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EU Commission adopts Temporary Framework for State aid to support the economy in the current COVID-19 outbreak and approves several national State aid schemes

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The COVID-19 pandemic has hit the European economy with brute force. Many businesses are facing drastic declines in revenues and are in urgent need of liquidity. Some have imposed temporary lay-offs or even face insolvency. The European Commission and most EU member states as well as the UK, which is temporarily still bound by EU State aid law, have announced plans to help the economy. Such plans resemble the reaction of European governments during the financial crisis in 2007/2008.

The EU's approach to State aid in the COVID-19 crisis

The flexible handling of State aid law will be a priority for the Commission. The Commission has already in the past days approved within a very short time the first national COVID-19 aid schemes to sectors that were facing particular difficulties, such as organizers of events that had to be cancelled. In order to be equipped for the expected number of State aid procedures, the Commission has shifted additional staff into its State aid teams. In addition, on 19 March the European Commission after coordination with the EU member states published a new Temporary Framework for State aid to support the economy in the current COVID-19 outbreak (the Temporary Framework). The Temporary Framework allows member states to take full advantage of the flexibility provided by the State aid rules to support the economy in this difficult time. It applies retroactively to all aid measures as of 1 February 2020. National measures will, however, still require notification to and approval by the Commission.

While member states can still rely on the general State aid rules (as recalled by the Commission in its communication of 13 March on coordinated economic response to the COVID-19 outbreak), such as the General Block Exemption Regulation 651/2014 or the guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, a more targeted approach is required in the current situation. The Commission identifies a number of sectors that have been hit particularly hard by the COVID-19 outbreak: transport, tourism, culture, hospitality, and retail. The retail sector had not been included in the first draft of the Temporary Framework, but since many member states imposed closures on retailers with the exception of grocery stores, this business segment has been heavily affected. This opens the door to potentially far-reaching aid measures, as the European retail sector accounted for sales of more than €3 trillion in 2019.

Importantly, the Temporary Framework provides that the "one time, last time" principle, according to which undertakings in difficulty should not receive more than one restructuring aid within 10 years (to avoid potential competitive distortions and undue public expenditures), does not prevent COVID-19 aid for transport, tourism, culture, hospitality, and retail even if they have already received State support in the last 10 years.

It is important to remember that State aid for ailing companies will still mainly come from EU member states. The EU has oversight on national aid schemes or individual support outside such schemes, but for companies seeking liquidity and other support the first authority to turn to is the government in the relevant member state. For a summary of key national responses in Germany, France, Italy, Spain, and the UK please see the second part of this client alert.

State aid covered by the Temporary Framework

The EU Temporary Framework provides the benchmark for member states to provide State aid. It recognizes that the entire EU economy is in a serious crisis. To remedy this, the Temporary Framework provides for five types of aid schemes that the Commission will quickly approve upon filing by the member states:

(i) Direct grants, selective tax benefits and upfront payments

Member states can set up rules to grant a company up to EUR 800,000 per undertaking (gross, i.e. before any deduction of tax or other charge) to meet its urgent liquidity needs. The aid needs to be granted based on a scheme with an estimated budget; *and* the recipient must not have been in financial difficulty prior to the COVID-19 outbreak.

(ii) Government guarantees for bank loans to companies

Member states may provide government guarantees (and loans, see section (iii) below) to ensure that banks continue to grant loans to companies. Guarantee premiums are set by the Temporary Framework at certain minimum levels which differ for SMEs and large undertakings, and depending on the maturity of the loan.

Member states may also notify schemes that deviate from the published premium levels of the Temporary Framework, e.g. lower guarantee coverage may offset a longer maturity. For loans with a maturity beyond 31 December 2020, the amount of the loan principal must not exceed:

a) twice the annual wage bill of the beneficiary company (including social charges and the cost of personnel working on site but formally in the payroll of subcontractors) for 2019; or

b) 25% of total turnover of the beneficiary in 2019; and

c) with justification and a self-certification by the beneficiary of its liquidity needs, the amount of the loan may be increased for the coming months (18 months for SMEs and 12 months for large enterprises).

For short-term loans with a maturity before 31 December 2020, the amount of the loan principal may be higher with appropriate justification and considering the principle of proportionality. In the initial draft, this deadline was foreseen to last only until the end of September, but recent predictions of the duration of the crisis have led the Commission to extend this period. The overall duration of the guarantee is limited to maximum six years and the public guarantee must not exceed:

a) 90% of the loan principal where losses are sustained proportionally and under same conditions, by the credit institution and the State; or

b) 35% of the loan principal, where losses are first attributed to the State and only then to the credit institutions (i.e. a first-loss guarantee); and

c) in both of the above cases, when the size of the loan decreases over time, e.g. due to reimbursement, the guaranteed amount has to decrease proportionally.

This means that public and private guarantors generally need to share the risk of the loan under the Temporary Framework, and deviating solutions will require an individual State aid assessment. Moreover, guarantees may only be granted to companies that are in difficulty solely as a result of the COVID-19 outbreak.

(iii) Subsidized public loans to companies

Member states can grant public loans directly to companies at reduced interest rates. These loans can help companies to meet immediate working capital and investment needs. The interest rates for the loans are set at certain published minimum levels which differ for SMEs and large undertakings, and depending on the maturity of the loan. Member states will often provide such public loans only in conjunction with private loans (see below (iv) and Section 2 for individual member states' approaches), which will raise again the question of public guarantees for the private part of the loan packaged.

Otherwise, the same criteria as for the guarantees set out in (ii) above apply, i.e. for loans with a maturity beyond 31 December 2020, the amount of the loan principal is limited to the same thresholds, whereas for short-term loans higher amounts may be individually justified.

(iv) Safeguards for banks that transfer state aid to the real economy

Many member states build on private banks' existing credit capacity and use it as a channel to support businesses, especially for SMEs. The Temporary Framework clarifies that aid channeled through private banks is considered direct aid to the customers of the banks and not to the banks themselves (which otherwise would raise complex questions under the existing State aid rules for the financial sector). However, the financial intermediary will need to be able to demonstrate that it operates a mechanism that ensures that the advantages are passed on to the largest extent possible to the final beneficiaries in the form of higher volumes of financing, riskier portfolios, lower collateral requirements, lower guarantee premiums or lower interest rates.

(v) Short-term export credit insurance

The Temporary Framework provides additional flexibility to demonstrate that certain countries pose non-marketable risks so that governments can provide short-term export credit insurance if necessary. According to the Temporary Framework, this requires that (i) a large, well-known international private export credits insurer and a national credit insurer produce evidence of the unavailability of such cover; or (ii) at least four well-established exporters in the member state produce evidence of refusal of cover from insurers for specific operations.

Member states must show that State aid measures notified to the Commission are necessary, appropriate and proportionate to remedy a serious disturbance in the economy. As currently thousands of companies are in need of financial support across Europe, it is particularly important to (i) pre-assess a company's eligibility under the various aid programs in order to avoid hitches in the application process, and (ii) for individual aid that falls outside the scope of approved schemes, to have a strategy in place on how to present a case for State aid to the respective governments.

As the aid measures are taken by the EU member states, and the EU Temporary Framework only provides guidance for the assessment of national measures by the Commission, we set out below a selected number of individual national measures in the largest European economies:

Italy

On 22 March 2020, under the Temporary Framework described above, the Commission has approved the first Italian aid scheme. It is noteworthy that the EUR 50 million scheme has been approved within 48 hours from receiving the notification from Italy in order to support the production and supply of medical devices, such as ventilators, and personal protection equipment, such as masks, goggles, gowns, and safety suits. The scheme will help Italy provide the necessary medical treatment to those infected, while protecting healthcare operators and citizens.

The notification from Italy is the result of the Italian Government's third COVID-19 decree of 18 March 2020 containing several measures in favor of the sectors hit by the coronavirus outbreak. The decree, in particular, contains measures, in favor of the healthcare, air transport, agricultural and fisheries, cinema and movie sectors as well as for SMEs:

- For the healthcare sector the so-called "Cura Italia" decree authorizes Invitalia, a public entity

controlled by the Ministry of Economy, to grant financing to companies active in the production of medical devices and individual protection, for a total amount of €50 million in 2020:

- For the agricultural and fisheries sector, the decree provides, inter alia, for the creation of a special fund of €100 million to cover the passive interests of financing granted in favor of enterprises in these sectors.
- For the air transport sector, the decree provides for the introduction of measures (to be further enacted by the competent Ministry) to compensate companies active in this sector for the losses suffered as a result of the COVID-19 pandemic. Special measures are also introduced for Italy's flag carrier Alitalia as a company already facing financing difficulties. For this purpose, the decree introduces a special fund of €500 million for 2020. In addition, it is provided that the existing solidarity fund for the air sector is increased by further €200 million.
- For the cinema and movie sector, the decree provides for the creation of two funds covering a total of €130 million in favor of enterprises and operators active in this sector for the year 2020. It is further provided that the fees deriving from audio-video reproduction are devolved in favor of artists.
- For SMEs, the decree contains a series of measures to enhance the current mechanisms through which the Italian State guarantees their financing by the financial institutions. In particular, it provides for the increase of the maximum amount of the guaranteed loans up to €5 million per enterprise.

Further legislative decrees are expected to fully implement the Commission's Temporary Framework, which was published only subsequent to the Italian decree mentioned above.

Germany

Germany announced several responses to the COVID-19 outbreak. A first package of 13 March 2020 is labeled as a "Protective shield for employees and companies." It consists of several pillars:

- As an employment law tool, making reduced hours compensation benefit more flexible;
- The options for deferring tax payments and reducing prepayments will be enhanced, and enforcement rules will be adapted. Businesses will be able to defer billions of euros in tax payments.
- Existing liquidity assistance programs, in particular by the State-owned KfW bank, will be expanded to make it easier for companies to access loans with reduced interest rate or guarantee conditions. These instruments are complementing loans offered by private banks. The current turnover threshold of €2 billion will be raised to €5 billion and risk assumption will be increased to up to 70% (from 50%). For companies with a turnover of more than €5 billion, support will be provided on a case-by-case basis. The KfW bank will be equipped with around €500 billion to support the economy. The government will also double the guarantee limit or guarantee banks to €2.5 million.

Germany notified the liquidity assistance programs to the Commission as two separate measures under the Temporary Framework and the EC granted approval on 22 March. The measures will allow the KfW bank to provide liquidity as follows:

- A loan program covering up to 90% of the risk for loans for companies of all sizes. Eligible loans may have a maturity of up to 5 years and can reach €1 billion per company, depending on the company's liquidity needs.
- A loan program in which the KfW participates together with private banks to provide larger loans as a consortium. For this scheme, the risk taken by the State may cover up to 80% of a specific loan but not more than 50% of total debt of a company.

As a federal State, there are additional initiatives at *Länder* level, e.g. loans and guarantees are available from the public banks owned by the German regional States. As far as the measures extend beyond the existing schemes that have already been in place, Germany will be in discussions with the Commission again to notify the additional German plans as quickly as possible.

In addition, the German government has prepared a draft Act to limit the implications of the COVID-19 disease by measures of civil law, insolvency law and criminal procedural law. The law will be put before Parliament in the week of 23 March 2020 and enacted as quickly as possible.

France

The European Commission approved the following three State aid schemes of €300 billion notified by the French government:

- Two schemes enabling the French public investment bank Bpifrance to provide State guarantees on commercial loans and credit lines for companies with up to 5,000 employees; and
- A scheme providing State guarantees to banks on portfolios of new loans for all types of companies. This will enable banks to quickly provide liquidity to companies.

In addition, a €45 billion package has been set up by the French government to fund the following measures:

- Postponement of payments of social contributions or tax installments for March 2020;
- Short-time working scheme; and
- Setup of a "solidarity fund" for companies that have been forced to shut down (in particular, in the catering and tourism sectors) and whose annual revenue is below €1 million and/or whose revenue has sunk by more than 70%.

Spain

The Spanish government has approved two consecutive packages of urgent measures to respond to the economic impact of COVID-19 on 12 and 17 March.

The measures adopted include the implementation of an economic and liquidity assistance scheme mostly for the health system, families and other vulnerable groups, the tourism sector, the self-employed and SMEs, and public administrations.

The most relevant economic and liquidity measures adopted to date include:

- Exemption from 75% of the obligation to contribute to Social Security for companies with more than 50 employees requesting a temporary employment regulation files (ERTEs).
- Suspension of tax deadlines until at least until 30 April 2020.
- Line of credit (of up to €100 billion) for coverage by the State for financing granted by financial institutions to companies and the self-employed.
- Extension (by €10 billion) of the net debt limit of the Official Credit Institute to facilitate liquidity, fundamentally to SMEs and the self-employed.
- Deferment of tax debts for SMEs and freelancers for six months.
- Extraordinary line of insurance coverage for exporting companies (of up to €2 billion) financed by the Internalization Risk Reserve Fund.
- Suspension of insolvency petitions (while the State of Emergency remains in force). Also, mandatory insolvency petitions will not be admitted if they were filed during the State of Emergency and the two months thereafter. Voluntary insolvency petitions filed during this period will be admitted, prioritizing by necessity, even if filed on a later date.

The government has already announced that it is considering the adoption of more ambitious measures that will be announced soon and has publicly requested a more proactive role of the European Union in addressing the economic downturn produced by the COVID-19 pandemic.

UK

Under Brexit transition arrangements, the UK is still subject to the EU State aid rules until at least the end of this year (and possibly longer if the transition is delayed due to the impact of COVID-19).

Having announced a £330 billion package of support for the economy earlier in the week, on Friday 20 March the Government published more details of specific measures involved. Key elements of the package are as follows:

- Reimbursement of 80% of affected workers' wage costs, up to a cap of £2,500 per month.
- Deferral of VAT payments due from employers for three months and deferral of income tax payments due from the self-employed for six months.
- Reimbursement of SMEs for up to two weeks' statutory sick payments to employees absent due to COVID-19.
- For retail, hospitality, and leisure businesses in England, a 12-month business tax rates holiday and cash grants of up to £25,000 – with the devolved Welsh, Scottish and Northern Irish governments announcing similar packages totaling a further £620 million of support.

- Grants of £10,000 for small businesses already benefiting from business rate relief.
- A temporary loan scheme to support SMEs whereby the government will provide lenders with a guarantee of 80% of value of loans of up to £5 million.
- A new lending facility for larger firms facing short term liquidity problems whereby the Bank of England will buy their short term debt.

Conclusion

We expect more national schemes and individual measures in the coming months, as the COVID-19 crisis unfolds dynamically. The Commission's handling of such plans and measures will need to apply the required level of flexibility for an unprecedented challenge to the European economy. The experience of dealing with the financial crisis a little more than a decade ago should, it must be hoped, enable the Commission and national governments to react swiftly and to provide targeted support measures for the ailing European economy.

We will continue to monitor the situation and make information on the EU's and member states' response to the COVID-19 available at our State aid topic center at: https://www.hoganlovells.com/en/aof/state-aid. Our EU and national State aid law experts are available to discuss any questions you may have.

Contacts

Dr. Falk Schöning

Partner

Sabrina Borocci

Partner

Casto González-Páramo Rodríguez

Partner

Mark Jones

Partner

Eric Paroche

Partner

Dr. Marc Schweda

Partner

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