

# COVID-19 and EU State aid recapitalisation

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The EU Commission ("EC") has, for the second time, expanded its Temporary Framework of 19 March 2020 ("Temporary Framework") to provide national governments with further guidance and additional tools to support distressed companies amidst the economic fallout of the COVID-19 crisis.

As noted in our last [blog post](#) covering the first amendment to the Temporary Framework of 3 April 2020 ("First Amendment"), the EC consulted Member States regarding a second amendment allowing governments to recapitalise companies through the use of equity and/or hybrid capital instruments as well as to grant subordinated loans. The EC had to go through several rounds of consultation with Member States with some finding the EC's proposed conditions to the recapitalisation measures overly far-reaching and stringent. According to press reports,<sup>[1]</sup> the EC's proposed amendments drew heavy criticism from Sweden who took the view that national governments should decide about exit strategies for State participation and that a premature exit could lead to unwanted foreign takeovers from investors attempting to benefit from the pandemic. Additionally, Sweden argued that behavioural restrictions such as a ban on M&A activity would make it harder for companies to recover from the crisis. The consultation process also took place against a backdrop of northern Member States seeking to relax State aid rules. For example, Austria (unsuccessfully) called for a temporary suspension thereof during the fight against COVID-19.<sup>[2]</sup>

On 8 May 2020, the EC adopted the second amendment proposal to the Temporary Framework ("Second Amendment") taking account of Member States' concerns.<sup>[3]</sup> While certain compromises such as longer periods for governments to exit aid beneficiaries were found, a number of behavioural restrictions in return for recapitalisation aid were adopted with the final version.

This blog post summarises the key provisions of the Second Amendment with regard to recapitalisation and provides some initial observations on this latest expansion of the Temporary Framework.

## Key provisions of the amended Temporary Framework

The main recapitalisation provisions of the Second Amendment are set out below.<sup>[4]</sup>

### 1. Available recapitalisation measures<sup>[5]</sup>

Member States can use two sets of recapitalisation instruments:

- Equity instruments, in particular the issuance of new common or preferred shares; and / or
- Debt instruments with an equity component (so-called "hybrid capital instruments", in particular profit participation rights, silent participations and convertible secured or unsecured bonds).

Member States have discretion as to the amount of recapitalisation support but it must not exceed the minimum needed to ensure the viability of the company receiving the aid, and should not go beyond restoring the capital structure of the beneficiary predating the COVID-19 outbreak, i.e. the situation on 31 December 2019. When assessing the proportionality of the any recapitalisation measure, other State aid received, planned, or generally available in the context of COVID-19 will be taken into account by the EC.

Member States can notify either recapitalisation schemes or individual measures to the EC under the amended framework. However, even under approved schemes, the EC will still require an individual notification for aid amounts exceeding EUR 250 million to any single beneficiary. If recapitalisation aid is granted to beneficiaries as part of a scheme, Member States have to publish details on the identity of the companies that have received aid and the amount within three months of the recapitalisation.

The State's support can take the form of any variation of these instruments or a combination of equity and hybrid capital instruments. However, the Member State must ensure that the selected recapitalisation instruments appropriately address the beneficiary's recapitalisation needs, while at the same time being the least distortive to competition (any equity stake should be as small as possible).

### 2. Aid beneficiary<sup>[6]</sup>

Recapitalisation measures by a State should be a last resort and only be considered if no other appropriate solution is available. Companies are only eligible if they fulfil the following conditions:

- Absent the recapitalisation measures, the beneficiary would go out of business or face serious difficulties to maintain its operations. Such difficulties may especially be demonstrated by a deterioration of the beneficiary's debt to equity ratio (or similar indicators);
- It is in the common interest for the State to intervene, e.g. to avoid social hardship and market failure due to loss of employment, the exit of an innovative firm or systemically important company, or the risk of disruption to an important service;
- No financing is available on the market at affordable terms and measures existing in the Member State to cover liquidity are insufficient to ensure the beneficiary's viability; and
- As is generally the case under the Temporary Framework, the beneficiary must not have been in financial difficulties prior to 31 December 2019 within the meaning of the GBER.<sup>[7]</sup>

### 3. Remuneration of the government<sup>[8]</sup>

The State should receive appropriate remuneration for its investment which should be as close to market terms as possible. Additionally, remuneration requirements must be 'stepped-up' after four years if the State has not sold at least 40 percent of its equity participation and further 'stepped-up' after six years, if the State has not sold its equity participation in full. This provides a clear incentive for the beneficiary to redeem the State recapitalisation at the earliest possible moment.

### 4. Behavioural commitments<sup>[9]</sup>

Given its potential to distort competition in the EU economy, the amended Temporary Framework requires governments to subject a beneficiary of recapitalisation aid to strict behavioural restrictions, in particular:

- **No pay-outs:** As long as recapitalisation measures have not been fully redeemed, the beneficiary cannot make dividend payments, non-mandatory coupon payments or buy back shares (other than in relation to the State).
- **No cross-subsidisation:** Companies are not permitted to use financing received through the State aid measure to cross-subsidise economic activities of integrated undertakings that were already in financial difficulties on 31 December 2019 (within the meaning of the GBER).
- **Acquisition ban:** As long as at least 75% of the recapitalisation measures have not been redeemed, beneficiaries (other than SMEs) are, in principle, prevented from acquiring more than 10% in competitors or other operators in the same line of business (including suppliers and customers).
- **No bonus payments:** As long as at least 75% of the recapitalisation measures have not been redeemed, the beneficiary's management is not allowed to receive any bonus payments above the fixed part of their remuneration as of 31 December 2019.
- **Limits on expansion, risks and advertising:** Recipients of recapitalisation measures must not engage in aggressive commercial expansion financed by State aid, take excessive risks or advertise the receipt of COVID-19 recapitalisation aid for commercial purposes.
- **Commitments for aid recipients of more than EUR 250 million:** If the beneficiary of a recapitalisation measure exceeding EUR 250 million is a company with "significant market power",<sup>[10]</sup> the relevant Member State must impose additional measures. In particular, it may enact behavioural or structural commitments as foreseen by the EU Merger Regulation.
- **Transparency:** Beneficiaries (other than SMEs) have to publish information on the use of the aid received, including how the use of the aid received supports the company's activities in line with EU and national obligations linked to green and digital transformations.

Additionally, Member States are free to add further conditions to recapitalisation measures in line with additional policy objectives, e.g. the European Green Deal and digital transformation objectives.

### 5. Exit strategy<sup>[11]</sup>

All government recapitalisation schemes need to incentivise companies to redeem the State's participation as quickly as possible in order to end any distortion of competition. The rules for the State exit are as follows:

- **Exit strategy:** Companies (except for SMEs), in which a State has received equity of more than 25%, must set out a credible exit strategy, including a plan on the use of the State funds, a payment schedule of the State remuneration and a schedule of the redemption of the State investment within 12 months from the aid being granted.
- **Annual reporting:** Every 12 months, the Member State must update the EC on the implementation of the repayment schedule and the beneficiary's compliance with the behavioural commitments.
- **Restructuring plan:** If, six years (seven years for SMEs or non-listed companies) after the recapitalisation, the State has not reduced its equity interest to below 15%, the company and the relevant Member State must submit a restructuring plan compliant with the Rescue and Restructuring Guidelines<sup>[12]</sup> to the EC.

### 6. Relevant time period

Currently, the Temporary Framework is in place until the end of December 2020 (Executive Vice President Margrethe Vestager has already said that the EC will consider prolonging the framework after the summer). However, for recapitalisation measures only, the EC has extended this period until the end of June 2021 (as solvency issues may materialise only later).<sup>[13]</sup>

## Initial observations

### 1. Attractiveness of the recapitalisation route

By extending the Temporary Framework to recapitalisation measures, the EC introduces additional flexibility to its State aid framework in order to help Member States deal with the economic fallout of the COVID-19 pandemic. However, the strict conditions that the framework imposes – in particular on the commercial behaviour of beneficiaries – may diminish its appeal for Member States set up recapitalisation schemes (or to provide for individual capitalisation measures) and for companies to participate in those. As noted, Member States had voiced serious concerns already during the consultation phase.

As a result, Member States may, where feasible, prefer to apply for individual aid in the form of guarantees and loans based on Article 107(3)(b) TFEU in conjunction with the Temporary Framework or on the basis of Article 107(2)(b) TFEU. Recent examples in the aviation sector include the EUR 7 billion liquidity support given to Air France,<sup>[14]</sup> two guarantees of EUR 137 million each for SAS by Denmark<sup>[15]</sup> and Sweden<sup>[16]</sup> respectively on a revolving credit facility and a State-guaranteed loan of EUR 550 million for Condor by Germany.<sup>[17]</sup>

Also, while the Temporary Framework is aimed at limiting distortion, several terms in the Second Amendment that are not entirely clear may be a possible source of distortion as long as they are open to interpretation by Member States in their implementation. For instance, unlike during the banking crisis it seems more difficult to determine what companies are "systemically important" and therefore eligible under the framework? In the aviation sector specifically, could this lead to measures that include national flagship carriers but exclude low cost carriers?

### 2. Burden sharing

The amended Temporary Framework does not formally introduce a concept of burden sharing. Yet it does

emphasise that distortions of competition need to be limited as much as possible, that recapitalisation can only be a last resort and that dividend payments to shareholders are prohibited, which indicates the need for company owners and shareholders to contribute or at least to share the pain. In addition, the strict conditions imposed on the beneficiary's commercial behaviour may impact shareholder investment, potentially leading to a reduction of the share price of listed companies, similarly to the ban on dividend payments, which may deter interest of new investors.

If Member States demand influence over a company's business decisions in return for recapitalisation aid the other shareholders' investment may be further impacted. This may, in particular, be the case if a government pushes decisions that are influenced by broader political considerations such as favouring certain national suppliers or job preservation. For instance, Lufthansa appears to be concerned that the German government would side with employee group representatives if the State were to be represented in the company's supervisory board in return for aid.<sup>[18]</sup> Another example is the French Finance Minister requesting that the aid recipient Air France should continue to be "a good customer for Airbus"<sup>[19]</sup>. It can also not be excluded that the EC will introduce explicit burden sharing requirements in future iterations of the Temporary Framework, as it did in the evolution of its banking guidelines.

### 3. Green and digital transformation objectives

Demonstrating the complexity of EU policy-making, the amended Temporary Framework encourages Member States to design national measures in line with the European Green Deal and digital transformation objectives which are at the top of the agenda of EC President Ursula v.d. Leyen.<sup>[20]</sup> Large companies receiving recapitalisation are even compelled to report on how the aid received supports their activities in line with EU objectives.<sup>[21]</sup> Will the EC be able to convince Member States to require green or digital measures in return for aid?

France went ahead already prior to the adoption of the Second Amendment, by obliging Air France to accept environmental conditions (notably a reduction of its carbon footprint)<sup>[22]</sup> in return for liquidity aid of EUR 7 billion and asking Renault to accelerate its ecological transition in exchange for its EUR 5 billion loan guarantee.<sup>[23]</sup> How governments will push the digital transition through conditions in return for recapitalisation aid remains to be seen, perhaps requiring an increased use of paperless e-tools, apps, blockchain or IoT.

A divergence in Member States requiring such conditions could lead to a distortion of competition in the EU economy as such conditions may put them at a cost disadvantage to other rivals who receive aid without such conditions attached in their "home" Member State. Such distortions would be minimised if aid recipients have to meet similar environmental or digital conditions but this would have to be mandated under separate rules, as the current EC State aid legislation does not allow the Commission to demand such conditions without Member States.

*The views expressed by the authors in this blog post are entirely personal and cannot be attributed to Kirkland & Ellis.*

[1] See mlex insight report on 16 April 2020: EU states seek flexibility in recapitalization rules available at <https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1180761&siteid=190&dir=1>.

[2] See <https://www.euractiv.com/section/competition/news/austria-demands-greater-flexibility-of-eu-state-aid-law-in-latter-to-vestager/>.

[3] See the Commission's press release and the Second Amendment at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_838](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_838).

[4] References are made to the *Informal consolidated version of the Temporary Framework as amended on 3 April 2020 and 8 May 2020 ("Consolidated Version of the Temporary Framework")* as published by the Commission at [https://ec.europa.eu/competition/state\\_aid/what\\_is\\_new/TF\\_consolidated\\_version\\_as\\_amended\\_3\\_april\\_and\\_8\\_may\\_2020\\_en.pdf](https://ec.europa.eu/competition/state_aid/what_is_new/TF_consolidated_version_as_amended_3_april_and_8_may_2020_en.pdf).

[5] See Consolidated Version of the Temporary Framework, paras. 52-54.

[6] See Consolidated Version of the Temporary Framework, para. 49.

[7] See paragraph 18 of Article 2 ("Definitions") Regulation 651/2014 ("GBER") which provides the criteria for what constitutes an undertaking in difficulty.

[8] See Consolidated Version of the Temporary Framework, paras. 60-70.

[9] See Consolidated Version of the Temporary Framework, paras. 71-78.

[10] Presumably this term has the same meaning as significant market power under the EU regulatory framework for telecommunications (Article 4 of the Directive 2002/21/EC).

[11] See Consolidated Version of the Temporary Framework, paras. 79-85.

[12] Available here: [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0731\(01\)&from=GA](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0731(01)&from=GA).

[13] See Consolidated Version of the Temporary Framework, para. 48.

[14] See Commission Decision of 4 May 2020 on State Aid SA.57082 (2020/N) – Cadre temporaire 107(3)(b) – Garantie et prêt d'actionnaire au bénéfice d'Air France, press release available at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_796](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_796).

[15] See Commission Decision of 15 April May 2020 on State Aid SA.56795 (2020/N) – Compensation for the damage caused by the COVID-19 outbreak to Scandinavian Airlines, press release available at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_667](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_667).

[16] See Commission Decision of 24 April May 2020 on State Aid SA.57061 (2020/N) – Compensation for the damage caused by the COVID-19 outbreak to Scandinavian Airlines, press release available at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_748](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_748).

[17] See Commission Decision of 26 April May 2020 on SA.56867 (2020/N) – COVID 19 Support for Condor, press release available at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_752](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_752).

[18] See <https://onemileatime.com/lufthansa-state-aid/>.

[19] See <https://www.reuters.com/article/health-coronavirus-france-economy/air-france-must-be-good-airbus-customer-finance-minister-idUSP6N2B01Z>.

[20] As set out in EC President v.d. Leyen's Mission Letter to Commissioner Margrethe Vestager in September 2019 available at [https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-margrethe-vestager\\_2019\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-margrethe-vestager_2019_en.pdf).

[21] See Consolidated Version of the Temporary Framework, para. 44.

[22] See <https://www.france24.com/en/20200424-french-government-announces-historic-%E2%82%AC7-billion-aid-pak-age-for-air-france-klm>.

[23] See discussions on the ecological conditions for Renault at <https://www.wsj.com/articles/renault-lines-up-state-aid-as-it-emerges-from-coronavirus-lockdown-11587640923>.