The financial crisis and state aid

BY PHEDON NICOLAIDES* AND
IOANA ELEONORA RUSU**

After the outbreak of the financial crisis in September 2008, Member States adopted a variety of policy instruments in order to protect their financial institutions and national economies. Within a mere couple of weeks after the outbreak of the crisis, it became obvious that existing EU rules were not suitable for dealing effectively with the problems facing financial markets, and single national measures could lead to excessive distortions of competition and disruption to the flow of resources between Member States. Instead of completely putting aside the existing state aid rules, the European Commission adopted special rules allowing it to act swiftly in times of financial crisis. These newly adopted measures raise questions regarding not only the integrity of the Internal Market but also the extent of the Commission control under the new system, legal certainty, the protection of competitors and the exit strategy.

* European Institute of Public Administration, Maastricht, The Netherlands.

** European Institute of Public Administration, Maastricht, The Netherlands.

AUTHORS' NOTE: *We have written extensively on state aid and the enforcement of state aid law, including the chapter in* IOANNIS KOKKORIS & RODRIGO OLIVARES-CAMINAL, ANTITRUST POLICY IN THE WAKE OF FINANCIAL CRISES *(forthcoming 2010).*

© *2010 by Federal Legal Publications, Inc.*

1. INTRODUCTION

When the financial crisis broke out in September 2008, Member States and EU institutions responded with a variety of policy instruments. Member States primarily injected capital into banks and raised deposit guarantees to assure the public and prevent runs on banks.[1] European institutions also acted, but with varying degrees of speed and effectiveness. The European Central Bank extended credit lines immediately and increased liquidity in financial markets to prevent them from freezing up completely.

The European Commission intervened to ensure that national measures to prop up banking activities were not discriminatory. Then it issued new guidelines on state aid to banks and committed itself to deal with notified measures within record time, normally not more than a couple of days. In December 2008, it broadened the new rules to cover the real economy as well. The Council recommended that Member States increase public spending by about € 200 billion. However, most of that money was not new. It was to come from accelerated uptake of structural funds. Member States also shied away from establishing a common European fund for rescuing banks in trouble.

The policy measures mentioned above have been coupled with proposals for significant institutional changes. In 2009, the EU began discussion on possible reform of the regulatory framework for financial services. On the basis of recommendations made by the de Larosière report,[2] the Commission proposed[3] in the autumn of 2009 the establishment of four new institutions: a European Systemic Risk

[1] Case N41/2008, Liquidation Aid to Bradford & Bingley, 2008 O.J. (C 290) (United Kingdom), NN 48/2008, Guarantee Scheme for Banks in Ireland, 2008 O.J. (C 312) (Ireland), NN 51/2008, Liquidity Support Scheme for Banks in Denmark, 2008 O.J. (C 273) (Denmark), N 337/2009, Prolongation for the Fund for the Acquisition of Financial Assets in Spain, 2009 O.J. (C 216) (Spain).

[2] Report of the High-Level Group on Financial Supervision in the EU (Jacques de Larosière, Chair, Feb. 25, 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

[3] Commission Proposal for a Regulation on Community Macro Prudential Oversight of the Financial System and Establishing a European Systemic Risk Board, COM (2009) 499 final (Sept. 23, 2009).

Board, a European Banking Authority, a European Insurance & Occupational Pensions Authority, and a European Securities Authority. Deliberations on the structure and mandate of these new entities are still ongoing.

However, of all policy instruments at the disposal of EU institutions, the most extensively used were the rules of state aid. The Commission had to intervene on a number of occasions to prevent distortions in the Internal Market and then to lay down new rules concerning aid to financial institutions and enterprises in the real economy. As the then-Commissioner for Competition put it, "state aid rules [were] part of the solution, not part of the problem."[4]

The first challenge to the functioning of the Internal Market came in mid-September 2008 with the announcement of the Irish government that it would cover deposits in only six Irish banks by a state guarantee scheme. That presented a serious risk of a large outflow of capital from noneligible competitors. The Commission asked the Irish government to broaden the coverage of the scheme so that the guarantee would be available to all banks with subsidiaries or branches in Ireland and having a significant presence in the domestic economy.[5]

Similarly, when France announced its planned aid to the automotive sector, which originally raised concerns concerning state aid and the integrity of the Internal Market because it was offered on condition that the recipients repatriate their foreign operations to France, the Commission stated without ambiguity that any aid granted subject to additional noncommercial conditions concerning

[4] Press Release, European Commission, State Aid: Commissioner Kroes Briefs Economics and Finance Ministers on Financial Crisis Measures (Dec. 2, 2008), http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/757&format=HTML&aged=0&language=EN&guiLanguage=en.

[5] NN 48/2008, Guarantee Scheme for Banks in Ireland, 2008 O.J. (C 312). The original Irish scheme had to be modified, in order to delete any discriminatory coverage of banks with systemic relevance to the Irish economy. *See* Press Release, European Commission, State Aid: Commission Welcomes Revised Irish Guarantee Scheme (Oct. 12, 2008), http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/615&format=HTML&aged=0&language=EN.

the location of investments (and/or the geographic distribution of restructuring measures in another case) could not be regarded as compatible with Treaty rules. After intensive discussion between the Commission and the French authorities, France committed itself to avoiding any conditions contrary to the Single Market rules. This approach has been maintained in all other cases, in particular with regard to the German plans in relation to Opel.[6]

Within a mere couple of weeks from the outbreak of the crisis, it became obvious that existing state aid rules were not suitable for dealing effectively with the problems facing financial markets. The Commission, therefore, proceeded to adopt the following new guidelines:

- application of State Aid Rules to Measures Taken in Relation to Financial Institutions in the Context of the Current Global Financial Crisis[7];
- Recapitalisation of Financial Institutions in the Current Financial Crisis: Limitation of Aid to the Minimum Necessary and Safeguards against Undue Distortions of Competition[8];
- Treatment of Impaired Assets in the Community Banking Sector[9];
- Return to Viability and the Assessment of Restructuring Measures in the Financial Sector in the Current Crisis Under the State Aid

---

[6] Press Release, European Commission, State Aid: Commissioner Kroes Expresses Concerns that New Opel Aid is Conditional on Choice of Magna/ Sberbank (Oct. 16, 2009), http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/460&format=HTML&aged=0&language=EN&guiLanguage=en.

[7] Communication from the Commission, Application of State Aid Rules to Measures Taken in Relation to Financial Institutions in the Context of the Current Global Financial Crisis, 2008 O.J. (C 270) 8 [hereinafter Application of State Aid Rules].

[8] Communication from the Commission, Recapitalisation of Financial Institutions in the Current Financial Crisis: Limitation of the Aid to the Minimum Necessary and Safeguards against Undue Distortions of Competition, 2009 O.J. (C 10) 2 [hereinafter Recapitalisation of Financial Institutions].

[9] Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, 2009 O.J. (C 72) 1.

Rules (Restructuring Communication for Financial Institutions)[10]; and

- A Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis.[11]

The purpose of this article is to assess the application of the new rules by the Member States and the Commission. There is no doubt that these rules have not been strict. Member States have been allowed to grant large but not unlimited amounts of aid. However, they have been prevented from discriminating in favor of their national banks. They have also been required to submit realistic restructuring plans and compensate competitors to the extent possible for distortions caused by aid. The new rules and practice of the Commission so far have reflected the exceptional nature and unprecedented magnitude of the financial crisis. What is not possible to assess at the time of writing of this article is how quickly those rules will be withdrawn. Their phasing out is part of the "exit" strategy of the Commission—and other EU institutions such as the European Central Bank—and will very much depend on how quickly the European economy recovers.

The article is structured as follows. The next section summarizes the main points of the new rules. We then examine in detail a number of landmark cases and conclude with an assessment of how the Commission has interpreted and applied the new rules.

II. THE NEW STATE AID RULES

As a part of the European Economic Recovery Plan announced in November 2008, the European Commission adopted a Temporary

[10] Commission Communication on the Return to Viability and the Assessment of Restructuring Measures in the Financial Sector in the Current Crisis under the State Aid Rules, 2009 O.J. (C 195) 9 [hereinafter Restructuring Communication for Financial Institutions].

[11] Communication from the European Commission, Temporary Community Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis, 2009 O.J. (C16 1), as amended, Feb. 25, 2009, Oct. 28, 2009, and Dec. 2009, http://ec.europa.eu/competition/state_aid/legislation/temp_framework_en.pdf.

Framework[12] providing additional means of tackling the effects of the credit squeeze on the real economy. The Temporary Framework allowed Member States to grant aid under existing instruments for all sectors of the economy through higher limits on grants, credit guarantees, risk capital, and loans. It also introduced a number of temporary measures that may be granted by Member States until the end of 2010, including:

- a lump sum of aid up to € 500,000 per company for the next two years, for relief from current difficulties;
- state guarantees for loans at reduced premiums;
- subsidized loans, in particular for the production of green products (meeting environmental protection standards early or going beyond such standards);
- risk capital aid up to € 2.5 million per Small and Medium Enterprise per year (instead of the current € 1.5 million) in cases where at least thirty percent (instead of the current fifty percent) of the investment cost comes from private investors.

An amendment of the Temporary Framework adopted on February 25, 2009, introduced the obligation of the Member States to show that the state aid measures notified to the Commission under the Temporary Framework are necessary, appropriate and proportionate to remedy a serious disturbance in the economy of the Member State concerned and that all the conditions are fully respected.[13] Based on Member States' reports and depending on whether the crisis continues, the Commission will evaluate whether the measures should be maintained beyond 2010.

In addition to the Temporary Framework, the Commission has adopted a Communication on the Application of State Aid Rules to Measures Taken in Relation to Financial Institutions in the Context of

---

[12] Communication from the European Commission, Temporary Community Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis, 2009 O.J. (C 16) 1–9, http://ec.europa.eu/competition/state_aid/legislation/temp_framework_en.pdf.

[13] Communication from the Commission, Amendment of the Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis (Feb. 25, 2009), http://ec.europa.eu/competition/state_aid/legislation/atf_en.pdf.

the Global Financial Crisis (the Banking Communication)[14] and a Communication on the Recapitalisation of Financial Institutions (the Recapitalisation Communication).[15]

The Banking Communication gives guidance on the application of state aid rules to state support schemes and individual assistance for financial institutions in the crisis. Support schemes can be approved by the Commission in an accelerated procedure if they fulfill conditions that guarantee that they are well-targeted and proportionate to the objective of stabilizing financial markets and contain certain safeguards against unnecessary negative effects on competition (e.g., nondiscriminatory access, clear definition and limited scope, and appropriate contribution of the private sector). The document introduces behavioral constraints ensuring that beneficiary financial institutions do not engage in aggressive expansion against the background of the guarantee to the detriment of competitors not covered by such protection.

Up to the date of the publication of the Recapitalisation Communication, the Commission had approved recapitalization schemes in three Member States,[16] as well as individual recapitalization measures[17] based on the Banking Communication. However, the latter document proved insufficient, as many countries envisaged the recapitalization of banks not primarily as a rescue measure, but rather to ensure lending to the real economy. Therefore, the Commission adopted the Recapitalisation Communication. The objective of the Recapitalisation Communication is the restoration of the financial stability of the banks, ensuring lending to the real economy and avoiding the systemic risk of possible insolvencies. The

---

[14] Application of State Aid Rules, *supra* note 7, at 8–14.

[15] Recapitalisation of Financial Institutions, *supra* note 8, at 2–10.

[16] Case N507/2008, Financial Support Measures to the Banking Industry in the U.K., 2008 O.J. (C 290); Case N512/2008, German Banks Rescue Scheme, 2008 O.J. (C 293); and Case N560/2008, Support Measures for the Credit Institutions in Greece, 2008 O.J. (C 125).

[17] Case N528/2008, Participatie in het Kernkapitaal van ING, 2008 O.J. (C 328), and Case NN68/2008, Public Support Measures to JSC Parex Banka, 2009 O.J. (C 147).

Commission pointed out that state interventions must be proportional and temporary and must distinguish between fundamentally sound and less-well-performing banks. The document details the principles governing the different types of recapitalization, i.e., recapitalization at current market rates and the temporary recapitalization of fundamentally sound banks in order to foster financial stability and lending to the real economy.

In July 2009, the Commission issued the Restructuring Communication for Financial Institutions.[18] The Restructuring Communication for Financial Institutions outlines how the competition rules will be applied to support financial stability, as the return of banks to viability is the best guarantee for stability and for their sustained ability to lend to the economy. The approach is based on three principles:

- aided banks must be made viable in the long term without further state support;
- the banks and their owners must carry a fair burden of the restructuring costs; and
- measures must be taken to limit distortions of competition in the Internal Market.

The criteria for determining the existence of the long-term viability of a bank are presented in detail. If a return to long-term viability is not possible, a winding up must be considered. The Restructuring Communication for Financial Institutions will remain in force until December 31, 2010.

III. APPLICATION OF THE SPECIAL STATE AID RULES

On January 26, 2010, the Commission published an Overview of National Measures Adopted as a Response to the Financial/Economic Crisis.[19] The document shows the total reported amount of state aid in various forms for financial institutions. By the end of 2009 it had

---

[18] Restructuring Communication for Financial Institutions, *supra* note 10, at 9–20.

[19] Press Release, European Commission, State Aid: Overview of National Measures Adopted as a Response to the Financial/Economic Crisis (Jan. 26, 2010), http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/13.

reached a staggering € 3,630 billion. It is worth noting that of a total of eighty-five measures, seventy-nine have been approved with no objections and only six have been approved conditionally. However, there were nine additional measures about which the Commission had concerns, and as of January 2010 they were still under investigation. Even if the number of decisions adopted by the Commission between 2008 and 2010 and the number of cases of financial institutions currently under formal investigation are combined to give a grand total of ninety-four measures, the Commission will have approved unconditionally approximately eighty-four percent (seventy-nine out of ninety-four) of the national measures to combat the financial crisis.

The Overview of National Measures also contains data on the number and type of measures adopted by each Member State to support the real economy. Of a grand total of seventy-one measures, the Commission has investigated only one.[20]

These statistics raise a fundamental question: Has state aid control become too permissive as a result of the financial crisis? Certainly the outcome of the Commission's assessment of each notified case is a combination of two factors: (1) the requirements laid down by Commission guidelines and (2) the contents of the measures that are formulated and notified by the Member States.

There is no doubt that the special rules for the financial services sector are quite permissive. The mere fact that they exist at all signifies the intention of the Commission to allow aid for that particular sector. In addition, the Commission has been willing to apply laxer rules in view of the gravity of the situation in that sector. For example, and as will be shown in the two case studies below, banks that receive public funds for restructuring may not be required to undertake divestments to the same extent as other undertakings that received aid for the same purpose in the past.

With regard to the real economy, some of the aid that is allowed by the Temporary Framework is operating aid that is normally not

---

[20] Case C 36/2009, Temporary Framework Guarantee in Favour of Oltchim, 2010 O.J. (C 19) (Romania).

authorized. But here, again, the avowed intention is not to induce beneficiaries to undertake new investment but to release liquidity so that they will be able to cover their day-to-day costs and remain in business.

Member States have been quite adept in designing their national measures to comply with the requirements of the new rules. The vast majority of their notifications have been approved by the Commission without any objection. Given the fact that the new rules are very accommodating, one wonders why the Commission expressed doubts about the compatibility of even a small minority of measures with the Internal Market. Again as shown by the case studies below, the answer is likely to be that certain banks found themselves in such complex situations and faced such difficult problems that the solutions they devised in cooperation with Member State authorities did not fit well into any set of EU rules. Therefore, it was perhaps unavoidable that the Commission would have concerns and would want to launch formal investigations.

IV. CASE STUDIES

The cases reviewed below demonstrate two important aspects of the application of state aid rules during the financial crisis. First, the Commission has been willing to adjust the rules to enable Member States to address the crisis speedily and effectively. Not only did the Commission change the legal basis for assessing many of the emergency measures put in place by the Member States (i.e., from Article 107(3)(c) to Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU)), but, probably more importantly, it also relaxed the existing rules to give more leeway to the Member States and the beneficiaries of state aid. For example, it did not insist that beneficiary banks make large contributions to their own restructuring plans or that they sell assets immediately, as that would further depress their prices.

Second, the complexity of the problems facing financial institutions meant that Member States had a difficult task in designing appropriate measures. Consequently, the Commission's task of assessing the various schemes was equally difficult. In many

cases such as *Sachsen LB*,[21] *WestLB*,[22] *Dexia*,[23] and *Fortis*,[24] the issue was not just recapitalization. The real problem was to remove nonperforming assets from the balance sheets of the banks to enable them to start lending again. It was not always easy to identify all the beneficiaries and calculate the amount of aid in the various state guarantees and capital injections.

A. Sachsen LB

This case involved a package of two different measures in favor of Sachsen LB.[25] First, a number of German Landesbanken agreed to offer liquidity to Sachsen LB through a commitment to buy the commercial paper that was to be issued by one of its subsidiaries. The commitment would come into effect only if the commercial paper could not be placed on the market. The subsidiary in question functioned as a special conduit for the trading of asset-backed securities and found itself in trouble when the American subprime mortgage market collapsed. Second, Sachsen LB was to be sold to Landesbank of Baden-Wurttemberg (LBBW). The sale was accompanied by a guarantee of € 2.75 billion to cover potential losses. In addition, Sachsen LB was to be restructured. The restructuring plan was produced by LBBW.

The Commission regarded the liquidity measure as state aid for the following reasons. First, the Landesbanken who committed themselves to buying the commercial paper of Sachsen LB's subsidiary were part of the state as they were closely affiliated with public authorities. Second, the market for that kind of commercial paper had dried up. Since no private investor would grant such liquidity, the Commission concluded that there was an advantage for Sachsen LB.

---

[21] Case C 9/2008, Sachsen LB, 2008 O.J. (C 71).

[22] Case NN25/2008, West LB, 2008 O.J. (C 189).

[23] Case C 9/2009, Dexia, 2009 O.J. (C 181).

[24] Case C 11/2009, Fortis, 2010 O.J. (C 95).

[25] *Sachsen LB*, 2008 O.J. (C 71).

The sale of Sachsen LB to LBBW could involve state aid in two respects: first, to the buyer, LBBW, if too low a sales price was accepted, and, second, to Sachsen LB, if liquidation would have been less costly than agreeing to go through with the sale. While an open, transparent, and unconditional sale signifies the absence of state aid, it does not follow that a negotiated sale necessarily contains state aid.

The Commission considered that the sale price paid by LBBW corresponded to the market value of Sachsen LB and that the State of Saxony conducted negotiations with several potential buyers and in the end decided to sell Sachsen LB to LBBW because it made the best offer. The Commission found no reason to suspect that Sachsen LB was sold at a price below its market value. Its conclusion was that there was no state aid to LBBW. However, it also found that there was state aid to Sachsen LB because it would have been cheaper for the State of Saxony to liquidate the bank instead of selling it with the guarantee.

The next step in the Commission's analysis was its assessment of the compatibility of the aid with the Internal Market. It rejected German arguments for the aid to be declared compatible on the basis of Article 107(3)(b). The Commission decided that

> a serious economic disruption is not remedied by an aid measure that "resolve[s] the problems of a single recipient [. . .], as opposed to the acute problems facing all operators in the industry." Also in all cases of banks in difficulty, the Commission has to date not relied on this provision of the [EU] Treaty.[26]

It went on to observe that

> the investigation has confirmed the Commission's observation that the problems of Sachsen LB are due to company-specific events. Moreover, the information provided by the German authorities has not convinced the Commission that the systemic effects that might have resulted from a bankruptcy of Sachsen LB could have reached a size constituting "a serious disturbance in the economy" of Germany within the meaning of Article 107(3)(b) TFEU. Therefore, the present case must be regarded as based on individual problems, and thus requires tailor-made remedies, which can be addressed under the rules on firms in difficulty. The Commission therefore finds no grounds for compatibility of the measures on the basis of Article 107(3)(b) TFEU.[27]

---

[26] *Id*. at ¶ 7.2.1(94).

[27] *Id*. ¶ 7.2.1(95) (footnote omitted).

These two paragraphs from the Commission's decision reveal the extent of the change in the Commission's attitude that occurred a mere two months later. In the first instances of support to financial institutions in late 2007 and early 2008, such as the rescue of Northern Rock, the Commission insisted on relying on Article 107(3)(c) TFEU and the Community Guidelines on State Aid for Rescue and Restructuring Firms in Difficulty (Rescue & Restructuring Guidelines).[28] However, as of September 2008, it changed tack and recognized the wider possibilities offered by Article 107(3)(b) TFEU. While Article 107(3)(c) TFEU requires the "development" of certain economic activities or sectors, Article 107(3)(b) TFEU allows for aid that is neither for rescuing or restructuring, nor for development. For example, state guarantees to creditors of banks or state guarantees for the debt held by banks would more naturally fall under Article 107(3)(b) TFEU rather than Article 107(3)(c) TFEU.

In applying the conditions of the Rescue & Restructuring Guidelines, the Commission had to determine whether the bank would return to viability within a reasonable period of time (normally within five years), whether the bank itself made a significant contribution to its restructuring, and whether there were sufficient compensatory measures to reduce distortions to competition.

The Commission was satisfied that the restructuring plan addressed the source of the problems facing the bank and that Sachsen LB contributed more than 50% of the cost of restructuring through its own resources. With respect to the compensatory measures, as is normally the case with restructuring aid, the Commission asked for divestment. Sachsen LB sold a number of foreign subsidiaries and withdrew from certain international activities, mainly in real estate. It was probably quite natural for Sachsen LB to focus on its own domestic market where it had stronger presence.

B. WestLB

The notified measure involved the restructuring and sale of WestLB.[29] The sale would be effected through an open, transparent,

[28] Communication from the Commission, Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, 2004 O.J. (C 244).

[29] Case C 43/2008 (ex N 390/2008), West LB, 2009 O.J. (L 345).

and nondiscriminatory procedure. In order to facilitate the sale, the restructuring plan foresaw cost cutting and downsizing through divestiture and closure of operations in certain locations. WestLB would close down five of its eleven locations in Germany and twenty-three of its thirty locations outside Germany. It would also abstain from external growth through mergers or acquisitions.

A significant aspect of the restructuring was the transfer of impaired assets with a nominal value of € 23 billion to a special purpose vehicle. This transfer would be accompanied by a guarantee of € 2 billion issued by the owners of WestLB and an additional guarantee of € 3 billion issued by the Land of North Rhine-Westphalia.

The Commission agreed with Germany that the guarantees constituted state aid. However, there was a significant difference of opinion with respect to the amount of aid. Given that the impaired assets of WestLB had hardly any market value and that, in view of WestLB's troubles, it was unlikely that any private investor would agree to provide a guarantee, the Commission concluded that the amount of state aid was equal to the total amount covered by the guarantee, i.e., € 5 billion.

Once it established that the measure contained state aid, the next step in its analysis was the assessment of the compatibility of the aid with the Internal Market. In the opening of the formal investigation, the Commission declared that Article 107(3)(c) TFEU was the legal basis for the compatibility assessment of the aid measure in question. However, in the meantime the Commission acknowledged that there was a threat of serious disturbance in the German economy and that measures supporting banks were apt to remedy that threat. Therefore it accepted that the legal basis for the assessment of the aid measure was Article 107(3)(b) TFEU.

The Commission then explained how it would assess aid granted to banks. Such aid would be

> assessed in line with the principles of the Rescue & Restructuring Guidelines taking into consideration the particular features of the systemic crisis in the financial markets. The [Rescue & Restructuring] Guidelines require that state aid is accompanied by thorough restructuring to

> restore viability, by an adequate contribution of the beneficiary to the restructuring costs and by measures to remedy the potential distortions of the competition. . . . However, the nature and the scale of the present crisis call for further specific elements related to the current market conditions to be taken into account. Therefore the principles of the [Rescue & Restructuring] Guidelines have to be modulated when applied to the restructuring of WestLB in the present crisis. Special attention should be given to the rules set out in the [Rescue & Restructuring] Guidelines for the own contribution of the beneficiary. Given the fact that the external financing for WestLB has [. . .] [sic], the 50% target set in [Rescue & Restructuring] Guidelines appears very difficult to achieve, the Commission accepts that it may during the systemic crisis in the financial markets not be appropriate to request a precise quantification of the own contribution. Furthermore the design and implementation of measures to limit distortion of competition may also need to be reconsidered in so far as WestLB may need more time for their implementation due to market circumstances.[30]

With respect to the return of WestLB to viability, the Commission observed that one of the reasons for WestLB's problems was the ownership structure of the bank and the different interests of the respective owners. Therefore the Commission considered that the change of ownership, to be achieved prior to the end of 2011 in the form of an open, transparent, and nondiscriminating tender procedure was a key element of solving the difficulties. It made the sale of the bank a condition for the approval of the state aid.

It was also satisfied that the planned cost cutting, the removal of impaired assets from the balance sheet of the bank, the sale of nearly all its subsidiaries, and the closure of the majority of its locations would restore its viability. These actions would eliminate loss-producing and noncore activities and would refocus the bank on its core customers. In addition, these measures would reduce any distortions of competition as they would limit the presence of the bank in various markets. Lastly and as mentioned above, the Commission did not require WestLB to make an own contribution of at least fifty percent of restructuring costs, as required by the Rescue & Restructuring Guidelines.

---

[30] *Id.* ¶ 63.

C. Commerzbank[31]

This measure was within the already authorized Special Financial Market Stabilisation Fund (the Fund). However, due to its magnitude, Germany chose to notify it individually for reasons of legal certainty.

As a result of its recent acquisition of Dresdner Bank, Commerzbank is the second largest Germany bank with universal banking operations. Because some of its assets were not performing due to the financial crisis, Commerzbank requested equity support from the Fund. This support, which was provided in different tranches, amounted, by the time of notification, to € 18.2 billion. The Fund had also extended a guarantee in the amount of € 15 billion.

Since in this case there was no disagreement between the Commission and Germany on whether the measure constitutes state aid, the primary issue under consideration was the compatibility of the aid and its impact on competition. As with other cases, the assessment of compatibility was done on the basis of Article 107(3)(b) and the Rescue & Restructuring Guidelines. Again as in other cases, the Commission accepted that the Rescue & Restructuring Guidelines had to be adjusted appropriately, especially with respect to the rules for "own contribution." Given the fact that it was almost impossible to obtain contributions from investors in the market and that the requirement of an own contribution of fifty percent was unrealistic, the Commission accepted that during the financial crisis it could be excessively harsh to request that the own contribution represent a predefined proportion of the costs of restructuring. Furthermore prevailing market circumstances might necessitate the redesign of measures to limit distortion of competition and the granting to Commerzbank of more time for their implementation.

After examining the restructuring plan of Commerzbank and satisfying itself that it was based on realistic assumptions and risks and that it took into account several scenarios, the Commission concluded that the plan was capable of returning the bank to long-term viability.

The Commission then turned its attention to the issue of whether the aid was the minimum necessary and whether the own

---

[31] Case N 244/2009, Commerzbank, 2009 O.J. (C 147).

contribution was sufficient. It found that shareholders could not be asked to contribute more and that the bank, by selling assets, was making a substantial contribution from its own funds.

Finally, the Commission had to consider the impact on competition. To offset any negative effects on competition, Germany and Commerzbank proposed a series of measures covering the disposal of shareholdings and other assets, limits on future growth (including in core business areas), and restrictions regarding Commerzbank's behavior in terms of competition and market entry.

In particular, Germany gave the Commission an undertaking to ensure that Commerzbank would:

- reduce its balance sheet from 1,100 billion to 600 billion;
- refrain from acquiring any finance institutions or other businesses in potential competition with Commerzbank until 2012;
- not offer more favorable terms for its products and services than its three lowest-priced competitors;
- not use the granting of the aid or any advantages over competitors arising in any way out of the aid for advertising purposes;
- take into account the credit requirements of businesses, especially SMEs, by offering generally accepted market terms;
- follow a prudent, sound business policy geared toward sustainability while implementing the planned measures; and
- review its internal incentive schemes and take steps to ensure that they do not encourage unreasonable risk-taking.

On the basis of these commitments, the Commission approved the measure as compatible with the Internal Market.

V. ASSESSMENT

A. The choice of the legal basis for state intervention to counter the financial crisis

When faced with the decision on the role of state aid control during the crisis, the Commission, through the voice of Commissioner Neelie Kroes, repeatedly stressed that Directorate-General for Competition would act as "part of the solution, not part of the problem."[32] It was

[32] Press Release, European Commission, *supra* note 4.

pragmatic to adapt state aid rules to the new circumstances, instead of completely putting them aside for the time of the crisis. A more restrictive approach and a rigorous application of the state aid rules would have prevented Member States from acting quickly and, therefore, would have led Member States to ignore them.[33] Indeed, this latter scenario would have raised enormous problems during the period after the crisis, in which Member States will return to the original regime of state aid.

Until September 2008, the Commission adhered to the then-existing state aid rules (mainly the Rescue & Restructuring Guidelines) in assessing the compatibility of the individual aid measures. The Commission argued that there was a risk of "systemic failure," which would allow exceptional treatment. An application of Article 107(3)(b) was therefore explicitly refused.[34] Later on, after the collapse of Lehman Brothers, the Commission changed its approach and applied the provisions regarding the aid for the remedy of a serious disturbance in the economy of a Member State.

In the words of Commission President José Manuel Barroso, "exceptional times call for exceptional measures."[35] But even these exceptional measures taken by the Commission had to be justified within the logic of the general state aid law system. Until 2009, it was unprecedented for the Commission to authorize state aid on the basis of Article 107(3)(b), so there was little guidance on the definition of "serious disturbance." Only once in the previous twenty years had the Commission approved that kind of aid. The case concerned Greece, and the reasoning of the Commission decision approving the Greek measures is revealing:

> The economic situation in Greece had been constantly deteriorating up to October 1985. Both internal and external imbalances had created a difficult situation which demanded firm policy measures. In particular the Greek

---

[33] Thomas Jaeger, *How Much Flexibility is Needed? Commission Crisis Management Revisited*, 1 EUR. STATE AID L.Q. 3 (2009).

[34] Case NN 25/2008, WestLB, 2008 O.J. (C 189) 3, ¶ 41.

[35] José Manuel Durão Barroso, President of the European Commission, Creating a European Response to a Global Crisis, Speech to the European Parliament of Enterprises 2 (Oct. 14, 2008).

> authorities were confronted with very serious external payments and pressures on the exchange rate in September 1985. Thus, on 11 October 1985, they introduced an economic stabilization and recovery programme. This programme included measures to devalue the drachma by 15%; the introduction of a non-interest-bearing import deposit scheme; a complete overhaul of wage indexation; a major fiscal adjustment; a tightening of credit and monetary policy. The European Community recognized the implications of the situation in Greece by agreeing to measures which would normally be regarded as infringements of the EEC Treaty and applied the measures provided for pursuant to Article 98 (now 108) of the Treaty.[36]

Whereas the overall necessity of state intervention to limit the effects of the financial crisis was not disputed, there were different opinions as to the appropriate legal basis for such interventions. While some authors were very much in favor of using Article 107(3)(b) as a legal basis,[37] others suggested that recourse to the existing legal framework would have been more appropriate.[38] The latter opinion raises a number of issues.

First, Article 107(3)(b) had never been used in the past for one operator or one sector,[39] but only when the entire economy was affected. At the beginning of the financial crisis, the application of this exemption was rejected even in the Northern Rock case. Second, the Rescue & Restructuring Guidelines could have applied in this scenario. Third, the impact of the GBER might be largely negated by these exemptions.

These arguments notwithstanding, it appears with the benefit of hindsight that the recourse to Article 107(3)(b) was pragmatic, and the decision to allow Member States to design aid schemes providing for

---

[36] Decision 88/167, Aid to Greek Industry, 1988 O.J. (L 76) part V.

[37] Christian Koenig, *Instant State Aid Law in Financial Crisis, State of Emergency or Turmoil*, 4 EUR. STATE AID L.Q. 627f (2008); Paris Anestis & Sarah Jordan, *The Handling of State Aid During the Financial Crisis: An Efficient Response or Trouble for the Future?*, GLOBAL COMPETITION REV., Sept. 2009, *available at* http://www.globalcompetitionreview.com/reviews/19/sections/67/chapters/740/state-aid/.

[38] Rose M. D'Sa, *"Instant" State Aid Law in a Financial Crisis—A U-Turn?*, 2 EUR. STATE AID L.Q. 139 (2009).

[39] *Id*. at 142.

multiple awards of individual aid relieved the Commission from the burden of assessing every individual case.

B. *Ad hoc and/or ineffective policy making?*

The emergency state aid rules and procedures have come under scrutiny in the literature and have been criticized for several reasons.[40] The most common concerns have been the following.

1. ARE THE NEW RULES LESS STRICT? The answer is certainly in the affirmative. Undoubtedly, however, neither financial markets nor the real economy could function without state support in the form of guarantees, capital injections, and cheap loans. Some authors also argued that in the absence of general economic measures concerning the economic and monetary policy adopted by the Council of Finance Ministers of the European Union the possibilities of control given to the European Commission were limited to an incidental control of particular sectors and only to individual or ad hoc measures in the field of state aid and merger control.[41]

2. IS THE COMMISSION'S CONTROL ONLY CURSORY? The shortening of the decision making process and the possibility that a decision might be issued within twenty-four hours, compared to the rather long procedural burdens of the normal procedure, could lead to the conclusion that investigations can only be superficial. However, the answer to the question is mostly negative. It is true that the Commission has approved many schemes in record time, but where it had doubts it did not hesitate to open formal investigations, ask Member States to justify their measures, and impose conditions in order to approve them. A large number of measures have been approved quickly simply because the new rules have not been too difficult for Member States to follow. The important role given to the prenotification talks has certainly contributed to a swift authorization process. However, in a number of cases the Commission has been willing to accept perhaps too readily

---

[40] Philipp Werner & Martina Maier, *Procedure in Crisis? Overview and Assessment of the Commission's State Aid Procedure during the Current Crisis*, 2 EUR. STATE AID L.Q. 177 (2009); Anestis & Jordan, *supra* note 37.

[41] Editorial Comments, *Weathering Through the Credit Crisis: Is the Community Equipped to Deal with It?*, 46 COMMON MKT. L. REV. 3 (2009).

that proposed measures were necessary to remedy a serious disturbance in the economy of the Member State that proposed them. (Examples include any of the measures approved under the Temporary Framework.) The texts of the decisions do not reveal that the Member States concerned had to submit any extensive or detailed analysis of the expected impact of their measures.

3. IS THERE NOW LESS LEGAL CERTAINTY? As shown by the case studies above, the Commission has shown considerable flexibility in deviating from the requirements of the Rescue & Restructuring Guidelines. But precisely because it is not clear under which conditions such deviation is possible and what kind of proof the Commission expects to receive, and because required evidence for the systemic impact on the economy is not well defined, it is not possible to know beforehand what the Commission may or may not authorize. Some authors even argued that the operative parts of some decisions contain significant "accumulations of empty formulas and quasi-circular reasoning."[42] Effective numbers or hard data on the scale and effects of the measures in question, which could have provided further guidance as to the general criteria of compatibility, were missing.

4. IS THERE NOW LESS PROTECTION FOR COMPETITORS? The partial reasoning of the decisions and the (lack of) transparency of the examination affect not only the principle of legal certainty, but also raise questions on the right of competitors to contest the approved aid measures. Certainly, some competitors have chosen to challenge Commission decisions authorizing state aid.

5. WHEN WILL THE NEW RULES BE TERMINATED? Some of the new rules have explicit expiry dates. However, nothing prevents the Commission from extending their period of validity for as long as conditions in the EU have not improved significantly. However, Member States still have to design their measures to fall within the periods of validity provided by the current rules.

To conclude, the new system has advantages in preserving the consistency of the general system of state aid control, by adapting the strict rules of state aid to the need to act swiftly in times of a financial

[42] Jaeger, *supra* note 33, at 4. *See id*. for examples.

crisis. To summarize so far, the Commission appears to have done reasonably well in view of the magnitude of the problem and the urgency of the measures that were adopted by the Member States.

C. *Are state aid rules a threat to the integrity of the Internal Market?*

The application of state aid rules during the financial crisis instigated a complaint voiced primarily by some German officials.[43] The Commission was criticized for its handling of certain cases of aid to financial institutions because the beneficiaries were allegedly forced to withdraw from other Member States, which, it was claimed, was damaging to the integrity of the Internal Market.

First of all, it is true that the Rescue & Restructuring Guidelines require that the recipients of aid compensate their competitors.[44] This requirement is intended to minimize the distortive effect of aid. The typical compensatory measure is divestment, closure of capacity, or withdrawal from certain markets or activities. Therefore, there was nothing unusual in the Commission's demands.

Second, the Internal Market concept has been defined as an area without barriers or frontiers. The rules of the Internal Market are phrased in the form of prohibitions. They stipulate the removal of barriers but not the presence of companies in the markets of other Member States. It cannot be expected that in an integrated market all companies will be present in all locations. Their choice of location depends on their competitiveness and business model. In the same way that companies choose not to locate in certain areas within a country, they also choose not to operate in all countries of the EU.

Third, getting rid of loss-producing assets, disengaging from marginal activities, and focusing on core businesses and customers

[43] *See Weber Hits Out at Brussels*, Financial Times, Apr. 22, 2009, *available at* http://www.ft.com/cms/s/0/cf80892c-2ed7-11de-b7d3-00144feabdc0.html ("Europe's competition authorities risk throwing the continent's economic integration into reverse with their response to the financial crisis, [Axel Weber] the head of Germany's Bundesbank, has warned in rare public criticism of Brussels.").

[44] D'Sa, *supra* note 38, at 139.

make companies stronger. This kind of restructuring intensifies competition and in the longer term enables companies to offer better products and to enter new markets. The viability of the Internal Market very much depends on the strength of competition.

Fourth, the compensatory measures included in restructuring plans are defined first by the beneficiaries themselves and then proposed by the corresponding Member States. The Commission does not request that companies exit the markets of other countries. However, the Commission does expect to see exit from unprofitable markets (so that companies can return to viability) and substantial limitation of the activities of aid recipients so that their competitors are disadvantaged to the smallest possible extent. Therefore, it is unfair to accuse the Commission of acting in a way that undermined the cohesion of the Internal Market.

VI. CONCLUSION

State aid policy has played an important role during the financial crisis. It has allowed Member States to support, initially, financial institutions and then the real economy, while at the same time striving to prevent excessive distortion to competition and disruption to the flow of resources between Member States.

At this stage it is not possible to know whether indeed the distortion has been kept to the minimum. No cost-benefit analysis has been carried out so far. However, it is possible to surmise with a fair degree of confidence that certain forms of distortion have been avoided. Member States have not been allowed to discriminate in favor of their own banks. They have not been allowed to grant unlimited amounts of aid. They have been required to submit realistic restructuring plans, which in some cases have led to the sale of the beneficiaries or even to their closure.[45]

The more difficult question is whether the permitted amount of aid was excessive. There is no doubt that the special rules that were issued by the Commission were accommodating. Given that similar

---

[45] *See, e.g.*, Case NN 39/2008, Aid for Liquidation of Roskilde Bank (Denmark), 2009 O.J. (C 12).

and even more generous measures have been adopted by countries outside the European Union, it is not unreasonable to conclude that the special rules merely reflected the exceptional nature and unprecedented magnitude of the crisis.

The question for the near future is how quickly the special rules will be phased out. The Temporary Framework for aid to the real economy expires at the end of 2010. It is not yet clear what the "exit" strategy is likely to be for aid to financial institutions.

Copyright of Antitrust Bulletin is the property of Federal Legal Publications Inc. and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.