Sheppard Mullin

Webinar: State aid and Coronavirus – the UK and EU Perspective

Thursday 30 April 2020

- Comments on the first phase since mid-March
- Compensation of damages caused by Covid-19

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Comments on the first phase (1)

- Impact of no aid measures or *de minimis* aid
  - general measures
  - support to citizens
  - wage subsidies
  - suspension or deferral of corporate taxs & VAT (w/o sector differentiation)
  - de minimis aid

- Quick reaction targeting liquity needs
  - Legal clarification (similar to October 2008 communication)
  - Procedure (notification templates, waiver on language, speed, dedicated means & webpage)

- TF too general and not targeted enough?
  - Moral hazard? Zombies firms? Cleansing effect? Sufficient safeguards?
  - How loans and loan guarantees can make good a lockdown effect for several months?

- No rescue and restructuring cases?

Some comments on the first phase (2)

- Unbalanced reaction by Member States: (92 decisions as at 29.4.2020 - 9:15 am)

<table>
<tr><th>Article 107(2) b)</th><th>Article 107(3) b)</th><th>Article 107(3) c) under TF</th></tr>
<tr><td>8 decisions</td><td>77 decisions under TF – 3 107(3 b)</td><td>4 decisions (Covid-19 products)</td></tr>
<tr><td>No discretion by Commission</td><td colspan="2">Discretion by Commission</td></tr>
<tr><td>Past</td><td colspan="2">Future</td></tr>
<tr><td>Detailed financial data required</td><td colspan="2">Limited to no financial data required</td></tr>
<tr><td colspan="2">Can be cumulated</td><td></td></tr>
<tr><td>Cash needed in principle</td><td>Less cash needed</td><td>Cash needed</td></tr>
</table>

Some comments on the first phase (3)

- Aid tailored by sector?
  - TF not sector by sector but 107(2)(b) notification template focuses on sectors (aviation)
  - Mostly: (air) transport, automotive, agriculture, energy, digital sector, health, event companies
  - Commissioner Vestager on 107(2)(b) measures: "*the most obvious way to go*"

- Global competition and recovery plans
  - State aid as a unique control system in the world
  - Many FTAs include "State aid" provisions but weak enforcement
  - Need for reciprocity

- EU distortion - disparity
  - Big pocket Member States
  - EU-wide recovery fund for certain sectors?
  - Recovery plans and Green Deal and Digital Agenda?

- Litigation?

Article 107(2) b) – "*to make good damages caused by exceptional occurrences*"

- "*Natural disaster*"
  - storms, earthquake, floods, eruptions

- "*Exceptional occurrences*"
  - war, strikes, major industrial accidents, terrorism (9/11 – 11/15 & 3/16)

- Aid compatible <u>in law</u>
  - No discretion for the Commission
    - T-268/06 *Olympiaki Aeroporia Ypiresies AE v Commission*, para 51

  - But aid still to be notified and approved
    - Covid-19 notification template published by DG COMP

- Objective conditions to be construed restrictively

Article 107(2) b) – conditions

- Exceptional occurrence
  - The Covid-19 outbreak constitutes such an exceptional occurrence
    - TF, § 8, 15
    - 8 decisions (DK (4), FR (1), SW (2), GE (1))
  - Sectors (not limited to):
    - transport, tourism, culture, hospitality, retail, organisers of cancelled events

- Damage caused by the exceptional occurrence
- Direct causal link
- Damage assessed as precisely as possible
    - C-346/03 and C-529/03 *Atzeni a.o. v Commission*, para. 79
    - T-268/06 *Olympiaki Aeroporia Ypiresies v Commission,* para. 52

  - Reference period?
    - When companies “could not operate normally”
    - Income recorded during the reference period v. income recorded prior to the event
    - This can include costs which occurred beyond the days of the event (progressive exit)
      - catching-up phase following the reopening of the business
      - additional costs linked to the restart of the operations
      - decision 1.8.2011 SA.32163 - 2010/N - Slovenia – Icelandic volcano ash in April 2010

Article 107(2) b) – No overcompensation

- Counterfactual value-added (average value-added of the previous year): what the company would have accrued if the event would not have happened
  - foregone revenues due to the closure + additional costs directly attributable to the closure
  - minus operational costs avoided during the closure
  - actual damage: the difference in turnover and costs between what actually occurred and what should have happened (the counterfactual scenario)
- Indicators
  - revenue and cost items likely to be affected by the event
  - cost items unlikely to be affected under the counterfactual scenario compared to the actual one (not considered for compensation)
- Safeguards
  - verification of aid applications at several levels by specially appointed bodies
  - documentary evidence
  - prosecution for false or incorrect declarations and recovery with interests.

Article 107(2) b) and Temporary Framework

- No aid granted to an undertaking in difficulty at the time of the event
  - Difficulty:
    - Economic death certain w/o State intervention
    - Loss of +50% of capital or be subject to collective insolvency proceedings
    - Large undertakings (past two years)
      - debt to equity ratio > 7.5
      - EBITDA interest coverage ratio < 1.0
- "One time last time" principle does not apply (107(2) not an 'R&R' aid)
  - Member States may compensate damages directly caused by Covid-19 to undertakings that have received aid under the R&R Guidelines.
  - However, they should no longer be 'in difficulty': i.e. having completed the restructuring plan
- No circumvention of rescue and restructuring aid principles
  - Not used to remedy undertakings' problems unrelated to the relevant events.
- Non-discriminatory

Article 107(2)(b) decisions (as at 29 April 2020)

- Only four Member States: DK, FR, SW, GE
  - Cancellation of events and schemes
  - Airlines
- Only three individual measures:
  - DK and SW – SAS
    - DK+SW: partial compensation (2 X €137 m guarantees on revolving credit facility) for the cancellation or re-scheduling of flights
    - DK: exact damage quantified after the crisis (2020 operating accounts); quantification method subject to Commission's prior approval; claw-back mechanism
    - SW: complementary to another State guarantee scheme for airlines (difficulties in obtaining loans); alternative to the guarantee scheme; claw-back mechanism
  - GE - Condor (rescued Thomas Cook German subsidiary)
    - flights cancellations, loan guarantee (€550 m), no cash, claw-back mechanism

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Next steps?

- Recapitalisation (Article 107(3) b TFEU)
- Rescue & Restructuring?

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Recapitalisation measures?

- Commission consulted Member States on 9 April 2020
  - ongoing debate on the strict conditions for such structural measures
- Inspiration from the financial crisis?
  - o miscellaneous financial instruments, not limited to capital
    - o subordinated loans? [max 5% turnover; 40% annual wage bill?]
  - o repayment terms with incentives to exit the State at the earliest
    - State remuneration increasing over time to reach the market price
  - o restrictions on the behaviour of beneficiaries
    - commercial restraint, ban on acquisitions, dividends, bonuses, buyback programmes
  - o State remuneration in proportion to the size of the beneficiary company
  - o specific structural and behavioural remedies (divestitures) and exit strategy
    - according to the size of the companies and their market position
    - restructuring plan if State stays on beyond a certain date?
    - exit depending on the State's concerned situation?

Other types of measures? Rescue & restructuring aid?

- If in difficulty after 31.12.2019

- Rescue
  - Temporary, reversible; minimum necessary (formula)
  - Social hardship or market failure
  - Loans or guarantees - max. 6 months, 1-year IBOR + 400 bps

- Restructuring
  - Restructuring plan (LT viability)
  - Aid limited to the minimum
  - Burden sharing - Significant contribution of the beneficiary
  - Avoidance of undue distortions of competition
  - Counterfactuals / compensatory measures

- New Covid-19 adjusted R&R guidelines?
  - 2014 guidelines very much shaped by 2009 fiancial crisis guidelines
  - Shift from “bail out” towards “bail in” applicable for Covid-19?