V

(Announcements)

PROCEDURES RELATING TO THE IMPLEMENTATION OF THE COMPETITION POLICY

COMMISSION

STATE AID — UNITED KINGDOM

State aid C 55/07 (ex NN 63/07) — Crown guarantee to BT Pension Fund

Invitation to submit comments pursuant to Article 88(2) of the EC Treaty

(Text with EEA relevance)

(2008/C 15/04)

By means of the letter dated 28 November 2007 reproduced in the authentic language on the pages following this summary, the Commission notified the United Kingdom of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty on the exemption of BT plc and BT Pension Fund from the application of the minimum funding requirements laid down in the 1995 and 2004 Pension Acts for BT Pension Fund's pension liabilities covered by the 1984 Crown Guarantee and from the payment of the part of the levy to be paid to the Pension Protection Fund for the part of BT Pension Fund's liabilities covered by the 1984 Crown Guarantee.

The Commission decided not to raise any objections to the Crown Guarantee itself, as far as it covers BT's pension liabilities, as described in the letter following this summary.

Interested parties may submit their comments on the measures in respect of which the Commission is initiating the procedure within one month of the date of publication of this summary and the following letter, to:

European Commission
Directorate-General for Competition
State aid registry
SPA-3 6/5
B-1049 Brussels
Fax (32-2) 296 12 42

These comments will be communicated to the United Kingdom. Confidential treatment of the identity of the interested party submitting the comments may be requested in writing, stating the reasons for the request.

TEXT OF SUMMARY

PROCEDURE

The measures on which the Commission has opened the procedure laid down in Article 88(2) were brought to the Commission's attention by a complainant or in correspondence with the United Kingdom authorities following this complaint. None of these measures have been notified to the Commission.

DESCRIPTION OF THE MEASURES

Before the privatisation of British Telecommunication, later BT plc ('BT'), its employees enjoyed the benefits of a pension scheme which was transferred to the privatised entity. BT's liabilities to BT Pension Scheme ('BTPS') fall under two heads: its regular employment contributions and additional contributions that BT may be required to make under a recovery plan to return it to full funding. Under the result of the most recent actuary valuations, BTPS' liabilities amount to GBP 37,8 billion while its assets amount to GBP 34,4 billion. According to the recovery plan, BT must finance this deficit by 2015.

Under the 1984 Telecommunications Act, the UK government granted a Crown Guarantee covering the liabilities transferred by the government to BT. The scope of the present decision is limited to the effects of this guarantee on BT's pension liabilities. According to this Crown guarantee, in case BT is insolvent, and only in respect of the BT's employees at the time of privatisation, the State will ensure the payment of the pensions if there are not enough assets in the fund. The aim was to reassure these employees who, until then, enjoyed State protection for their pensions.

The 1995 Pension Act introduced minimum funding requirements for pension funds. However, the legislation exempted pension funds enjoying a Crown guarantee, like BTPS from the application of these minimum funding requirements. These minimum funding requirements were altered by the 2004 Pension Act, with once again an exemption for pension funds enjoying a Crown guarantee.

The 2004 Pension Act established a Pension Protection Fund ('PPF'). Its function is to pay compensation to member of eligible pension schemes in case of insolvency of the sponsor employers, and when the assets of the scheme are insufficient to cover all the pension liabilities. The PPF is essentially financed by a levy which is paid by the pension funds. Again, pension funds with a Crown guarantee are exempted from the payment of this levy.

ASSESSMENT OF THE MEASURES

Existence of aid

On the basis of the information available, the Commission considers that the Crown guarantee in itself, as far as it covers BT's pension liabilities has not conferred any advantage to BT until the 1995 and 2004 Pension Act which significantly changed its effects. Until these dates, and as far as pension liabilities are concerned, the Crown guarantee's only beneficiaries are the members of the BTPS.

However, in 1995, the exemption from application of minimum funding requirements to BT's pension liabilities covered by the Crown Guarantee may have conferred an advantage to BT since it did not have to finance its pension fund's deficit under the more stringent conditions imposed by the 1995 Pension Act. Such an advantage is likely to constitute State aid. The same reasoning would apply to the funding requirements introduced by the 2004 Pension Act.

The UK authorities claim that BT financed its deficit independently from the Crown guarantee. They have not explained why BT did not avail itself of this exemption nor why its pension fund still have a significant deficit if BT respected the funding requirements laid down in the 1995 Pension Act. As a result, the Commission has doubts that BT did not receive an aid in the form of an exemption from the application of the minimum funding requirements to its guaranteed pension liabilities.

Furthermore, in 2004, the exemption from the payment of a levy to the PPF of the levy corresponding to the BTPS pension liabilities covered by the Crown guarantee is also likely to constitute an advantage, and therefore State aid, to BT.

BTPS and the UK authorities consider that there is no advantage. First, they argue that since the levy reflects the risk born by the pension scheme and since the section of the BTPS covered by the Crown guarantee cannot default, the fact that BTPS and therefore BT do not have to pay a levy for this section is justified by the logic of the system.

BTPS also argues that the guarantee was known by the shareholders when BT was privatised. Consequently, they paid a market price for it and no advantage was involved. They also argue that, in the case this exemption from the payment of part of the levy constitutes an advantage, it is more than compensated by the extra-liabilities borne by BT and BTPS. These extra liabilities are in particular enhanced redundancy terms, the deficit of the pension scheme inherited at the time of the privatisation, and the enhanced civil service benefits for the members of BTPS.

The Commission has doubts that these arguments can be accepted, and therefore that no advantage and no State aid in the form of an exemption from the full payment of the levy to the PPF by the BTPS and BT is involved.

Compatibility of aid

The only basis for compatibility for these measures, if they contain State aid, would at this stage appear to be Article 87(3)(c) of the Treaty. However, the measures do not appear to conform with any of the rules concerning the application of that sub-paragraph that the Commission has promulgated to date. If therefore State aid is involved, the Commission doubts whether these measures are compatible with the common market.

In accordance with Article 14 of Council Regulation (EC) No 659/1999, all unlawful aid can be subject to recovery from the recipient.

TEXT OF LETTER

'(1) The Commission wishes to inform the United Kingdom that, having examined the information supplied by your authorities on the aid measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

1. **PROCEDURAL ASPECTS**

(2) On 26 April 2006, one of BT's competitors, which requested confidentiality, lodged a complaint against the guarantee given by the Minister of the Crown ("Crown guarantee") which had been granted to BT. By e-mails dated 24 May 2006 and 22 June 2006, it provided further information to the Commission.

(3) By letter dated 18 May 2006, the Commission requested information to the UK authorities, which provided it by letter dated 18 July 2006.

(4) By letter dated 21 December 2006, the Commission requested further information. After an extension of the deadline, the UK authorities responded by letter dated 27 February 2007.

(5) On 26 March 2007, a meeting was held, at their request, with the lawyers representing the Trustees of the BT Pension Scheme ("BTPS"). They submitted further information by e-mail dated 10 May 2007.

(6) By letter dated 10 May 2007, the Commission requested information to the UK authorities. After an extension of the deadline and a meeting which took place on 11 June 2007, the UK authorities responded by letter dated 19 June 2007.

(7) By letter dated 3 August 2007, the Commission requested further information. After an extension of the deadline, the UK authorities responded by letter dated 3 October 2007.

2. DESCRIPTION OF THE MEASURES

2.1. **BT Pension Scheme**

(8) Until 1969, employees of the Post Office were civil servants. In that year, they became employees of the Post Office public corporation, which ended their status as members of the civil service. The Post Office was assigned general responsibility for the payment of staff pensions, with the establishment of the Post Office Staff Superannuation Scheme ("POSSS").

(9) By virtue of the British Telecommunications Act 1981, the telecommunications operation which had formerly formed part of the Post Office was transferred to a new public corporation, British Telecommunications. Certain employees were transferred to the new organisation, while keeping their status as employees of a public corporation. In 1983, the British Telecommunications Staff Superannuation Scheme ("BTSSS"), the terms of which were closely modelled on those of the POSSS, was established.

(10) The 1984 Telecommunications Act (the "1984 Act") provided for the privatisation of British Telecommunications, with the transfer of all its property, rights and liabilities (including the BTSSS) to BT plc. As from 31 March 1986, British Telecommunications plc ("BT") established a further pension scheme for new employees (the British Telecommunications plc New Pension Scheme, BTNPS). The BTSSS was closed to new members from that date. Both were merged and renamed BT Pension Scheme ("BTPS") in 1993.

(11) The investment objective of BTPS is to ensure that over the long term, the scheme will always have enough money to meet the cost of the pension benefits to be paid. BT's liabilities to BTPS fall under two heads: regular employment contributions and additional contributions that BT may be required to make under a recovery plan to return the BTPS to full funding where Scheme liabilities are higher than Scheme assets. The latter reflects a general requirement under BTPS rules for BT to make good any deficit disclosed by an actuarial valuation.

(12) Under these rules, the Scheme Actuary is required to make an actuarial valuation of the assets and the liabilities (i.e. future pension benefits and other costs and expenses) of the scheme at intervals not exceeding 3 years and report the position to BTPS' Trustees and to BT. BT will ensure the payment to BTPS of contributions that are necessary to repair any deficit identified by the valuation.

(13) The results of the most recent valuation were announced in December 2006 and disclosed accrued liabilities of GBP 37,8 billion and assets of GBP 34,4 billion (a deficit of GBP 3,4 billion). According to the recovery plan, fully financed by BT, the scheme should return to full funding by 2015: BT agreed to pay GBP 280 million per annum for ten years, which combined with investment returns, is anticipated to pay off the deficit. These yearly amounts come on top of BT's regular employer contributions to the scheme, which amounted to GBP 395 million in the financial year 2006/2007.

2.2. **The Crown guarantee**

(14) The Crown guarantee is laid down in Section 68 of the 1984 Act which reads as follows:

"(1) This Section applies where

(a) a resolution has been passed, in accordance with the [Insolvency Act 1986], for the voluntary winding up of the successor company, otherwise than merely for the purpose of reconstruction or amalgamation with another company; or

(b) without any such resolution having been passed beforehand, an order has been made for the winding up of the successor company by the court under that Act.

(2) The Secretary of State shall become liable on the commencement of the winding up to discharge any outstanding liability of the successor company which vested in that company by virtue of Section 60 above [1].

(…)

(4) Where the Secretary of State makes a payment to any person in discharge of what appears to him to be a liability imposed on him by this Section, he shall thereupon become a creditor of the successor company to the extent of the amount paid, his claim being treated for the purposes of the winding up as a claim in respect of the original liability."

(15) Section 68(2) was amended by the Communication Act of 2003 and now provides that "*the Secretary of State shall become liable on the commencement of the winding up to discharge any outstanding liability of the successor company for the payment of pensions which vested in that company by virtue of Section 60 above*" (emphasis added). While the Crown guarantee in its original version covered all liabilities of the corporation transferred to BT in 1984, it now only covers the pension liabilities transferred at that date.

[1] Section 60 specifies that all the property, rights and liabilities to which British Telecommunications was entitled or subject are transferred to the privatised entity.

(16) The scope of the present decision is limited to the effect of the Crown guarantee as far as it covers pension liabilities. This decision is without prejudice to the effects of the Crown guarantee on the other liabilities that were transferred to BT in 1984 and that were covered by the Crown Guarantee until the 2003 Communication Act.

(17) In so far as the pension liabilities are concerned, the Crown guarantee requires the UK government to discharge any liability of the public corporation for payments in respect of pensions transferred to BT, but only:

(i) if BT is insolvent and is being wound up;

(ii) in respect of employees who were members of the public corporation's employee pension scheme before 6 August 1984; and only

(iii) if the liability is wholly or partly outstanding at the beginning of the winding up.

(18) This means that the UK government will ensure payments in respect of pensions transferred to BT if the company becomes insolvent, the assets of BTPS are insufficient to cover its liabilities at the time of insolvency and only in favour of employees who were members of the public corporation pension scheme before the date of privatisation. Although the 1984 Act is not clear on this point, the UK authorities are of the opinion that the Crown guarantee is capable of covering not only the pension rights acquired by these employees before the privatisation but also those that they acquired after it.

(19) As concerns pension rights, the Crown guarantee was apparently provided in view of the concern of the public corporation's employees that they would no longer enjoy the comfort of State protection for their pension. They were in particular worried about what would happen if the privatised successor company were to become insolvent leaving a pension scheme with a deficit between assets and liabilities. The Crown guarantee responded to these concerns.

(20) The UK authorities indicated that they were not able to specify the value of the liabilities that would be covered by the guarantee. Indeed the liabilities to be covered would depend on the members to be covered and on the assets of BTPS at the time of BT's insolvency.

(21) According to the explanations provided by the UK authorities, in case BT becomes insolvent, the UK government would immediately become liable on commencement of the liquidation for any of BT's liabilities to the pension scheme for staff transferred to BT at privatisation and which remain outstanding. The Secretary of State would make payment to BTPS in respect of these outstanding liabilities and would become an unsecured creditor of BT for that amount. BTPS would also be an unsecured creditor of the insolvent BT for any liabilities related to staff not covered by the Crown guarantee since the law does not give any special preference to pension scheme trustees.

2.3. **Main developments of UK pension legislation since 1984**

(22) UK Pension law has been subject to several changes since 1984. According to the information available to the Commission, it appears that the main modifications of the general pension regulatory framework were introduced by the 1995 and the 2004 Pensions Acts.

The 1995 Pension Act: minimum funding requirements

(23) Article 56 of the 1995 Pension Act introduced a Minimum Funding requirement that the value of the assets of the scheme is not less than the amount of the liabilities of the scheme. However, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 provide that

> "*Section 56 (minimum funding requirement) does not apply to […] any occupational pension scheme in respect of which any Minister of the Crown has given a guarantee or made any other arrangements for the purpose of securing that the assets of the scheme are sufficient to meet its liabilities. […] Where such a guarantee has been given in respect of part only of a scheme, Sections 56 to 60 and these Regulations shall apply as if that part and the other part of the scheme were separate schemes*" *(emphasis added).*

(24) Furthermore, Article 75 of the 1995 Pension Act foresees that if at the time of insolvency the value of the assets of the scheme is less than the amount of the liabilities of the scheme, an amount equal to the difference shall be treated as a debt due from the employer to the trustees or managers of the scheme. However, the Occupational Pension Schemes (Deficiency on Winding up) Regulations 1996 provide that:

> "*Section 75 does not apply […] to any occupational pension scheme in respect of which any Minister of the Crown has given a guarantee or made any other arrangements for the purpose of securing that the assets of the scheme are sufficient to meet its liabilities*" *(emphasis added).*

The 2004 Pension Act: Pension Protection Fund and Statutory Funding Objectives

(25) Part 2 of the 2004 Pension Act introduced the Pension Protection Fund (PPF) on account of intense political pressure, after over thousands workers in various companies lost large amounts of their pension benefits in recent years following the bankruptcy of their sponsoring companies. The PPF was created in April 2005. Its function is to pay compensation to members of eligible pension schemes whose sponsor employers have suffered insolvency leaving insufficient assets in the scheme to provide their members with protection equivalent to the level of compensation payable by the PPF. The PPF is financed partly by the assets transferred from schemes from which it has assumed responsibility and partly by an annual levy raised on eligible pension schemes. This levy includes an administration levy and a risk levy which incorporates two elements:

— a risk-based element that takes into account the likelihood of employer insolvency (80 % of the levy),

— a scheme based element paid by the schemes on the basis of the size of their liabilities (20 % of the levy).

(26) The initial levy for 2005/2006 was set without taking into consideration the risk-based element.

(27) The PPF (Entry Rules) Regulations 2005 specify that "*a scheme in respect of which a relevant public authority has given a guarantee or made any other arrangements for the purposes of securing that the assets of the scheme are sufficient to meet its liabilities*" is exempted from the PPF. Where a part of a scheme is guaranteed by the Crown, the guaranteed and non-guaranteed parts of the scheme should be considered as separate schemes.

(28) Finally, Part 3 of the 2004 Pension Act introduced new scheme funding requirements ("Statutory funding objectives") which replaced the 1995 minimum funding requirements. Section 222 of the Act provides that schemes are subject to a requirement to hold sufficient and appropriate assets to cover their technical provisions. The Occupational Pension Schemes (Scheme Funding) Regulations 2005 exempt a scheme which is guaranteed by a public authority. Again, a part of a scheme is guaranteed by the Crown, the guaranteed and non-guaranteed parts of the scheme should be considered as separate schemes.

3. COMMENTS FROM THE PARTIES INVOLVED

3.1. The complaint

(29) The main argument of the complainant is that the guarantee allows the managers of BT's pension fund to adopt an aggressive, riskier investment policy, which provides higher returns. These higher returns may have been taken into account by the actuaries in their valuation of the assets and liabilities. The increase in the value of the assets has the effect of decreasing the deficit of the pension fund and the level of contribution that BT will have to pay to achieve full funding. The Crown guarantee would allegedly reduce the pressure on the fund to ask BT for the repayment of the deficit. This is an advantage which, in the view of the complainant, results into State aid.

3.2. Position of the UK authorities

(30) The UK authorities consider that BT did not receive State aid. To substantiate this claim, they submitted the following arguments.

(31) Firstly, since the guarantee applies only if BT is wound up, the Section does not have the effect of preventing BT from becoming insolvent. Since BT is solvent, the guarantee has not helped BT to meet its obligation under BTPS rules to contribute sufficient amounts to the pension scheme to remove any deficit between assets and liabilities.

(32) Secondly, the Crown guarantee has had no impact on the credit rating of BT. They provided quotations by Standard and Poors and Fitch indicating that the guarantee had had no impact on their assessment of BT's default rating since it is only effective for pension creditors after it becomes insolvent.

(33) Thirdly, the complainant's argument that the managers of BTPS could have adopted an aggressive investment policy thanks to the guarantee is not supported by the facts: BTPS' investment policy is very similar to that of other large UK pension schemes.

(34) Fourthly, the Crown guarantee did not have any impact on the management and funding of BTPS. Under the rules of BTPS, BT is required to make the same provision in respect of its pension liabilities as if the guarantee did not exist. In particular, in certifying the contributions required by BT, the actuary has not taken account of the guarantee in making his report on the valuation of the assets and liabilities of the pension funds. Similarly, BT has not taken the guarantee into account in making good any deficiency identified by the actuary.

(35) Finally, the exemption from the payment of levy to the PPF does not constitute State aid since the reduction is within the logic of the system: the contribution to the PPF is supposed to reflect the risk born by the pension schemes concerned. If a pension scheme has a zero risk of defaulting, it will not have to pay any levy. In the present case, since part of the liabilities are guaranteed, the fact that BT does not have to pay a levy on these liabilities is within the logic of this system and therefore is not an advantage.

3.3. Position of BTPS' trustees

(36) BTPS provided similar arguments to those put forward by the UK authorities. In particular, on the specific issue of the exemption from the payment of the levy to the PPF, BTPS claimed that this exemption did not constitute State aid since it was within the logic of the system. It further argued that the guarantee was known from the shareholders when they bought BT in 1984, as a result of which its value was taken into account in the overall price that they paid for BT. Consequently, they paid a market price for this guarantee, and no advantage was involved.

(37) Furthermore, BTPS argued that the potential advantage resulting from this exemption is more than compensated by the extra liabilities borne by BT and BTPS because of the special nature of BTPS and of the status of BT's employees at the time of privatisation. These extra liabilities are:

— Enhanced redundancy terms. After privatisation, BT employees retained special rights in the event of redundancy that they had enjoyed as former public sector employees. The enhanced pension terms on redundancy applying to the employees covered by the Crown Guarantee consists in particular of unreduced pensions from age 50. These benefits are mandatory in the event of compulsory redundancy. As a result, BT has had to offer similar terms in order to induce such members to accept voluntary redundancy. BT has therefore incurred significant additional redundancy costs over the period since privatisation, since redundancy significantly increases the Scheme's liabilities. These extra costs are estimated to amount to […] (*) for the period 1984-2005.

(*) […]: the information in brackets is covered by the obligation of professional secrecy.

— The 1984 deficit in the pension scheme: upon privatisation, the new company inherited a net deficit of around GBP 470 million in the pension scheme which BT has subsequently had to make good.

— […].

— Enhanced civil service benefits for certain membership categories of BTPS. Under the terms of BTPS deed in place at the time of privatisation, the BTPS was required to provide benefits in respect of those employed at that time in line with civil service benefits. In practice, the benefits that the scheme has been required to provide since privatisation have been significantly better than those typically offered by the private sector pension schemes in the 1980s. For instance, BTPS is required to pay benefits from age 60 to men and women, whereas typical pension schemes had normal retirement ages of 65 for men. According to BTPS, the gross estimate of these additional costs amounts to more than […].

4. **ANALYSIS**

4.1. **Qualification of the measures as State aid**

(38) Article 87(1) of the EC Treaty states:

> *"Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market."*

In order for Article 87(1) to be applicable, there needs to be an aid measure imputable to the State which is granted by State resources, affects trade between Member States and distorts competition in the common market, and confers a selective advantage to undertakings.

(39) In order to analyse the presence of State aid, it is necessary to successively analyse the different measures under consideration in this case:

(a) The granting of the Crown guarantee on BT's pension liabilities in 1984 to BT.

(b) The exemption of BTPS from the application of the minimum funding requirements introduced by the 1995 and 2004 pension acts to the BTPS' pension liabilities covered by the Crown guarantee.

(c) The exemption of BTPS under the PPF (Entry rules) Regulations 2005 from the requirement laid down in part 2 of the 2004 Pension Act to contribute an annual levy to the PPF corresponding to its pension liabilities covered by the Crown guarantee.

(40) As a preliminary remark, it must be underlined that BTPS and BT are two different legal entities. The Crown guarantee covers partly any deficit between BTPS' liabilities and assets and also the exemptions mentioned in point (b) and (c) in the previous paragraph directly concern BTPS.

(41) However, it is concluded that if there is an advantage to BTPS, it can be considered that this advantage is entirely and directly transferred to BT since the latter must cover any deficit and administrative costs of its pension scheme as long as it is solvent.

4.1.1. *The 1984 Crown Guarantee as far as it concerns pension liabilities*

(42) It appears that the Crown guarantee, as far as it concerns pension liabilities, was granted in 1984 with the aim of reassuring BT's employees by providing them with the same degree of protection of their pension rights as they had enjoyed when they were employed by a public corporation. The beneficiaries of this guarantee are these employees. The Commission must check whether BTPS and as a result BT could not have also benefited from the guarantee.

(43) It is to be noted that the Crown guarantee is different from traditional loan guarantees, referred to in the Community notice on the application of Article 87 and 88 of the EC Treaty to State aid in the form of guarantees ([2]). Loan guarantees enable the beneficiary to obtain more favourable interest rates and/or offer less security. This is why the undertaking should normally pay a market premium for such a guarantee. State guarantees granted without a premium are generally considered to fall within the scope of Article 87(1) EC. The question in the present case is whether the Crown guarantee provided an advantage to BT so that BT would normally have been willing to pay a premium in order to benefit from this guarantee. If such an advantage exists, and since BT did not pay any premium for this guarantee, it would then be possible to conclude to the presence of State aid. On the basis of the information currently available to it, the Commission has analysed the various potential economic effects of the guarantee on BT.

Potential effects on the investment policy of BTPS

(44) The argument put forward by the complainant to conclude to the presence of State aid is that, thanks to the guarantee, the fund managers of BTPS were able to adopt a riskier investment policy, with a higher rate of return, which would have the effect of reducing the deficit of the fund, and therefore the contributions that BT has to pay to rebalance it.

(45) However, the guarantee can only be called upon in case of insolvency of the sponsor company, not in case BTPS makes losses as a consequence of its investment decisions. Any loss of BTPS must be covered by BT as long as it is solvent. This has several implications:

([2]) OJ C 71, 11.3.2000, p. 14.

(46) First, in the hypothetical case that BTPS' managers decided to adopt a more risky investment policy with the prospect of a higher but more volatile return, this could not automatically be linked to the existence of the Crown guarantee. Indeed any losses incurred by BTPS would be covered by BT as long as it is solvent without calling upon the Crown guarantee. The only situation in which the Crown guarantee could be called upon is BTPS' investment policy is so risky that it may generate losses large enough to make it impossible for BT to cover them without becoming insolvent. This is an extremely remote possibility, given the binding rules under which BTPS trustees operate ([3]).

(47) Second, a BTPS investment policy risky to the point of threatening BT's solvency is most likely not to the advantage of BT. On the one hand, it can hardly be argued that BT would accept bankruptcy as an acceptable risk to obtain reduced contributions to BTPS. On the other hand, BT would remain liable for all potential losses of BTPS it could afford to pay without becoming insolvent.

(48) Third, BTPS would adopt an extremely risky policy only if it was not concerned about the solvency of its sponsor company. Such an assumption does not appear to be reasonable given the economic dependency of BTPS on its sponsor employee BT: BT is the only provider of funds to BTPS.

(49) Fourth, it should be recalled that the guarantee only covers part of BTPS' liabilities, i.e. the pension liabilities of BT's employees at the time of the privatisation. If it were to adopt a risky investment policy because of the Crown guarantee, BTPS would not take into account the interests of the uncovered employees, whose pension liabilities are not negligible since they represent about a quarter of the total liabilities.

(50) In conclusion, the existence of an economic advantage resulting from a risky investment policy which would be made possible by the Crown guarantee cannot in principle be established.

(51) Moreover, information provided by the UK authorities does not indicate that BTPS fund managers implement a particularly aggressive investment policy. The UK authorities provided data on BTPS' investment policy, as well as summary data on the 50 largest UK pension schemes (the "WM 50") over the period 1996-2005 and an independent benchmarking operated by WM Performance Services. The Commission considers that data over that period can be considered to be sufficient to draw general conclusions on the effects of the Crown guarantee on BTPS investment policy since 1984.

(52) First, this data indicates that BTPS' assets allocation is very similar to the average asset allocation of the WM 50. In recent years, it appears that BTPS has generally held less than average in equity investments but rather more in property, which does not appear to be an indication of a risky strategy.

(53) Second, on the assumption that a more risky investment policy is generally characterised by higher volatility of returns, the Commission found that the variations of BTPS' returns over the period are not indicative of a more risky investment policy. It appears that BTPS has never been among the best or worst performers among these 50 funds in any given year, with the possible exception of 2003 and 2004 when it was the third best performing fund. Apart from these two years, the deviation of its return with respect to the average return is always inferior to the standard deviation.

(54) The Commission also notes that investment decisions taken by the Fund managers such as a predominantly passive investment strategy ([4]) or the decision to hedge the currency exposure associated with overseas equities within the scheme are also indicative of an investment policy that does not seem particularly risky.

(55) To conclude on this point, although it appears that BTPS' investment policy is relatively more successful than average (it has produced an annual average investment return over the last 10 years of 9,2 % compared to an average return of 8,3 % for the WM 50), there is no indication that this is the result of a more risky strategy. According to the UK authorities, BTPS' relatively higher returns would be linked to the performance of the fund manager. The fact that the returns of BTPS and the returns on other mandates of the fund manager were similar supports the claim of the UK authorities.

(56) Given that the existence of an advantage for BT or BTPS deriving from a risky investment policy cannot be demonstrated, that data available to the Commission does not indicate that BTPS has had a more risky investment policy and that the investment policy followed by the fund manager of BTPS is comparable to its investment policy for other mandates, the Commission concludes that on the basis of the information available no link between BTPS investment policy and the Crown guarantee as far as it concerns BT's pension liabilities can be established.

Potential effect on the employment policy of BT

(57) The Commission also considers that the Crown guarantee as far as it concerns BT's pension liabilities does not provide advantages to BT in terms of employment policy: the existence of the guarantee may have facilitated the privatisation process back in 1984 and avoiding some social unrest at that time by reassuring BT's employees concerning their pension rights, but if the guarantee had this effect, it was mainly to the benefit of the UK government while it was conducting the privatisation process of BT. It cannot be argued either that this guarantee helped BT to recruit some valuable employees who could have been attracted by safer pension rights, since the guarantee only applies to those who were employed in 1984, and not to those who were hired after privatisation.

([3]) For instance, under Section 35 of the 1995 Pension Act, the trustees must elaborate and at regular intervals of time revise a statement of investment principles, which must be submitted to an expert and the employer. According to this statement, "the investment of the assets of the scheme should be consistent with funding a defined level of benefits while trying to minimise the cash cost to BT over the long term, having regard to the funding requirements of the Pension Act 2004 and an acceptable level of risk of significant cash injections being required from BT".

([4]) Passive investment strategy involves investment in a well diversified portfolio to represent a broad-based market index without attempting to search out mispriced securities.

Potential effect on the credit rating of BT

(58) As underlined above, this guarantee is different from loan guarantees: loan guarantees provide an advantage to the firm if they enable it to obtain a loan on conditions that are more favourable than the market would have allowed. A State guarantee could be specific to a loan, or of a more general nature, such as the special status of a firm that would guarantee creditors' debts in case it goes bankrupt, and could therefore affect its credit rating. In the present case, the guarantee does not affect the ranking of any of BT's liabilities. As a result, the fact that the guarantee exists does not imply that more assets would be available to these creditors. It cannot be argued that creditors might be more willing to lend to BT since the guarantee does not make their claims more secure or more likely to be satisfied. The fact that the guarantee has no impact on BT's credit rating is further confirmed by the fact that credit ratings agencies have not taken the guarantee into account when assessing BT's default rating. In its report on BT dated 19 September 2006, Standard & Poors stated:

> *"the existence of a Crown Guarantee for about three-quarters of the current pension liabilities is not important for our probability of default rating analysis, because it is only effective for pension creditors after BT becomes insolvent"*

(59) In their report "BT Pension Funding Removes Uncertainty" of 19 December 2006, Fitch stated that the Crown Guarantee would at best "*guarantee the pensions of scheme members once a default has already occurred. Its presence or otherwise does not have any impact on BT's Issuer Default*".

Conclusion

(60) The Commission's analysis on the basis of the information available indicates that the guarantee itself, as far as it concerns BT's pension liabilities does not confer any advantage to BT: it cannot affect the investment policy, credit rating or employment policy of BT. The Commission can therefore conclude that the Crown guarantee as far as it concerns BT plc's pension liabilities in case of insolvency did not confer in itself on BT any specific additional advantage, independently from the changes in the legal framework introduced in 1995 and 2004, and therefore any State aid within the meaning of Article 87(1) EC.

4.1.2. *The exemption from the minimum funding requirements laid down in the 1995 and 2004 Pension Acts*

(61) As explained in Section 2.3, the 1995 Pension Act introduced a minimum funding requirement, from which pension funds which enjoy a Crown guarantee are exempted. Part 3 of the 2004 Pension Act also introduced new scheme of funding requirements, from which pension funds with a Crown guarantee are also exempted.

(62) The 1995 Pension Act provides that the value of the assets of the scheme must not be less than the amounts of the liabilities of the scheme. However, pension funds which, like BTPS, enjoy a Crown guarantee are exempted from this requirement by the Occupational Pension schemes Regulations 1996. Part 3 of the 2004 Pension Act introduced new funding requirements, from which pension fund with a Crown guarantee are exempted.

(63) This exemption from the minimum funding requirement resulting from the Crown guarantee could in principle constitute State aid. Indeed, this exemption would constitute an advantage since the firm would not have to finance its pension fund's deficit under the more stringent conditions imposed by the 1995 and 2004 pension acts. Therefore, BT could use the funds that it would have had to apply to remedying its pension fund's deficit under the strict conditions laid down in the 1995 and 2004 legislation for its other economic activities.

(64) If the presence of an advantage is confirmed, it appears that this advantage is financed out of State resources: in order to benefit from this guarantee, without which the exemption of the minimum funding requirements is not possible, BT would have had to pay a premium in 1995, which it did not. In addition, the exemption from the minimum funding requirements means that the assets in the pension fund could be lower and that the exposure of the State in case of bankruptcy could be higher after 1995 than it would have been if the minimum funding requirements had been binding on BT. To summarise, the new legal frameworks in 1995 and 2004 and the new rules that they laid down on minimum funding requirements substantially altered the nature and effects of the Crown guarantee, as a result of which an advantage financed by the State was granted to BT and the BTPS from 1995 onwards.

(65) Given BT's activities in national and international markets for telecommunications, this advantage may affect competition and trade between Member States and therefore is likely to constitute an aid within the meaning of Article 87(1) EC.

(66) However, the UK authorities claim that, in effect, BT has not made use of the exemption from the minimum funding requirements laid down in the 1995 and 2004 Pension Acts and has therefore funded BTPS as if these rules fully applied to it. The UK authorities provided all BTPS' Statement of Investment Principles since 1996 to the Commission. It is correct that they always state that investment policy of BTPS had regard to the minimum funding requirements laid down in the 1995 and 2004 Pension Acts.

(67) Furthermore, the content of the latest BTPS recovery plan, agreed between BT and BTPS trustee in December 2005, was subject to the Pension Regulator's scrutiny. The Pension Regulator is an independent authority, set by the 2004 Pension Act, in charge of the regulation of pension schemes. The British authorities formally confirmed the Pension Regulator was satisfied that the guarantee was not being used to extend the recovery period or affect any of the key assumptions in the actuarial valuation or recovery plan of BTPS.

(68) However, the Commission notes that, despite the fact that under the 1995 Pension Act, the value of the assets of the scheme must not be less than the amounts of the liabilities of the scheme, BTPS still had a GBP 3,4 billion deficit according to the 2006 valuation. The UK authorities have not explained how such a significant deficit could have accrued if the principles laid down in the 1995 legislation had been fully respected and applied by BTPS and BT.

(69) In conclusion, the Commission has doubts about the claims that BTPS did not avail itself of the exemptions from the application of the minimum funding requirements laid down in the 1995 and 2004 Pension Act, and that as a result, BT has not received State aid in the form of less stringent conditions for the financing of its pension fund deficit since 1995.

4.1.3. *The exemption from the payment for a levy to the PPF corresponding to the pension liabilities covered by the Crown Guarantee*

(70) As described in Section 2.3, the 2004 Pension Act introduced another significant change: it created the Pension Protection Fund, to which pension funds generally have to contribute by paying an annual levy, unless they benefit from a Crown guarantee and are as a result exempted from this payment.

(71) BT's contribution must cover BTPS' trustees' costs, including the PPF levy payments. Under the PPF entry rules regulations, the guaranteed Section of BTPS is exempted. Therefore, BTPS levy is calculated by the PPF excluding all members of the scheme who joined before privatisation on the understanding that Section 68 of the 1984 Act guarantees the liability of BT to make contributions to BTPS in respect of these members. The initial levy was actually set at GBP […]. If the full levy had been charged, BTPS would have paid GBP […]. No determination has yet been made in respect of the 2006/2007 levy ([5]) […].

(72) The Crown guarantee on Pension liabilities and the PPF pursue basically the same purpose: to offer additional protection to workers in case of insolvency of the employer. Up to 2004, protection of pensions in case of insolvency was limited to a portion of the workers benefits and ensured by the State on an individual company basis. As from 2004 the PPF general system has been established and occupational pension schemes (and indirectly employers) have to make contributions to the PPF, which guarantees the employees of any contributor scheme. In other words the general system is that additional protection must be paid by the employers in the form of the payment of a full levy.

(73) It should be recalled, however, that the UK authorities and BTPS have argued that BTPS and BT did not receive any advantage for the reasons described in Section 3.2 and 3.3 of this decision. However, the Commission has doubts that these arguments can be accepted.

(74) The Commission has doubts that the reduction of the levy to be paid to the PPF is justified "by the logic of the system". The Commission does not consider that the "system" can be regarded as constituted by the PPF only. Rather, all measure established in order to achieve a protection of pensions must be taken into consideration. In this context, it is noted that whereas under the PPF, the employers must make a financial contribution to the protection of the pensions of their employees, this does not apply for the pensions covered by the Crown guarantee. The Commission does not consider that this difference in approach can be justified by a "logic of the system". The only "logic" apparent in this case is that where State resources are made available for the protection of an undertaking's pension scheme, private provision becomes otiose.

(75) The Commission has also doubts that no advantage is present on the ground that this guarantee has already been paid by BT's shareholders in the overall price that they paid for the company in 1984. As explained in Section 4.1.1 of this decision, the Commission concludes on the basis of the information available that the Crown guarantee in itself, as far as it covers BT's pension liabilities did not confer any advantage to BT at the time it was granted, and not until 1995, when its effects were substantially changed by the legislation. It means that at least at the time of the privatisation, the Crown guarantee on pension liabilities had no value to BT's shareholders: in 1984, it was not possible to anticipate the application of minimum funding requirements and the obligation to contribute to the PPF, nor the potential economic advantage resulting from the exemption from these obligations thanks of the Crown guarantee.

(76) BTPS also put forward the argument that the potential advantage deriving from the lower levies to the PPF is more than compensated by extra liabilities borne by BT and BTPS because of the special nature of BTPS. First, the Commission notes that, in application of BTPS' reasoning, the nature of the contracts with BT's employees before privatisation was known at the time of privatisation, and should have therefore been taken into account into BT's price: the argument is therefore in contradiction with the one described in the previous paragraph. Secondly, the disadvantages described by BT are linked to specific rules that have been applied to BTPS and a certain category of employees since the privatisation of BT. Thee is no causal nor temporal link between these alleged disadvantages and the apparent advantage resulting from a reduced contribution to the PPF, which materialised 20 years later. The Commission therefore has doubts that these alleged disadvantages could be used to offset this advantage.

(77) If the arguments put forward by BTPS and the UK authorities are rejected, and if it is concluded that there is an advantage in the form of a reduced contribution to the PPF, this advantage appears to be financed through State resources since it is the consequence of the State guarantee, which has been granted to BT without the payment of any premium by this firm. In addition, in case BT becomes insolvent and its pension fund is in deficit, the pensions of the employees concerned will be paid by the State, rather than by the (privately funded) PPF, as would be the case if the normal rules had applied. To summarize, the change in the legal framework in 2004 and the setting up of a new system based on the PPF with an exemption for funds with a Crown guarantee substantially altered the nature and the effects of the Crown guarantee enjoyed by BT, as a result of which an advantage financed by the State appears to have been granted to BT from 2004 onwards.

([5]) BTPS indicated that these amounts are likely to increase in the future, maintaining the same ratio between actual and full levy.

(78) This advantage would be selective, since it is available only to BT for the part of its employees covered by the Crown guarantee.

(79) Given BT's activities in national and international markets for telecommunications, this advantage may affect competition and trade between Member States and therefore is likely to constitute an aid within the meaning of Article 87(1) EC.

(80) To conclude, on the basis of the information available at this stage, the Commission is of the opinion that the exemption from the contribution to the PPF for BTPS pension liabilities covered by the 1984 Crown guarantee is likely to constitute State aid granted to BT.

4.2. **Lawfulness of the measures if State aid if present**

(81) The 1995 and 2004 Pension Acts have created general obligations for pension funds from which BTPS and consequently BT are relieved thanks to the Crown guarantee. These new legislations have substantially altered the effects of the Crown guarantee on BT's pension liabilities. Since the enactment of these acts, the Crown guarantee on BT's pension liabilities appears to provide an advantage to BT in the form of an exemption of BTPS from the minimum funding requirements, on the one hand, and from the full contribution to the PPF, on the other hand.

(82) These advantages are likely to constitute State aid within the meaning of Article 87(1) of the EC Treaty. If the presence of State aid is confirmed, it has not been notified. As a result, it is unlawful as from ten years before the Commission started its investigation in 2006, in compliance with Article 15 of Council Regulation (EC) No 659/1999.

4.3. **Assessment of compatibility of the measures if State aid is present**

(83) To the extent that the presence of State aid in the form of an exemption from the minimum funding requirement or in the form of an exemption from the minimum funding requirements and from full contribution to the PPF levy is confirmed, it is necessary to consider the compatibility of such State aid under Community rules.

(84) Although BT is entrusted with certain obligations of general public interest, it appears that, if State aid is present, it benefits the entirety of its activities, in which case Article 86(2) EC would not be applicable.

(85) The measures involved do not appear to be compatible under Article 87(2) EC either. Article 87(2)(a) EC concerns aid with a social character granted to individual consumers. The State aid at stake consists in an exemption from minimum funding requirements and from the contribution to the PPF: such aid benefits BT itself. Consequently, such State aid would not fall within the scope of Article 87(2)(a) EC.

(86) The only possible basis for compatibility under Article 87(3) EC for these measures, if they contain aid, would at this stage appear to be Article 87(3)(c) EC, which provides that aid to facilitate the development of certain economic activities or certain economic areas can be found to be compatible when it does not affect trading conditions to an extent contrary to the common interests.

(87) However, the measures involved do not appear to comply with any of the rules concerning the application of that sub-paragraph that the Commission has promulgated to date in the form of guidelines and communications. Consequently, the compatibility of these measures, if they contain aid, would have to be assessed directly on the basis of Article 87(3)(c) EC. To date, the UK authorities have not provided any information that would enable the Commission to conclude to the compatibility of these measures on that basis.

(88) To conclude, if State aid is involved, the Commission doubts whether these measures are compatible with the common market.

5. **DECISION**

(89) In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 88(2) of the EC Treaty, requests the United Kingdom to submit its comments and to provide all such information as may help to assess the exemption of BTPS from the minimum funding requirements laid down in the 1995 and 2004 Pension Acts and from the payment of a levy to the PPF, for the pension liabilities covered by the Crown guarantee.

(90) In particular, the Commission requests the UK to provide:

— Explanations as to why and clear evidence that, as alleged by the UK authorities, BTPS did not avail itself of the exemption from the minimum funding requirements imposed by the 1995 and 2004 Pension Acts.

— Full explanations as to why, in their views, the exemption from the contribution to the PPF does not constitute aid.

— Full explanations as to why these measures, should the Commission conclude that they constitute State aid, can be found to be compatible with State aid rules, and in particular under Article 87(3)(c) EC.

(91) The Commission requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

(92) The Commission wishes to remind the United Kingdom that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

(93) The Commission warns the United Kingdom that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.'