



## Further Extension of the EU State Aid Temporary Framework Allows for State Recapitalizations Under Strict Conditions

**May 13, 2020**

On May 8, 2020, following consultation with EU Member States, the European Commission (the 'Commission') amended for the second time the State aid Temporary Framework (the 'TF'). The most significant feature of this amendment lies in the addition of capital injections (State recapitalizations) to the panoply of State aid measures that Member States may adopt to support businesses that are suffering because of the COVID-19 outbreak. These State recapitalization measures aim to address solvency issues that businesses are expected to face in the longer term, whereas the initial focus of the TF was on support measures that help companies cope with immediate liquidity shortages. The amendment also introduces the possibility for Member States to grant support in the form of subordinated debt, which is subordinated to ordinary senior creditors in the case of insolvency proceedings.

### KEY TAKEAWAYS

- In the TF, the Commission acknowledges that, in certain circumstances, State recapitalizations may constitute a suitable instrument to support the economy in the current COVID-19 crisis. At the same time, the Commission emphasizes their potential to distort competition in the EU Single Market. Therefore, the revised TF only considers such measures compatible with EU State aid rules to the extent that a number of strict eligibility criteria and conditions, which partly aim to pursue the EU's wider policies, are complied with.
- State recapitalizations are only available under the amended TF as a last resort. The eligibility criteria limit this type of intervention to instances where, in particular: (i) the beneficiary is a structurally viable non-financial business, (ii) the beneficiary is unable to secure financing on the markets at affordable terms, and (iii) there is a common interest to intervene to avoid that the beneficiary would go out of business or face serious difficulties to maintain its operations.
- Moreover, State recapitalizations that are eligible under the amended TF must be proportionate in their amount and are subject to stringent and potentially far-reaching conditions which have a direct impact on beneficiary companies. Those conditions include, inter alia, restrictions on a beneficiary's ability to engage in M&A activity and to make dividend payments.
- Businesses exploring State recapitalizations should carefully analyze the eligibility criteria and the conditions attached to the granting of the aid, as well as any requirement to notify the measure to the Commission, before requesting such support. Depending on the case, this assessment may be complex

and involve a number of pitfalls. Once a recapitalization is in place, beneficiaries should ensure that all conditions are complied with, failing which they could be ordered to reimburse the capital that was injected.

- Where Member States inject capital essentially in the same way as a rational private investor would do, State aid rules do not apply.

We provide below more detail on (i) when COVID-19 recapitalizations are eligible under the TF, (ii) which form those measures may take, (iii) the conditions to which COVID-19 State recapitalizations are subject, and (iv) practical considerations for companies that may be concerned by such measures, as well as third parties.<sup>1</sup>

## WHEN ARE COVID-19 RECAPITALIZATION MEASURES ELIGIBLE UNDER THE TF?

### Market investor test

As a preliminary point, the TF, including its eligibility criteria and other conditions, only applies to State intervention that qualifies as State aid. The TF therefore explains that where Member States behave in a manner akin to a rational private investor, by acquiring existing shares of companies at market price or investing in comparable circumstances and on comparable terms as private shareholders, such intervention normally does not constitute State aid. The same applies where Member States purchase newly issued shares and/or provide other types of equity support or hybrid capital instruments on market terms.

### Eligibility criteria

In relation to recapitalization measures that do qualify as State aid, the TF sets out a number of eligibility criteria. First, as for other State aid measures governed by the TF, financial institutions such as banks, as well as businesses that were already in difficulty (within the meaning of EU State aid rules) on 31 December 2019 are not eligible. Second, COVID-19 recapitalization measures shall not be granted later than 30 June 2021. Third, all of the following specific “entry conditions” must be met:

- Without the State intervention, the beneficiary would go out of business or would face serious difficulties to maintain its operations;
- It is in the common interest to intervene, for example, to avoid social hardship and market failure due to significant loss of employment;
- The beneficiary is unable to secure financing on the markets at affordable terms and the measures existing in the Member State concerned to cover liquidity needs are insufficient to ensure its viability; and
- The beneficiary has requested the recapitalization aid in writing.

## WHICH FORM MAY COVID-19 RECAPITALIZATION MEASURES TAKE UNDER THE TF?

Member States may grant COVID-19 recapitalization measures based on general schemes or through individual measures. In either case, prior notification to the Commission is required. In addition, even where a Member State decides to adopt a scheme, aid granted to individual beneficiaries in excess of EUR 250 million will still require separate notification.

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<sup>1</sup> For additional details on the TF, please refer to our previous State aid alerts ‘[Avoiding the Pitfalls](#)’ and ‘[Between Speed, Flexibility & Vigilance](#)’

The recapitalization may take the form of (i) equity instruments, in particular the issuance of new common or preferred shares, and/or (ii) “hybrid capital instruments” (i.e. instruments with an equity component), which may be combined.<sup>2</sup> Member States must ensure that the selected recapitalization instruments and the conditions attached thereto are appropriate to address the beneficiary’s recapitalization needs, while at the same time being the least distortive to competition.

The amount of the recapitalization must be proportionate, i.e. it must not exceed the minimum needed to ensure the viability of the beneficiary, and should be confined to restoring the beneficiary’s capital structure as it existed prior to the COVID-19 outbreak (i.e. on 31 December 2019). For the purposes of assessing proportionality, State aid already received or planned in the context of COVID-19 shall be taken into account (this presumably refers to situations where the beneficiary has already received, or is expected to receive, other types of State aid in connection with COVID-19, for example subsidized loans or State guarantees).

## CONDITIONS ATTACHED TO THE COVID-19 RECAPITALIZATION MEASURES

The amended TF attaches a number of conditions to State recapitalization measures, with a view to minimizing any distortions of competition. These conditions presumably constitute the most controversial part of the second amendment to the TF: compared to the initial draft, the final text reflects certain concessions made by the Commission to take into account objections voiced by Member States during the consultation phase, although the main principles have remained unaffected. The conditions are stringent, and do not only relate to the involvement of the State, but also include prescriptions or restrictions regarding the beneficiary’s ability to engage in ordinary business conduct.

However, these conditions are not unprecedented. Some of these conditions are in fact reminiscent of the financial crisis of 2008, when the Commission adopted a similar approach to recapitalizations, albeit limited to financial institutions; the Commission was strict on enforcing those conditions at the time. The main conditions are set out below.

### State remuneration

- The State shall receive appropriate remuneration for the investment. The TF therefore sets out certain requirements governing the remuneration of equity instruments and hybrid capital instruments.<sup>3</sup>
- The recapitalization shall be redeemed when the economy stabilizes. Member States must put in place a “step-up mechanism” to gradually incentivize redemption (or alternative mechanisms that lead to a similar outcome). In particular, the remuneration of the COVID-19 recapitalization measure should be increased in order to converge with market prices to provide an incentive to the beneficiary and the other shareholders to redeem the State recapitalization measure and to minimize the risk of distortions of competition.<sup>4</sup>

### Governance and prevention of undue distortions of competition

- The beneficiary must not engage in “aggressive commercial expansion” financed by State aid or excessive risks taken by the beneficiary.

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<sup>2</sup> Additional details and examples in relation to those terms are provided in the TF. The TF also clarifies that aid granted in the form of subordinated debt should be assessed in line with all the conditions applicable to COVID-19 recapitalization measures to the extent that certain ceilings are exceeded. Below those ceilings, subordinated debt is assessed as aid in the form of debt instruments, to which different, less stringent conditions apply.

<sup>3</sup> Details vary depending on the type of recapitalization instrument.

<sup>4</sup> The TF provides for additional details, which again vary depending on the type of recapitalization instrument.

- Where the COVID-19 recapitalization measure exceeds EUR 250 million and the beneficiary has “significant market power” in at least one of the relevant markets in which it operates, Member States must propose additional measures to preserve effective competition, such as structural or behavioral remedies (typically offered in complex merger cases).
- As long as at least 75% of the COVID-19 recapitalization has not been redeemed, beneficiaries other than SMEs are, in principle, banned from acquiring stakes in excess of 10% in competitors or other operators in the same line of business, including upstream and downstream operations. Acquisitions of stakes in excess of 10% in businesses operating upstream or downstream of the beneficiary may, however, be authorized by the Commission in exceptional circumstances where they are necessary to maintain the beneficiary’s viability.
- As long as the COVID-19 recapitalization has not been fully redeemed, beneficiaries are prevented from making dividend payments and non-mandatory coupon payments, and from buying back shares, other than in relation to the State. As long as at least 75% of the recapitalization has not been redeemed, the beneficiaries are prevented from increasing the fixed remuneration of management members beyond the level as of 31 December 2019, and from paying bonuses or other variable remuneration elements.

#### State exit strategy and reporting obligations

- Within 12 months from the date of the granting of the aid, beneficiaries other than SMEs that have received a recapitalization of more than 25% of equity at the moment of intervention must, in principle, submit to the Member State concerned a credible strategy for the exit of that State from the participation.
- If, six years after the COVID-19 recapitalization (seven years for beneficiaries that are not publicly listed or that are SMEs), the State’s intervention has not been reduced below 15% of the beneficiary’s equity, the Member State has to notify a restructuring plan to the Commission for approval under EU State aid rules.
- Various reporting obligations also apply.

### **PRACTICAL CONSIDERATIONS FOR COMPANIES CONCERNED AND THIRD PARTIES**

The revised TF sets out detailed rules regarding the assessment of COVID-19 recapitalization measures under the State aid rules. Nevertheless, the assessment of such measures remains complex and involves a number of pitfalls. Businesses are well advised to carefully examine the conditions and limitations associated with State recapitalizations under the TF, before requesting and accepting this type of aid. In particular:

- Businesses first need to ascertain whether they can actually benefit from recapitalization measures under the TF and, in particular, whether they meet the entry conditions. If not, such recapitalization would in principle not receive approval from the Commission (if it is an individual measure), nor could it benefit from a Member State scheme (if there is such a scheme in place). Although Member States are entitled to notify alternative recapitalization mechanisms that do not meet the conditions set out in the TF, such mechanisms are generally less likely to be approved by the Commission.
- Businesses should also carefully consider the conditions attached to recapitalization measures and bear in mind that some of them may significantly restrict their ability to engage in ordinary business conduct. However, given that State recapitalizations are essentially only envisaged as a last resort, companies exploring such measures may not have any other options.

- Businesses should assess whether their recapitalization requires prior notification to the Commission. This will, in principle, be the case where the Member State at issue has not put in place a scheme, but also where the individual aid exceeds the threshold of EUR 250 million.
- Once the aid is granted, it is important that businesses carefully monitor that all conditions are complied with. Failing this, the beneficiary incurs a risk of recovery by the Member State, i.e. the beneficiary could be ordered to reimburse the capital that was injected.

For companies that are concerned about competitors benefiting from undue recapitalization, the scope to influence or challenge recapitalization measures may vary depending, in particular, on the Commission's approach (e.g. whether it adopts decisions within a matter of days or opens a formal investigation) and the particular case (e.g. whether it is a scheme or an individual decision). In any event, competitors can be vigilant in ensuring that any applicable conditions attached to the recapitalization are enforced and, if that is not the case, bring the matter to the attention of the Commission.

*If you have any questions regarding these developments or other issues related to State aid, please contact [Matthew Levitt](#), [Leigh Hancher](#) and [Daniel Vasbeck](#).*