

[Latham & Watkins Antitrust & Competition Practice](#)

11 May 2020 | Number 2724

Visit Latham's [COVID-19 Resources page](#) for additional insights and analysis to help navigate the legal and business issues arising from the global pandemic.

EU State Aid Temporary Framework for COVID-19 — Second Amendment

The second amendment allows EU Member States to provide State aid in the form of recapitalisations and subordinated debt to companies affected by COVID-19.

On 8 May 2020, the European Commission (Commission) adopted a second amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (Temporary Framework)¹ in order to allow EU Member States to provide recapitalisations and subordinated debt to companies in need. The amendment takes immediate effect, and also introduces additional clarifications and clerical corrections to existing provisions, in light of the Commission's experience in applying them.

The Temporary Framework — which the Commission introduced on 19 March 2020 — was designed to enable national governments to use the full flexibility of the State aid rules to support the economy during the pandemic. The first amendment to the Temporary Framework, adopted on 3 April 2020, enables Member States to grant State aid to accelerate R&D, testing, and production of products relevant to fight the pandemic, as well as to allow for targeted support for the protection of jobs and those sectors and regions hit particularly hard by COVID-19. Since the adoption of the Temporary Framework, the Commission has approved with great speed a number of Member States' support schemes as well as measures for individual companies (which the Commission estimates to be €1.9 trillion in State aid to the EU economy).

Overarching considerations

The Commission recognises that well-targeted public interventions providing equity and/or hybrid capital instruments to companies could reduce the risk of a serious downturn in the EU economy, contribute to the continuity of economic activity, and provide a strong platform for recovery. However, the Commission emphasizes that the provision of national public support in the form of the purchase of newly issued shares and/or the provision of hybrid capital instruments, as part of schemes or in individual cases, should be considered only “if no other appropriate solution can be found and be subject to stringent conditions”. The interventions should be subject to clear conditions, including those concerning the State's entry, remuneration, and exit from the companies concerned, as well as governance provisions.

The Commission also emphasizes the importance of green and digital transformation, and encourages Member States to take these issues into account when designing national support measures. The Commission requires large undertakings benefiting from aid under the Temporary Framework to publish information on how the aid received supports their activities relating to EU and national obligations linked to the green and digital transformation, including the EU objective of climate neutrality by 2050.

The Commission recalls that the following measures do not normally constitute State aid and thus do not need to be formally notified for approval:

- The purchase by Member States of existing shares of companies at market price or investment *pari passu* with private shareholders
- The purchase by Member States of newly issued shares and/or provision to companies of other types of equity support or hybrid capital instruments on market terms (under conditions complying with the Market Economy Operator Principle)

Types of recapitalisation measures

Member States can provide COVID-19 recapitalisation measures using one or both of the following distinct sets of recapitalisation instruments:

- Equity instruments (in particular, the issuance of new common or preferred shares)
- Instruments with an equity component (referred to as “hybrid capital instruments”), in particular profit participation rights, silent participations, and convertible secured or unsecured bonds

State intervention can include a variation of the above instruments (e.g., non-voting shares) or a combination of equity and hybrid capital instruments. However, the selected instrument and the conditions attached must be the most appropriate to address the beneficiary’s recapitalisation needs whilst at the same time being the least distortive to competition.

The recapitalisation measures must be for non-financial undertakings, and must be granted no later than 30 June 2021.

Eligibility

The beneficiary must fulfil the following four conditions:

1. Necessity of the aid, since without it, the beneficiary would go out of business or would face serious difficulties to maintain its operations without the State intervention. Such difficulties can be shown by the deterioration of, in particular, the beneficiary’s debt-to-equity ratio or similar indicators.
2. Presence of common interest to intervene. This may relate to avoiding social hardship or market failure due to significant loss of employment, the exit of an innovative or a systemically important company, or the risk of disruption to an important service.
3. Financing on the markets not available at affordable terms, and the support measures that are available to cover liquidity needs in the relevant Member State are insufficient to ensure the beneficiary’s viability.

4. Not a company that was already in difficulty on 31 December 2019 within the meaning of Article 2(18) of the General Block Exemption Regulation (GBER).

In the case of both schemes and individual aid, the Commission imposes on the Member States an obligation to obtain a written request for the recapitalisation aid from the prospective beneficiary undertaking. For individually notifiable aid, Member States will even have to provide evidence of such written request as part of the notification of the measure to the Commission.

When an individual recapitalisation under an already approved scheme exceeds €250 million, a separate notification to the Commission for individual assessment is required. This means that most of the important restructuring in Europe will be individually assessed by the Commission.

Amount

The amount of the COVID-19 recapitalisation must not exceed the minimum needed to ensure the viability of the beneficiary, and should not go beyond restoring the capital structure of the beneficiary to the one predating the pandemic, *i.e.*, the situation on 31 December 2019.

Remuneration of the State

In order to minimize the potential distortion of competition, aid should last as little as possible and remuneration should be as close as possible to market terms. Hence, Member States are required to put in place a mechanism to gradually incentivize redemption.

The Commission sets out the following specific remuneration methodologies for equity instruments and hybrid capital instruments.

Equity instruments

A capital injection by the State should be conducted at a price that does not exceed the average share price of the beneficiary over the 15 days preceding the request for the capital injection. If the beneficiary is not publicly listed, an estimation of its market value should be calculated by an independent expert or other proportionate means.

Any recapitalisation measure must include a step-up mechanism increasing the remuneration of the State (in order to incentivize the beneficiary to buy back the State capital injections). This increase in remuneration can take the form of additional shares, and should correspond to a minimum 10% increase in remuneration of the State (for the participation resulting from the State's COVID-19 equity injection that has not been repaid), for each of the step-up steps.

- **Four years after the COVID-19 equity injection**, if the State has not sold at least 40% of its equity participation resulting from the COVID-19 equity injection, the step-up mechanism will be activated.
- **Six years after the COVID-19 equity injection**, if the State has not sold in full its equity participation resulting from the State's COVID-19 equity injection, the step-up mechanism will again be activated.

As an illustration, if the State's participation is 40%:

- Four years after the COVID-19 equity injection, the State's participation should increase by at least $0.1 \times 40\% = 4\%$ to reach 44%.
- Six years after the COVID-19 equity injection, to reach 48%.

If the beneficiary is not a publicly listed company, Member States may decide to implement each of the two steps one year later (*i.e.*, five and seven years after the COVID-19 equity injection).

According to the Commission, the State must receive "appropriate remuneration" for its investment.

- The buy-back price should be the higher amount of (i) the nominal investment by the State increased by an annual interest remuneration 200 basis points (bps) higher than presented in Table 1, below; or (ii) the market price at the moment of the buy-back.
- Alternatively, the State may sell its equity participation at market prices to purchasers other than the beneficiary, but this requires "an open and non-discriminatory consultation of potential purchasers" or a sale on the stock exchange.

Hybrid capital instruments

The minimum remuneration of hybrid capital instruments until they are converted into equity-like instruments shall be at least equal to the base rate (1 year IBOR or equivalent as published by the Commission), plus the premium as set out in Table 1, below.

Table 1

TYPE OF RECIPIENT	1st year	2nd and 3rd year	4th and 5th year	6th and 7th year	8th year and after
Small and medium-sized enterprises (SMEs)	225 bps	325 bps	450 bps	600 bps	800 bps
Large enterprises	250 bps	350 bps	500 bps	700 bps	950 bps

The conversion of hybrid capital instruments into equity shall be conducted at 5% or more below the Theoretical Ex-Rights price (TERP) at the time of the conversion.

The following step-up mechanism must be included.

- If the equity resulting from the State's COVID-19 intervention is still owned by the State **two years** after the conversion into equity, the State shall receive an additional share of ownership of the beneficiary in addition to its remaining participation resulting from the State's conversion of the COVID-19 hybrid capital instruments. This additional share of ownership shall be at a minimum 10% of the remaining participation resulting from the State's conversion of the COVID-19 hybrid capital instruments.

Governance

The Commission imposes the following conditions on governance and restrictions to limit distortions of competition:

- As long as at least 75% of the COVID-19 recapitalisation measures have not been redeemed, beneficiaries (other than SMEs) shall be prevented from acquiring a more than 10% stake in competitors or other operators in the same line of business, including upstream and downstream operations.
 - In exceptional circumstances, and without prejudice to merger control, such beneficiaries may acquire a more than 10% stake in operators upstream or downstream in their area of operation, only if the acquisition is necessary to maintain the beneficiary's viability. The Commission may authorise the acquisition if it is necessary to maintain the beneficiary's viability. The acquisition may not be implemented before the Commission has taken a decision on this issue.
- Clear account separation shall be put in place in integrated companies to demonstrate that the recapitalisation measure does not lead to cross-subsidies of other economic activities that were in economic difficulties already on 31 December 2019.
- Until the COVID-19 recapitalisation is fully redeemed, beneficiaries cannot make dividend payments or non-mandatory coupon payments. They cannot buy back shares, other than in relation to the State.
- As long as at least 75% of the COVID-19 recapitalisation measures have not been redeemed, remuneration of each member of the management of the beneficiaries must not go beyond the fixed element of remuneration on 31 December 2019 (no bonuses, or other variable or comparable remuneration elements).
- Beneficiaries are prohibited from advertising receipt of COVID-19 recapitalisation measures for commercial purposes.

In addition to these general conditions, if the beneficiary of a COVID-19 recapitalisation measure above €250 million is a company with significant market power on at least one of the relevant markets in which it operates, Member States must propose additional measures (such as structural or behavioural commitments) to preserve effective competition in the relevant markets.

Exit strategy

Beneficiaries (other than SMEs) that have received a COVID-19 recapitalisation of more than 25% of equity at the moment of intervention are required to demonstrate a credible exit strategy for the participation of the Member State, unless the State's intervention is reduced below the level of 25% of equity within 12 months from the date of the granting of the aid. This strategy needs to be a written plan that is prepared for and endorsed by the Member State.

Such beneficiaries shall, within 12 months from the date of the granting of the aid and thereafter periodically every 12 months until full redemption, publish information on the use of the aid received, which includes information on how their use of the aid received supports their activities in line with EU objectives and national obligations linked to the green and digital transformation (including the EU objective of climate neutrality by 2050). In addition, annual reporting is required from the beneficiaries to

the relevant Member State and from that Member State to the Commission with regard to the repayment schedule and the compliance with the governance conditions set above.

If **six years after the COVID-19 recapitalisation (or seven years for a non-listed company or an SME)** the State's intervention has not been reduced below 15% of equity, a restructuring plan in accordance with the Rescue and Restructuring Guidelines shall be notified to the Commission for approval. This requires the Commission to assess whether the actions contemplated in the restructuring plan ensure the viability of the beneficiary, with a view of EU and national obligations linked to the green and digital transformation.

Subordinated debt

The Second Amendment also adjusts the rules for loans that were set out in the Temporary Framework specifically for subordinated debt (debt instruments that are subordinated to ordinary senior unsecured creditors in case of insolvency proceedings). The Commission allows Member States to grant subordinated loans, provided the amount of subordinated debt shall not exceed the following thresholds:

- Two-thirds of the annual wage bill of the beneficiary
- 8.4% of the beneficiary's total turnover in 2019 (12.5% of the beneficiary's turnover for SMEs)

The loans must be granted at reduced interest rates that are at least equal to the base rate and credit risk margins referred to in Table 2, below, plus 200 bps for large enterprises and 150 bps for SMEs. As with other subsidized public loans set out in the Temporary Framework, the loans must be for a maximum of six years.

If Member States want to provide subordinated debt in amounts exceeding the annual wage/turnover thresholds listed above, all conditions for COVID-19 recapitalisation measures will apply.

Table 2

TYPE OF RECIPIENT	Credit risk margin for a 1-year maturity loan	Credit risk margin for a 2-to-3-year maturity loan	Credit risk margin for a 4-to-6-year maturity loan
Small and medium-sized enterprises (SMEs)	25 bps	50 bps	100 bps
Large enterprises	50 bps	100 bps	200 bps

The above rules concerning subordinated debt apply until the end of December 2020.

Conclusion

The Second Amendment enlarges the toolkit available to Member States to ease the consequences of the COVID-19 pandemic on business. However, three fundamental issues arise from the way the Commission is addressing the economic repercussions of this crisis.

At a macro level, the establishment of the compatibility conditions for Member States to grant State aid does not mean that support will actually be granted to the industries most affected and that this will ensure a level playing field in a given sector. In fact, only some Member States will have the budgetary ability to provide State aid, and each of them will decide independently which sector or company to aid. This fact is, of course, nothing new in State aid law and policy, but it is exacerbated in a crisis that is world-wide and hence affects all companies no matter where they are located. Commission Vice President Margrethe Vestager acknowledged this reality in her press statement on the Second Amendment, stating that much more than just State aid control is needed to ensure that “this global symmetric crisis does not transform into an asymmetric shock to the detriment of Member States with less possibility to help their industry”.

At a micro level, the Temporary Framework's exclusion from most State aid measures of undertakings in difficulty on 31 December 2019 is creating serious anti-competitive effects. An undertaking is deemed to be in difficulty if it falls under one of the circumstances listed in Article 2(18) of the GBER, which include the case of companies whose accumulated losses exceed half of the subscribed share capital. While this definition may be appropriate when identifying a company that needs rescue and restructuring aid, in this context it has the effect of discriminating against a number of companies that have retained losses due to their specific leverage structures, such as scale-ups supported by venture and growth capital, PE-backed companies, and companies relying on shareholder loans. The result is that these otherwise financially healthy (but for COVID-19) undertakings risk not being able to access liquidity or recapitalisation measures in the same manner as their competitors.

Last but not least, from a procedural point of view, the Commission has so far approved all notifications received, whether schemes or individual aid, and dealt with them under the Temporary Framework or directly under Article 107 TFEU. This is rather unique in State aid enforcement since, often, Member States' plans for sustaining a sector or a company raise doubts and warrant a more in-depth investigation, with the intervention of all third parties concerned.

To receive the latest COVID-19-related insights and analysis in your inbox, [subscribe to Latham's COVID-19 Resources mailing list](#).

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Elisabetta Righini

elisabetta.righini@lw.com
+32.2.788.6238
Brussels

Adrien Giraud

adrien.giraud@lw.com
+32.2.788.6000
+33.1.40.62.20.25
Brussels / Paris

Stephanie Kate Adams

stephanie.adams@lw.com
+44.20.7710.4518
London

Natalia Solarova

natalia.solarova@lw.com
+32.2.788.6225
Brussels

Simon Troch

simon.troch@lw.com
+32.2.788.6184
Brussels

Peter Citron

Knowledge Management Counsel
peter.citron@lw.com
+32.2.788.6117
Brussels

The authors would like to thank Anna Escrigas Canameras, Apostolos Papadimitriou, and Piera Amato for their contributions to this *Client Alert*.

You Might Also Be Interested In

[COVID-19: Resources for Responding to Business and Legal Issues](#)

[COVID-19 — State Aid EU and UK](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp> to subscribe to the firm's global client mailings program.

Endnotes

¹ Communication from the Commission of 19 March 2020: Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, available at https://ec.europa.eu/competition/state_aid/what_is_new/sa_covid19_temporary-framework.pdf.