The Hague, 14 April 2020

Response of the Dutch authorities on the draft second amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak:

COMMUNICATION FROM THE COMMISSION
Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak Recapitalisation of non-financial undertakings

---

This response reflects the views of the Dutch 'Interdepartementaal Steun Overleg (ISO)'. The ISO is a national State aid committee composed of all Dutch ministries and representatives of the regional and local authorities.

1. General remarks

The Dutch authorities would like to thank the European Commission for its work to the extension of the Temporary Framework. However we have some serious concerns regarding the suitability, the proportionality and effectiveness of this draft Amendment. In particular, the Dutch authorities would like to flag the following concerns:

1) The basic argumentation of why this Amendment to the temporary framework is needed to ensure the level playing field in the internal market and why new rules beyond the "Communication on the notion of Aid" and the "Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty" are in our view insufficient. For specific sectors a dedicated framework may be needed, but it seems disproportionate to apply what is in essence the former temporary framework for the financial sector from 2009/2010 to the whole economy without an adequate justification.
2) We have fundamental reservations about the core principles underpinning the draft Amendment:
    a. The notion that the decision to enter into public ownership and/or take a majority/minority stake in a company is a "<u>measure of last resort</u>" is in breach with the principle in Union law of neutrality towards public and private property, enshrined in the Schuman declaration.
    b. Applying stricter conditions towards new equity stakes / hybrid financing tools vis-à-vis existing equity stakes and pari passu market transactions is not always logical under current market conditions. It even puts European strategic assets/infrastructure at risk if Member States are restricted in providing equity or hybrids on the basis of this Amendment – giving an advantage to foreign direct investors from third countries in strategic sectors (i.e. start- and scale-up scene, high-tech industries).
3) The following elements of the draft Amendment are in our view disproportionate and too restrictive:

    a) <u>Eligibility and entry conditions:</u> the requirement that companies should have exhausted the possibilities to find financing on the markets and the horizontal measures existing in the MS concerned, seriously risks that funding will be found in third countries willing to take a substantial risk – it should at the very least be clarified that we are referring to the internal market. Also, this requirement could be detrimental to the long-term viability of the company concerned, potentially seriously undermining the bargaining power of both company and MS involved when providing the hybrid/equity funding.

    b) <u>Types of recapitalization measures:</u> Hybrid capital instruments (debt financing instruments with potential equity component) are regular funding instruments for R&D intensive companies / off-balance sheet projects and can be seriously limited by this framework. This potentially hinders aid toward scale-ups involved in Covid-19 related vaccine research. Therefore it would be undesirable to include these instruments under the scope of the draft Amendment.

c) Amount of recapitalization: the limitation of recapitalization to the minimum needed to ensure viability, not going beyond restoring the capital structure of the beneficiary to the one predating the Covid-19 outbreak, is difficult to implement consistently and may increase the vulnerability of FDI-take-over or the collapse of the company.

d) Remuneration and exit of State; the forced exit of state does not take into account sovereign right of MS to maintain ownership of an equity stake. The proposed timeframe seriously risks an oversupply of shares/refinancing requirements in 2023/2024, negatively impacting value of MS equity holding / hybrid portfolios (and thereby government finances).

e) Governance/prevention undue distortions competition:
Obligation to offer structural or behavioral commitments does not take into account the contexts of world markets / specific sectors, possibly resulting in weakening / restructuring strategic companies such as Airbus.

2. **Specific remarks**

The Netherlands would like to raise the following issues:

Please find below the description of the above concerns in full detail.

General remarks and remarks concerning paragraph 3.11.1. Applicability:

- The Dutch authorities support the need for ensuring the level playing field on the internal market, but is not convinced that both the Communication on the notion of Aid and the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, are insufficient to deal with the need to ensure the level playing field on the internal market. Both the recitals of the draft Amendment nor the relevant paragraphs of the Draft framework provide any arguments why these existing frameworks are insufficient, especially as the Guidelines on State aid for rescuing and restructuring non-financial undertakings are meant to deal with undertakings in financial difficulties as is clearly stated in paragraph 2.1 of those guidelines which do allow for sectoral regimes. This is even more surprising as point 44 of the Rescue and Restructuring Guidelines is referred to in recital 46 of the draft Amendment.
- The Dutch authorities do agree that for some sectors a dedicated framework may be needed (as is the case with the financial sector), however by more or less copying the guidelines for aid to the financial sector as was applied in 2009/2010 for the whole – non-financial – economy lacks proportionality and does not take into account the specificities of different sectors. The draft Amendment does not take into account the characteristics of e.g. the manufacturing sector, agriculture, retail, et cetera.
- Furthermore, the draft Amendment limits the possibilities of Member States to nationalize companies or participate in the equity in companies in breach of the fundamental principle of Union law of neutrality regarding public or private property as stated in one of the key founding documents of Union law, the Schuman declaration. More specifically it is incorrect under Union law that the possibilities to enter into public ownership of to take a majority or minority stake of a company in a company should only be done *as a measure of last resort*, as referred to in paragraph 1, recitals 6 and 7 of the draft Amendment. The choice to have public ownership and/or equity stakes in a company is a sovereign choice of MS, which may require a justification under the free movement of capital and freedom of establishment, but is not only allowed as a measure of last resort in line with the jurisprudence of the ECJ but is dependent on the societal choices and justification provided (see e.g. Essent e.o, C-105/12 – C-107/12, recitals 53-55).
- This limitation in the draft Amendment in paragraph 1, recitals 6 to 8, is contradictory and incomplete, as it does not sufficiently take into account the concern the European Commission itself voiced through its Communication from the Commission of the 25th of March 2020 - Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation), C(2020) 1981 final.
- It is for example not in line with reality to assume that taking a (minority) stake in a European strategic asset will only be undertaken through a pari passu market transaction or transaction

at market price regarding an existing equity stake: the vulnerability of European companies is not limited through the downward pricing of existing shareholdings, but is increased or originated by the need for European companies to issues new shares or to attract hybrid financing. Existing (friendly shareholdings) may be diluted, existing protection measures at company level may lose effectiveness as new investors / capital providers may require more strategic influence or elimination of such measures. In that context we cannot limit MS in providing equity or hybrids on the basis as developed in paragraph 1, recital 6 and subsequent paragraphs. Especially in the start- and scale ups scene and in high-tech industries, this risk has already been seen by the Dutch authorities.

- Therefore the framework severely limits the possibility for MS to choose the best route to either nationalize or take an equity stake in relevant strategic European assets or companies, especially as the conditions of draft Amendment for such measures increase the risk (e.g. the notion that such intervention should only be a measure of last resort).
- Recital 45 states that 'COVID-19 recapitalisation measures shall not be granted later than 31 December 2020' . If recapitalisation is considered to be an intervention of last resort, then there should be time to first mobilize less far reaching interventions/instruments. This deadline might push governments to immediately switch to recapitalisation measures, as opposed to what is intended considering possible distortions of the internal market. We would suggest to see if a extension of this deadline is necessary in the autumn of 2020.
- Finally the draft Amendment is unclear on:
  - The relationship between this draft amendment regarding the temporary framework COVID-19 and existing state aid frameworks such as the GBER, the Notion of Aid and authorized state aid measures of MS. The precedent of a similar framework regarding the financial sector shows that such a framework was deemed to have priority to other existing frameworks. In this specific case the draft Amendment makes clear that equity investments or hybrids – even if they are in line with the principles laid down in the Notion of Aid – would still need to comply with this framework. Especially recital 44 of the draft Amendment suggests this is the case.
  - The equity stakes and hybrids provided by national promotional banks or institutions through their own balance sheets. When dealing with funding supported through EFSI, the Commission still retained a certain *droit de regard* regarding the funding provided by NPIs. It would seem inconsistent to be very stringent with regard to funding provided by the government budget, but not regarding funding provided through the balance sheets of NPBs and NPIs especially when that funding is not channeled through pan-European mechanisms.
  - The application of the state aid rules under this amendment in case of support for these type of measures granted at EU level. State aid of member states granted through pan-European mechanism should be assessed under the same (less) stringent conditions as state aid for these type of measures granted at the level of the member state.

<u>Remarks concerning paragraph 3.11.2. Eligibility and entry conditions:</u>

- Recital 46, criterion sub b, states that the beneficiary of a COVID-19 recapitalisation measure must fulfil the following conditions; its failure would likely involve social hardship or market failure, within the meaning of point 44 of the Rescue and Restructuring Guidelines. Social hardship and market failure *as meant in the R&R Guidelines* could prove not to be a proper test criteria for assessing whether aid to remedy a serious disturbance in the economy of a Member State caused by measures to combat the spread of the COVID 19 pandemic is justified. The temporary framework is aimed at enabling companies that were not in difficulty at the beginning of the pandemic, to carry out a necessary and limited recapitalisation, thus preventing companies that are competitive per se from having to exit the market as a result of covid19. It is therefore problematic to refer to the norm of a set of rules with a fundamentally different objective. Moreover, it is hard to prove that a single company will lead to market failure by itself. This condition might prove to make framework ineffective. We suggest to re-evaluate 46(b) and look into the possibility to make a 'social hardship and market failure' condition which fits the COVID-19 crisis.

- Recital 46, criterion sub c, states that the company concerned has exhausted the possibilities to find financing on the markets and the horizontal measures existing in the Member State concerned to cover liquidity needs are insufficient to ensure its viability. This requirement is contradictory, disproportional and may increase the cost of interventions by MS.

- First this requirement refers to either markets or the horizontal measures existing in the Member State concerned to cover liquidity needs are insufficient to ensure its viability, without defining what both those markets may be or which horizontal measures of MS are referred to. With regard to markets, it is conceivable that funding may be found in jurisdictions of third countries which may be willing to invest even taking a substantial risk. Do we really want to have European industries looking first for funding abroad (even going so far as having a fire sale) before funding through MS becomes available? At the very least it should be made clear that the markets as referred to, do not require companies to search beyond the internal market.
- A similar issue concerns the "horizontal measures existing in the Member State concerned to cover liquidity needs"…i.e. this text seems to imply that a MS which was quick to adopt a broad liquidity package (including the possibility of hybrids) has more freedom, than MS which want to adopt such measures at a later stage…or does this statement refer to non-aid instruments of MS? At least the text should clarify what the reference covers.
- Second this requirement may be detrimental to the long term viability of the companies concerned. By requiring to find funding as much as possible on the market, the companies involved may stuff their balance sheets which too much debt and sureties: this may negatively impact on both the bargaining bower of both the company and MS when trying to provide the hybrid or equity funding. Market financiers may prefer to have the company in receivership and use their sureties to subsequently sell assets of the company at a profit…this risk may increase as the company in distress is forced to find funding on the market at any cost. The notion that financiers will easily accepts haircuts to their debt instruments and sureties cannot be assumed across the board, especially when dealing with SME's or non-listed companies. This is even more concerning as current market circumstances are far from normal, especially in light of geostrategic circumstances of recent years.

<u>Remarks concerning paragraph 3.11.3. Types of recapitalization measures</u>:

- Recital 49, sub b, refers to debt financing instruments with a potential equity component (referred to as 'hybrid capital instruments'), in particular profit participation rights, silent participations and convertible secured or unsecured bonds.
- This reference to such debt financing does not take into account that this type of funding is normal when dealing with funding for R&D intensive companies or off-balance sheet projects. Innovative SME's and scale-ups both through market funding but also aid measures may receive this type of hybrid funding. For market investors this type of funding makes sense as this type of R&D intensive companies usually do not reward their investors through dividends but through increase of value of the company. A MS may wish to either mirror those market approaches for market conform aid measures or may wish to increase the revolving nature of its state aid instruments by achieving sufficient repayments as to recoup part of the state aid provided at portfolio level.
- The draft Amendment does not take into account this type of companies and instruments suited to those R&D intensive industries. E.g. if a scale up involved in COVID-19 vaccine research would receive a hybrid funding by a MS, it is unclear if this funding would be allowed under this draft Amendment while under paragraphs 3.6 to 3.8 under the Temporary Framework COVID-19 it would seem that such support is also positively viewed by the Commission.
- Finally it should be noted that subordinated debt is allowed under the Notion of Aid and the reference methodology. Subordinated debt often contains certain profit participation rights to compensate for the increased risk, especially when sureties are low. This draft Amendment does not take this aspect into account.

<u>Remarks concerning paragraph 3.11.4 Amount of the recapitalization</u>

- This paragraph requires that the amount of the COVID-19 recapitalization must not exceed the minimum needed to ensure the viability of the beneficiary, and in any event must not go beyond restoring the capital structure of the beneficiary to the one predating the COVID-19 outbreak.
- However this leaves quite a lot of discretion to the Commission to decide if either a minimum to ensure the viability is allowed or if restoration of the capital structure of the beneficiary to the one predating the COVID-19 outbreak is allowed.
- This is second option is even more a hypothetical possibility in light of the obligation to exhaust first all market possibilities: to recapitalize a company to restore the capital structure of the

beneficiary to the one predating the COVID-19 outbreak, it would require not only to provide equity and hybrids to restore a viable balance sheet, but also to pay off commercial investors. This seems contradictory.

- Finally for some sectors a limitation of recapitalization to ensure the viability of the beneficiary, may increase the vulnerability of FDI take-overs or a collapse of the company at the required exit date for the MS capital.

<u>Remarks concerning paragraph 3.11.5. Remuneration and exit of the State</u>

- Recital 52 The State shall receive appropriate remuneration for the investment. The closer the remuneration is to market terms, the lower the potential competition distortion caused by the State intervention'. In general it is true that distortive effects are mitigated if the capital instruments are remunerated at market rates. However, this condition might prove to be hard to fulfill in practice, as there is *no orderly market environment*. Market terms would result in high spreads which would aggravate the problem or make aid ineffective. This is why companies turn to their government in the first place. Further guidance on this topic is welcomed
- Recitals 53-56 require incentives and a forced exit of MS (redemption). This obligation both may increase the risk for a deluge of shares and refinancing requirements in 2023/2024 while both the market may not be able to absorb all offers without either drastically lowering the value of MS equity holding or hybrid portfolio's with negative effect on government finances. It would furthermore expose EU companies to strategic FDI investments. Recital 56 does not take into account these market circumstances and risks but only provides flexibility regarding the specific balance sheet of a company concerned.
- Recitals 57-58 are not effective for not listed companies and does not take into account the specificities of different sectors (e.g. high tech or pharma).
- Recital 58 states that As of 1 January 2024, if the State has not sold in full its equity participation resulting from the State's COVID-19 equity injection, the State will receive a second additional share of ownership of the beneficiary of a minimum of [10] percent of the remaining participation resulting from the State's COVID-19 equity injection. This term might force companies to buy back shares/governments to sell shares, whereas market conditions might call for prolonged intervention. Suggestion to leave these dates open until end of 2020, when the economic impact of covid-19 on Member States economy becomes more clear. Suggestion to stick to the general term of " proportionate measures" to remedy disturbance of the economy.
- Recitals 58-60, does not take into account the sovereign right of MS to maintain ownership of an equity stake (see above general remarks).
- Recital 60 states that the beneficiary shall have at any time the possibility to buy back the equity stake that the State has acquired. To ensure that the State receives appropriate remuneration for the investment, the buy-back price should be the higher amount of (i) the nominal investment by the State increased by an annual interest remuneration [500] basis points higher than presented in Table 1 below; or (ii) the market price at the moment of the buy-back' . This disincentivizes the buy back. Why not take the nominal investment made as a minimum? Furthermore adding the 500 basis points to the remunerations in table 1 would lead to returns higher than the average equity returns for listed companies in the Member States in recent years. These equity returns from a government perspective do not correspond to a time frame of a health crisis and high possibility of an economic recession. For unlisted companies it is even more unpredictable.
- Recitals 62-67, especially the table in recital 63, fundamentally deviates from the reference rate table and communication and the notion of aid. It seems that the table is just focused on forcing both the beneficiary and MS to redeem the hybrid loan which may both contrary to the financial interests of a MS and increases the vulnerability of companies concerned.
- Recital 63 states that 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 Commission8), plus the premium as set out in the table below'.
- The minimum remuneration for hybrid capital instruments in the subordinated area proposed in text number 63 is clearly too high overall. These margins should – depending on the rating before the crisis - be reduced by a noticeable number of basis points. Otherwise, the price of hybrid instruments would be very unattractive for companies and would aggravate the problems or push companies into more equity like instruments.

- The step up mechanism provided for in recital 58 might be not compatible with the mandatory European legal provisions on company law, applicable to public limited liability companies. Shares may only be granted if the shareholder has paid his contribution. This follows from Art. 48 and Art. 69 of Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 on certain aspects of company law In order to protect creditors and minority shareholders, Art. 53 of this Directive expressly and without exception prohibits the exemption of one or more shareholders from this obligation to make a contribution.

- Recital 65 states that after conversion into equity, a step-up mechanism has to be included to increase the shareholding of the State to incentivise the beneficiaries to buy back the State capital injections. Two years after the conversion into equity, if the equity resulting from the State's COVID-19 intervention is still owned by the State, 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] percent of the remaining participation resulting from the State's conversion of the COVID-19 hybrid capital instruments. The Commission may accept alternative step-up mechanisms provided they have the same incentive effects and a similar impact on the State's remuneration. This counteracts the actual objective: governments to exit from their shareholdings. Hard to understand an incentive mechanism supporting the "exit" leads to an increase in participation. This mechanism counteracts the actual objective and it is hard to view this in conjunction with text number 81 (that aims for an eventual exit from the State).

<u>Remarks concerning paragraph 3.11.6. Governance and prevention of undue distortions of competition</u>

- The obligation in recital 69 for MS to offer structural or behavioral commitments foreseen in Commission Notice on remedies acceptable under the Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 for undertakings with significant market power on at least one of the relevant markets in which it operates, does not take into account both the context of world markets or specific sectors concerned. E.g. this obligation would possibly to have a fundamental weakening or restructuring of the Airbus group.
- Similarly the prohibition to advertise as referred to in recital 70 does not take into account the international context and the fact that international competition is not subject to such obligations, even as they are supported by their own jurisdictions. The Dutch authorities do agree that market expansion should not directly be funded by government equity or hybrid loans, but defending market shares – especially in highly competitive international markets – should be allowed.
- However the Dutch authorities fully support the limitations as laid down in recital 74, as long as they are time limited and do not negatively affect the government budgets.
- In view of the Dutch authorities the possibility for undertakings that have received measures under the Framework to merge with other undertakings that would otherwise not be viable, makes clear that for some sectors it is more logical to work with restructuring and consolidation through a specific tailor made framework and that this framework is not effective to meet that end.

<u>Remarks concerning paragraph 3.11.7. Exit strategy of the State from the participation resulting from the recapitalization</u>

As follows from the remarks provided above the Dutch authorities are not supportive of the strict exit strategy obligations laid down in the paragraph, especially paragraph 81.