ADDLESHAW GODDARD

STATE AID AND COVID-19

Our updated observations on the position this morning, 13 July 2020

THE PURPOSE OF THIS MEMO

- This is the fifth iteration of our predictions for how each aspect of the UK's £350bn package will be dealt with from a State aid perspective. Since the first version some clarity has emerged but a number of questions still remain.
- State support needs to be in line with EU State aid rules. Some aspects of the UK's £350bn support package seem to be designed as "no-aid" or to fall within existing safe harbours.
- The European Commission's (**Commission's**) Temporary Framework, announced on 19 March and revised on 3 April, 8 May and 29 June (the **Temporary Framework**), effectively provides a new safe harbour (subject to a highly expedited notification process). The UK has already sought to take advantage of that greater flexibility for some aspects of its package.
- Additional UK measures are being announced frequently – *we will keep this note updated*.
- For further details on the measures announced by the Government (including the two Government-backed funding schemes and how to access them), as well as our observations on whether those measures go far enough to support businesses struggling to access cash at this time, please refer to our briefing.

SUPPORT PERMITTED BY THE EXISTING RULES

1. STATE SUPPORT THAT IS NOT AID

- "Non-selective" measures available to all companies (e.g. extension of payment deadlines for tax).
- The provision of loans or State guarantees at market rates.
- Aid to citizens and to health services or other public services coming from EU or national funds to tackle COVID-19.

2. STATE SUPPORT FALLING WITHIN AN EXISTING SAFE HARBOUR

- *De minimis* support – €200,000 cumulatively over three rolling years (for most sectors), subsidised loans of up to €1 million, and subsidised guarantees for loans of up to €1.5 million.
- The General Block Exemption (**GBER**) offers routes including aid to SMEs, local infrastructures, regional airports and ports.

MEASURES REQUIRING NOTIFICATION AND CLEARANCE

- Support to SMEs can be implemented through a scheme, requiring only a single notification and approval. Examples include support to SMEs facing liquidity shortages for up to 18 months. Larger, bespoke bailout packages are also likely – and we have seen that in other Member States. This may be individual support for larger organisations or schemes for groups of smaller companies, which don't fit within a safe harbour. Any additional support is to be cleared by the Commission before it can be provided. Clearance typically takes c.6 months.
- The Commission's Temporary Framework provides a framework within which Member States can design and notify proposals, thereby receiving an expedited clearance (i.e. within a few days).
- A number of countries, including the UK, have notified "Umbrella schemes" by which the Temporary Framework is incorporated into a national temporary framework for state aid, avoiding the need for the UK to notify each individual scheme which falls

under the Temporary Framework (the **Umbrella Scheme**). The UK has also notified and received clearance for the guarantee and interest free period under the Coronavirus Business Interruption Loan Scheme (**CBILS**).[1]

- As it did in the financial crisis, the Commission is expediting the process. On 13 March the Commission approved the first Covid-related notification within 24 hours, a €12m Danish scheme to compensate event organisers for cancellations. The approval was given under Article 107(2)(b) of the Treaty, as aid to make good damage caused by exceptional occurrences.

OUR OBSERVATIONS ON THE UK'S PACKAGE

- Although details have now begun to emerge as to the State aid characterisation on a number of the UK's measures, several questions still remain.
- We have been here before and we've learnt from it. The Commission's Temporary Framework was assembled in days (vs. 3 weeks in the financial crisis). The UK is working with the Commission in parallel – so expect the framework to be used.

MEASURE	DESCRIPTION	STATE AID ANALYSIS
Coronavirus Job Retention Scheme	All UK businesses eligible. Firm must designate affected employees as "furloughed workers" and notify them. 80% reimbursement to company, up to a monthly cap of £2.5k. System being set-up.	
VAT and income tax payment deferrals	VAT payments deferred for three months for businesses (20 March – 30 June 2020). Income tax payments due in July 2020 deferred to January 2021. All UK businesses eligible. No applications required – automatic.	Each of these measures appears to attract a "no aid" characterisation on the basis that they are "non-selective" measures available to all companies. While the UK has not made this clear in its analysis, the EC has indicated as such in paragraphs 5-7 of the Temporary Framework.
The HMRC Time To Pay Scheme	All businesses and self-employed people in financial distress, and with outstanding tax liabilities, may be eligible to receive support with their tax affairs through HMRC's Time To Pay service.	
12-month business rates holiday for all retail, hospitality and leisure businesses in England[2]	On 17 March this 100% relief was extended to qualifying retail, leisure and hospitality premises. Since the guidance was issued, the government has also announced that child care nurseries will be exempt. Local authorities to apply the measures and send out revised bills directly.	It is difficult to see how this aid is not selective, meaning it should not benefit from the same "no aid" characterisation as the measures above. Nevertheless, the UK government appears to be taking a robust approach and in its guidance on the Expanded Retail Discount states: "*The Government's assessment is that, given the impact of Covid-19 in the sectors receiving the relief, the business rates expanded retail, leisure and hospitality discount 2020-21 is not a state aid. The Government has considered this matter in discussions with the European Commission and is content with this analysis following*

[1] Non-UK schemes approved by the Commission under the Temporary Framework include a Danish guarantee scheme for SMEs, French schemes to provide state guarantees on commercial loans and credit lines, two German loan schemes and a guarantee scheme, Portuguese guarantee schemes for four different sectors, an Italian support scheme for the production and supply of medical equipment and masks, a Latvian loan guarantee and subsidised loan scheme, two Luxembourg schemes, one to provide repayable advances to affected companies and a loan guarantee scheme, a Spanish guarantee scheme to assist companies and the self-employed, a Danish compensation scheme for the self-employed, a Bulgarian Development Bank guarantee scheme, a Polish loan and guarantee scheme and a Dutch grant scheme for e-Health services.

[2] This is an extension to the 2020 Budget, which applied 100% rate relief to qualifying retail premises with a rateable value below £51k. You can estimate the business rate charge you will no longer have to pay this year using the business rates calculator.

		those discussions. Local Authorities should apply the relief to all eligible properties." This text seems to have been quite carefully worded – it is saying the UK government is content with this analysis. It does not say the EC is content with it. The position is also contrary to that in the Temporary Framework whereby any selective tax advantages would need to fall within the same €800,000 pot as other grant aid offered to undertakings. A compromise might be for the UK to notify the scheme under Article 107(2)(b), as the Danish government did in relation to aid to event organisers, as aid "to make good damage caused by exceptional occurrences". Indeed, the Commission's guidance notes that "*Member States can also compensate undertakings in sectors that have been particularly hit by the outbreak (e.g. transport, tourism, culture, hospitality and retail) and/or organisers of cancelled events for damages suffered due to and directly caused by the outbreak. Member States can notify such damage compensation measures and the Commission will assess them*".
Statutory Sick Pay relief package for SMEs	Legislation to allow SMEs to reclaim statutory sick pay for up to 2 weeks per employee who is off work due to COVID-19. A rebate scheme is being developed. Details will follow the legislation.	The Government has confirmed that this relief is being dealt with under the Temporary Framework.
Grant funding of £25k for retail, hospitality and leisure businesses	£25k grant provided to retail, hospitality and leisure businesses that would have been in receipt of the Expanded Retail Discount on 11 March 2020 with a rateable value of less than £51k.	BEIS has published guidance in relation to the Retail, Hospitality and Leisure Grant (**RHLG**) and Small Business Grant Funding (**SMGF**) which sets out the state aid position for each. The RHLG will be delivered under the Temporary Framework. In light of the approval of the Umbrella Scheme we do not expect this funding to be separately notified. The grant payments will therefore need to fall within the four corners of the Temporary Framework/Umbrella Scheme, i.e. not exceed €800,000 per undertaking, be granted prior to 31 December 2020 and undertaking which were in difficulty on 31 December 2019 will not be eligible. The small business grant funding (**SMGF**) will primarily be delivered under the existing *de minimis* exemption. However, where this threshold has or would be reached by accepting SBGF, a business may receive the funding under the Temporary Framework. In light of the approval of the Umbrella Scheme we do not expect this funding to be separately notified.
Grant funding of £10k for businesses in receipt of SBBR or rural rate relief	£10k grant provided to small businesses that already pay little or no business rates because of small business rate relief (**SBBR**).	
The Coronavirus Business Interruption Loan Scheme[3]	The government is providing accredited lenders with a guarantee of 80% on loans of up to £5m (subject to a per-lender cap on claims). Government will also cover the first 12 months of interest payments and any lender-levied fees. Eligibility criteria include UK business with turnover of no more than £45m Available as of 23 March.	The European Commission has approved both the CBILS guarantee and loan grant scheme under the Temporary Framework. It relation to the loan grant it did so on the basis that: • the support per company will not exceed €800 000 per company; and • the grant amount per company is linked to the market sector in which the company is active. In relation to the guarantee it did so on the basis that:

[3] On 3 April the government announced the CLBILS (the Coronavirus Large Business Interruption Loan Scheme). There is currently only a limited amount of information available regarding the scheme and it does not appear to have been notified to date. The scheme is open to businesses with an annual turnover between £45m and £500m who can apply for loans of up to £25m with a government guarantee of 80% on

		• the underlying loan amount per company is linked to the company's liquidity needs for the foreseeable future is limited to a maximum six-year duration and entails a guarantee premium that is at least as high as that set in the Temporary Framework; and • the scheme includes safeguards to ensure that the advantages of the guarantee are effectively passed on to the borrowers and that the lending is used to cover short-to medium term liquidity needs. In each case the Commission considered that the measure is necessary, appropriate and proportionate to remedy a serious disturbance in the economy of a Member State, in line with Article 107(3)(b) TFEU and the conditions set out in the Temporary Framework. Although the government has set a turnover cap of £45m, as this measure has been blessed under the temporary framework, reference must be made to the State Aid definition of SME which actually refers to different thresholds.
Covid-19 Corporate Financing Facility from the Bank of England to help support liquidity among larger firms, to bridge cash flow disruption	The Bank of England (**BoE**) will buy short term debt from larger companies affected by a short-term funding squeeze. The scheme will be available early in week beginning 23 March 2020. Further information available shortly.	Less clear. In order to ensure the greatest flexibility and allow the BoE's terms to be less restrictive, this measure would need to be notified although to date the UK government has not taken this approach. It *may* be possible to recast this as a direct loan on subsidised interest rates, as per section 2 of our note below, on the Temporary Framework. In practice, this seems unlikely – and would bring additional restrictions / less flexibility.
Self-employed Income Support Scheme	The scheme will allow self-employed individuals and members of partnerships to claim a taxable grant of 80% of their average monthly trading profits. This will be paid out in a single instalment covering 3 months and be capped at £7,500.	The scheme was notified to the Commission under the Temporary Framework and was approved on 11 May.

THE COMMISSION'S TEMPORARY FRAMEWORK (FIRST PUBLISHED 19 MARCH, AMENDED 3 APRIL, 8 MAY AND 29 JUNE)

- Accompanied by a dedicated hotline, mailbox and web page including guidance for Member States providing liquidity, fast.
- The Commission finalised its Temporary Framework on 19 March and published its first amendment to the Temporary Framework on 3 April. The Commission determines that the COVID-19 outbreak constitutes a "*serious disturbance in the economy*" of all Member States (Article 107(3)(b) of the Treaty). Accordingly, for a limited period, the additional aid measures set out below will be deemed compatible with the internal market.
- The temporary framework provides a basis for Member States to put measures in place using an expedited notification process (4 days in the recent French case). Additional publication, reporting and record keeping obligations also apply to the Member State.
- All aid must be granted / loan contracts signed by 31 December 2020 at the latest and in all cases the relevant undertaking must not have been in difficulty on 31 December 2019, except that, in accordance with the Commission's third amendment to the Temporary Framework on 29 June 2020, aid may be granted to SMEs even if they were in difficulty on 31 December provided that they are not subject to collective insolvency procedure and have not received rescue or restructuring aid.

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each loan. Banks, insurers, reinsurers, public bodies, grant funded further-education establishments and state-funded primary and secondary schools are ineligible for the scheme.

- The Commission applies the provisions of this Communication to all relevant notified measures as of 19 March 2020 even if the measures had already been notified prior to that date.
- The Commission's third amendment to the Temporary Framework dated 29 June 2020 clarified that no aid under the Temporary Framework should be conditional on the relocation of the production activity or of another activity of the beneficiary from another country within the European Economic Area to the territory of the Member State granting the aid.

1. DIRECT GRANTS, REPAYABLE ADVANCES OR TAX ADVANTAGES

- Within the safe harbour, provided the aid:
  - Does not exceed €800,000 per undertaking, gross, before any deduction of tax or other charge,
  - Is granted on the basis of a scheme with an estimated budget,
  - Is granted to undertakings that were not in difficulty (within the GBER definition) on 31 December 2019 (except where that undertaking is a SME) and
  - Where granted to undertakings active in agricultural processing and marketing, is not partly or entirely passed on to primary producers and is not fixed on the basis of the price or quantity of products purchased from those producers.
- Reduced thresholds and additional conditions apply to agricultural, fisheries and aquacultural sectors.

2. LOAN GUARANTEES AND SUBSIDISED INTEREST RATES

- A key uncertainty in the financial crisis was whether banks administering e.g. mortgage guarantee schemes were themselves in receipt of aid (because they were able to sell more mortgages as a result). The Commission clarifies this time. Lenders will not be in receipt of aid as long as, to the largest extent possible, they pass on the advantages to the final beneficiaries. Adequate processes must be put in place to ensure this and, where there is a legal obligation to extend the maturity of existing loans for SMEs, no guarantee fee may be charged.
- Guarantee premiums must be at the minimum level set out in the table below or, for subsidised rates, the reduced rates must be at least equal to the base rate (1 year IBOR or equivalent as published by the Commission) applicable on 1 January 2020 plus the credit risk margins set out below for loan guarantees (with a minimum all-in interest rate of at least 10 bds per year). Only if a scheme is notified can the table below be flexed (whilst retaining the principles - e.g. by lowering guarantee coverage and offsetting it against a longer maturity).

TYPE OF RECIPIENT	CREDIT RISK MARGIN (BASIS POINTS)		
	1-YEAR LOAN MATURITY	2-3 YEARS LOAN MATURITY	4-6 YEARS LOAN MATURITY
SMEs	25	50	100
Large enterprises	50	100	200

- For loans with a maturity beyond 31 December 2020, the amount of the loan principal does not exceed double the annual wage bill of the beneficiary (guidance is provided), or 25% of the total turnover of the beneficiary in 2019. With appropriate justification it can be increased to cover the liquidity needs, from the moment of granting, for 18 (SME) or 12 months.
- For loans with a maturity until 31 December 2020, the amount of the loan principal may be higher with appropriate justification and provided that proportionality of the aid remains assured.
- Any loan *guarantee* does not exceed: (i) 90% of the loan principal where losses are sustained proportionally and under same conditions, by the credit institution and the State; or (ii) 35% of the loan principal, where losses are first attributed to the State and only then to the credit institutions (i.e. a first-loss guarantee); and (iii) in both of the above cases, when the size of the loan decreases over time, for instance because the loan starts to be reimbursed, the guaranteed amount has to decrease proportionally.
- Is granted to undertakings that were not in difficulty (within the GBER definition) on 31 December 2019 (except where that undertaking is a SME).
- Both loans and guarantees may relate to both investment and working capital loans.
- For the same underlying loan principal, aid granted as loan guarantees cannot be cumulated with aid granted as subsided interest rates on loans.
- Maximum 6 year duration.

3. SHORT TERM CREDIT EXPOSURE

- The Commission's communication on short term export-credit insurance (**STEC**) stipulates that marketable risks cannot be covered by export-credit insurance with the support of Member State. The Commission recognises that, at present, cover for marketable risks could be temporarily unavailable, as such, the Commission considers all commercial and political risks associated with exports to the countries listed in the Annex to STEC to be temporarily non-marketable until 31 December 2020.

4. AID FOR RELEVANT RESEARCH AND DEVELOPMENT

- Aid will be available for compatible projects including those which are carrying out Covid-19 and other antiviral relevant research provided that the conditions at paragraph 18 of the amendment to the Temporary Framework are satisfied.

5. INVESTMENT AID FOR TESTING AND UPSCALING INFRASTRUCTURE AND THE PRODUCTION OF COVID-19 RELEVANT PRODUCTS

- Provided that the eligibility criteria at paragraphs 19 and 20 of the amendment to the Temporary Framework are satisfied, aid may be granted for the production of and the construction or upgrade of testing and upscaling infrastructures required to develop, test and upscale, up to first industrial deployment prior to mass production, COVID-19 relevant medicinal products and treatments; active pharmaceutical ingredients; medical devices, hospital and medical equipment; disinfectants; and data collection/processing tools. The aid also applies to raw materials and intermediary products where applicable.

6. AID IN THE FORM OF DEFERRALS OF TAX AND/OR OF SOCIAL SECURITY CONTRIBUTIONS

Deferrals of payments of taxes etc. will only be considered aid under Article 107(1) TFEU if they are restricted to certain sectors, regions or types of undertakings. Where this is the case, the Commission will nevertheless consider such measures to be compatible with the internal market under Article 107(3)(b) TFEU provided that such aid is granted prior to 31 December 2020 and the end date for the deferral is no later than 31 December 2022.

7. AID IN THE FORM OF WAGE SUBSIDIES FOR EMPLOYEES TO AVOID LAY-OFFS DURING THE COVID-19 OUTBREAK

- Such measures will only constitute state aid if they are restricted to certain sectors, regions or types of undertakings. Where this is the case, the Commission will nevertheless consider such measures to be compatible with the internal market under Article 107(3)(b) TFEU provided that the following conditions are met;
    - The aid is aimed at avoiding lay-offs during the Covid-19 outbreak and is granted in the form of schemes to undertakings in specific sectors, regions or of a certain size that are particularly affected by the outbreak;
    - The wage subsidy is granted over a period of not more than 12 months after the application for aid to an employee that would otherwise have been laid-off due to the reduction in business activities resulting from the outbreak and that employee must be maintained in continuous employment for the entire period for which the aid is granted;
    - The monthly wage subsidy must not exceed 80% of the employee's monthly gross salary; and
    - The wage subsidy may be combined with other generally available or selective employment support measures provided the combined support does not lead to overcompensation of the wage costs of the individual concerned.

FURTHER EXTENSION OF TEMPORARY FRAMEWORK (8 MAY)

- On 8 May the Commission published a further amendment to the Temporary Framework to deal with recapitalisation and subordinated debt to companies in need. The amendment allows well-targeted public interventions in the form of recapitalisation aid (in the form of an equity instrument and/or an instrument with an equity component) to non-financial companies but sets out a number of conditions that must be complied with when doing so. These include conditions on:
    - The necessity, appropriateness and size of intervention: there must be no other solution available, it must be in the common interest to intervene and the aid should not go beyond restoring the beneficiary's capital structure to before the Covid-19 outbreak.
    - Conditions on the State's entry in the capital of companies and remuneration: the state must be sufficiently remunerated and the beneficiaries should be incentivised to buy out the shares acquired by the state.

- Conditions regarding the exit of the State from the capital of the companies concerned: If six years after recapitalisation aid to publicly listed companies, or up to seven years for other companies, the exit of the state is in doubt, a restructuring plan for the beneficiary must be notified to the Commission.
- Conditions regarding governance: this includes bans on dividends and share buybacks and, until at least 75% of the recapitalisation is redeemed, bonus payments.
- Prohibition of cross-subsidisation and acquisition ban: beneficiaries cannot use aid to support economic activities of integrated companies that were in economic difficulties prior to 31 December 2019 and, until at least 75% of the recapitalisation is redeemed, beneficiaries, other than SMEs, are in principle prevented from acquiring a stake of more than 10% in competitors or other operators in the same line of business.

- In relation to subordinated debt, the Temporary Framework now allows for the provision of subordinated debt to companies on favourable terms. This concerns debt instruments that are subordinated to ordinary senior creditors in case of insolvency proceedings. Where a member state wishes to provide subordinated debt in excess of the following thresholds, the conditions for recapitalisation, as set out above, will apply:
  - Two thirds of the annual wage bill of the beneficiary for large enterprises and the annual wage bill of the beneficiary for SMEs
  - 8.4 % of the beneficiary's total turnover in 2019 for large enterprise and 12,5 % of the beneficiary's total turnover in 2019 for SMEs
- The Commission's third amendment to the Temporary Framework on June 29 2020 adapted the above conditions for cases were private investors contribute to the capital increase of companies together with the State:
  - where the State grants recapitalisation aid, but private investors contribute to the capital increase in a significant manner (in principle at least 30% of the new equity injected) on the same conditions as the State, the acquisition ban and the cap on the remuneration of the management are limited to three years; and
  - 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.

THE UK "UMBRELLA" SCHEME

- On 6 April 2020 the Commission approved a £50 billion "umbrella" scheme to support SMEs and large corporates within the United Kingdom that have been affected by Covid-19. The measure acts as a UK-wide national temporary framework for state aid permitting the UK to grant the types of funding envisioned by the Temporary Framework without having to submit a number of individual state aid notifications.
- In particular, the measure allows for the provision of aid in the form of:
  - Direct grants, equity injections, selective tax advantages and advance payments;
  - State guarantees for loans subject to safeguards for banks to channel State aid to the real economy;
  - Subsidised public loans to companies with favourable interest rates;
  - Support for coronavirus related research and development (R&D);
  - Support for the construction and upscaling of testing facilities to develop and test products useful to tackle the coronavirus outbreak;
  - Support for the production of products relevant to tackle the coronavirus outbreak.
- We expect the eligibility requirements for each of the above to reflect the eligibility requirements in the Temporary Framework.
- The measure allows aid to be granted by UK authorities at all levels, including central government, devolved governments, local authorities and other bodies administering schemes involving state resources channelled through their own budgets.
- Where the measure concerned guarantees or loans they will be granted through credit institutions and other financial institutions as financial intermediaries.
- Aid under the Umbrella Scheme cannot be granted to any undertaking that was in financial difficulty on 31 December 2019.

BREXIT AND STATE AID

The UK has agreed a transition period during which it remains treated for almost all purposes as part of the EU.

The transition period is due to end on 31 December 2020, and the Government is currently still committed to that.

Given the current focus of Government and businesses it is possible that an extension may now be required, as there may now not be sufficient time to prepare for the changes that will be needed when transition ends.

AL MANGAN
Partner
+44 207 544 5352
+44 772 578 1720

BRUCE KILPATRICK
Partner
+44 207 544 5214
+44 774 892 6591

addleshawgoddard.com

Aberdeen, Doha, Dubai, Edinburgh, Glasgow, Hamburg, Hong Kong, Leeds, London, Manchester, Muscat, Singapore and Tokyo*

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