

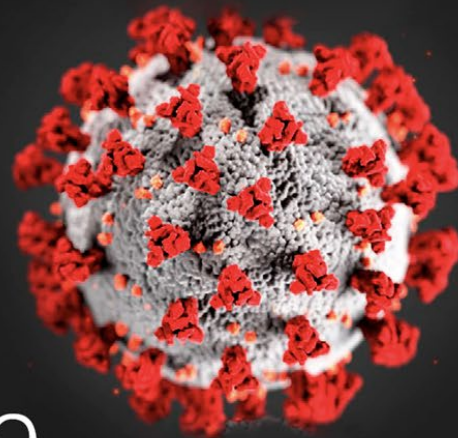
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# #3 **STATE AID** IN THE COVID-19 CONTEXT

## Introduction

- EU = EU market integration = EU State aid control
  - manage competition between Member States

- TFEU's toolbox

- No "State aid" measures (non selective measures) – see however Articles 116-117 TFEU
- Article 107(2) b
  - “aid to make good the damage caused by [...] exceptional occurrences”
- Article 107(3) b
  - “aid [...] to remedy a serious disturbance in the economy of a Member State”
- Article 107(3) c
  - “aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest” – rescue & restructuring aid

- Κρίσις, κρίσεως
- Κρίνω
- Κρασις



## Outline

- **Temporary framework - Article 107(3) b)** [mainly]
  - Legal: François-Charles Lapr votte
  - Economics: Georges Siotis
- ***Exceptional occurrences* - Article 107(2) b)**
- **'Ordinary' measures - Article 107(3) c)**
  - Legal: Jacques Derenne
  - Economics: Nicole Robins
- **Q&A**

# Temporary Framework Legal issues

- The Commission's COVID-19 Temporary Framework for State aid
  - A comparison with the 2009 framework
  - Liquidity aid (Article 107(3) b) TFEU)
  - Aid to combat COVID-19 (Article 107(3) c) TFEU)
  - Sectoral aid to preserve employment (Article 107(3) b) TFEU)
  - Articulation with other aid measures and cumulation issues
  - The Commission's decisional practice
  - Open issues

# From one crisis to another: the TF at a glance

2008 Financial Crisis Temporary Framework for the Real Economy	2020 COVID-19 Temporary Framework
<b>Adoption Process</b>	
3 weeks	2 days (but first amendment within 2 weeks)
<b>Period of Application</b>	
2008-2010 (+New Framework until 2011)	Mar 19 – Dec 31, 2020 (for the moment)
<b>Specific Measures</b>	
<i>1. Direct grants</i>	
€500,000 per undertaking No fisheries/agriculture	€800,000 per undertaking Fisheries/agriculture included (but lower ceilings)
<i>2. State Guarantees</i>	
SMEs: up to 25% reduction of premium; Large companies: up to 15% reduction	In practice very low premium floors, regardless of risk or Member State (25 to 100 bps for SMEs; 50 to 200 for others)
Loan principal must be less than 100% total annual wage bill	Loan principal must be less than: (i) 200% total annual wage bill; (ii) 25% of total annual turnover; or (iii) total liquidity demand for next 12 or 18 months
Max duration: 2 years	Max duration: 6 years
<i>3. Subsidized Interest Rates</i>	
Central bank overnight rate + premium (difference between average 1-year interbank rate and average of central overnight rate from 1 January 2007 to 30 June 2008) + credit risk premium corresponding to recipient risk profile	Base rate as of 1 January 2020 (1-year IBOR or rate published by Commission) + credit risk premium calculated like guarantee fee
Loan of any duration	Max duration: 6 years
No limit on loan principal	Loan principal limited as for state guarantee above
<i>4. Additional Measures</i>	
(i) export credit insurance; (ii) production of green products; (iii) risk capital measures	(i) export credit insurance; (ii) aid aimed at combating COVID-19; (iii) aid aimed at preserving employment for companies particularly affected

## 2 Liquidity aid and export credit insurance- sections 3.1. to 3.5

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- **Direct grants, selective tax advantages and advance payments (3.1.)**
  - Maximum amount (gross, i.e. before any deduction of tax or other charge): €800,000 per undertaking (specific thresholds for agriculture and fishery)- particularly well suited for SMEs
  - Must be granted on the basis of a scheme with pre-determined budget
  - Cannot be granted to undertakings in financial difficulties as of December 31, 2019
  - Extended on April 3rd to guarantees, loans and equity injections
- **Export credit (3.5.)**
  - State support can be extended to export credit insurance relating to marketable risks (including exports to EU-27 or OECD countries) until the end of the year
  - Subject to Communication on short-term export credit insurance
  - Reflects current lack of sufficient private supply of credit export insurance (anticipated reduction in underwriting capacity -15% and up to -40% for SMEs according to Commission's consultation)

# 2 Liquidity aid and export credit insurance- sections 3.1. to 3.5

- **Guarantees and subsidized loans (sections 3.2. - 3.3.):**
  - Eligible instruments: Investment and/or working capital loans
  - Undertakings in financial difficulties as of December 31, 2019 are excluded
  - Maximal loan duration: maximum 6 years
  - Maximum amount of the loan principal:
    - The double of the 2019 wage bill of the beneficiary; or
    - 25% of the 2019 total turnover of the beneficiary; or
    - With appropriate justification and based on a self-certification, the total amount of the liquidity needs for the next 12 months (if large enterprise) or 18 months (if SME).
    - Possibility to exceed these caps for loans expiring before the end of 2020
  - Maximum amount of the guarantee: 90% of the underlying loan (or 35% if first-loss guarantee)
  - Minimum guarantee fee or credit risk premium (on top of 1-year EURIBOR for loans):

Type of beneficiary	For 1 <sup>st</sup> year	For 2 <sup>nd</sup> – 3 <sup>rd</sup> year	For 4 <sup>th</sup> – 6 <sup>th</sup> year
SMEs	25bps	50bps	100bps
Large enterprises	50bps	100bps	200bps



# 3

## Aid to combat COVID-19 - sections 3.6. to 3.8

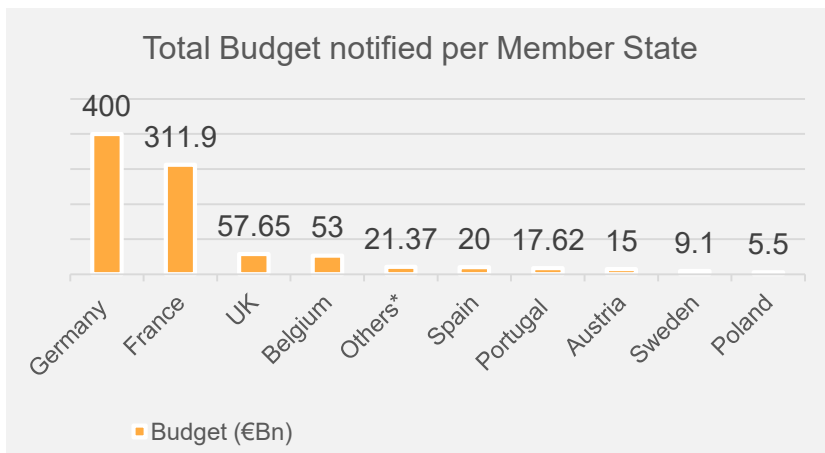
- **Aid for COVID-19 and other antiviral relevant R&D (including vaccines, medicinal products and treatments, medical devices, etc.)**
    - Form: direct grants, repayable advances or tax advantages.
    - Maximum amount: up to 100% of the eligible costs for fundamental research and 80% of eligible costs for industrial research or experimental development.
    - Commitment: granting of non-exclusive licences under non-discriminatory market conditions to third parties in the EEA.
  - **Investment aid for testing and upscaling infrastructures required to develop COVID-19 related medicinal products**
    - Form: direct grants, repayable advances or tax advantages; can be complemented by loss guarantee over 5 years (assuming reasonable profit of 10%)
    - Maximum amount: up to 75% of the eligible costs.
    - Project completion within 6 months after the granting of the aid (25% penalty per month of delay).
    - Commitment: to charge prices corresponding to the market levels; to open infrastructure to several users on a transparent and non-discriminatory basis
  - **Aid for the production of COVID-19 relevant products**
    - Form: direct grants, repayable advances or tax advantage; can be complemented by loss guarantee over 5 years (assuming reasonable profit of 10%)
    - Maximum amount: up to 80% of the eligible costs.
    - Project completion within 6 months after the granting of the aid (25% penalty per month of delay).
- ✓ Additional support when the projects are supported by more than one Member State and/or the investments are concluded within 2 months of the granting of the aid.
  - ✓ Assumption of incentive effect for projects started after February 1, 2020
  - ✓ May not be granted to undertakings in financial difficulties as of December 31, 2019

- **Temporary deferrals of tax and/or of social security contributions or obligations**
  - Selective basis: schemes aimed at companies particularly affected by the COVID-19 outbreak because of the economic sector in which they operate, their location, or their size.
  - End date of the deferral: no later than December 31, 2022.
  - No exclusion for companies in financial difficulties
- **Wage subsidies schemes for employees to avoid lay-offs during the COVID-19 outbreak**
  - Wage subsidy duration: No more than 12 months from the application for the aid.
  - Maximum amount: than 80% of the benefitting employees' individual monthly gross salary.
  - May be combined with other employment support measures, provided that this does not result in overcompensation, as well as with tax deferrals and deferrals of social security payments.
  - No exclusion for companies in financial difficulties

# 5 Articulation with other aid measures

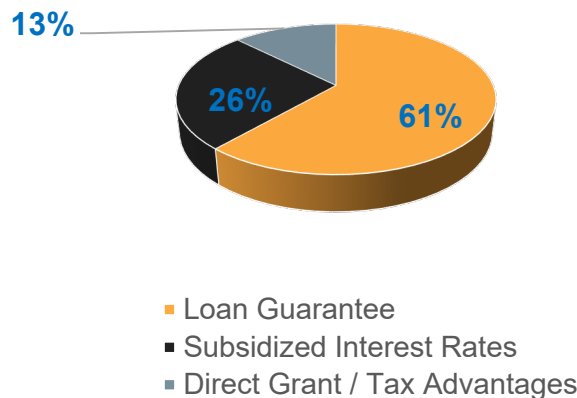
- **Aid measures under the TF can be combined with each other, with two exceptions:**
  - Section 3.2. and 3.3. aid (guarantees/ loans) cannot be cumulated for the same underlying loan or if the overall amount exceeds the relevant thresholds; and
  - aid aimed at supporting COVID-19-related activities cannot be cumulated if various types of aid concern the same costs.
- **Aid measures under the TF may in principle be complemented with other public support tools :**
  - i. measures that do not qualify as aid in light of their general character
  - ii. de minimis aid (up to EUR 200,000.00 per beneficiary over 3 years)
  - iii. compensation aid for direct damages (Article 107(2) b)), provided no overcompensation; and
  - iv. rescue or restructuring aid to companies in financial difficulties under Article 107(3) c) TFEU (but aid granted under the TF would presumably be taken into account to assess necessity of additional aid under Article 107(3) c)).

# 6 Overview of the decisional practice



Total amounts notified: >  
**€ 890 Billion\***

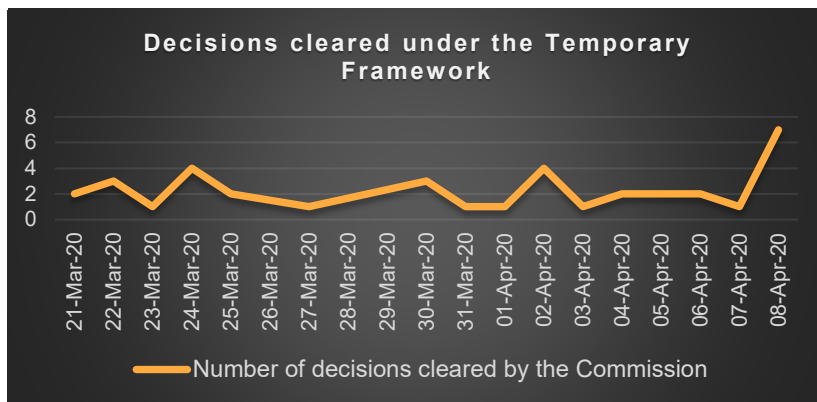
Aid instruments based on budget



Member State	Decisions
<b>Total</b>	<b>47</b>
Germany	4
Belgium, Denmark, France, Greece, Luxembourg, Poland, Portugal, the UK	3
Croatia, Italy, Latvia, Lithuania, Norway, Spain, Sweden	2
Austria, Bulgaria, Estonia, Hungary, Ireland, Latvia, Malta, the Netherlands, Romania	1

All figures as of April 13; conservative estimates as not all budgets are publicly available yet; some budgets are based on press estimates (e.g. Germany) <sup>12</sup>

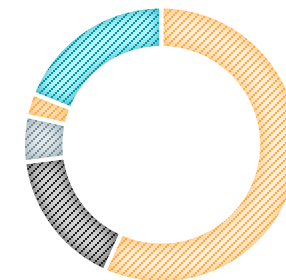
# 7 Overview of the decisional practice (2)



Notified measures are approved **within 24-48 hours on average**

Allocation Period (up to)

- 31-Dec
- 30-Sep
- 30-Jun
- 31-May
- TBD



Specific considerations so far raised in the decisions:

- **Prevention of spill-over of aid to banks and non-application of the BRRD** (Section 3.4. of the TF): e.g. when guarantee covers existing loans, commitment to maintain the total amounts lent at the level recorded before the guarantee was granted (see e.g. France, Estonia, Bulgaria).

# 8 Open issues

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- Interaction with Article 107(2) b): is the TF a complement or a substitute?
  - See e.g. aid to Walloon airports or Swedish airlines (granted under the TF and Article 107(3) b))
- Additional conditions imposed by Member States and not required under the TF
  - Eg. Prohibition of dividends, use of proceeds
- Different level of support among Member States
- Beyond liquidity: recapitalizations, structural measures
- Ex post control on implementation

# Temporary Framework Economics

- Adoption of 2009 Temporary Framework: tensions in financial markets, extremely high borrowing costs (margins) despite drastic cuts in ECB rates. 2020 starting point differs: low central bank rates, but higher debt/GDP ratio in some Member States.
- Common exogenous shock, but impact differs across Member States in terms of incidence. The speed and nature of (health) policy responses varied.
- Initial conditions: significant differences in terms of fiscal headroom.
- Approved schemes: tip of the iceberg. Total public resources deployed (so far) are much larger (e.g. general tax measures). Bruegel estimates: <https://www.bruegel.org/publications/datasets/covid-national-dataset/>



## 2 Temporary framework 2020: some magnitudes

- More than 300 firms have seen their ratings drop to B3 (limit for investment grade) or below (Moody's). Scramble for liquidity (credit lines). Default rates expected to spike above 10% (+/- 3% since 2011).
- Applicable margins (both for loans and guarantees) are not conditioned on credit rating (unlike TF 2009).
- Direct grants (800k) that can be cumulated with *de minimis* (200k). Larger than TF 2009 (latter case: differential take up by Member States).
- Recapitalisation: under what conditions? Pricing? Exit strategy? (In principle, no aid if *pari passu* principle is respected).
- 2020 TF: more flexible (and generous) as compared to 2009 TF.

# 3 Sustainability of public intervention

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- To a large extent, the sustainability of State support will depend on the shape of the recovery.
- Best case: V shaped contraction, strong bounce back (DE CEA), borrowing costs for highly indebted Member States remain low. The abrupt shortfall in aggregate demand is neutred by heavy public spending and TF 2020 is part of the solution. Contingent liabilities (eg. guarantees) are not activated.
- Worst case: L (or flat U) shaped, 10% + GDP decline, bond spreads rise, productive capacity (supply) is significantly reduced, creeping stagflation. Both private and public sector debt reach levels perceived to be unsustainable.

# 4

## Downside risks

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- Spain and Italy are worst hit (so far); Spain could end up with Italy's (2019) debt as a % of GDP and Italy with Greece's (2019) debt to GDP ratio (Bruegel: <https://www.bruegel.org/2020/03/the-fiscal-consequences-of-the-pandemic/>).
- Both countries heavily rely on tourism (-80% for 2020?); exports have been a source of growth. Banks' heavy exposure to these industries.
- The line between liquidity shortages and insolvency can be thin, both for sovereigns (growth and interest rates) and private undertakings

# 5 Medium term

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- In the context of a protracted contraction, risk of an ‘economic attrition war’ between Member States.
- Not much DG COMP can do to prevent it (general measures).
- TF 2020 provides the desired flexibility; but how long will some Member States be able to exploit it to sustain their industrial fabric? Two edged.
- This pandemic may lead to permanent shifts in both supply and demand. Is it desirable to sustain activities for which demand has permanently fallen? Aid as one off compensation to foster exit?
- The fiscal burden will increase; how will it be shared?

“Exceptional occurrences”  
“Ordinary” measures and next steps  
Legal issues

# 1 Article 107(2) b) – “*to make good damages caused by exceptional occurrences*”

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- Many cases on “natural disaster” (storms, earthquake, floods, eruptions)
- Less cases on “exceptional occurrences” (war, internal disturbances and strikes, major industrial accidents resulting in widespread economic loss – 9/11)
- Aid compatible in law provided it satisfies objective criteria
  - Automatic exemption
  - No discretion for the Commission (T-268/06 Olympiaki Aeroporia Ypiresies AE v Commission, para 51)
- Exceptional occurrence?
  - The Covid-19 outbreak constitutes such an exceptional occurrence (TF, § 8, 15; 4 decisions)
  - Specific sectors: transport, tourism, culture, hospitality, retail, organisers of cancelled events
- Notification template published by DG COMP

# 2 Article 107(2) b) – Scope of application

- Exception to be interpreted narrowly
  - Only damage caused by the exceptional occurrences may be compensated
  - Direct link between the damage caused by the exceptional occurrence and the State aid
  - The assessment of the damage suffered must be as precise 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?
  - The period for which the 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 end of Covid-19 outbreak)
    - catching-up revenue after the reopening of the business and additional costs linked to the restart of the operations (see decision 1.8.2011 SA.32163 - 2010/N - Slovenia – Icelandic volcano ash in April 2010)
    - period starting from the closure of the activity until “normal operations”, provided that there is a direct causal connection

# 3 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.



# 4 Article 107(2) b) – Undertakings in difficulty?

- No aid granted to an undertaking in difficulty at the time of the event
  - 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 and EBITDA interest coverage ratio < 1.0.
- Non-discriminatory
- No circumvention of rescue and restructuring aid principles
  - Not used to remedy undertakings' problems unrelated to the relevant events.
- But “one time last time” principle does not cover compatible aid under Article 107(2)(b) TFEU: this is not “rescue aid, restructuring aid or temporary restructuring support”.
  - Member States may compensate damages directly caused by Covid-19 to undertakings that have received aid under the Rescue and Restructuring Guidelines.
  - However, they should no longer be ‘in difficulty’: i.e. having completed the restructuring plan

# 5 Article 107(3) c) – When relevant?

- Times in crisis not suitable to this provision
- Legal basis for new TF measures (aid to combat Covid-19)
- Rescue & Restructuring aid? If undertaking 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 R&R guidelines?
  - 2014 guidelines very much shaped by 2009 financial crisis guidelines
  - Shift from “bail out” towards “bail in” applicable for Covid-19?

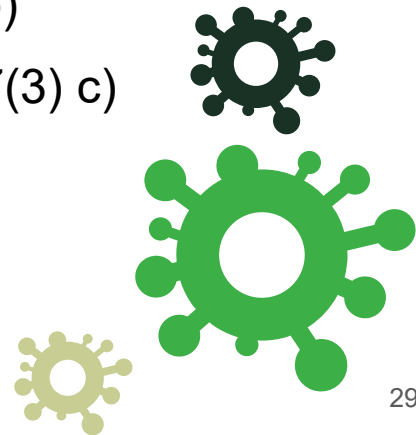
- Article 107(2) b) & Article 107(3) b) aid measures
  - No discretion / discretion
  - Past / Future
  - Can be cumulated
- TF too general and not targeted enough?
  - Moral hazard? Zombies firms? Cleansing effect?
  - Sufficient safeguards ?
  - Damages: how loan and loan guarantees can make good for absence of business?
- Identification of beneficiaries (within a group)
  - Analogy to R&R principle : companies belonging to or being taken over by a larger business group are not eligible for aid for R&R aid
  - Exceptions: if difficulties are intrinsic, not the result of an arbitrary allocation of costs within the group, too serious to be dealt with by the group itself
  - Determination in recovery aid cases – Commission's discretion

# Exceptional occurrences “Ordinary” measures and next steps Economics

# The economics in measures adopted under Art. 107(2) b) and Art. 107(3) c)

## Overview

1. How to calculate compensation for damages – Art. 107(2) b)
2. Aid under the Rescue & Restructuring Guidelines – Art. 107(3) c)
3. Concluding remarks



# 1 How to calculate damages under 107(2) b)

## Financial evidence expected in these cases

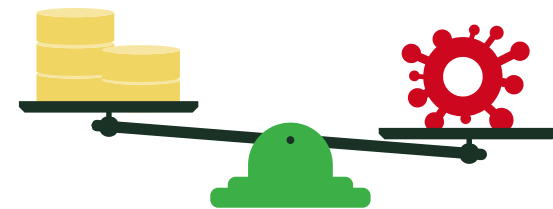


Member States must set out:

- a detailed description of the damages
- the methodology used to calculate the damages

It is necessary to demonstrate that:

- costs unrelated to the pandemic are not covered by aid
- the aid does not exceed the damages suffered

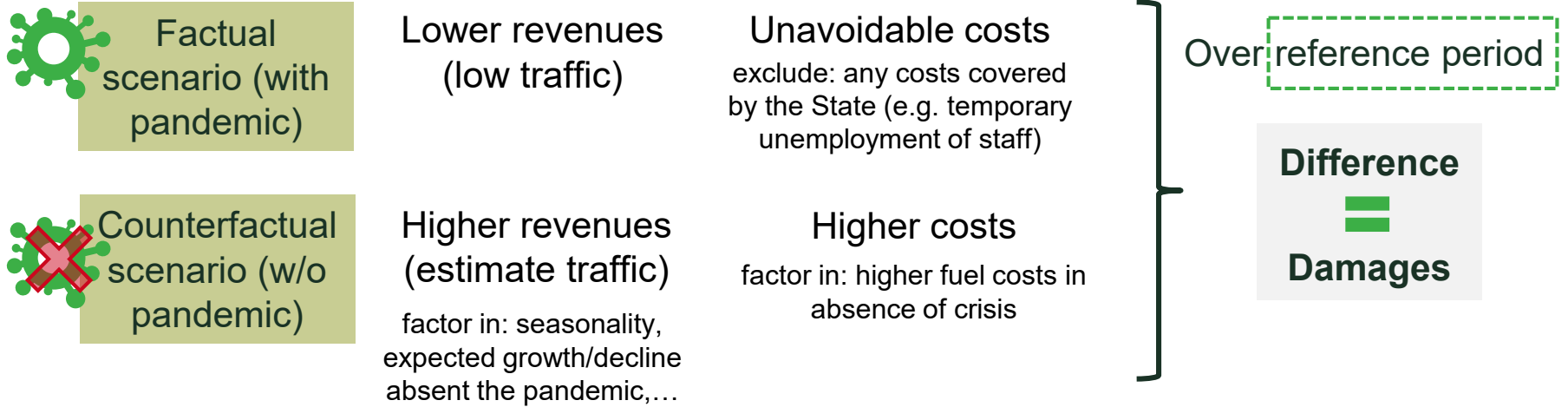


This can be done through robust estimates of the damages which isolate the impact of the pandemic, and/or by clawback mechanisms

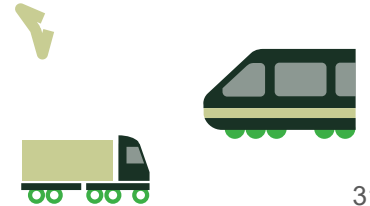
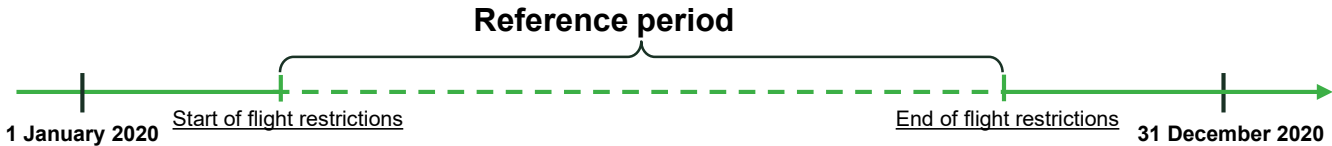
# 1 How to calculate damages under 107 (2) b)

## The specific case of the transport sector

### Example: calculation of damages for an airport



Basis for calculation:



# 2 Rescue aid under the R&R guidelines

## Financial evidence required in these cases

For companies seeking liquidity support under the R&R guidelines, the following financial analysis is needed:



- quantification of the extent to which the company is already suffering (or is likely to suffer) from liquidity issues due to the pandemic; and
- assessment of the period over which liquidity support is required, taking into account the availability of other financing support

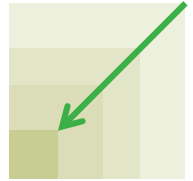




# 2 Restructuring aid under the R&R guidelines

## Possible route for longer-term intervention

In specific areas, financial evidence is needed to demonstrate the **compatibility** of restructuring aid:



# 3 Concluding remarks

## One part of a wider picture

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A number of the aid routes require demonstrating the direct relationship between the company's financial difficulties and the COVID-19 pandemic through financial analysis; however, this may not be straightforward in some cases

The routes described, and the associated economic and financial analysis, form only one part of a wider toolbox of measures



There may be potential market-conforming approaches if the State has prior economic exposure to the company concerned (e.g. private creditor test)

- forgoing debt repayments over a temporary period might be the less costly option compared to a counterfactual scenario where the company enters into liquidation