

The EC's third amendment to the State aid Temporary Framework

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On 29 June 2020, the European Commission ("EC") adopted a third amendment to the Temporary Framework of 19 March 2020 ("Temporary Framework") to extend the options available to Member State governments seeking to support their economies further. Specifically, the assistance covers aid for smaller companies as well as means of encouraging additional investment from the private sector alongside State-sponsored recapitalisations.

Compared to the first two amendments on 3 April (see our [blog post](#)) and 8 May 2020 (see our [blog post](#)), which introduced new categories of support measures, the latest expansion of the Temporary Framework is more modest in scope. The amendment also provides clarification of certain provisions of the Temporary Framework adopted by the EC prior to the third amendment.

1. Four Key Changes to the Temporary Framework

(1.1) Inclusion of micro and small enterprises

First, the amended framework provides an exemption for micro and small enterprises, allowing them to be eligible for government support if they have been in financial difficulties prior to 31 December 2019. Businesses that were 'undertakings in difficulty' under the General Block Exemption Regulation ("GBER")^[1] before that date were so far generally excluded from aid under the Temporary Framework; following the latest extension of the Temporary Framework Member States are now permitted to support micro and small enterprises further.

Micro and small enterprises are defined in Annex I of the GBER as:

- micro-enterprises employing fewer than 10 persons with an annual turnover and/or annual balance sheet total that does not exceed EUR 2 million; and
- small enterprises employing fewer than 50 persons with an annual turnover and/or annual balance sheet total that does not exceed EUR 10 million.

These micro and small enterprises are now only excluded from receiving grants, loans, guarantees, recapitalisations and other measures as prescribed in the Temporary Framework if they are subject to a collective insolvency procedure or if they are still subject to conditions due to receiving rescue or restructuring aid.^[2] To the extent that Member States amend existing schemes to take account of this change, they must notify the EC as per an annex attached to the framework amendment.

In the recital to the third amendment of the framework, the EC notes that the latest changes are aimed at increasing support to innovative start-up companies which are seen as crucial for the economic recovery of the EU. The definition of micro and small enterprises being used as a proxy, given the lack of an EU definition of start-up enterprises. The EC notes further that all SMEs that were in existence for less than three years on 31 December 2019 are not undertakings in difficulty under the GBER and therefore were already eligible for aid under the Temporary Framework prior to the third amendment.

(1.2) Incentivising private participation in recapitalisations

Secondly, if private investors significantly contribute to the recapitalisation of an undertaking alongside State recapitalisation, the Member State and the aid beneficiary will not have to comply with certain of the strict conditions generally attached to recapitalisations under the Temporary Framework. This part of the expansion of the framework is aimed at incentivising aid recipients to attract equity commitments from the private sector in the situation where the State is already an existing shareholder or starts acquiring shares in the aid recipient.

If the private investment equates to at least 30% of the new equity injected into a company in which the State is already a shareholder and if the conditions of the private investment are on equal footing with the State's new investment as well as being pro rata to the State's existing shareholding, the conditions imposed by the latest amendment of the framework are less stringent than they would be in case of a "State only" recapitalisation (for details, see our [last blog post](#)). In detail, the conditions in situations of private participation alongside State contributions are as follows:

- **The State's remuneration is not required to be stepped-up:** The appropriate remuneration that the State should receive for its investment does not have to be 'stepped-up' (e.g. the issuance of new shares to the State to increase its participation) after four years if the State has not sold at least 40% of its equity participation and does not have to be further 'stepped-up' after six years, if the State has not sold its equity participation in full.
- **The acquisition ban is limited to three years:** The ban that prevents companies from acquiring more than 10% in competitors or other operators in the same line of business (including suppliers and customers) until at least 75% of the recapitalisation measures have been redeemed, ceases to apply automatically after three years.
- **Bonus payments to management can resume after three years** even if by then less than 75% of the recapitalisation are redeemed.
- **Dividends can be paid to certain shareholders:** Provided the State has been remunerated for any COVID-19 hybrid capital and subordinated debt instruments it holds (i.e. interest or any other payments due), the following shareholders can then receive a dividend:
 - all holders of new shares,
 - holders of existing shares, if the shares of all existing holders combined have been diluted to less than 10% of the interest in the company,
 - all holders of existing shares, if the shares of all existing holders combined have not been diluted to less than 10% of the interest in the company, after three years.
- **No exit strategy required:** The Member State is not required to present an exit strategy or a restructuring plan, which would normally have to be submitted to the EC within 12 months from the aid being granted, if a Member State's participation accounts for more than 25% of the equity of an aid beneficiary. There remains however an obligation to submit annual report on the implementation of the repayment schedule and the beneficiary's compliance with the behavioural commitments.

For recapitalisations of beneficiaries in which the State is not already an existing shareholder, the relaxation of the conditions imposed is more limited. If the private investment equates to at least 30% of the new equity injected and its investment is on equal footing with that of the State it is only possible to pay dividends to certain shareholders under the conditions described above; other than that the "State only" recapitalisation rules apply.

(1.3) Additional Protection for the Internal Market

Thirdly, the amended framework specifies that aid should not be conditional on the relocation of a production activity of the beneficiary from another country within the EEA to the territory of the Member State granting the aid, since such a condition would be particularly harmful for the internal market.

(1.4) Behavioural Commitments continue to apply if State sells below market price

Fourthly, the third amendment to the Temporary Framework clarifies that if the State sells its shareholding in a company that it acquired through a recapitalisation measure under the Temporary Framework below market price or a stipulated return,^[3] the restrictions of the Temporary Framework for companies with State investments (e.g. acquisition ban, etc.) continue to apply at least until four years after the COVID-19 equity injection measure was granted.

2. Additional Clarifications

The third amendment also includes clarifications on certain provisions of the Temporary Framework that were adopted prior to the latest amendment. These include:

- linking the calculation of the reduced interest rates on loans to the time of the aid notification;
- specifications regarding wage subsidy schemes for the self-employed;
- limitations on the reporting requirements for governments with regard to individual aid measures above EUR 100,000; and
- clarifications regarding the limits applied to the fixed remuneration for new members of management hired by the beneficiary after State recapitalisation aid has been received, linking the salaries to their level of responsibility rather than the lowest fixed remuneration of any of the members of the management on 31 December 2019.

Interestingly, the amendment also contains a clarification as to when aid should be granted under Articles 107(2)(b) and 107(3)(b) TFEU. The new provision notes that aid pursuant to Article 107(2)(b) TFEU must compensate for damage directly caused by the COVID-19 outbreak and that aid more generally addressing the economic downturn from the COVID-19 outbreak is to be assessed under Article 107(3)(b) TFEU and the Temporary Framework.

3. Initial Observations

(3.1) Continuous exclusion of certain categories of companies

The expansion to cover micro and small enterprises in difficulties before the end of 2019 will not satisfy those who have called for a farther-reaching expansion of the Temporary Framework.^[4] For instance, companies who had a book debt to equity ratio greater than 7.5 for the past two years are not eligible to receive State aid under the Temporary Framework, even if the book debt relates to shareholder loans - an instrument

frequently used, for example, by private equity and venture capital investors. Similarly, many start-ups are often highly leveraged based on future valuations or upcoming funding rounds.

Unless the EC further expands its rules, companies who are in difficulty as defined in the GBER may only apply for aid pursuant to the conditions of Article 107(3)(c) TFEU as restructuring aid. This route was recently chosen by the Portuguese government which received EC approval under Article 107(3)(c) TFEU for a EUR 1.2 billion rescue loan to the Portuguese airline TAP.[5]

(3.2) Private investments

By incentivising private investors to buy new shares in companies, the EC recognises that a public sector response alone will likely not be sufficient to tackle the economic crisis caused by COVID-19.[6] While investors will run lengthy risk assessments before becoming new shareholders of companies in need of fresh equity, existing shareholders are much more likely to re-invest further equity and the EC's relaxing of some of the behavioural commitments under the Temporary Framework recapitalisation rules is a welcomed first step. Existing private shareholders are arguably more likely to work with governments to find solutions for the recapitalisation of companies instead of leaving it to the State to come to a company's rescue.

While further incentives may be required to tap into investors' pockets, given the uncertainty caused by the pandemic, the first joint equity injections already occurred prior to the third amendment of the Temporary Framework, when Finnair launched a rights issue on 10 June 2020 in which both private shareholders and the Finnish government participated.[7]

(3.3) Reminder of the importance of the single market

A main criticism of the interventions by national governments through State aid measures has been the perceived unequal use of aid by Member States, with Germany accounting for more than half of the COVID-19 State aid approved so far by the EC.[8] Whilst the different levels of aid available throughout the EU might lead to distortions on the EU's single market, the EC currently has limited tools to deal with this concern. The third amendment acts as a general reminder that State aid should not be used in a way which is harmful to the internal market. The insertion of a specific provision is likely a reaction to recent announcements made by Member State governments, e.g. the request of French finance minister Bruno Le Maire that French car manufacturers should move part of production their production back to France in return for aid.[9]

The views of the authors expressed in this blog post are personal.

[1] See paragraph 18 of Regulation 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 TFEU.

[2] This would for instance be the case if the company receiving aid under the Temporary Framework has not at the time of COVID-19 aid being granted reimbursed a previous loan, terminated a previous guarantee granted as rescue aid or is still subject to a restructuring plan.

[3] As stipulated in point 63 of the Temporary Framework.

[4] See Europe Invest's *Comment Letter on changes to EU State Aid Temporary Framework* dated 30 June 2020 available to download at <https://www.investeurope.eu/policy/publications/>; also see the fifth report of the British Private Equity & Venture Capital Association dated 23 April 2020 addressing the definition of an "undertaking in difficulty" as a key issue (available at <https://www.bvca.co.uk/Portals/0/Documents/Policy/BVCA%20Feedback%20on%20the%20impact%20of%20COVID-19%20-%2024-04-20.pdf>) or a letter by Invest Europe to the European Commission with regards of the limited definition of SMEs dated 28 April 2020 (available at <https://www.investeurope.eu/media/3035/pae-invest-europe-letter-on-sme-definition.pdf>).

[5] See EC press report on the approval of the loan by the EC available at https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1029

[6] See call for more private investment at <https://www.weforum.org/agenda/2020/06/private-sector-investors-must-now-step-up-to-quell-the-covid-19-crisis/>

[7] See EC press report available at https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1032

[8] See <https://www.euractiv.com/section/competition/news/germany-gains-most-from-relaxed-eu-state-aid-rules/>

[9] See <https://www.archyde.com/bruno-le-maire-wants-relocations-in-exchange-for-state-aid/>