

EUROPEAN COMMISSION PUBLISHES THIRD AMENDMENT TO THE TEMPORARY FRAMEWORK: START-UPS (AND PRIVATE EQUITY) TO GET A PIECE OF THE STATE AID PIE

To Our Clients and Friends:

On June 29, 2020, the European Commission (the *Commission*) published a Third Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (the *Temporary Framework*).^[1]

As described in Gibson Dunn's client alert of 27 March 2020, on 19 March 2020 the Commission adopted the Temporary Framework aimed at enabling Member States to use State aid rules to support the economy in the context of the on-going pandemic, namely by allowing Member States to ensure that sufficient liquidity remains available to businesses and to preserve the continuity of economic activity during and after the COVID-19 outbreak.

Since its adoption, the Temporary Framework has already been subject to several amendments by the Commission. Firstly, it was amended on 3 April 2020, to include aid to accelerate the research, testing and the production of COVID-19 relevant products, to protect jobs and to further support the economy during the current crisis (the *First Amendment*).^[2] Secondly, it was amended on 8 May 2020, to further ease access to capital and liquidity for undertakings affected by the crisis (the *Second Amendment*).^[3]

With the Third Amendment the Commission further extended the scope of the Temporary Framework, in order to enable Member States to provide public support to micro and small companies, even in cases where the companies were already in financial difficulty on 31 December 2019, with the exception of companies undergoing insolvency proceedings and of companies which have received rescue aid that has not been repaid, or are subject to a restructuring plan under State aid rules. In addition, the Commission also took this opportunity to introduce certain clarifications to the application of the Temporary Framework, drawing from its experience in applying the relevant rules during the previous months.

The First and Second Amendments

On 3 April 2020, the Commission adopted the **First Amendment** to the Temporary Framework, so that Member States would be able to accelerate the research, testing and production of relevant products in the COVID-19 context, protect jobs and further support the economy in light of the pandemic.

The Commission recognized that beyond ensuring access to liquidity and finance, it was also important to foster research and development, as well as to protect employment across the European Union. Therefore, the amendment introduced five additional types of aid measures: (i) support for research and

development related to COVID-19, in the form of direct grants, repayable advances or tax advantages; (ii) support for the construction and upscaling of testing facilities, in the form of direct grants, tax advantages, repayable advances and no-loss guarantees; (iii) support for the production of products deemed relevant to tackle the pandemic outbreak in the form of direct grants, tax advantages, repayable advances and no-loss guarantees; (iv) targeted support in the form of deferral of tax payments and/or suspensions of social security contributions, in order to reduce liquidity constraints on companies; and (v) targeted support in the form of wage subsidies for employees, to limit the impact of the outbreak on workers.

Moreover, to encourage cooperation and support between Member States, in the first three types of aid listed above the Commission introduced the possibility of increasing the aid intensity in projects involving cross-border cooperation between Member States.

On 8 May 2020, the Commission adopted the **Second Amendment** to the Temporary Framework. The amendment expanded the Temporary Framework in order to enable Member States to provide recapitalizations and subordinated debt to companies in distress. The Commission recognized that well-targeted public interventions providing equity and/or hybrid capital instruments to companies could reduce the risk of a serious economic downturn impacting the whole EU economy, ensure the continuity of economic activity during the outbreak and foster subsequent economic recovery. Therefore, the amendment further allows Member States to design measures in line with additional policy objectives, setting conditions in order to avoid undue distortions of competition, namely (i) conditions on the necessity, appropriateness and size of the intervention; (ii) conditions on the State's entry in the capital of companies and remuneration; (iii) conditions regarding the exit of the state from the capital of the companies concerned; (iv) conditions regarding governance; as well as (v) a prohibition of cross-subsidization and an acquisition ban. The Commission also emphasizes the importance of green and digital transformation, encouraging Member States to take these into consideration when designing national support measures.

In addition, the Commission also adjusted the rules for loans, in particular with regard to subordinated debt. According to the amendment, Member States can provide subordinated loans subject to the Member States receiving a higher remuneration and a further limitation as to the amount when compared to senior debt.

The Third Amendment

The **Third Amendment** aims at: (i) extending the scope of the current framework in order to allow access to liquidity support also to micro and small companies as well as start-ups; (ii) providing incentives for private investors to participate in coronavirus-related recapitalization aid measures; (iii) eliminating the dependency of aid on the relocation of a production activity from another country within the European Economic Area (*EEA*) to the territory of the Member State granting the aid; and (iv) introducing procedural adjustments and improvements on the basis of the acquired experience over the past four months.

i. Micro and small companies and start-ups

Micro and small companies. The Commission has now further extended the Temporary Framework to micro and small companies (*i.e.*, undertakings with less than 50 employees and less than EUR 10 million of annual turnover and/or annual balance sheet), as these companies have been particularly affected by the liquidity shortage caused by the pandemic. Further to the Third Amendment, State aid can be granted to micro and small enterprises even if they were in financial difficulty on 31 December 2019.[4] The Commission's rationale is premised on the fact that due to their limited size and involvement in cross-border transactions, this type of aid will be less likely to distort competition in the Internal Market than State aid provided to larger companies.

However, the amendment is not applicable to companies subject to collective insolvency procedures under national law and to companies which have received either rescue aid that has not been repaid or restructuring aid and are operating under a restructuring plan.

Start-ups. The amendment is also intended to increase the possibility to provide support to innovative start-up companies, which are in their high-growth phase and may be considered crucial for the economic recovery of the European Union. Although there is no EU-wide definition for start-ups, it appears that the vast majority would fall within the micro and small companies cluster of the definition of small and medium enterprises (SMEs) in Annex I of the General Block Exemption Regulation (the **GBER**).[5] It should be recalled that even prior to this amendment, all SMEs that were in existence for less than three years on 31 December 2019 already benefitted from the possibility of receiving State aid provided under the Temporary Framework, since they could not qualify as undertakings in difficulty under the GBER.

In addition, the current framework provides the possibility to Member States to modify existing schemes already approved by the Commission under the Temporary Framework in order to include as beneficiaries within their scope micro and small companies that were already in difficulty on 31 December 2019.

ii. Incentives for private investors to participate in COVID-19-related recapitalization aid measures

The Commission has also adapted the conditions for recapitalization measures under the Temporary Framework for those cases where private investors contribute to the capital increase of companies together with the State.

These changes will encourage capital injections with significant private participation in companies, limiting the need for State aid and the risk of competition distortions. In particular, if the State decides to grant recapitalization aid, but private investors contribute to the capital increase in a significant manner (in principle at least 30% of the new equity injected) at the same conditions as the State, the acquisition ban and the cap on the remuneration of the management are limited to three years. Furthermore, the dividend ban is lifted for the holders of the new shares as well as for existing shares, provided that the holders of those existing shares are altogether diluted to below 10% in the company.

Furthermore, in line with the principle of neutrality towards public and private ownership, this amendment will also enable companies with an existing State shareholding to raise capital from their

shareholders similar to private companies. In instances where the conditions above as regards the participation of private investors in the capital increase are met and the State was a shareholder already before the granting of recapitalization aid, if the State invests *pro rata*, the Commission will not to impose specific conditions as regards the State's exit.

iii. Relocation of a production activity

The amendment also clarified that the aid should not be conditioned on the relocation of the production activity or of another activity of the beneficiary from another country within the EEA to the territory of the Member State granting the aid. According to the Commission, such a condition would be particularly detrimental to the internal market.

iv. Clarifications ameliorations to the current framework

Building on the experience of the application of the Temporary Framework in the previous months, the Commission also seized this opportunity to introduce some clarifications to the Temporary Framework. In particular, the Commission clarified the method for analyzing the compatibility of the measures and the factors taken into account for the balancing test applied in the context of this analysis.

In addition, the Commission also specified the methods for applying recapitalisation measures, as well as measures intended to reduce companies' wage costs.

Conclusion

The Third Amendment constitutes a welcomed development in the Commission's State aid policy-making in view of the pandemic, which will remedy the paradox of having the "undertakings in difficulty" rules preventing government support for lossmaking companies.

The application of these rules has so far been an obstacle for many high-growth equity backed businesses in essential sectors, such as pharmaceuticals and technology, from accessing crucial State funds. The lifting of this impediment is expected to allow governmental bodies to finally be able to direct funds to viable innovation-driven companies of significant importance to the post-pandemic economy.

At the same time, the Third Amendment will also allow private equity-backed companies which often use specific tax-structures in order to hold stakes that can leave their balance sheets in the negative to be entitled to State aid. This means that otherwise viable companies will be able to eventually take part in government loan schemes aimed at helping businesses that have suffered from the pandemic.

[1] Communication from the Commission of 19 March 2020, C(2020)1863, OJ C 091I of 20.03.2020, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.CI.2020.091.01.0001.01.ENG>

[2] Communication from the Commission of 3 April 2020, C(2020) 2215, OJ C 112I of 04.04.2020, available [here](#).

[3] Communication from the Commission of 8 May 2020, C(2020) 3156, OJ C 164, 13.05.2020, available [here](#).

[4] Companies that were already in difficulty before 31 December 2019 are not eligible for aid under the Temporary Framework, but may benefit from aid under existing State aid rules, in particular the Rescue and Restructuring Guidelines. These Guidelines set clear conditions according to which such companies must define sound restructuring plans that will allow them to achieve long-term viability.

[5] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty Text with EEA relevance, OJ L 187, 26.6.2014, p. 1–78



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