Kluwer Competition Law Blog

Update on the EU’s State aid response to COVID-19

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Our previous blog post covered the EU Commission’s (“**EC**”) Temporary Framework of 19 March 2020 (“**Temporary Framework**”), which aims at enabling national governments to use the full flexibility of State aid rules to support the economy in the context of the COVID-19 outbreak. Since the adoption of the Temporary Framework a number of Member States and the UK have notified support schemes which have been approved by the EC at an impressive speed (including on weekends). Whilst the focus of these schemes has been on aiding SMEs in the initial phase, a few of the larger Member States (e.g. Germany, Spain, Italy) and the UK have now introduced schemes aimed at supporting larger companies as well.

On 3 April 2020, the EC issued a first amendment to the Temporary Framework (“**First TF Amendment**”) enabling Member States to accelerate R&D, testing and the manufacture of COVID-19 relevant products (e.g. vaccines) and to allow for the protection of jobs and further support for those economies hit particularly hard by the crisis.[1] Currently the EC is consulting Member States on a second amendment to the Temporary Framework (“**Second TF Amendment**”) which would allow – as a last resort – Member States to recapitalise companies in return for equity. This blog post summarises the key (implemented and proposed) changes to the Temporary Framework and discusses some of the initial trends that are starting to emerge from the EC’s and government response to COVID-19.

First TF Amendment

The first amendment to the Temporary Framework is a mix of new permissible aid measures as well as the expansion (and clarification) of measures that were allowable under the initial Temporary Framework. As before, the Temporary Framework will be in place until 31 December 2020 and aid pursuant to the Framework must be granted by this date.

The first decision encompassing features of the First TF Amendment was taken within three days of the amendment being adopted (interestingly the scheme was notified on 26 March 2020 before the amendment was finalised). The UK umbrella scheme explicitly includes support for COVID-19 related R&D, the construction and upscaling of testing facilities and for the production of products relevant to tackle the COVID-19 outbreak. Further schemes have been approved in line with the First TF Amendment, including: a Luxembourg scheme providing direct grants to support COVID-19 related R&D and investments in the production of relevant products; a Croatian scheme, which includes zero interest loans up to €800,000; and the expansion of two previously approved German schemes including to extend permissible measures to cover the provision of loans, zero-interest guarantees and equity of up to €800,000.

New aid measures

The First TF Amendment introduces five additional types of aid measures permitted under the Temporary Framework aimed at facilitating the Member States' response to the COVID-19 outbreak:

1. **Support for COVID-19 related R&D:** Member States can grant aid in the form of direct grants, repayable advances or tax advantages for COVID-19 and other relevant antiviral R&D products (vaccines, medicinal products etc.) for projects that started on or after 1 February 2020 (which the EC views as the relevant date for the beginning of the crisis). Eligible costs include all costs necessary for the R&D project (incl. costs for personnel, equipment and tools). The beneficiary must commit to grant non-exclusive licences under non-discriminatory market conditions to third parties and the aid intensity can be increased if support comes from more than one Member State or if the project is completed in two months.[2]
2. **Support for the construction and upscaling of testing facilities:** Member States can grant aid in the form of direct grants, tax advantages, repayable advances and no-loss guarantees to support investments enabling the construction or upscaling of infrastructures needed to develop and test products useful to tackle the COVID-19 outbreak. The investment project should be completed within six months after the aid has been granted (otherwise a penalty of 25% of the aid amount is due per month of delay). Projects started on or after 1 February 2020 are eligible (if projects have been started before that date only additional costs relating to acceleration efforts of the project will be eligible for aid). The aid intensity can be increased if support comes from more than one Member State or if the project is completed in two months. A loss cover guarantee may also be granted.[3]
3. **Support for the production of products relevant to tackle the COVID-19 outbreak:** Member States can grant aid in the form of direct grants, tax advantages, repayable advances and no-loss guarantees to support investments enabling the rapid production of COVID-19-relevant products, e.g. medicinal products such as vaccines, ventilators, protective clothing and equipment. The investment project should be completed within six months after the aid has been granted (otherwise a penalty of 25% of the aid amount is due per month of delay). Projects started on or after 1 February 2020 are eligible; if such projects have been started prior to that date, only additional costs relating to the acceleration of efforts are eligible for aid. This can be increased if support comes from more than one Member State or if the investment is completed in two months. A loss cover guarantee may also be granted.[4]
4. **Deferrals of tax payments and/or suspensions of social security contributions to certain** sectors, geographic regions or companies of a certain size (including self-employed individuals) that are hit hardest by the outbreak. The deferral cannot extend past 31 December 2022.[5]
5. **Targeted support in the form of wage subsidies for employees (by way of Member States**

schemes) to help limit the COVID-19 crisis for workers. The subsidy shall generally not exceed 80% of the monthly gross salary.[6]

As was the case for the initial aid measures covered by the Temporary Framework, in order to be eligible for aid under measures 1-3, companies must not have been in financial difficulty before 31 December 2019 within the meaning of the GBER[7]. This however does not apply to measures 4 and 5, i.e. also firms who were in difficulty before the end of 2019 are eligible for deferrals and wage subsidies.

Expansion of existing aid measures

The amended Temporary Framework also expands on the types of aid measures Member States can give to companies in need. In addition to direct grants, repayable advances and tax or payments advantages, Member States can now:

- Grant loans with zero-interest rates with a nominal amount up to €800,000;
- Provide guarantees covering 100% of the risk for loans up to the nominal value of €800,000; and
- Provide equity up to the nominal value of €800,000 per company.[8]

The First TF Amendment also clarifies / adds that all aid covered by the Temporary Framework may be cumulated with the exception that:[9]

- A company who has received a government loan under a support scheme cannot have that same loan principal guaranteed by government. However, a beneficiary can receive a guarantee and a different subsidised public loan up to the overall caps per beneficiary set out in the Temporary Framework.
- Once a support measure has compensated a company for a particular cost arising related to COVID-19 projects mentioned above under 1-3, that already compensated cost cannot be used as the basis of an application under another government scheme.[10]

Second TF Amendment

On 9 April 2020, the EC announced it is consulting Member States on a second extension of the Temporary Framework which would allow Member States – as a last resort – to recapitalise companies in return for equity.[11] This follows discussions at Member State level (e.g. in Germany and Italy) as to whether governments should buy stakes in companies in need (e.g. in the airline sector), see further details below. The details under which conditions companies would qualify, the requirements that would be attached for state entry or pricing are not yet public. It is intended that this further extension of the Temporary Framework will be in place in the week of 13 April 2020.

Trends emerging from EC and Member State practice

Decisions predominantly under the Temporary Framework

Since the beginning of the crisis, of the over 40 schemes approved by the Commission, only four have not been under the Framework. These schemes were approved under Article 107(2)(b) TFEU and relate to three Danish schemes to compensate organisers of events cancelled due to COVID-19, private companies, which have a proven decline in revenues of more than 40% and the self-employed; and a French scheme deferring payment by airlines of certain taxes.[12] The decisions approving these schemes are yet to be published so it is not clear why in particular the Danish schemes were not notified / granted pursuant to the Temporary Framework.

It may not be surprising that the Member States are utilising the Temporary Framework given that under the Art. 107(2)(b) TFEU, Member States must provide information on the causal link between COVID-19 outbreak and damage suffered and between the damage and aid. Schemes must also show the methodology used for assessing the damage per beneficiary, including the documents to be submitted by beneficiaries, certification of the documents by independent experts and verification by competent authorities.[13]

However, Article 107(2)(b) TFEU can be a flexible tool that allows specificity to deal with particularly hit sector. The other benefit of utilising Art. 107(2)(b) TFEU is that it can be applied to sectors or companies that may have been in difficulty prior to the COVID-19 outbreaks or that have received aid previously (i.e. aid approval under this provision is subject to less stringent conditions than under the Temporary Framework). Given this flexibility and specificity, it is likely that more schemes will be notified under Art. 107(2)(b) TFEU.

Specific sector assistance

The French Scheme is likely only the first of a number of schemes that will be notified in relation to airlines. Indeed, in a recent speech,[14] Competition Commissioner *Margrethe Vestager* had identified airlines as one of the sectors that would need specific assistance under Art. 107(2)(b) TFEU.

Article 107(2)(b) TFEU was used in relation to aid to airlines following the events of 11 September 2001. Following the attacks, the airspace of the US was closed for a number of days. Interestingly, the measures in the French scheme may be already broader than those approved in the context of 9/11. The 9/11-related schemes only compensated for direct losses from the days airspace was closed and not for any follow-on period.[15] From the EC press release, the aid offered under the French scheme is not a one-off payment as offered in the context of the 9/11 attacks (and Icelandic volcano disruptions), but is seeking to protect liquidity for a longer time using a payment deferral for taxes falling due between March 2020 and December 2020. What remains to be seen is how the Commission will assess grants of direct aid with longer terms than in the 9/11 and Icelandic volcano cases.

Another badly affected sector that may need a tailored response is that of retail. In particular, many high street shops were already in difficulty before the COVID-19 outbreak but have been pushed further into distress by the current crisis. Such companies may not be eligible for certain types of aid under the Temporary Framework but could be eligible for a wider range of measure under a scheme notified and approved under Art. 107(2)(b) TFEU.

Scope of the schemes

As mentioned, many of the schemes notified earlier since the Temporary Framework was launched were aimed in particular at SMEs, however, now schemes are aimed broadly at the wider economy including so-called “umbrella” schemes with both Spain and the UK notifying such schemes to the EC. The Spanish scheme is aimed at the whole spectrum of the economy from self-employed to large companies; the UK scheme is aimed at small and large companies. These schemes are also broader in scope than previous schemes foreseeing the use of a wide range of measures where earlier schemes had often focused on a smaller range of permissible measures.

The scope of the schemes is likely to keep increasing as Member States introduce further measures. This intervention has now been further supported by the EU, with the Eurogroup putting forward a €500 billion Corona support package, a main component of which involves the European Stability Mechanism making €240 billion available to guarantee spending by Euro area Member States.[16]

Risk and burden sharing

Currently the Temporary Framework makes no mention of burden sharing. This is not unusual as in State aid that principle arises where there is moral hazard around the State taking measures in the context of restructuring.[17] The currently permissible measures do not give rise to such hazards with equity investments being limited to €800,000. However, as things develop we may perhaps see a call for the Temporary Framework to be expanded to included larger equity contributions or to give convertible loans. Indeed, as mentioned, the EC is consulting on a further expansion of the Temporary Framework to allow for re-capitalisation of companies in need. Details are yet to emerge, but this expansion could contain burden-sharing provisions.

Already Member States have been seeking to restrict the behaviour of companies that have received aid. The French Minister of the Economy and Finance, *Bruno Le Maire*, has said that he would not sign off on any state guarantee for a loan to a company that did not scrap its dividend and that any companies that benefited from the tax relief and were found to have paid a dividend would be forced to repay the money.[18] Similarly, in Germany politicians have been calling for companies that receive State aid not to pay out dividends.[19] The exact legal provisions, if any, formalising these desires are yet to be seen for France and Germany but press reports note that Italy has included a moratorium on approving dividend payments for a year for companies that receive loan guarantees under its latest scheme.[20]

Spectre of nationalisation

While currently most Member States are attempting to keep companies afloat without the possibility of public ownerships, some Member States are lining up measures that may result in partial or full nationalisation. Italy has indicated it may renationalise its bankrupt flagship carrier Alitalia (Alitalia has already received a €400 million loan in December 2019)[21], with a new €600-million loan under discussion.[22] Similarly, Germany has indicated it may take a stake in Lufthansa; however the size of such a stake is still unknown.[23] Commissioner *Vestager* has already indicated the EC may be pragmatic on any such nationalisations noting in response to questions on Alitalia that she's "*neutral*" on any plan and that approval for the proposed transaction could depend on if it is done at market prices, which might be "*quite low*" in the current circumstances.[24]

The UK has intervened to prop-up private rail operators by temporarily suspending normal franchise agreements and transferring all revenue and cost risk to the government for a limited period, initially six months – effectively renationalising the railways.[25] Meanwhile, the French government has said that it will take whatever measures are necessary and this could include capital injections or taking stakes in struggling companies.[26]

The EC, as mentioned, has now reacted quickly with a proposal to further expand the Temporary Framework to allow for capitalisation of companies in need in return for equity.

Conclusion

As the fallout from the COVID-19 outbreak continues Member States are starting to take more drastic actions to respond to the pandemic. The EC has so far been reacting quickly by adapting the Temporary Framework and by approving government schemes within a matter of days. With regard to large amounts of capital injections and taking equity positions the EC has a wealth of experience on Member States in financial institutions from the banking crisis. Therefore, any radical action such as nationalisations will hopefully be dealt with effectively by the EC. The EC's proposed expansion of the Temporary Framework to permit government recapitalisation measures is an important first step.

All views expressed are the authors' personal views and do not necessarily reflect those of Kirkland & Ellis.

[1] An informal consolidated version of the amended Temporary Framework is available at: https://ec.europa.eu/competition/state_aid/what_is_new/TF_consolidated_version_as_amended_3_april_2020.pdf.

[2] For further details see section 3.6 of the amended Temporary Framework.

[3] For further details, see section 3.7 of the amended Temporary Framework.

[4] For further details, see section 3.8 of the amended Temporary Framework.

[5] For further details, see section 3.9 of the amended Temporary Framework.

[6] For further details, see section 3.10 of the amended Temporary Framework.

[7] 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.

[8] For further details, see para. 13 of the amended Temporary Framework. These and the existing measures can be combined with so-called d*e minimis* aid to bring the aid per company to up to €1 million (assuming that the conditions for such *de minimis* aid are met) and with other types of aid.

[9] See paras. 20, 26 of the amended Temporary Framework.

[10] For completeness, the amended Temporary Framework also explicitly mentions that flat premiums may be used for the duration of guarantees if higher than the minimum applicable first year premiums. Similarly, for loans, a flat credit risk margin can be used if higher than the minimum applicable first year credit risk margin. The amended Temporary Framework**.** The amended Temporary Framework also clarifies that the conditions for loan guarantees and subsidised interest loans apply per loan and per beneficiary. The amended Temporary Framework reflects the Commission Communication on short-term export-credit insurance allowing cover to be provided for countries previously considered "marketable" (including EEA Member States) until 31 December 2020.

[11] See: https://ec.europa.eu/commission/presscorner/detail/en/statement_20_610.

[12] See, Commission Decision of 12 March 2020 on State Aid SA.56685 (2020/N) – DK – Compensation scheme for cancellation of events related to COVID-19, Danish scheme to

compensate self-employed for damages suffered due to coronavirus outbreak (press release: IP/20/515), Danish scheme to compensate companies particularly affected by the coronavirus outbreak (press release: IP/20/541), and French scheme deferring payment by airlines of certain taxes to mitigate economic impact of coronavirus outbreak (press release: IP/20/514).

[13] See, Information that should be provided for notifications of aid under Article 107(2)(b) – exceptional occurrence available at https://ec.europa.eu/competition/state_aid/what_is_new/Notification_template_107_2_b_PUBLICATION.pdf.

[14] https://ec.europa.eu/commission/presscorner/detail/en/statement_20_479.

[15] See for example, 2010/768/EC: Commission Decision of 26 April 2006 on State aid C 39/03 (ex NN 119/02) implemented by Greece for air carriers in respect of losses sustained from 11 to 14 September 2001.

[16] https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/

[17] See paras. 65 *et seq*. of the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty *OJ C 249, 31.7.2014, p. 1–28.*

[18] https://www.reuters.com/article/france-dividends/update-3-french-firms-seeking-state-aid-forced-to-ditch-dividends-idUSL8N2BK23P

[19] https://www.ft.com/content/040be2bd-a202-46e7-92d2-2c227c8e0465.

[20] https://www.reuters.com/article/health-coronavirus-italy-decree/update-1-italy-announces-guarantees-for-bank-loans-worth-over-400-bln-euros-idUSL8N2BU5T8.

[21] The EC has opened an in-depth investigation into this loan, see https://ec.europa.eu/commission/presscorner/detail/en/IP_20_349.

[22] https://www.flightglobal.com/airlines/alitalia-to-be-renationalised-under-broad-emergency-decree/137337.article.

[23] https://www.nytimes.com/reuters/2020/04/02/business/02reuters-health-coronavirus-germany-lufthansa-exclusive.html.

[24] https://www.bloomberg.com/news/articles/2020-04-03/alitalia-sale-to-italy-won-t-vex-eu-s-vestager-if-price-is-right.

[25] https://www.theguardian.com/world/2020/mar/23/covid-19-government-suspends-rail-franchise-ag

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[2 6] https://www.dw.com/en/coronavirus-forces-eu-leaders-to-weigh-nationalization-options/a-52838689.

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