the possibility that the measure may confer aid on at least three different levels:

- Aid to investors;
- Aid to funds (including their management) through which the measure operates;
- Aid to the companies invested in.

1.1 Aid to investors

(38) Paragraph 31 of section 3.2 of the Risk Capital Guidelines states that where a measure allows private investors to effect equity or quasi-equity investments into a company or set of companies on terms more favourable than public investors, or than if they had undertaken such investments in the absence of the measure, then those private investors will be considered to receive an advantage.

(39) In the case of the notified scheme, 15% of the capital injected by the state will be allocated to the other investors as additional shares in the fund. It therefore appears that the state does not participate *pari passu* with the private investors, and therefore that the equity contribution by the state is not granted on conditions that would have been acceptable to a market investor. Hence, advantages are conferred on the private investors as they will participate in the investment on more favourable terms than if they had undertaken such investments in the absence of the measure.

(40) Even though the investors will be approached by way of an open invitation to all market investors, only the investors selected at the outcome of the procedure will benefit from the state's participation. The scheme is therefore considered to be selective in nature.

(41) The scheme strengthens the position of the selected investors compared to other investors who do not benefit from these favourable investment conditions. Further, investment in capital is subject to considerable trade between EEA States. The scheme is, therefore, liable to affect trade between EEA States and to distort competition.[17]

(42) At the level of the investors, the Authority therefore considers that the National Seed Capital scheme results in the granting of state aid within the meaning of Article 61(1) of the EEA Agreement.

1.2 Aid to the funds and their fund management

(43) Paragraph 32 of section 3.2 of the Risk Capital Guidelines states that in general, the Authority considers that an investment fund is an intermediary vehicle for the transfer of aid to investors and/or enterprises in which investments are made, rather than being the beneficiary itself. This is normally only different in case of direct transfers or fiscal advantages granted to an existing fund. These exceptions do not apply to the case at hand.

(44) According to the Risk Capital Guidelines, there is a presumption that no aid is present at the level of fund managers if they are chosen through an open and transparent public tender procedure or if they do not receive any other advantages granted by the state. In the case at hand, the scheme foresees a an open, transparent and non-discriminatory tender

[17] See Joined Cases E-5/04, E-6/04 and E-7/04 *Fesil and Finnfjord a.o. v EFTA Surveillance Authority* [2005] EFTA Court Report 2005, p. 117, paragraph 93.

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procedure with objective selection criteria including track record and competence of the managers, their ability to attract investors and the price of their services. This will exclude that the fund managers will receive remuneration beyond the market level and thus any advantage. The Norwegian authorities further committed that they will comply with the applicable EEA and Norwegian procurement rules.

(45) The Authority therefore considers that the National Seed Capital scheme does not result in the granting of state aid within the meaning of Article 61(1) of the EEA Agreement in favour of the investment funds or their fund managers.

1.3 Aid to the enterprises invested in

(46) It follows from paragraph 33 of section 3.2 of the Risk Capital Guidelines that, where aid is present at the level of the investors, it will normally be considered to be at least partly passed on to the target enterprises. However, it is also stated that this may not be the case where investments are made on terms which would have been acceptable to a private investor in a market economy in the absence of state intervention.

(47) Although the scheme foresees that the funds will be profit-driven and based on business plans providing for an exit strategy, the Authority considers that the private investors in the funds benefit from reduced risks and enhanced returns when making an investment, and consequently can no longer be said to operate as normal economic operators. Moreover, it is stated in the notification that the scheme will encourage investors to provide risk capital to the target enterprises, which would not have happened in the absence of the aid. Thus, there is a possibility that some of the advantages accorded to investors in the funds are passed on to the enterprises invested in.

(48) As the scheme is limited to initial investments in micro and small enterprises in their start up and early stages (maximum five years from incorporation) as well as follow-on investments in these companies, it is considered to be a selective measure.

(49) Finally, the scheme strengthens the position of the target undertakings compared to other undertakings who do not benefit from the funds' investments. As companies invested in may be, or become engaged in activities involving intra-EEA trade, the scheme is liable to affect intra-EEA trade and to distort competition.[18]

(50) At the level of the enterprises invested in by the funds, the Authority therefore considers that the National Seed Capital scheme results in the granting of state aid within the meaning of Article 61(1) of the EEA Agreement.

2. Procedural requirements

(51) Pursuant to Article 1(3) of Part I of Protocol 3, "the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (…). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision".

(52) The Authority notes that the Norwegian authorities have not yet implemented the National Seed Capital scheme and that no state aid has yet been granted. Furthermore, by submitting the notification received and registered by the Authority on 16 January 2013 (Events No 659632 and 659635), the Norwegian authorities complied with the notification requirement.

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[18] *Ibid.*

(53) The Authority can therefore conclude that the Norwegian authorities have respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

3. Compatibility of the aid

(54) Under Article 61(3)(c) of the EEA Agreement, aid to facilitate the development of certain economic activities or of certain economic areas may be considered to be compatible with the functioning of the EEA Agreement where such aid does not adversely affect trading conditions to an extent contrary to the common interest.

(55) The primary objective of the National Seed Capital scheme is to increase the supply of risk capital to innovative young enterprises. This objective falls within the scope of the Risk Capital Guidelines as expressed in their section 2.1. The Authority further notes that none of the exclusions in this section apply.

(56) The compatibility of the notified scheme thus has to be assessed pursuant to the conditions laid down in the Risk Capital Guidelines.

3.1 Compatibility assessment under section 4 of the Risk Capital Guidelines

(57) Section 4.3 of the Risk Capital Guidelines provides for specific compatibility criteria. If all these conditions are fulfilled, the incentive effect, the necessity and the proportionality of the aid can be considered as present, and the overall balance of the potential negative and positive effects of the aid can be considered as positive, without the need for a more detailed assessment.

3.1.1 Maximum level of investment tranches

(58) Section 4.3.1 of the Risk Capital Guidelines stipulates that tranches of finance, whether wholly or partially financed through state aid, must not exceed EUR 2.5 million per target enterprise over each 12-month period.

(59) Under the notified scheme, the funds will operate in accordance with this limit. Section 4.3.1 of the Risk Capital Guidelines is therefore complied with.

3.1.2 Restriction to seed, start-up and expansion financing

(60) According to section 4.3.2 of the Risk Capital Guidelines, a risk capital measure must be restricted to small enterprises up to their expansion stage.

(61) Under the notified scheme, only micro and small enterprises in their seed and start-up phase are eligible for initial investments by the funds. However, the funds are allowed to carry out follow-on investments that are not limited to the expansion phase, nor by the size of the company. Therefore, the measure does not comply with section 4.3.2 of the Risk Capital Guidelines.

3.1.3 Prevalence of equity and quasi-equity investment instruments

(62) Section 4.3.3 of the Risk Capital Guidelines requires that at least 70% of the measure’s budget must be used in the form of equity and quasi-equity investments.

(63) Investments by the funds under the notified scheme will only take the form of equity or quasi-equity, i.e. any instruments the return on which is based on the profits and losses of the target company and that are unsecured in case of default. The measure thus fulfils the criterion in section 4.3.3 of the Risk Capital Guidelines.

3.1.4 Participation by private investors

(64) Moreover, section 4.3.4 of the Risk Capital Guidelines requires that outside assisted areas, at least 50% of the funding of the investments must be provided by private investors.

(65) The Norwegian authorities argue that the Authority should not distinguish between private investors and publicly owned investors that act on a purely commercial basis. However, the purpose of aid to investors as described in the Risk Capital Guidelines is to attract private investors who would not otherwise have invested in early-stage investment funds. Moreover, the compatibility criteria under section 4.3 of the Risk Capital Guidelines are designed to allow for aid measures to be authorised without the need for a detailed assessment. Given that the economic assessment under Article 61(3)(c) of the EEA Agreement normally requires a detailed examination of the incentive effect, the necessity and proportionality of the aid, the presumption set out in paragraph 41 of the Risk Capital Guidelines constitutes an exception, which has to be interpreted narrowly. Finally, the Authority notes a similarity to the application of the market economy investor principle, which also requires a comparison of the investment decisions of a publicly owned entity with those of a genuine private investor. For these reasons and for the purpose of section 4.3.4 of the Risk Capital Guidelines, the term private investor therefore has to be interpreted narrowly as “genuine” private investor.[19]

(66) The notified scheme foresees that a minimum of 50% of the funds’ capital will be contributed by investors other than the Norwegian State. However, it does not limit this contribution to genuine private investors. As a result, the Authority finds that the notified scheme does not comply with the criterion in section 4.3.4 of the Risk Capital Guidelines.

3.1.5 Profit-driven character of the investment decisions

(67) Section 4.3.5 of the Risk Capital Guidelines sets out three cumulative conditions to assess the profit-driven character of investment decisions:

- First, according to section 4.3.5 (a) of the Risk Capital Guidelines, a significant involvement of private investors as described in section 4.3.4 of the Risk Capital Guidelines, providing investments on a commercial basis (that is, only for profit) into the equity of the target enterprises, must be present. As described above, the Authority does not consider that the notified scheme meets the criterion for a signification involvement of genuine private investors laid down in section 4.3.4 of the Risk Capital Guidelines. The notified scheme therefore does not fulfil this condition either.

- Second, and pursuant to section 4.3.5 (b) of the Risk Capital Guidelines, a detailed business plan for each investment, establishing a project’s *ex ante* viability, must exist. Given that the funds’ investment decisions will be profit-driven and based on a business plan, this condition is fulfilled.

- Third, as set out in section 4.3.5 (c) of the Risk Capital Guidelines, a clear and realistic exit strategy must exist for each investment. The notified scheme requires the funds to establish an exit strategy for each investment. Therefore, this condition is also fulfilled.

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[19] The European Commission followed a similar approach in its decision on State aid N 263/2007 – Germany (Saxony) – Saxon Early Stage Fund (Technology Founder Fund Saxony), the full text of which is available on the Commission’s website at http://ec.europa.eu/competition/state_aid/register/.

(68) Given that the notified scheme does not fulfil all three conditions, the Authority finds that it does not comply with section 4.3.5 of the Risk Capital Guidelines.

3.1.6 Commercial management

(69) According to section 4.3.6 of the Risk Capital Guidelines, three cumulative conditions need to be fulfilled to find that the funds' management is carried out on a commercial basis:

- First, section 4.3.6 (a) of the Risk Capital Guidelines requires an agreement between the fund management and the fund participants, providing that the management's remuneration is linked to performance, as well as setting out the objectives of the fund and the proposed timing of investments. The Norwegian authorities have submitted a draft Seed Capital Framework Agreement that will be concluded between the fund management and the investors in line with these requirements. Accordingly, this condition is met.

- Second, pursuant to section 4.3.6 (b) of the Risk Capital Guidelines, private investors must be represented in the decision-making of the fund, such as through an investors' or advisory committee. The notified scheme foresees the establishment of advisory committees to enable genuine private investors to advise on investment decisions. Therefore, this condition is fulfilled, assuming that there are at least some genuine private investors in each fund.

- Third, section 4.3.6 (c) of the Risk Capital Guidelines requires that best practices and regulatory supervision apply to the management of the funds. Fund managers under the notified scheme will apply the best practice standards of the NVCA and will be subject to regulatory supervision as well as reporting obligations towards Innovation Norway. This condition is therefore also fulfilled.

(70) The Authority thus concludes that the notified scheme fulfils all the conditions laid down in section 4.3.6 of the Risk Capital Guidelines.

3.1.7 Sectoral focus

(71) The notified scheme does not foresee that the funds will be focussed on any specific sector.

3.1.8 Result of the analysis under section 4.3 of the Risk Capital Guidelines

(72) The Authority concludes that the notified scheme does not comply with the criteria set out in sections 4.3.2, 4.3.4 and 4.3.5 of the Risk Capital Guidelines as it is not limited to genuine private investors and because it lacks restrictions in relation to follow-on investments. The measure will therefore have to be subject to the detailed compatibility assessment provided for by section 5 of the Risk Capital Guidelines.

3.2 Compatibility assessment under section 5 of the Risk Capital Guidelines

3.2.1 General considerations

(73) Section 5.1 of the Risk Capital Guidelines sets out general considerations regarding the types of risk capital measures not complying with one or more of the conditions set out in section 4.

(74) Regarding follow-on investments beyond the target companies' early-growth stage, section 5.1 (a) of the Risk Capital Guidelines recognise that this may be necessary to avoid dilution of the public participation in these financing rounds while ensuring

continuity of financing for the target enterprises so that both public and private investors can fully benefit from the risky investments. The Authority thus can accept such follow-on investments provided their respective amounts are consistent with the initial investments and with the size of the relevant funds.

(75) The Authority notes that the funds will invest in early-stage projects with high risk. This means that a considerable number of investments is likely to result in losses. In turn, the possibility to make follow-on investments beyond the early-growth stage increases the likelihood that the funds will generate profits for the investors and thus be able to make up for losses from less successful projects. Without the ability to make follow-on investments, there is a risk of dilution of the funds' shareholding in these financing rounds, which would not only threaten the profitability of the funds, but could also unduly benefit investors that are only coming in at later stages.

(76) The Authority further notes that the experience from the previous scheme shows the impact restrictions on follow-on investments can have on profitability. It is therefore plausible that any further restrictions on follow-on investments would have a negative impact on investors' decisions whether to invest and could seriously hinder the establishment of the funds. This view is also confirmed by comments from market participants submitted by the Norwegian authorities.

(77) The Authority finally notes that the notified scheme foresees that each follow-on investment tranche will be limited to EUR 2.5 million in any 12-month period, in line with Section 4.3.1 of the Risk Capital Guidelines, and that the funds will not invest more that 15% of their capital in any single company. Given these limitation as well as the commercial management of the funds, the Authority considers that there are sufficient safeguards to ensure that the amount of follow-on investments will be consistent with the initial investment and with the size of the funds.

(78) For these reasons, the Authority concludes that section 5.1 (a) of the Risk Capital Guidelines can be applied to the notified scheme.

(79) Regarding the lack of genuine private investors, section 5.1 (d) of the Risk Capital Guidelines recognises that the level of development of the private risk capital market varies to a significant extent in the various EEA States. In some cases, it might be difficult to find genuine private investors, and therefore the Authority is prepared to consider declaring measures with a private participation below the thresholds set out in section 4.3.4 of the Risk Capital Guidelines compatible with the functioning of the EEA Agreement.

(80) The Authority has noted the arguments put forward by the Norwegian authorities concerning the high share of publicly owned companies in Norway and the experience from the previous scheme. Given these specificities of the Norwegian economy, the Authority considers that completely excluding publicly owned companies from investing under the notified scheme would most likely result in insufficient capital to be committed for the funds to be established. The Authority notes in particular that the funds under the notified scheme are larger than under the previous one and that banks, which have been important investors in the previous scheme, are less likely to continue investing seed capital in Norway given the changes in the regulatory framework (e.g. regarding capital requirements) following the financial crisis. Furthermore, the Authority notes that the notified scheme gives priority to genuine private investors and contains safeguards to ensure that only publicly owned companies that act on a commercial basis are allowed to invest in the funds.

(81) On this basis, the Authority concludes that section 5.1 (d) of the Risk Capital Guidelines can be applied to the notified scheme.

(82) Finally, the Authority also concludes that the safeguards to ensure that publicly owned investors act on a commercial basis, in combination with the professional fund management and the existence of an advisory committee, will ensure the profit-driven character of investment decisions.

(83) The Authority can thus apply section 5.2 of the Risk Capital Guidelines, under which it needs to carry out a detailed compatibility assessment based on a number of positive and negative elements.

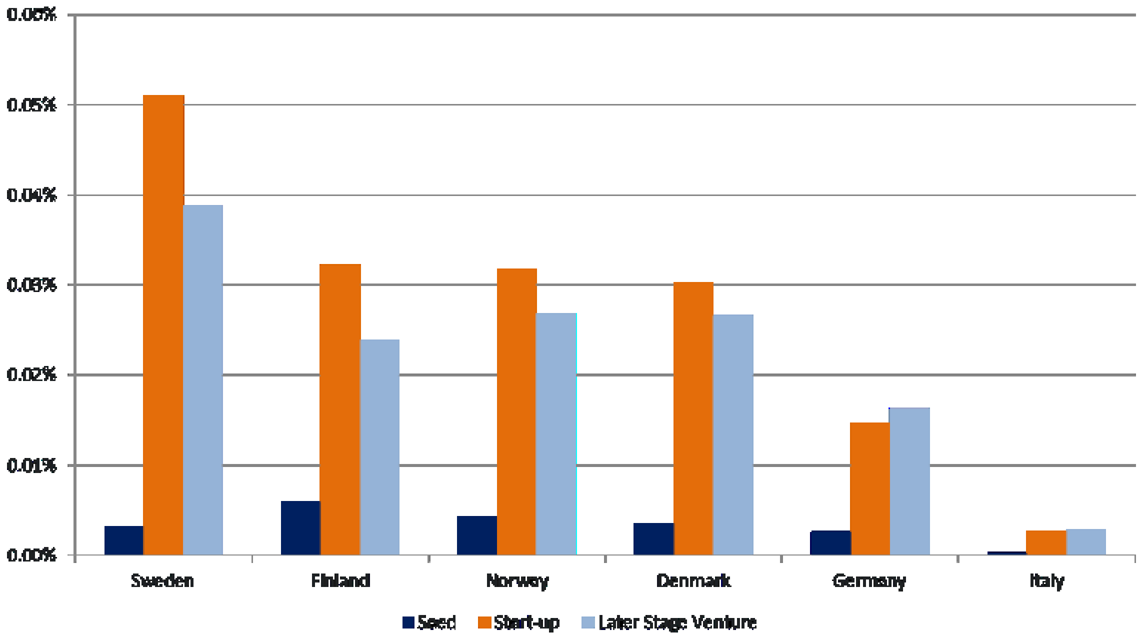
3.2.2 Detailed assessment – evidence of market failure

(84) For risk capital measures envisaging investment tranches into target enterprises beyond the conditions laid down in section 4 of the Risk Capital Guidelines, in particular those providing for tranches above EUR 2.5 million per target enterprise over each period of twelve months, follow-on investments or financing of the expansion stage for medium-sized enterprises in non-assisted areas as well as for measures specifically involving an investment vehicle, the Authority will require additional evidence of the market failure being tackled at each level where aid may be present before declaring the proposed risk capital measure compatible with the functioning of the EEA Agreement.

(85) The notified scheme foresees the possibility for funds to carry out follow-on investments beyond the start-up stage and irrespective of company size. Accordingly, the Authority needs to undertake a detailed assessment of the alleged market failure.

(86) The MENON study submitted by the Norwegian authorities shows the level of total venture investments at seed, start-up and later development/expansion stages in Norway, and provides a comparison to selected other European countries.

Total venture market investment 2007-2010 per GDP by phase[20]



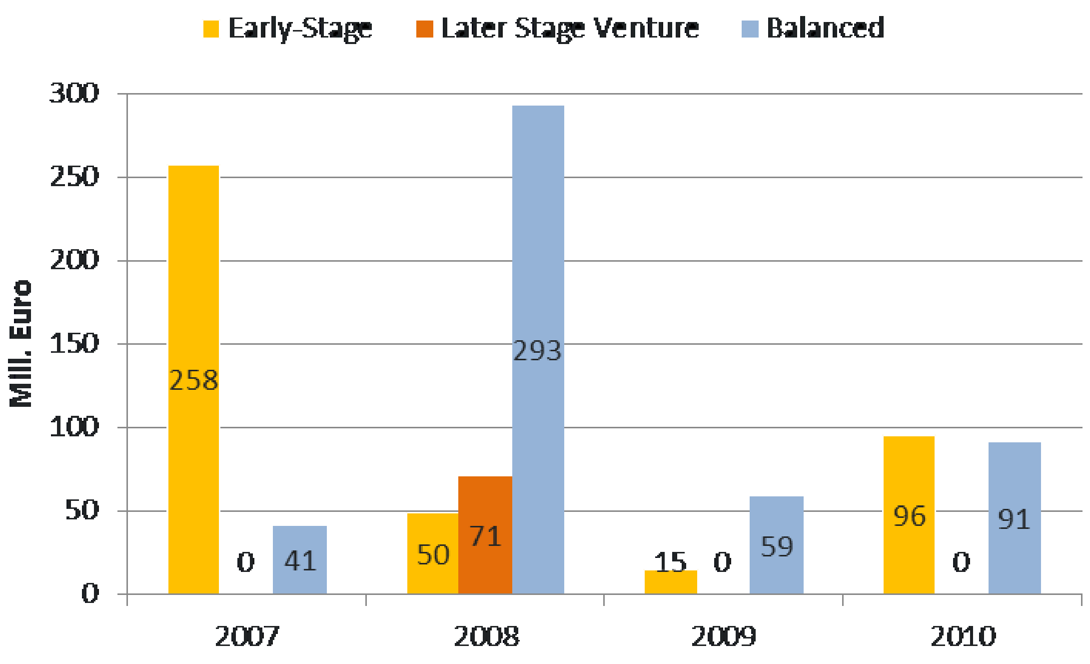
[20] MENON publication no. 18/2011, page 36.

(87) The study shows that in comparison to other Nordic countries, the level of total venture investments at seed, start-up and later development/expansion stages in Norway can be considered as average: it is lower than in Sweden and merely to the levels in Denmark and Finland.

(88) In addition, the study highlights that seed investments in Europe generally is far lower than in the US. For example, whereas seed capital investments represent only 0.004% of GDP in Norway, the number is three times higher in the US (0.012%). According to the study, this indicates a significant equity gap at the seed stage in Norway. The equity gap is less pronounced at the start-up stage, where levels in Norway are similar to those observed in the US. At the expansion stage, however, the study shows once again a significant difference, with capital investments in the US (0.065% of GDP) representing more than double the level observed in Norway. The study thus indicates that there is a shortfall of investment capital not only at the seed stage, but also at the later development/expansion stage.

(89) This shortfall is further evidenced by the limited fundraising by private investment funds in Norway, which also concerns the later development stage. Overall fund raising levels have declined sharply since the beginning of the financial crisis, reducing the supply for both seed and expansion capital to firms in Norway.

Development of fundraising in Norway by phase 2007-2010[21]

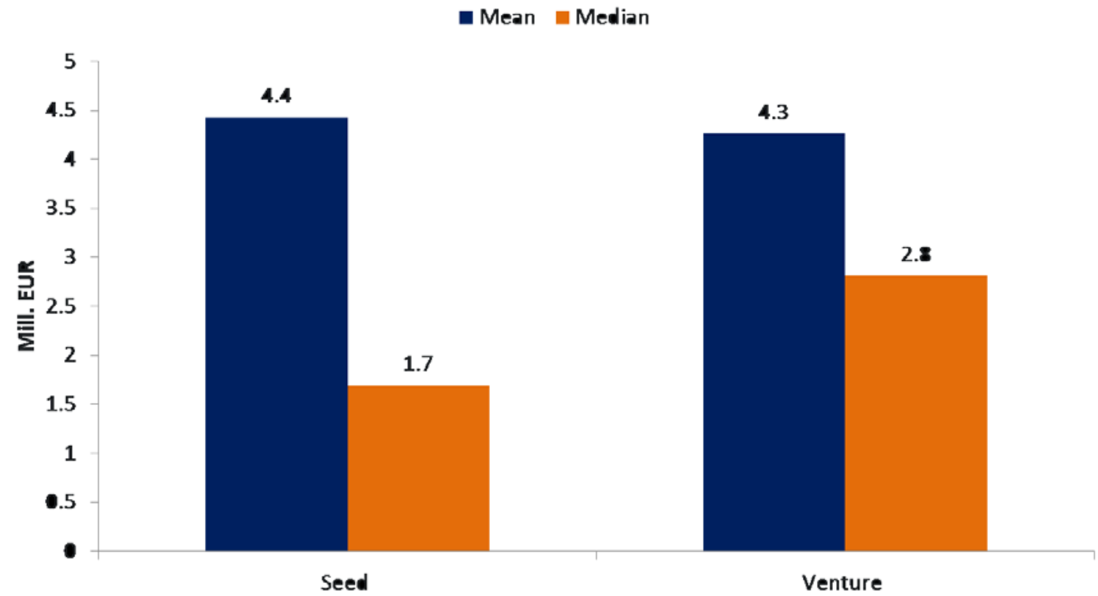


(90) The information submitted by the Norwegian authorities thus provide evidence of a market failure not only at the seed stage, but also at the later expansion stage.

(91) The MENON study shows the typical deal size of later-stage investments, which provides an indication for the likely size of the equity gap.

[21] MENON publication no. 18/2011, page 39. For the purposes of the study, a "balanced" fund means a mixed fund investing both at early and at later development stages of a company.

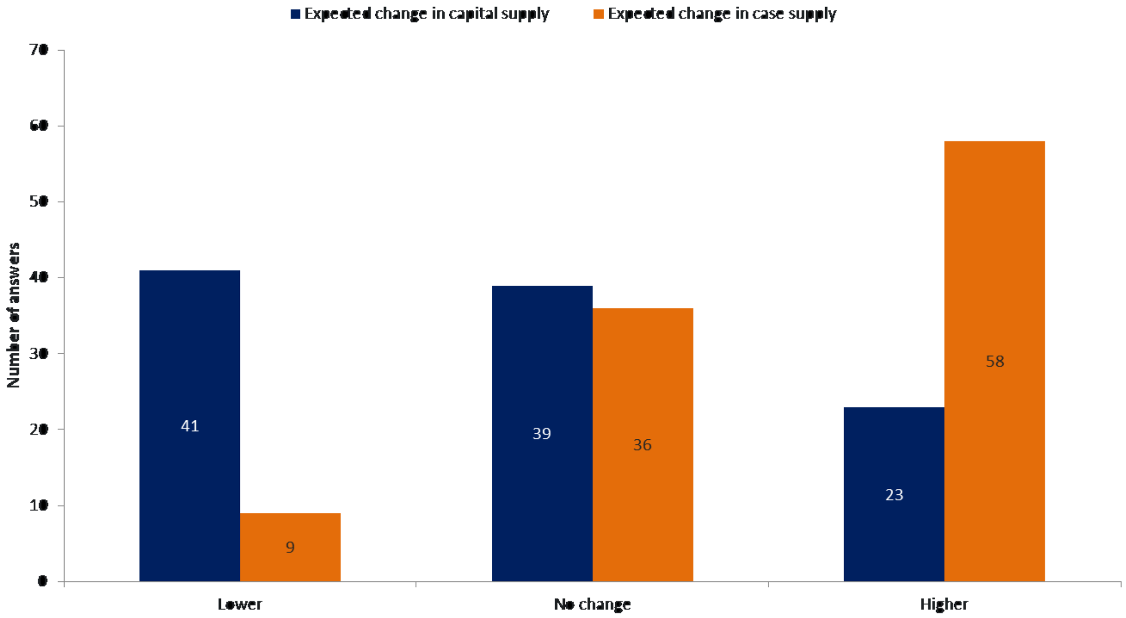
Average size of an investment – both initial and follow-on investment[22]



(92) The study reports that the median investment size by venture capital funds (initial and follow-on investments combined) at the later phases is about EUR 2.8 million.

(93) Finally, the MENON study provides a summary of a survey of market expectations about developments in the supply and demand in capital for the next few years.

Expectations about the next years (1-3 year perspective)[23]



(94) The majority of market participants in the survey estimated that the capital supply would remain stable at the current low levels or even decrease further, whereas the demand for capital would most likely increase. This tendency would further exacerbate the equity gap at all development stages.

22 MENON publication no. 18/2011, page 48.

23 MENON publication no. 18/2011, page 34.

(95) On the basis of these considerations, the Authority concludes that there is sufficient evidence of market failure in the form of an equity gap at the relevant development levels.

3.2.3 Detailed assessment – appropriateness of the instrument

(96) According to section 5.2.2 of the Risk Capital Guidelines, the Authority will take particular account of any impact assessment of the proposed measure, but will also assess evidence of other measures taken or to be taken to address the equity gap, notably *ex post* evaluations and both supply and demand side issues affecting the targeted enterprises, to see how they would interact with the proposed risk capital measure. This assessment is closely related to the assessment of the incentive effect and the necessity of aid, as set out in section 5.2.3 of the Risk Capital Guidelines.

(97) The Norwegian authorities have not presented a specific impact assessment for the notified scheme. However, they have supplied the Authority with evidence of market failures and showed how both supply and demand side issues are likely to further exacerbate the equity gap. In addition, the Authority received a detailed *ex post* evaluation of the functioning of the previous scheme, which provides insights into the likely effects of the notified scheme.

(98) On this basis, the Authority concludes that the notified scheme is an appropriate instrument to address the alleged market failures in Norway.

3.2.4 Detailed assessment – incentive effect and necessity of aid

(99) To establish whether the aid will provide an incentive effect and be necessary, the Authority will take into account the criteria in sections 5.2.3.1 to 5.2.3.4 of the Risk Capital Guidelines, showing the profit-driven character of investment decisions and the commercial management of the funds under the notified scheme:

- First, section 5.2.3.1 of the Risk Capital Guidelines, referring to the commercial management of a fund, notes that it is to be assessed positively if a fund is managed by independent professionals who were chosen preferably through an open tender and who have proven experience and a track record in similar capital market investments. The notified scheme complies with these conditions.

- Second, section 5.2.3.2 of the Risk Capital Guidelines refers to the presence of an investment committee, independent of the fund management and composed of independent experts and preferably of representatives of the investors. The notified scheme foresees that each fund will dispose of an advisory committee fulfilling these conditions.

- Third, section 5.2.3.3 of the Risk Capital Guidelines refers to a sufficient fund size to absorb transaction costs and to enable follow-on investments in later, more profitable financing stages of target enterprises. The notified scheme foresees a fund size of between NOK 350 million and NOK 500 million, which is larger than under the previous scheme. According to the Norwegian authorities, the increase in fund size is particularly aimed at ensuring robust and professional fund management and enabling follow-on investments at later stages. The notified scheme thus complies with these conditions

- Fourth, section 5.2.3.4 of the Risk Capital Guidelines assesses the involvement of business angels in investments in the seed stage as a positive signal, especially where the aid measure foresees a predominance of debt instruments. Under the notified scheme, funds will only invest in the form of equity or quasi-equity, and not by debt instruments. Furthermore, the notified scheme contains a mechanism by which business angels will receive priority. It therefore fulfils the conditions under this section.

(100) Taking into account all these considerations, the Authority concludes that the incentive effect and the necessity of aid have been demonstrated for the notified scheme.

3.2.5 Detailed assessment – proportionality

(101) According to section 5.2.4 of the Risk Capital Guidelines, the Authority shall examine the proportionality of the measure, and in particular that neither the investors nor the fund management will be overcompensated.

(102) The Authority notes that the following elements that have a positive influence on the proportionality assessment are present in the notified scheme:

- In accordance with section 5.2.4 (a) of the Risk Capital Guidelines, the notified scheme foresees a transparent, non-discriminatory open tender for the choice of the fund managers, based on a combination of quality and value for money. This will limit the cost of the fund management to the minimum necessary.

- In accordance with section 5.2.4 (b) of the Risk Capital Guidelines, the notified scheme also foresees an open invitation to attract investors acting on a commercial basis. In addition, the Authority notes that the level of support granted to investors is moderate, and in any event lower than in the previous Norwegian seed capital scheme.

(103) On this basis, the Authority concludes that the aid to be granted under the notified scheme is proportional within the meaning of point 5.2.4 of the Risk Capital Guidelines.

3.2.6 Detailed assessment – negative effects of the aid

(104) According to section 5.3 of the Risk Capital Guidelines, the Authority will assess the negative effects at the levels where aid is present. As set out above, the notified scheme involves aid at the level of the investors and at the level of the target enterprises.

(105) Section 5.3.1 of the Risk Capital Guidelines refers to the problem that aid in form of risk capital measures might result in the crowding out of private investments. According to the Norwegian authorities, the risk of crowding-out is, however, very remote given the lack of risk capital in the market, both at seed and later development stages. The notified scheme only seeks to address the market failure in Norway, and not to replace any existing risk capital. Furthermore, the funds will normally only hold up to a 49% share in the equity of a single company, which provides ample opportunities for co-investments by private investors.

(106) Section 5.3.2 of the Risk Capital Guidelines refers to other distortions of competition such as keeping inefficient firms afloat and artificially increasing the valuation of inefficient enterprises. However, under the notified scheme, initial investments will only be made into young micro or small enterprises that have reached a maximum of five years from incorporation. Such enterprises are unlikely to have significant market power. In addition, the investment tranches of the funds are limited to EUR 2.5 million over any 12-month period. Furthermore, the funds will only invest on the basis of business plans, assessed on a commercial basis by professional fund managers and the funds' advisory committees. Finally, the funds are not allowed to make investments in certain sensitive sectors.

(107) On the basis of these considerations, the Authority concludes that the possible negative effects of the notified scheme will be limited.

3.2.7 Detailed assessment – balancing of the positive and negative effects of the aid

(108) The Authority concludes that the notified scheme involves a large number of positive effects that on balance outweigh the possible distortions of competition, distortions that in any case do not affect trading conditions to an extent contrary to the common interest.

3.3 Respect of the cumulation rules

(109) Section 6 of the Risk Capital Guidelines provides for a reduction of aid intensities granted under the measure in question when used to finance investments or other costs eligible for aid under other block exemption regulations, guidelines, frameworks or other state aid documents. Accordingly, relevant aid ceilings must be reduced by 50% in general and by 20% for target enterprises located in assisted areas during the first three years of the risk capital investment and up to the total amount received. According to the same rule, however, this reduction is not applicable to aid intensities provided for in the Authority's Guidelines for State aid for Research and Development or any successor framework.

(110) The Authority notes that the notified scheme takes account of the cumulation rules and contains mechanisms ensuring their application, including a register of all companies invested in through the funds. On this basis, the Authority concludes that the notified scheme complies with the cumulation rules under section 6 of the Risk Capital Guidelines.

3.4 Monitoring and reporting

(111) Section 7 of the Risk Capital Guidelines sets out the conditions for the provision of annual reports on risk capital measures and for publication and recording obligations of the EFTA States. The Norwegian authorities have committed to respect these obligations.

4. Conclusion

(112) On the basis of the foregoing assessment, the Authority considers the proposed Norwegian National Seed Capital scheme to be compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) of the EEA Agreement.

(113) The Norwegian authorities are reminded about the obligation resulting from Article 21 of Part II of Protocol 3 in conjunction with Articles 5 and 6 of Decision No 195/04/COL to provide annual reports on the implementation of the scheme.

(114) The Norwegian authorities are also reminded that all plans to modify this scheme must be notified to the Authority.

HAS ADOPTED THIS DECISION:

Article 1

The National Seed Capital scheme notified by Norwegian authorities on 16 January 2013 is compatible with the functioning of the EEA Agreement.

Article 2

The implementation of the measure is authorised accordingly.

Article 3

This Decision is addressed to the Kingdom of Norway.

Article 4

Only the English language version of this decision is authentic.

Done at Brussels, 13 March 2013.

For the EFTA Surveillance Authority

Oda Helen Sletnes
President

Sabine Monauni-Tömördy
College member