

# Application of Article 107(2)(b) TFEU to Covid-19 Measures

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## Article

# Application of Article 107(2)(b) TFEU to Covid-19 Measures: State Aid to Make Good the Damage Caused by an Exceptional Occurrence

Phedon Nicolaides\*

## I. Introduction

On 12 March 2020, the European Commission approved the first state aid measure to combat the Covid-19 pandemic (case SA.56685 notified by Denmark). Two months later the Commission authorised more than 120 measures, mostly in the form of grants and subsidies for loan guarantees and interest rates.<sup>1</sup> The vast majority of those measures were authorised on the basis of Article 107(3)(b) TFEU which allows state aid to ‘remedy a serious disturbance in the economy of a Member State’. Only 10 measures were authorised on the basis of Article 107(2)(b) TFEU for the purpose of making ‘good damage caused by a natural disaster or exceptional occurrence’.

Covid-19 is both an exceptional occurrence and a serious economic disturbance. This suggests that Member States could choose to notify their aid measures on the basis of either Article 107(2)(b) or Article 107(3)(b). In theory, they should have chosen Article 107(2)(b) because the discretion of the Commission in this instance is narrower than under Article 107(3)(b). The Treaty itself declares aid to make good the damage caused by an exceptional occurrence compatible with the internal market, whereas aid to remedy a serious disturbance may be compatible with the internal market. Therefore, the discretion of the Commission is much wider in assessing whether the latter is or is not compatible.

Of course, what prompted Member States to choose between the two articles is an empirical issue. In theory, it

## Key Points

- More than 120 state aid measures have been implemented to combat Covid-19.
- Only 10 of those measures are based on Article 107(2)(b) TFEU which allows state aid in the form of compensation for damage suffered as a result of an exceptional occurrence, such as Covid-19.
- It appears that Article 107(2)(b) TFEU is more difficult to apply than Article 107(3)(b) TFEU which permits aid to remedy a serious economic disturbance.
- Compensation for damage requires quantification of losses in relation to a counterfactual of the state of physical assets or revenue levels.

is possible to ask all Member States to explain their decision and that would settle the issue. In practice, however, that is a rather impossible task.

In place of an empirical test, one may ask whether a priori, Article 107(2)(b) is more difficult to apply and less suitable to address the impact of a pandemic like Covid-19? Indeed, the difficulty of complying with Article 107(2)(b) or its suitability may explain the preference of Member States for Article 107(3)(b).

Article 107(3)(b) is likely more suitable to address the impact of the pandemic because aid on the basis of that Treaty provision can be granted both in order to remedy the actual effect of a serious disturbance and to prevent the worsening of the disturbance in the future. In other words, aid can be both ‘retrospective’ and ‘prospective’. In both instances of retrospective intervention and prospective intervention, the amount of aid that may be granted depends not just on the magnitude of the effect of the serious disturbance but also on how aid recipients intend to address their problems.

\* Phedon Nicolaides is a Professor in the University of Maastricht, and Visiting Professor in the College of Europe, Bruges and Luiss University, Rome. The views expressed in this article do not reflect those of any institution with which I am affiliated, and I have no personal interest or involvement in any of the cases that are reviewed in this article.

1 For a list of all state aid measures in connection to Covid-19, see special website of DG Competition: [https://ec.europa.eu/competition/state\\_aid/what\\_is\\_new/covid\\_19.html](https://ec.europa.eu/competition/state_aid/what_is_new/covid_19.html).

By contrast, aid on the basis of Article 107(2)(b) may only be granted for the purpose of compensating quantifiable damage. The amount of damage must be objectively measured. It does not depend on what the aid recipient was hoping to do before the exceptional occurrence or what it intends to do in order to improve its situation in the future. Article 107(2)(b) aid may be granted only for damage that has already been suffered. This implies that the exception in Article 107(2)(b) to the prohibition of state aid in Article 107(1) is not useful when the intention of the government is to offer to undertakings enough resources to enable them to implement preventive measures to avoid a further deterioration in their financial situation.

Aid on the basis of Article 107(3)(b) that is granted in conformity with the 2020 Temporary Framework is also easier to apply than aid under Article 107(2)(b). The Temporary Framework was adopted by the European Commission on 19 March 2020. It aims to define a minimum set of requirements in order to enable Member States to grant as quickly as possible state aid on the basis of Article 107(3)(b). Its main feature is that it does not define aid intensities as is done normally in terms of percentage of aid in relation to eligible costs.<sup>2</sup> It only sets limits in absolute terms either in maximum amounts or in minimum rates of guarantees or interest. Since the Temporary Framework does not require Member States to ensure that each undertaking receives only the amount of aid it strictly needs, it is in practice easier to apply than aid granted on the basis of Article 107(2)(b) that does not allow aid beyond the actual and quantifiable amount of damage. The fact that the Temporary Framework defines only absolute maximum and minimum limits necessarily implies that some aid recipients may get more than what they need in order to remedy the damage they have suffered and, of course, some may get less.

Therefore, the purpose of this short article is to explore how aid on the basis of Article 107(2)(b) is calculated so that it, hopefully, demystifies that process and makes it more accessible to Member States.

The article is structured as follows. First, reviews briefly the definition of ‘exceptional occurrence’. Then it examines how the amount of allowable state aid was quantified in the few cases before the outbreak of the Covid-19 pandemic. Next the article reviews the few current cases for which Commission decisions have been published. The penultimate section identifies particularly tricky issues in

the measurement of the damage that can be compensated by state aid.

## II. What is an ‘exceptional occurrence’?

The concept of state aid is objective. It does not depend on the intentions or aims of the granting authority or on the value or worthiness of public policy [see T-52/12, *Greece v European Commission (ELGA)*]. Therefore, aid ‘to make good the damage caused by natural disasters or exceptional occurrences’ or ‘to remedy a serious disturbance’ can be state aid if it fulfils all of criteria of Art 107(1) TFEU (see Commission decision 2020/394 on compensation for large forest fires).

The TFEU does not define the meaning of a natural disaster or exceptional occurrence. Article 50 of the General Block Exemption Regulation (Regulation 651/2014) allows aid under Article 107(2)(b) but refers only to ‘natural disasters’ and provides examples: ‘earthquakes, avalanches, landslides, floods, tornadoes, hurricanes, volcanic eruptions and wild fires of natural origin’. The GBER does not mention ‘exceptional occurrences’, nor does it refer to epidemics or outbreaks of disease.

It can be inferred from the decisional practice of the European Commission that aid granted on the basis of Article 107(2)(b) must satisfy three criteria:

- **Exceptionality:** the event must be (i) unforeseen or unpredictable, (ii) out of the bounds of normality, and (iii) have a large or significant impact. The following have been found to be exceptional: war, terrorist attack, civil strife, strikes, major nuclear, maritime or industrial accidents, large fires and epidemics. This is not an exhaustive list. Member States who claim they have been hit by an exceptional occurrence must, however, prove that indeed it is out of the range of normal or expected events.
- **Causality:** there must be a direct link between the exceptional occurrence and the damage that is suffered. The damage does not have to be limited to physical damage. It can also be financial such as loss of income.
- **Proportionality:** the amount of aid may cover 100 per cent of the damage or loss but may not exceed the total cost of the damage. In addition, the cost of the damage that can be compensated must be net of any insurance pay out and the amount of compensation must be calculated at the level of the individual beneficiary.

In its decision 2010/332 on aid granted by Italy to prevent avian influenza, the Commission stressed that ‘(58)

<sup>2</sup> The first version of the Temporary Framework on state aid to counter Covid-19 is published in OJ C 91I, 20 March 2020, pp. 1–9. A revision is published in OJ C 112I, 4 April 2020, pp. 1–9. A consolidated version can be accessed at: [https://ec.europa.eu/competition/state\\_aid/what\\_is\\_new/covid\\_19.html](https://ec.europa.eu/competition/state_aid/what_is_new/covid_19.html).

as a general rule, the Commission does not accept that outbreaks of animal or plant diseases can be considered to constitute natural disasters or exceptional occurrences. However, in one case the Commission did recognise the very widespread outbreak of a completely new animal disease as an exceptional occurrence.<sup>3</sup> That was the BSE epidemic. See for example, decisions N 657/2001 and N 437/2001 concerning aid granted by Belgium to bovine producers.

In the same decision on avian influenza, the Commission explained that '(60) in general, an exceptional occurrence must at least present the characteristics of an occurrence that, by its nature and its effect on the operators concerned, is clearly distinguished from usual conditions and is outside the framework of the normal conditions under which a market operates'. An exceptional occurrence cannot be 'a recurring phenomenon' even if serious.

In decision NN 44/2009 concerning dioxin contamination of meat products in Ireland, the Commission highlighted some of the relevant features of an exceptional occurrence: event clearly outside the normal functioning of the market, loss of consumer confidence, serious disturbance in the relevant market, significant losses for a number of undertakings, large-scale human food, and animal feed contamination (paragraphs 49–52). It described the contamination as an 'extraordinary event' (paragraph 56).

But then the Commission also stressed that '(50), as a general rule, the Commission does not accept that the chemical contamination of human food or animal feed could be qualified as an exceptional occurrence within the meaning of Article 107(2)(b) of the Treaty. On the contrary, the risk of contamination is a foreseeable consequence of not assuring the highest level of quality throughout the food sector.'

In the current situation, however, the Commission has made the task of Member States much easier because it itself has declared that 'in its Decision of 12 March 2020, the Commission concluded that the COVID-19 outbreak qualifies as an "exceptional occurrence" for the purpose of Article 107(2)(b) of the Treaty on the Functioning of the European Union'.<sup>3</sup>

### III. How is compensation determined?

This section reviews the main cases before 2020 and the few cases in 2020 for which Commission decisions have

been published. For each case, it identifies the eligible undertakings, eligible costs, aid intensity, the form of the aid, and any safeguards to prevent excessive aid or cheating.

#### A. Past cases

##### 1. NN 82/2000: oil spill caused by the sinking of Erika off the coast of Brittany (FR)

Eligible undertakings: SMEs affected by the contamination of the sea and beaches.

Eligible costs:

- Investments for the replacement of damaged production facilities (buildings, warehouses, and vehicles).
- Damaged stock.
- Bank charges for the pre-financing of investments.
- Extra service costs or subcontracting necessitated by the interruption in production.

Aid intensity: 100 per cent maximum for financial costs and 50 per cent material costs.

Aid form: Grant.

Safeguards:

- Any insurance payout was subtracted from the amount of aid.
- If a company purchased extra or more efficient equipment, aid was limited to the cost of identical replacement.

##### 2. N 217/2002: explosion at Enschede fireworks factory (NL)

Eligible undertakings: Those that suffered damage.

Eligible costs:

- Clearing of property.
- Repairs to damaged buildings and equipment.
- Travel and subsistence expenses incurred because the area was declared disaster area and was closed.
- Transportation and storage of movable assets up to a certain maximum.
- Restarting expenses up to a certain maximum.
- Losses from business interruption in relation to the average of the previous 3-year period.

Aid intensity: 100 per cent of the damage, minus own-risk of 10 per cent for material damage and 30 per cent for other losses.

Aid form: Grant.

Safeguards:

- Any insurance payout was subtracted from the amount of aid.
- Assessment by independent experts.

<sup>3</sup> See the template for notification of state aid under Article 107(2)(b). It can be accessed at: [https://ec.europa.eu/competition/state\\_aid/what\\_is\\_new/Notification\\_template\\_107\\_2\\_b\\_PUBLICATION.pdf](https://ec.europa.eu/competition/state_aid/what_is_new/Notification_template_107_2_b_PUBLICATION.pdf).

### 3. SA.32163: closure of airspace due to atmospheric ash (SI)

Eligible undertakings: airlines and airport operators.

Eligible costs: loss of income as indicated by the loss of value-added compared to the benchmark period of the previous year (value-added is revenue less cost of inputs; it includes wages, depreciation, and profits before taxes).

Aid intensity: 60 per cent of damage.

Aid form: Grant.

Safeguards:

- No compensation for damage to equipment or for any other type of costs.
- Verification by independent experts.

The Slovenian methodology was already approved by the Commission in two measures for compensation of damage caused by excessive rainfall and severe flooding that were categorised as natural disaster.

### 4. SA.32162 & N 32/2008: damage caused by floods (SI)

Damage to machinery and equipment: Purchase price-market value before and after the disaster, taking into account depreciation; no reimbursement for machinery and equipment that is fully depreciated.

Damage to stocks: Value established on the basis of accounting documents (delivery note, invoice, etc.) before and after the disaster.

Loss of income: Monthly value-added before and after the disaster [i.e. net earnings before interest and taxes (EBIT), depreciation and labour costs].

### 5. SA.33487: burst aluminium sludge reservoir, flooding of hazardous industrial waste (HU)

Eligible undertakings: agricultural undertakings damaged by the sludge.

Eligible costs: material damage to land, buildings, machinery & stocks calculated as the difference in value before and after the disaster.

- For buildings, the total construction or reconstruction work is eligible.
- For machinery and equipment, the eligible costs are repairs or cost of replacement.
- For stocks and other materials, the eligible cost is market or purchase value minus any residual value after the disaster.
- Not eligible: loss of income and foregone revenue associated with the interruption of the production process, the loss of orders, customers or markets.

Aid intensity: 100 per cent of eligible costs.

Aid form: Grant.

Safeguards:

- Damaged calculated by independent assessors.
- Insurance payout deducted.

### 6. NN 44/2009: dioxin contamination of meat products (IE)

Eligible undertakings: Affected agricultural undertakings.

Eligible costs:

- Value of animals slaughtered.
- Slaughter costs.
- Rendering of contaminated meat products.
- Transport costs.

Aid intensity: 100 per cent of eligible costs.

Aid form: Grant.

Safeguards:

- Evidence of production, contracts and rejection of product.
- Insurance payout deducted.

## B. Current cases

As of 30 April 2020, only four Member States had nine measures in total approved by the Commission on the basis of Article 107(2)(b). These measures are indicated in [Table 1](#).

In case **SA.56765**, eligible beneficiaries are airlines registered in France.

The eligible costs (i.e. the amount of the damage) are the loss of turnover between March and December 2020 in comparison to the same period in 2019 minus a profit margin (according to 2019 results) and avoided costs. Fixed costs (i.e. non-avoided costs) are not taken into account. Assuming a drop in traffic of 50 per cent, then the amount of the damage is:  $\text{Damage} = [\text{revenue} \times 50 \text{ per cent}] - [\text{avoided costs} \times 50 \text{ per cent}] - [\text{profit} \times 50 \text{ per cent}]$ . These losses are estimated at EUR 680 million. The deferred taxes are estimated at only EUR 30 million.

In case 'SA.56774', the eligible beneficiaries are private companies in Denmark that suffer more than 40 per cent turnover reduction.

The eligible costs are fixed costs, including rent, interest expenses, and non-negotiable contract-related expenses during the period from March to June 2020. The aid measure provides compensation on a variable scale ranging from 25 per cent to 100 per cent of fixed costs, corresponding to reduction of turnover from 40 per cent

Table 1: Approved measures of compensation for damage suffered as a result of Covid-19.

MS	Number	Amount (€ billion)	Objective	Eligible costs of damage
DK	SA.56685	0.012	Compensation for event cancellation	100 per cent of income loss & additional costs
FR	SA.56765	0.030	Deferred airline taxes	Losses in 2020
DK	SA.56774	5.4	Compensation for income loss exceeding 40 per cent	
DK	SA.56791 SA.56892	1.330	Compensation for self-employed for income loss exceeding 30 per cent	75 per cent of income loss
DK	SA.56795	0.137	Guarantee for credit facility for SAS	Losses in 2020; claw-back mechanism
DE	SA.56867	0.550	Guarantee for loan to Condor	Losses in 2020; claw-back mechanism
SE	SA.57051	0.038	Compensation for event cancellation	50 per cent–75 per cent of income loss & additional costs
SE	SA.57061	0.137	Guarantee for credit facility for SAS	Losses in 2020; claw-back mechanism
NL	SA.57217	0.600	Compensation for loss of revenue in floriculture	70 per cent of revenue loss

to 100 per cent. In addition, the maximum amount of compensation per company is capped at EUR 8 million.

In case ‘SA.57051’, the eligible beneficiaries are organisers of cancelled events in Sweden.

The aid measure compensates up to 75 per cent of the lost income and additional costs up to EUR 91,000 and only 50 per cent of amounts exceeding that threshold. The maximum amount of compensation per company is EUR 906,000. The damage is defined as loss of revenue minus avoidable costs. Lost profits, arbitration awards, or insurance payouts are not eligible.

#### IV. What are the pitfalls in calculating the amount of damage?

The compensated damage must be caused by an exceptional occurrence. It follows that the first step is designing a state aid measure for the compensation of such damage is the correct identification of the exceptional occurrence. The occurrence must be unpredictable, out of the ordinary and must have a substantial impact.

The next step is the definition of a cut-off date. Some events such as a terrorist attack or industrial accident happen in matters of minutes or seconds. Some other events such as an epidemic evolve over a period of days. For Covid-19, the cut-off date, as laid down in the 2020 Temporary Framework, is 1 January 2020. Any damage suffered before that date is not eligible for compensation. Naturally, for other exceptional occurrences, the setting of the precise cut-off date can be subjective. It must be backed by objective evidence such as an official declaration of emergency by the government.

The third step is the definition of the time period in which the damage occurs. In case of an accident, this period can be a few seconds. In the case of an epidemic

or pandemic, it can be very prolonged and extend over months. For Covid-19, the Temporary Framework allows aid up to 31 December 2020 and the Commission has used to the same time period (March to December) to authorise aid under Article 107(2)(b). In other cases of exceptional occurrences the relevant time period in which losses are incurred must be identified. The longer the period, the more difficult to prove that losses are caused primarily and ‘directly’ by the exceptional occurrence.

The fourth step is the quantification of the damage suffered by the event in question after the cut-off date. There are three problems here. The first problem is to establish the condition of the undertaking before the damage. Physical or material damage such as a dead animal or a collapsed building appears relatively easier to identify than financial loss. However, even in the case of physical or material damage, it is still necessary to establish the condition of the animal before it died or the state of the building before it collapsed. Was the animal in good health or was it sick? Was the building maintained well or was it derelict? In some cases ex post checks may be sufficient to determine the state of the damaged asset before the occurrence of the extraordinary event (e.g. medical tests on corpses). In other cases it may be much harder to reach a definitive conclusion [e.g. the condition of a building that is destroyed by a mob (civil unrest is an exceptional occurrence)].

The second problem is to disentangle the impact of the exceptional occurrence from other factors in the economy. Consider the example of a firm that registers zero revenue after the cut-off date 1 January 2020 as compared to the annual average of, say, 50. Is the whole reduction attributed to the deterioration of market conditions as a result of Covid-19? What if the same firm also registered zero revenue in the final quarter of 2019? Perhaps the firm sells a seasonal product (e.g. beach umbrellas) and

that it is normal for it in the winter not to make any profit. It becomes necessary to compare its performance after the cut-off date with the performance in a similar period. Typically, the benchmark period is the same month or season in the previous year or the average of the corresponding period in the previous two or three years.

Still, comparison with benchmark periods does not solve the problem completely. Some companies may experience unique problems caused by factors other than Covid-19 or another exceptional occurrence such as failed investments, mismanagement, or obsolete products. Therefore, establishing a credible counterfactual is essential in measuring correctly the extent of the damage and how much could be attributed to Covid-19.

The third problem concerns in particular compensation for damage in the form of loss of income. If the revenue of a company declines as a result of contraction of its business, its costs also decline. It makes no sense for a government to compensate companies for losses of gross revenue. They must always deduct from the amount to be compensated the costs that a company avoids by not producing a good or providing a service. Proper identification of avoidable costs is essential. Naturally, the costs of inputs that are bought in are avoided, while fixed costs cannot be avoided. But certain costs that appear to be fixed over a period of time or are not variable with the amount of output may also be avoided if, for example, contracts allow for their termination in case of force majeure.

Lastly, a government offering compensation for damages must also decide whether to include profits or not and, more broadly, how much of the damage to cover. State aid may be granted up to 100 per cent of the damage, but there is no obligation for Member States to offset 100 per cent of the damage. Easily identifiable losses such as repair and replacement costs may indeed be compensated up to 100 per cent. Other losses such as unearned income which can be more easily exaggerated or more likely to be influenced by other factors may be compensated at a lower rate to prevent cheating.

## V. Conclusions

This short article has examined the application of Article 107(2)(b) TFEU which allows state aid in the form of compensation for damage suffered as a result of an exceptional occurrence, such as Covid-19. In contrast, to Article 107(3)(b) which allows aid to remedy a serious economic disturbance, Article 107(2)(b) appears to be more difficult to apply. This article has reviewed prominent cases involving compensation for damage and has explained how the damage can be quantified and how the compensation can be calculated.

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