CLEARY GOTTLIEB

ALERT MEMORANDUM

Europe's Economic Response to the COVID-19 Crisis—the European Commission Steps In

March 16, 2020

Recognizing the serious economic consequences that the COVID-19 crisis may create, on March 12 the Commission approved within 24 hours of notification a COVID-19 related measure in Denmark aimed at compensating event organizers for losses caused by cancellations. Following this initial ad hoc approval, on March 13, the Commission unveiled a communication (the "Communication") setting out a number of proposals and actions to tackle the economic consequences of the COVID-19 sanitary crisis in the EU. The communication mentions a number of tools under EU law or budget that have been or will be activated by way of immediate response to smoothen the severe shock imposed by the COVID-19 outbreak on the European economies.

If you have any questions concerning this memorandum, please reach out to your regular firm contact, the following authors or our COVID-19 task force directly by clicking here.

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The overall message is two-fold:

— Solidarity: the Commission intends to prevent Member States from enacting uncoordinated "beggar thy neighbor" policies such as export or travel bans that would undermine both the single market and overall preparedness;

— Boldness: the EU should do " *whatever it takes*" to tackle the crisis, in particular actions with respect to the EU budget and European Investment Bank, State aid rules, and EU fiscal rules.

Member States will probably take further economic initiatives in the next few days and weeks as a result of the sanitary crisis. Companies faced with these initiatives should consider their EU law implications, in particular with respect to single market and State aid rules.

1. Preserving the Single Market

This section of the Communication focuses on the three industries that have been most impacted by the crisis: health, transport and tourism.

Health

The Communication contains a robust reminder on the need for solidarity between Member States in the face of various restrictions introduced over the past few days at national level on exports of protective equipment and medicines, for instance by France or Germany. This follows a video conference of Heads of State organized on March 10 where the Commission was tasked to centralize the analysis of the needs and come up with initiatives to prevent shortages. On this basis, the Commission has organized a joint procurement procedure for 20 Member States and started monitoring supply and needs at European level with Member States.

The Commission also recalls that ill-designed national restrictions can exacerbate problems and contribute to amplifying shortages in other Member. Under Articles 35 and 36 TFEU, export restrictions within the Single market are in principle prohibited except when justified (i.e. "suitable, necessary and proportionate") to protect human health. Any such measure must be notified to the Commission, which is to inform other Member States and will set up a joint task force to this effect. The Commission will assess the measures that are notified in order to ensure their proportionality and reserves the right to take legal action against Member States under Single market rules if they are not corrected accordingly. More specifically Annex 2 to the Communication specifies that (i) a simple export ban cannot on its own fulfill the proportionality requirement as it does not guarantee that the people who need the equipment the most will have access to it; (ii) measures without a clearly defined scope, rationale or duration are likely to be disproportionate; (iii) regulation measures aimed at channeling the goods where they are needed the most are encouraged and (iv) price regulation measures may be useful provided they are applied on a non-discriminatory basis. The Commission also reserves the possibility to put in place a regime for prior authorization of exports to non-EU third countries.

Transport

The Commission has proposed targeted legislation to temporarily alleviate airlines from their slot usage obligations under EU law. This legislation will prevent airlines from having to fly empty aircraft to retain their slots. The Communication has also noted the severe impact the outbreak has had on transport flows, but it does not propose any additional measures at this point.

Tourism

The Communication mostly notes the very severe impact of the outbreak without announcing specific measures at this stage.

2. EU budget and EIB

The Communication announces a number of support measures funded on the EU budget or by the EIB:

(i) Liquidity measures. These include a €1 Billion guarantee to the European Investment Fund, which should allow supporting around €8 Billion of working capital, and a further €1 Billion from the European Fund on Strategic Investment.

(ii) Employment measures. These include support for short-time schemes adopted by Member States, and a proposal for a European unemployment reinsurance scheme.

(iii) A new "Coronavirus Response Investment Initiative." This comprises €37 billion under the Cohesion policy to be used in 2020. This amount could be directed to the most immediate expenses required to tackle the outbreak, including:

   a. support to the healthcare system;

   b. liquidity support for companies and

   c. support to national short time working schemes.

   Additional funds will also be raised for 2020 from the Global Adjustment fund (€179 million) and the EU Solidarity Fund (€800 million).

The Communication also mentions the key role of the banking sector in ensuring liquidity flows to the economy. In addition to measures announced by the ECB and the European Banking Authority, the Commission has clarified that it will interpret the term "extraordinary public financial support" in the Bank Restructuring and Resolution Directive to exclude aid aimed at compensating banks for direct damage suffered as a result of COVID-19 under Article 107 (2) (b) TFEU (see Section 3. below). The upshot of this interpretation is that receipt of this aid will not trigger resolution.

3. State aid

Given the limited size of the EU budget (around 1% of the EU's GDP), most of the public expenses related to the COVID-19 crisis will likely be funded by national budgets and might therefore be subject to the strict State aid rules of Articles 107 and 108 TFEU. As was the case in the 2008 financial crisis (and in other more localized crises stemming from natural disasters) the Commission has indicated its willingness to relax these rules, while maintain a certain degree of control over public support initiatives. The Commission therefore:

— Encourages Member States to prioritize measures that do not qualify as State aid, such as non-selective wage subsidies or suspensions of taxes, social security contributions, or aid to consumers (e.g. for cancelled services).

— Encourages Member States to use existing tools that do not require prior Commission approval, such as the *de minimis* exemption regulation for small amounts of aid (less than 200,000 euros, with lower thresholds for the road freight an agricultural sector), or the General Block Exemption Regulation, which exempts several types of aid measures from prior Commission approval.[1]

— Stands ready to approve the provision of urgent liquidity aid through guarantees or loans for a maximum of 6 months under Article 107 (3) (c) TFEU, which allows aid to companies in difficulty (but requires prior Commission approval). Importantly (and similarly to the 2008 financial crisis) the Commission stands ready to relax the so-called "one time, last time principle", an established rule that prevented companies that had received this type of aid in the 10 previous years to receive additional support.

— Classifies COVID-19 as an "exceptional occurrence" under Article 107 (2) (b) TFEU,[2] which provides that *"aid to make good the damage caused by natural disasters or exceptional occurrences"* shall be compatible with the internal market. This legal basis was for instance exceptionally used to clear aid to airlines affected by post-September 11 shutdowns as well as the eruption of a volcano in Iceland. An important limitation is that there must be a direct causation link between the aid, the level of the damage, and the exceptional occurrence. But once it is determined that the aid comes under this provision the Commission has no discretion but to clear the aid. On March 11, the Commission applied this legal basis for the first time to the current sanitary crisis, approving within 24 hours of notification a COVID-19 related measure in Denmark aimed at compensating event organizers for losses caused by cancellations. Other approval decisions are likely to follow, although it remains to be seen how far the Commission will be ready to take the causality link in order to justify clearances. At this stage the Communication mentions the transport, tourism and hospitality sectors as possible beneficiaries of such aid. Banking is also incidentally mentioned, although it remains to be seen what the Commission would consider as "direct damage" suffered by this sector.

— Approves the application to Italy of Article 107 (3) (b), which relates to aid aimed at remedying a serious disturbance in a Member State economy

[1] Although the definition of "natural disasters" covered in the GBER does not include epidemics.

[2] Article 107 (2) (b) TFUE : « The following shall be compatible with t

and was extensively used after the 2008 financial crisis. The Communication specifically contemplates that this classification might be extended in the future to other Member States. The Commission is preparing a specific "legal framework" that could be used "in case of need" in this context.

4. Fiscal rules

Public expenditure interventions are subject to EU fiscal rules, in particular the Stability and Growth Pact. The Commission proposes to relax the application of these rules in order to encourage a coordinated fiscal response to COVID-19. In particular, the Commission will propose to exclude from the rules the one-off effect of fiscal measures aimed at addressing the economic consequences of COVID-19 and to adjust efforts required from Member States accordingly. More generally, the Commission stands ready to activate a general "escape clause" aimed at suspending fiscal adjustments required from individual Member States under existing rules in order to tackle a severe downturn in the economy.

The COVID-19 crisis and its economic consequences in Europe are evolving every day. It is clear that the Commission's Communication is only a first response and will be followed by other initiatives and decisions. In the field of State aid in particular, the Communication mentions numerous legal bases that may allow for a relaxation of the rules—it remains to be seen which of these will be more often invoked, and in particular how frequently and for how long the Commission will accept to clear public interventions based on the legal basis of Article 107 (2)(b). The decisional practice of the next few days and weeks will probably shed more light on this.

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