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Kirkland Alert

FAQs on EU Government Support Schemes During the COVID-19 Crisis

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Below are some frequently asked questions and responses regarding European Union ("EU") State aid rules applicable to government support schemes introduced in response to the COVID-19 crisis.

Which role does the EU Commission play regarding COVID-19-related government support schemes adopted by Member States?

The EU Commission has to ensure that support given by governments to companies is State aid-compliant and does not risk a distortion of competition in the EU. Government measures aimed at providing selective support to certain companies, sectors or regions have generally to be notified to and approved by the Commission, and this is no different for COVID-19-related government schemes.

In response to the COVID-19 outbreak, the Commission has adopted a Temporary Framework that specifies under which conditions COVID-19-related government schemes will be approved. The Temporary Framework has been amended on 3 April and 8 May 2020 to extend the toolbox of measures that can be used by governments to help companies in need. Numerous government schemes have been notified to the EU since March and the Commission has been granting approvals at an impressive speed (including on weekends).

Are portfolio companies of private equity firms eligible to access COVID-19 government support?

EU rules **do not prevent portfolio companies from being eligible** for government support.

However, many government schemes currently available are tailored to smaller companies with prescribed revenue limits. There is no general guidance on whether a company that is part of a private equity-controlled group is eligible for aid if its revenue is below the limit, but the private equity fund's revenue exceeds the limit. Additionally, the EU requirement to not have been in financial difficulty before the crisis may mean that financially leveraged portfolio companies might not qualify for certain aid schemes. Further information should be available in the scheme application forms and from the institution administering the scheme.

Are there maximum caps that apply to COVID-19 government support schemes?

The Commission's Temporary Framework **does not** place a financial cap on support measures in the form of **loans and guarantees** (instead, it puts in place a general cap that the loan amounts should not exceed 25% of the turnover of the beneficiary or twice its annual wage bill).

However, it does **limit direct grants, zero-interest loans and guarantees covering 100% of the loan principal to a maximum of €800,000 per company** (above this threshold, guarantees are generally limited to 90% of the loan principal). For a company that is part of a private equity-controlled group, it is not clear whether this cap will be applied to the whole group. We advise disclosing that the company is part of the private equity-group when applying in order for the scheme administrator to decide how to apply the cap.

Recapitalisation measures in return for equity or hybrid capital are not limited to a maximum amount. However, recapitalisation measures exceeding €250 million have to be notified to the Commission separately, even if the relevant support scheme has already been approved under State aid rules.

Governments may decide themselves to put caps in place. Details on current maximum caps under the available COVID-19 government support schemes are provided in the Kirkland *Alert* on COVID-19 Government and Central Bank Measures Supporting Business.

Which countries have set up schemes for larger companies?

The focus has very much been on smaller companies in the initial phase, but a few of the larger Member States and the UK have now **introduced schemes aimed at supporting larger companies as well** (some of which include limitations on size and different conditions from those applied to smaller companies):

- **France —** guarantees for one-year liquidity loans;
- **Germany —** subsidised loans through the KfW; WSF loan guarantees and equity participations to certain systemic companies (excluding banks); KfW-Schnellkredit ("instant loan") of up to €800,000 for companies with more than 50 employees (companies backed by private equity investors are in principle eligible to apply for the KfW-Schnellkredit);
- **Italy —** deferred tax payments; SACE guarantees;
- **Netherlands —** GO programme for larger companies;
- **Spain —** guarantees and loans for larger companies coordinated by the Instituto de Crédito Oficial;
- **United Kingdom —** Corporate Financing Facility through the Bank of England; Coronavirus Large Business Interruption Loan Scheme.

Additionally, **large companies are also eligible to apply for wage subsidies or tax deferrals** in a number of countries.

Further details and conditions of these schemes are set out in the Kirkland *Alert* on COVID-19 Government and Central Bank Measures Supporting Business.

Can companies combine multiple support measures under di erent schemes?

Unless expressly prohibited by a particular government scheme, **companies can apply to receive support through more than one scheme**.

A key exception set out in the Temporary Framework is that the same loan principal cannot be subject to both a State-subsidised interest rate and a State guarantee.

In addition, once a support measure has compensated a company for a particular cost or damage arising related to COVID-19, that **already compensated cost cannot be used as the basis of an application under another government scheme**.

Is it possible to access government support schemes in more than one European country?

Accessing government schemes in more than one European country is possible, provided the requirements of the different government schemes are met and subject to the principle that the same cost cannot be recovered more than once.

For instance, a company operating manufacturing sites in more than one country will be able to apply for wage subsidies if offered in each of these countries. Similarly, loans may be available to different local subsidiaries of a company if they are linked to local activities of those subsidiaries.

Are companies that were in financial difficulties prior to the COVID-19 crisis eligible for government support?

Generally, **schemes set up under the Temporary Framework cannot support companies that were in financial difficulties before 31 December 2019** (see below for the definition of "financial difficulty"). This does not apply to government support schemes in the form of deferrals of tax or social security contributions, or the granting of wage subsidies.

Based on EU State aid rules, companies who are part of a group are eligible for support under national schemes assuming that the parent group company was not in financial difficulty before the end of 2019, i.e., one looks at the the group as a whole (and not the individual applicant company). There are good arguments that companies belonging to a private equity-controlled group would be looked at on a stand-alone basis for the question of whether they are in difficulty, given that private equity companies normally do not generate consolidated financial statements. Guidance should be sought from the scheme administrator if possible.

Outside the Temporary Framework, specific support schemes that are set up to compensate companies for further damage suffered as a direct consequence of the COVID-19 crisis **can apply to companies in financial difficulties**. In these cases, there is also no requirement for these government schemes to take into account any restructuring or rescue aid that has previously been provided to a company (known as the “one time last time principle”). However, governments are likely to be reluctant to generally provide significant aid to such companies, unless they are economically/strategically significant.

Which factors determine whether a company was in financial difficulties prior to the COVID-19 crisis?

Any of the following indicate that a company was in difficulty (as at the end of December 2019) for the purpose of schemes of the COVID-19 Temporary Framework:

- loss of more than half of share capital due to accumulated losses;
- being in insolvency proceedings;
- having received rescue aid and not yet reimbursed the aid, or being subject to a restructuring plan; or
- book debt to equity ratio has been greater than 7.5 and the EBITDA interest coverage ratio has been below 1.0 for the past two years. Whether these conditions are met will primarily depend on the company’s financial statements (or, if the company belongs to a group, on the consolidated statements of the parent group company).

Which contributions are required by shareholders and owners before they can apply to support schemes?

At the moment, there is no express requirement for shareholders or owners of a company to inject funding before being eligible for government support schemes. The amendment of the Temporary Framework to enable Member States to recapitalise companies in return for equity or hybrid capital does not include an obligation of shareholders and debt holders to contribute (no formal burden sharing requirement). However, it cannot be excluded that such obligation will be introduced in the future.

Some companies in the public eye are also trying to manage reputational risk around this by being seen to take steps to shoulder some financial pain (e.g., by postponing

dividends or by not joining wage subsidy schemes).

Additionally, some Member States are starting to require companies to commit not to pay dividends or to take out profits while being subject to assistance in order to be eligible for support under the relevant government schemes. **For recapitalisation measures the amended Temporary Framework restrictions on the beneficiary's behaviour apply (e.g., M&A ban, no dividends or bonus payments).** In some cases, Member States have started to impose environmental conditions on the beneficiary in return for their support.

What happens if a company receives support from a Member State and later discovers this was in breach of EU State aid rules?

The risk that arises is that the Member State is later required to recover the entirety of the support provided to the company, plus cumulative interest at the applicable rate (1% added to the prevailing 1-year IBOR in the country granting the support).

Is recapitalisation allowed under EU State aid rules?

In principle, under EU State aid rules, any state participation should only occur as a last resort. However, given the likelihood that certain sectors will require extensive support in view of COVID-19, the Commission amended the Temporary Framework on 8 May 2020 to enable governments to recapitalise companies through equity injections or hybrid capital instruments (e.g., profit participation rights or silent participations).

The beneficiary will however only be eligible to receive recapitalisation aid if it would otherwise go out of business or face serious difficulties to maintain operations (which may in particular be shown by the deterioration of the beneficiary's debt to equity ratio). It also must be in the common interest to intervene by way of recapitalisation, e.g., to avoid social hardship or market failure due to significant loss of employment; the exit of an innovative or systemically important firm; or the risk of disruption of an important service. The beneficiary must furthermore not be able to find financing on the markets at affordable terms, and existing schemes or programmes available in the relevant Member State are insufficient to ensure the company's viability. Finally, the beneficiary must not have been in financial difficulty on 31 December 2019 (see above for details).

In addition, the amended Temporary Framework ties the State's participation to strict conditions, which include in particular:

- The **State must be sufficiently remunerated** for the risks it assumes through the recapitalisation aid and the remuneration should be as close to market terms as possible. The remuneration mechanism must incentivize beneficiaries/owners to buy out the shares acquired by the State to ensure that the State's participation is temporary.
- A **strategy detailing the State's exit must be submitted to the Commission within 12 months**, in particular as regards large companies that have received significant recapitalisation aid. If six years after the recapitalisation aid has been given to publicly listed companies (or seven years for non-listed companies and SMEs) the State's exit is in doubt, a restructuring plan for the beneficiary will have to be notified to the Commission.
- Until the State has exited in full, beneficiaries are **subject to bans on paying dividends and share buybacks**. Until 75% of the recapitalisation is redeemed, a strict limitation on management remuneration, including a **ban on bonus payments**, is applied.
- The aid **cannot** be used by beneficiaries to **cross-subsidise** economic activities of integrated companies that were in financial difficulty prior to 31 December 2019.
- Until 75% of the recapitalisation is redeemed, beneficiaries are in principle **prevented from acquiring a stake of more than 10% in competitors, suppliers or customers**.
- If the beneficiary of a recapitalisation measure of more than €250 million has "significant market power", Member States must propose additional measures to preserve effective competition in the market; in particular it can offer structural or behavioural remedies as foreseen under EU merger rules.

Given that the above relates to EU rules, does it apply to the UK?

The EU State aid rules continue to apply to the UK for the duration of the transition period (currently 31 December 2020).

The exact landscape of how EU State aid rules (including the rules on government support measures) will apply in the UK after the end of the transition period (currently 31 December 2020) is unknown and a key point in the ongoing EU-UK trade agreement negotiations.

However, it is clear that the Commission will remain competent for four years after the end of the transition period to pursue any legal proceedings against UK State aid that it considers to be unlawful if this aid was given before the end of the transition period.

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