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Questions Clients Are Asking About State Aid

No Arms Race For National Champions – State Aid During Covid-19 Measures

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The adverse economic impact of the Covid-19 pandemic has led to many European Union Member States to introduce support measures for businesses. If a Member State grants support that confers a selective advantage on some businesses or sectors (i.e., it is not of general application), and is liable to distort competition in the internal market, the measure may entail State aid within the meaning of Article 107(1) of the Treaty of the Functioning of the European Union. To address these issues and set out a common approach to state aid during the Covid-19 pandemic, on 19 March 2020, the European Commission (the **Commission**) published the Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak (**Covid-19 Communication**),[1] which was subsequently amended on 3 April 2020.

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While the Covid-19 Communication provides a helpful framework for what are bound to be urgent decisions on the part of Member States, it is important to appreciate its scope and interrelation with existing measures. In particular, although the framework enables Member States to implement and the Commission to approve aid expediently, the forms of aid granted must comply with the purpose and conditions set out in the Covid-19 Communication as well as the requirements of any additional applicable sector- or measure-specific rules. In addition, existing rules and guidance remain applicable for Member States to introduce state aid outside the framework of the Covid-19 Communication. The aim of this note is to set out the substantive forms of aid introduced by the Covid-19 Communication, followed by commentary on their limitations and context.

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I. Aim

Within existing state aid rules, Member States can already take action in a variety of ways to support businesses, in particular SMEs, that face economic difficulties due to the COVID-19 outbreak.The Covid-19 Communication complements the existing framework by introducing and providing guidance on specific temporary forms of state aid within Article 107(3)(b) TFEU. Executive Vice-President of the Commission Margrethe Vestager is quoted in a Commission press release as follows:

> *We need to act in a coordinated manner. So additional support may be granted to cross-border projects between Member States and to timely delivery of products. In addition, we have extended the temporary framework to give Member States further possibilities to ease liquidity constraints faced by companies and save jobs in sectors and regions that are hit particularly hard by this crisis*[2].

The specific new forms of aid are justified and may be declared compatible with the internal market if they are temporary and aimed at remedying the liquidity shortage caused by the Covid-19 outbreak and ensuring that disruptions faced by businesses in the pandemic do not undermine their viability.[3] Therefore, although the general disruptive nature of the pandemic is unlikely to be contested, any aid introduced within this framework is intended to benefit businesses who are in fact facing a

1 https://ec.europa.eu/competition/state_aid/what_is_new/TF_consolidated_version_as_amended_3_april_2020.pdf

2 See Commission Press Release of 6 April 2020, *State aid: Commission extends Temporary Framework to enable Member States to accelerate research, testing and production of coronavirus relevant products, to protect jobs and to further support the economy in the coronavirus outbreak*

3 Covid-19 Communication, [18]

liquidity shortage due to the pandemic (as opposed to businesses or sectors whose access to liquidity is unaffected or increased by the circumstances of the pandemic).

In addition, the Covid-19 Communication cross-references other state aid instruments and rules, such as the Recapitalisation Communication and the Rescue and Restructuring State Aid Guidelines, which the Covid-19 Communication is intended to complement, not substitute. Member States are thus not empowered during the pandemic to implement forms of state aid under the umbrella of the Covid-19 Communication so as to escape the requirements of guidelines and acts that were hitherto applicable to such aid. Equally, the inability to fit a form of aid under one of the headings in the Covid-19 Communication does not necessarily exclude its compatibility with the internal market pursuant to one of the existing guidelines, which remain available to Member States as guidance on granting state aid.[4]

II. Types of aid and conditions for their compatibility with the internal market

The Covid-19 Communication sets out the following forms of temporary aid:

a. Direct grants, repayable advances or tax advantages

These forms of aid may be provided to undertakings that were not already in difficulty on 31 December 2019 but have since faced a shortage or unavailability of liquidity. The nominal value of this form of aid is capped at 800,000 EUR per undertaking before tax (with lower limits and additional restrictions for aid to agri- and aquacultural business and fisheries).[5]

b. State guarantees on loans

State guarantees on loans may be granted temporarily to ensure access to liquidity to undertakings that face a sudden shortage and were not already in difficulty on 31 December 2019. For this type of aid, the Covid-19 Communication provides minimum levels of guarantee premiums per individual loans, increasing annually.

The duration of the state guarantee is limited to a maximum of six years. The extent of the guarantee is capped at 35% where the state bears the first loss, and 90% where losses are sustained proportionally and under the same conditions by the lender and the state. The guarantee may only relate to investment and/or working capital loans.

The overall amount of loans maturing after 31 December 2020 that are subject to state guarantees may not exceed, per each beneficiary, its double annual wage bill or 25% of its turnover, except with appropriate justification and self-certification by the beneficiary of its liquidity needs (which may include working capital and investment needs). In the latter case, the amount of the loan may cover the undertaking's liquidity needs for the coming 12 months starting from the grant of the loan, or 18 months if the beneficiary is an SME.

4 See, eg, footnote 5 to the Covid-19 Communication
5 Covid-19 Communication, [22]-[23]

The overall amount of loans with a maturity until and including 31 December 2020 is not subject to the above limits, as long as it is justified and the aid is proportional.

Where the guarantees are channelled through credit institutions or other financial institutions, there are specific requirements on the intermediary institutions, designed to minimise any element of aid to those intermediaries themselves that may be caused by the scheme. In particular, the intermediaries are required to pass on, to the largest possible extent, the advantages of the state guarantee to the final beneficiaries, and to demonstrate that they have a mechanism in place that ensures this. In addition, they may not charge a guarantee fee where there is a legal obligation to extend the term of an existing loan to an SME.[6]

c. Subsidised interest rates for loans

Member States may offer subsidised interest rates on loans temporarily to ensure access to liquidity to undertakings that face a sudden shortage and were not already in difficulty on 31 December 2019.

This type of aid may not be granted cumulatively to the same recipient as the state guarantees discussed above. The Covid-19 Communication provides minimum levels of applicable interest rates, increasing annually.

The same limits on the overall amounts of loans per beneficiary, the purpose of loans and the time when the beneficiary became an undertaking in difficulty apply as in the case of state guarantees. Where the loans are channelled through credit institutions or other financial institutions, the same extra safeguards apply as in the case of loans with state guarantees so channelled.[7]

d. Short-term export credit insurance

The Covid-19 Communication brings all commercial and political risks associated with exports to the countries listed in the Annex to the Communication from the Commission on short-term export-credit insurance ("**STEC**")[8] within the STEC until 31 December 2020, thereby opening the door for Member State support for export-credit insurance for such risks over this period.[9]

e. Aid for Covid-19 relevant research and development

Direct grants, repayable advances or tax advantages granted to antiviral research and development projects relevant to Covid-19 by 31 December 2020 may be provided if the recipient project has received a Covid-19-specific Seal of Excellence and started as of 1 February 2020, or if the project started before 1 February 2020 and aid is necessary to accelerate or widen its scope.

The Covid-19 Communication imposes limits on the aid intensity of these measures: 100% of eligible costs for fundamental research and 80% of eligible costs for industrial research and

6 Covid-19 Communication, [24]-[25]; [29]-[31]
7 Covid-19 Communication, [26]-[27]; [29]-[31]
8 The list of countries includes all EU Member States, Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the USA.
9 Covid-19 Communication, [32]-[33]

experimental development. The latter limit may be increased by 15 percentage points if several Member States support the project or it is carried out in cross-border collaboration.

The aid beneficiary must commit to grant non-exclusive licences under non-discriminatory market conditions to third parties in the EEA and must not have been in difficulty on 31 December 2019.[10]

f. Investment aid for testing and upscaling infrastructures

Direct grants, tax advantages or repayable advances granted for the construction or upgrade of testing and upscaling infrastructures required to develop, test and upscale COVID-19 relevant products up to their first industrial deployment prior to mass production are subject to the following limitations:

- The aid must be granted by 31 December 2020.
- The project must have started as of 1 February 2020 or, if it started before that date, aid may only be granted in respect of additional costs in relation to acceleration efforts or widening the scope of the project.
- The project must be completed within six months after the date of granting the aid.
- Aid intensity may not exceed 75% of eligible costs, which may be increased by 15 percentage points if either the investment is concluded within two months from the grant of aid or support is given by several Member States.
- The testing and upscaling infrastructures must must charge market price for their services and be open to several users on a transparent and non-discriminatory basis (except for undertakings that financed at least 10% of the investment costs, which may be granted prferential access).[11]

In addition to direct grants, tax advantages and repayable advances, this type of aid may include a loss cover guarantee in respect of losses assessed five years after completion of the investment.

g. Investment aid for the production of COVID-19-relevant products

Member States may grant aid in the form of direct grants, tax advantages or repayable advances to projects for the production of Covid-19-relevant products (including vaccines, treatments, active pharmaceutical ingredients, medical equipment and the like). This aid is subject to the same conditions as aid to testing and upscaling infrastructures, subject to two exceptions: the pricing and access conditions do not apply in respect of the production of Covid-19-relevant products, and the maximum aid intensity (which may be increased by 15% where support is received from several Member States) is 75% of eligible costs for the production of Covid-19-relevant products.[12]

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[10] Covid-19 Communication, [34]-[35]
[11] Covid-19 Communication, [36]-[37]
[12] Covid-19 Communication, [38]-[39]

h. Deferrals of tax and/or social security contributions

Where tax or social security contribution deferrals are not of general application, they may be granted to undertakings (including self-employed individuals) that are particularly affected by the Covid-19 outbreak if the measures are temporary, granted before 31 December 2020 and the end date for deferral is no later than 31 December 2022.[13]

i. Wage subsidies for employees to avoid lay-offs

Wage subsidies, if not of general application, may be granted on the following cumulative conditions:

- The aid is aimed at avoiding lay-offs during the Covid-19 outbreak.
- The aid is granted in the form of schemes to undertakings that are particularly affected by the Covid-19 outbreak because of belonging to a particular region, sector or size of business.
- The monthly wage subsidy does not exceed 80% of the monthly gross salary of the benefitting staff.[14]
- The wage subsidy is granted for a period of no more than twelve months, during which the benefitting personnel must remain in continuous employment.

III. Comment

a. No National Champions

The justification for temporary state aid measures during the Covid-19 outbreak, where they are not aimed at sectors directly engaged in Covid-19-relevant products or research and developments, is the need to remedy liquidity shortage caused by the pandemic and to ensure access to finance for businesses that face a sudden shortage.[15] For state guarantees and loan interest subsidies, the aim is repeated and clarified as *ensur[ing] access to liquidity*.[16]

Unsurprisingly, the Commission has not devised a free-for-all for Member States to channel fiscal support into their potential national champions where those businesses already have access to liquidity and/or finance.

b. Existing rules and assessment criteria still apply

Further, the framework introduced by the Covid-19 Communication is intended to clarify the application of the relevant Treaty Provisions and supplement existing state aid rules, rather than substitute them. This is confirmed in the recent Covid-19 State Aid decisions, some of which[17] cross-

13 Covid-19 Communication, [40]-[41]
14 Covid-19 Communication, [42]-[43]
15 Covid-19 Communication, [11]
16 Covid-19 Communication, [24], [26]
17 See, eg, Commission Decision SA.56722, recital (47)

refer to sectoral or instrument-specific State Aid rules in their assessment of compatibility with the internal market.

Therefore, before introducing a form of State Aid to address the disruption caused by Covid-19, Member States would be prudent to ensure the measure envisaged complies with all the relevant sectoral or specific rules and the usual assessment principles for compatibility of aid with the internal market, including the need for state intervention, appropriateness, incentive effect and proportionality to the potential distortion on competition.

c. Scope for modulation

It must also be noted that the Covid-19 Communication explicitly allows Mamber States to devise and notify for the Commission's approval loan guarantee or interest rate subsidy measures that are modulated versions of the schemes set out therein. Such aid may involve a deviation from, eg, the limits on loan interest subsidies, credit risk margins, the term of a loan or the coverage of a guarantee, if offset by a suitable set of other terms justifying the deviation.[18]

d. Quick turnaround, uncertain mechanics

As for the operation of state aid measures under the Covid-19 Communication in practice, it seems that the turnaround for approvals has been relatively short (in some cases less than a week). What remains to be seen is how the substantive conditions such as undertakings' self-certified liquidity needs will operate in practice and whether they will live up to potential challenges.

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If you have any questions about the issues addressed in this memorandum or otherwise, please do not hesitate to reach out to us.

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[18] Covid-19 Communication, [25(b)], [27(b)]