II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 8 July 1999

on a measure implemented by the Federal Republic of Germany for Westdeutsche Landesbank —

Girozentrale (WestLB)

(notified under document number C(1999) 2265)

(Only the German text is authentic)

(Text with EEA relevance)

(2000/392/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above (1) and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By a complaint dated 23 March 1993, the Bundesverband deutscher Banken e.V. (BdB), representing about 300 privately owned banks in Germany, urged the Commission to initiate the procedure laid down in Article 226 of the EC Treaty against the Federal Republic of Germany. It claimed that the German Banking Supervisory Authority (Bundesaufsichtsamt für das Kreditwesen — BAKred) had infringed Article 4(1) of Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions (Own Funds Directive) (2), as last amended by the Documents concerning the accession of Austria, Finland and Sweden, when accepting assets of the Wohnungsbauförderungsanstalt des Landes Nordrhein-Westfalen (Wfb), which had been merged with Westdeutsche Landesbank Girozentrale (WestLB), as own funds of the latter.

(2) By letter dated 31 May 1994, BdB informed Directorate-General IV, responsible for competition, of the asset transfer, alleging a distortion of competition in favour of WestLB. On 21 December 1994 it filed a formal complaint requesting the Commission to initiate the procedure laid down in Article 88(2) of the EC Treaty against the Federal Republic of Germany. In February and in March 1995 and in December 1996 ten individual banks associated themselves with the complaint of their association.


(4) After this exchange of information, the Commission deemed it necessary to initiate the procedure laid down in Article 88(2) of the EC Treaty. The relevant decision was adopted on 1 October 1997. In it the Commission concluded that the measure in question probably constituted aid within the meaning of Article 87(1) of
the EC Treaty and that it needed additional information to carry out the necessary appraisal. This information related mainly to the measures taken by the Land of North Rhine-Westphalia (hereinafter the Land) to ensure its proper participation in the additional profits which WestLB can generate on the basis of the capital transferred, the effects of the inadequate liquidity content of the transferred capital, the effects of the fact that the Land's influence on WestLB had not increased, the effects of the preferential nature of the fixed remuneration and of any other aspects determining the appropriate level of remuneration, the level of Wfa capital available to underpin WestLB's commercial business, the value of the amount exceeding this sum but shown in WestLB's balance sheet, the tax exemptions, the waiver of liability, the profitability of WestLB and the alleged synergies.

(5) The complaint referred to similar financial measures in Lower Saxony, Berlin, Schleswig-Holstein, Hamburg and Bavaria in favour of Norddeutsche Landesbank, Landesbank Berlin, Landesbank Schleswig-Holstein, Hamburger Landesbank and Bayerische Landesbank respectively. Since the complaint focused on the transfer of Wfa to WestLB on account of the exceptionally high volume of capital transferred, the procedure initiated addressed this case only. The Commission stated that it would review the capital transfers to other banks in the light of the findings of the present procedure.

(6) The decision to initiate the procedure laid down in Article 88(2) of the EC Treaty was notified to the German Government by letter dated 23 October 1997. Several minor errors in that decision were corrected by a Commission Decision of 3 December 1997, which was notified to the German Government by letter dated 22 December 1997.


(8) The Commission decision to initiate the procedure was published in the Official Journal of the European Communities (1). The Commission invited interested parties to submit their comments on the measure. It received comments from WestLB (19 May 1998), the Association française des banques (26 May 1998), the British Bankers' Association (2 June 1998) and BdB (4 June 1998). By letter dated 15 June 1998, it forwarded them to the German Government for its reaction, which it duly received by letter of 11 August 1998 after an extension of the deadline had been requested by letter of 30 June 1998 and granted by letter of 17 July 1998.

(9) Meetings took place with representatives of BdB on 15 January 1998 and 16 September 1998 and with representatives of WestLB on 9 September 1998. By letters dated 22 September 1998, the Commission departments invited the German authorities, WestLB and BdB to a joint meeting on various aspects of the case. BdB provided information by letter dated 30 October 1998. The meeting with the three parties took place on 10 November 1998. Following that meeting the Commission departments requested additional information and documents from the German authorities and from BdB by letter of 16 November 1998.

(10) By letter dated 14 January 1999, BdB submitted the information requested after an extension of the deadline had been requested by letter of 1 December 1998 and granted by letter of 15 December 1998. The German authorities submitted some information by two letters dated 15 January 1999 after an extension of the deadline had been requested by letter of 30 November 1998 and granted by letter of 15 December 1998. Additional information was provided by letter dated 7 April 1999.

(11) Since the German authorities refused to provide certain information, the Commission enjoined the German Government by Decision of 3 March 1999 to submit that information. The Decision was sent to the German Government by letter dated 24 March 1999. The German Government complied with this injunction by letter dated 22 April 1999 after an extension of the deadline had been requested by letter of 8 April 1999 and granted by letter of 14 April 1999.

(12) The Commission decided to arrange for an independent study to be carried out on the appropriate remuneration to be asked by the Land for the transfer of Wfa to WestLB. Representatives of the consultancy charged with that task also attended the meeting with the three parties on 10 November 1998.

II. DETAILED DESCRIPTION OF THE MEASURE

1. Westdeutsche Landesbank Girozentrale

(13) WestLB, the beneficiary of the transfer of Wfa, is a public-law institution (Amtsatz des öffentlichen Rechts) under a Land law (4) which stipulates three functions to be fulfilled by the bank:

— WestLB acts as central bank for the legally and economically independent local savings banks in North Rhine-Westphalia. In this way, it ensures

(1) See footnote 1.

(4) Sections 36 to 46 of the North Rhine-Westphalian law on savings banks (Gesetz über die Sparkassen sowie über die Girozentrale und Sparkassen- und Giroverbände).
equalisation of savings banks’ liquidity and provides supraregional services. Since 17 July 1992 WestLB has also been acting as the central institution for savings banks in the Land of Brandenburg by virtue of a contractual agreement,

— WestLB is engaged in the issuing of debt instruments and handling of financial transactions for its public shareholders (State-bank function),

— WestLB operates as a normal commercial bank in its own right.

(14) Notwithstanding these special legal provisions, WestLB is subject to banking supervision under the German Banking Law (Kreditwesengesetz).

(15) WestLB is 100 % publicly owned. The largest single stake in the nominal capital is held by the Land (43.2 %). Other shareholders are the municipal associations (Landschaftsverbände) of Rheinland and Westfalen-Lippe (11.7 % each) as well as the associations of local public savings banks (Sparkassen- und Giroverbände) of Rheinland and Westfalen-Lippe (16.7 % each). This ownership structure, which existed at the time of the transfer, has remained unchanged.

(16) As a public-law institution, WestLB benefits from two forms of guarantees from its public owner: ‘institutional responsibility’ (Anstaltslast) and ‘guarantor liability’ (Gewährträgerhaftung). Anstaltslast means that the owners of WestLB are responsible for securing the institution’s economic basis and operability for the entire duration of its existence. This guarantee does not create a liability on the part of the public authorities and the bank. Under the terms of the Gewährträgerhaftung, the owners meet all the bank’s liabilities which cannot be satisfied from its assets. It establishes a liability on the part of the guarantor vis-à-vis the creditors of the bank. Both guarantees are limited neither in time nor in value.

(17) Originally, WestLB was a regional institution which concentrated on supplementing the activities of local savings banks. Which in turn focused initially on a primarily social function, providing financial services in sectors characterised by market failure. However, the savings banks have long since developed into all-purpose credit institutions. Likewise, over the last few decades WestLB has developed increasingly into an independent commercial bank and is now a strong competitor on the German and European banking markets.

(18) At the time of the transfer, the WestLB group ranked third among German credit institutions behind Deutsche Bank AG and Dresdner Bank AG when measured by balance-sheet total.

(19) The WestLB group offers financial services to enterprises and public institutions (15) and is an important player on international capital markets, both for its own account and as manager of other issuers’ debt instruments. Like many German all-purpose banks, WestLB holds stakes in financial and non-financial enterprises. According to its annual report, WestLB operated banking offices in 24 countries at the end of 1991. One year later that number had risen to more than 30, of which 16 were in European countries. By the end of 1997 WestLB was present in more than 35 countries worldwide.

(20) In 1997 WestLB’s business operations outside Germany accounted for some 46 % (of which 28 percentage points in Europe) of the non-consolidated interest surplus, 48 % (of which 41 percentage points in Europe) of non-consolidated net income from financial transactions, 62 % (of which 45 percentage points in Europe) of non-consolidated commission surplus and 68 % (of which 60 percentage points in Europe) of non-consolidated other operating income.

(21) According to its annual report, WestLB held at the end of 1997 major direct or indirect stakes (at least 10 % of total equity) in the following companies outside the financial services sector: Thomas Cook Group (100 %), Thomas Cook Reisebüro (100 %), Thomas Cook Inc. (100 %), TUI (30 %), First Reisebüro (20 %), First Reisebüro Management (22 %), LTU Gruppe (34 %), Köln-Düsseldorfer Deutsche Rheinschifffahrt (89 %), Kaufland Warenhaus (13 %), TA Triumph Adler (19 %), Accumulatorenerwerke Hoppecke Carl Zollner & Sohn (25 %), Telius Grundstücksverwaltung-Gesellschaft (20 %), Preussag (about 30 %; plus a 10 % stake held by Niedersachsen Holding, in which WestLB has a 33 % interest), Deutsche Babcock AG (10 %), Märkische Faser (100 %), Mühl Product & Service and Thüringer Baustoffhandel (25 %), ISIS Multimedia Net (50 %), Schuh-Union (36 %), AW-Beteiligungs BmbH (24 %; this company has a 10 % stake in Fresenius), Kommunale Energie-Beteiligungsgesellschaft (28 %; this company has

(1) At 31 December 1991 55.6 % of WestLB group’s long-term claims on customers were loans to public institutions (Annual Report 1991, p. 72). At 31 December 1997 such loans had accounted for 32.9 % of WestLB group’s total claims on customers (Annual Report 1997, p. 74).
a 38 % stake in VEW), Westdeutsche Lotterie (100 %) and Westdeutsche Spielbanken (100 %).

(22) WestLB also has a number of important holdings in the financial services sector and runs a number of subsidiaries. Furthermore, under special legal provisions, WestLB, like other public credit institutions but unlike private banks, may conduct its mortgage-lending and savings-bank activities under the same organisational roof as its other operations. WestLB therefore ranks as one of Germany's most comprehensive all-purpose banks.

(23) On the other hand, WestLB does not operate a dense network of retail branches. This market segment is covered by the local savings banks, for which WestLB acts as the central institution. The balance-sheet structure of WestLB reflects this circumstance. Liabilities to banks accounted in 1997 for 38 % of the group's total liabilities, bonds issued for 28 % and liabilities to customers for 26 %. In connection with liabilities to other banks, it should be noted that local savings banks are required by law to deposit surplus liquidity with West LB(4). Funding through other credit institutions and the financial markets is facilitated by the bank's triple-A rating.

(24) WestLB's profitability, measured by pre-tax profits as a percentage of capital and reserves at group level, did not exceed 6.6 % on average over the eight years preceding the transfer of Wfa (1984 to 1991) and showed no clear upward tendency. This performance is substantially below the German as well as the European average.

(25) Table 1: Key figures from the WestLB group's annual reports (million DEM)

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<td>Total assets</td>
<td>178 821</td>
<td>205 205</td>
<td>230 305</td>
<td>274 708</td>
<td>332 615</td>
<td>378 573</td>
<td>428 622</td>
<td>470 789</td>
<td>603 798</td>
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<td>Claims on banks</td>
<td>64 485</td>
<td>67 495</td>
<td>69 628</td>
<td>75 401</td>
<td>87 940</td>
<td>109 150</td>
<td>130 753</td>
<td>146 957</td>
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<td>Claims on customers</td>
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<td>93 595</td>
<td>109 859</td>
<td>137 714</td>
<td>157 469</td>
<td>170 745</td>
<td>174 485</td>
<td>180 083</td>
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<td>Bonds</td>
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<td>28 243</td>
<td>31 084</td>
<td>40 011</td>
<td>60 108</td>
<td>68 600</td>
<td>75 805</td>
<td>95 589</td>
<td>125 867</td>
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<td>2 689</td>
<td>2 776</td>
<td>3 769</td>
<td>4 268</td>
<td>4 949</td>
<td>5 141</td>
<td>5 606</td>
<td>5 238</td>
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<td>Liabilities to banks</td>
<td>55 642</td>
<td>69 641</td>
<td>78 110</td>
<td>92 806</td>
<td>115 871</td>
<td>129 346</td>
<td>157 784</td>
<td>169 928</td>
<td>228 717</td>
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<td>Liabilities to customers</td>
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<td>45 221</td>
<td>50 305</td>
<td>57 648</td>
<td>79 411</td>
<td>91 580</td>
<td>98 425</td>
<td>111 306</td>
<td>156 048</td>
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<td>Documented liabilities</td>
<td>69 964</td>
<td>75 317</td>
<td>84 550</td>
<td>92 295</td>
<td>101 803</td>
<td>123 231</td>
<td>135 760</td>
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<td>Equity under German Commercial Code</td>
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<td>5 000</td>
<td>5 012</td>
<td>11 057</td>
<td>11 474</td>
<td>12 216</td>
<td>12 496</td>
<td>12 431</td>
<td>13 420</td>
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<td>Other capital and reserves</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>4 538</td>
<td>5 203</td>
<td>5 312</td>
<td>6 560</td>
<td>10 041</td>
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<td>Interest surplus</td>
<td>1 419</td>
<td>1 370</td>
<td>1 510</td>
<td>1 757</td>
<td>2 961</td>
<td>3 127</td>
<td>3 308</td>
<td>3 265</td>
<td>3 724</td>
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<td>Commission surplus</td>
<td>312</td>
<td>331</td>
<td>371</td>
<td>470</td>
<td>1 528</td>
<td>1 512</td>
<td>1 393</td>
<td>1 652</td>
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<td>Other income</td>
<td>1 459</td>
<td>1 264</td>
<td>1 476</td>
<td>1 754</td>
<td>1 982</td>
<td>1 932</td>
<td>1 686</td>
<td>1 457</td>
<td>2 537</td>
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(4) Section 4(2) of the Decree regulating the business activities of savings banks in North Rhine-Westphalia (Verordnung zur Regelung des Geschäftsrechts und des Betriebes der Sparkassen in Nordrhein-Westfalen).
(26) As can be seen from the above table, the WestLB group increased its balance-sheet total between 1991, i.e. before the transfer, and 1997 by 263%. The balance-sheet total of WestLB alone increased in the same period from DEM 211 500 million (EUR 108 100 million) to DEM 456 700 million (EUR 233 500 million), i.e. by 216%.

2. Wohnungsbauförderungsanstalt (Wfa)

(27) Wfa was founded in 1957 and operated until 31 December 1991 as a public-law institution (Anstalt des öffentlichen Rechts). As such, it was an independent entity with nominal capital of DEM 100 million (EUR 50 million) and the Land of North Rhine-Westphalia as the sole shareholder. Under Section 6(1) of the former North Rhine-Westphalian Law on the promotion of housing (Wohnungsbauförderungsgesetz)(7), Wfa devoted itself exclusively to the promotion of housing by granting low-interest or non-interest-bearing loans. On account of its non-profit character, it was exempt from corporation tax (Körperschaftsteuer), property tax (Vermögensteuer) and tax on business capital (Gewerbevermögensteuer).

(28) As a public-law institution, Wfa was covered by the Land’s ‘institutional responsibility’ (Anstaltslast) and guarantor liability (Gewährträgerschaft) for all its liabilities. These guarantees were not changed on account of the transfer.

(29) The largest single source of financing for the housing-promotion activities was and still is, the Land housing promotion fund (Landeswohnungsbauvermögen), which has been built up from interest income from housing loans granted by Wfa and annual cash injections from the Land budget. These resources, earmarked to serve exclusively as the funding base for housing loans by virtue of Section 16 of the Law on the promotion of housing, accounted for some 75% of Wfa’s refinancing, i.e. DEM 24 700 million (EUR 12 600 million) as at 31 December 1991.

(30) Prior to the transfer, Wfa guaranteed Land liabilities incurred for housing promotion purposes. Each year, in line with the Land’s repayments of its liabilities, Wfa’s guarantee was transformed into reimbursement claims of the Land against Wfa which reduced the value of the Land housing promotion fund accordingly. These liabilities of Wfa would have fallen due only when it no longer needed its revenues from interest and loan recovery in order to perform its public tasks. They amounted to about DEM 7 400 million (EUR 780 million) at the end of 1991 and were not shown directly in the balance sheet but only ‘below the line’.

(31) Table 2: Key figures from Wfa’s annual reports

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<tr>
<td>Total assets</td>
<td>33 234</td>
<td>33 049</td>
<td>34 953</td>
<td>36 487</td>
<td>38 021</td>
<td>42 365</td>
<td>42 988</td>
<td>44 041</td>
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<tr>
<td>Claims on customers</td>
<td>30 721</td>
<td>30 661</td>
<td>32 313</td>
<td>34 367</td>
<td>35 991</td>
<td>37 759</td>
<td>38 455</td>
<td>39 735</td>
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<tr>
<td>Liabilities to banks</td>
<td>4 952</td>
<td>5 001</td>
<td>6 201</td>
<td>6 853</td>
<td>7 271</td>
<td>8 058</td>
<td>7 593</td>
<td>7 737</td>
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<td>Land Housing Promotion Fund and nominal capital</td>
<td>23 836</td>
<td>24 779</td>
<td>25 768</td>
<td>26 896</td>
<td>28 125</td>
<td>29 406</td>
<td>30 847</td>
<td>32 116</td>
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### 3. Capital requirements under the Own Funds Directive and the Solvency Ratio Directive

Under Council Directive 89/647/EEC on a solvency ratio for credit institutions (Solvency Ratio Directive) and under the Own Funds Directive, banks must have own funds equivalent to at least 8% of their risk-adjusted assets and risk-bearing off-balance-sheet transactions. These Directives necessitated amendments to the German Banking Law which took effect on 1 January 1992. The new requirements entered into force on 30 June 1993. Until that date, German credit institutions were obliged to have own funds equivalent to 5.6% of their risk-adjusted assets.

As for the new threshold of these own funds have to be original own funds (Basis-eigenmittel), which consist of capital items available to a credit institution for unrestricted and immediate use to cover losses as soon as they occur. Original own funds are therefore of crucial importance for the level of a bank's total own funds for prudential purposes, as other own funds of lower quality, or ‘additional own funds’ (ergänzende Eigenmittel), are accepted only up to the amount of original own funds to underpin the risk-bearing business of a bank.

Moreover, the amount of own funds limits a bank’s exposure to large risks. At the time of Wfa's transfer, the German Banking Law (Section 13) laid down that no single loan granted may exceed 50% of a bank's own funds and that the total of such loans exceeding 15% of a bank's own funds may not be higher than eight times the bank's own funds. An amendment of the German Banking Law in 1994 to bring it into line with Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions reduced the maximum loan to 25% of a bank's own funds and laid down that the sum of single loans exceeding 10% of a bank's own funds may not be higher than eight times the total of own funds.

The size of qualifying holdings in other credit and financial institutions is limited by Article 12 of Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC. Furthermore, a special provision in the German Banking Law (Section 12), not based on

3. Capital requirements under the Own Funds Directive and the Solvency Ratio Directive

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<td>142</td>
<td>142</td>
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<td>1 000</td>
<td>1 100</td>
<td>1 200</td>
<td>1 300</td>
<td>2 000</td>
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<tr>
<td>Loans granted</td>
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<td>2 000</td>
<td>2 600</td>
<td>2 800</td>
<td>3 100</td>
<td>3 000</td>
<td>2 700</td>
<td>3 100</td>
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<tr>
<td>Interest income</td>
<td>365</td>
<td>393</td>
<td>410</td>
<td>414</td>
<td>436</td>
<td>477</td>
<td>561</td>
<td>586</td>
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<td>Land interest subsidy</td>
<td>36</td>
<td>0</td>
<td>0</td>
<td>25</td>
<td>55</td>
<td>78</td>
<td>12</td>
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<tr>
<td>Other income</td>
<td>52</td>
<td>35</td>
<td>36</td>
<td>47</td>
<td>48</td>
<td>43</td>
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<td>Interest expenses</td>
<td>78</td>
<td>123</td>
<td>187</td>
<td>262</td>
<td>304</td>
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<td>367</td>
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<td>Other expenses</td>
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<td>106</td>
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<td>103</td>
<td>92</td>
<td>115</td>
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<tr>
<td>Allocation to Land Housing Promotion Fund</td>
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<td>120</td>
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(33) The capital requirements must be met by credit institutions on a consolidated, a subconsolidated and an unconsolidated basis.
(34) The term ‘risk-adjusted assets’ is used below to describe all risk-bearing and risk-adjusted items.
(35) In fact, the new capital requirements should already have entered into force on 1 January 1993 but were implemented late in Germany.
(36) However, this figure was based on a definition of own funds that was narrower than the one set out in the Own Funds Directive.

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(33) It should, however, be pointed out that not only the thresholds were changed but also the definitions of ‘own funds’ and of ‘risk-adjusted assets’.

European legislation but found in other Member States limits the total amount of long-term investments, including holdings in non-financial enterprises, to the total amount of the bank's own funds.

(36) German banks had to adapt to the new capital requirements by 30 June 1993. The own funds cushion of many Landesbanks, including WestLB, was already comparatively small before transposal of the Solvency Ratio Directive into German law. According to test calculations made by the Deutsche Bundesbank in December 1991 on the basis of the provisions of the Directives, the Landesbanks had an average solvency ratio of [...] %, compared with the 8 % required from 30 June 1993. There was therefore an absolute need for these institutions to raise new capital in order to avoid restrictions on their business expansion and indeed to maintain their current level of activities. If a bank cannot demonstrate the necessary level of own funds, it will be ordered by the supervisory authorities to take immediate action to comply with the solvency rules either by raising additional capital or by reducing risk-adjusted assets.

(37) Private banks had to satisfy additional demand for own funds on the capital markets. Public banks could not move in the same direction, as public shareholders decided not to privatise (even in part) their credit institutions. Yet the generally tight budgetary situation meant that the public shareholders could not undertake cash injections of capital. Instead, other solutions were found to provide additional capital. In the case of WestLB, the Land decided to transfer Wfa to WestLB in order to strengthen the latter's own funds base. Similar transactions were carried out by some other Länder in favour of their respective Landesbanks.

4. The transfer and its effects

(a) The transfer

(38) On 18 December 1991 the parliament of North Rhine-Westphalia passed a law governing the promotion of housing (Gesetz zur Regelung der Wohnungsbauförderung), Article 1 of which ordered the transfer of Wfa to WestLB. The transfer became effective on 1 January 1992.

(39) According to the grounds of the Law, the primary reason for the transfer was to increase WestLB's own funds to enable it to comply with the stricter capital requirements entering into force on 30 June 1993. By way of the transfer this could be done without any financial burden on the Land budget. Combining the housing promotion activities of Wfa with those of WestLB was to have the secondary effect of increasing efficiency.

(40) As part of the transfer, the Land waived Wfa's guarantee of about DEM 7 400 million (EUR 3 780 million) for liabilities of the Land in connection with funds raised for housing promotion (see point II.2).

(41) WestLB became the universal legal successor to Wfa (except for Wfa's liability vis-à-vis the Land for debts entered into by the Land for reasons of housing promotion, which was waived prior to the transfer). Wfa became an organisationally and economically independent public-law institution without legal capacity within WestLB. Wfa's nominal capital and reserves must be shown in WestLB's balance sheet as a special reserve (Sonderrücklage). The Land continues to guarantee Wfa's liabilities under the Anstaltslast and Gewahrträgerhaftung.

(42) The assets transferred, i.e. nominal capital, capital reserves, the Land housing promotion fund and other claims of Wfa, as well as any future return flows from housing loans, remained earmarked for housing promotion under Article 2, Section 16(2) of the law even after their transfer to WestLB. The same provision established that the assets transferred also serve as equity capital within the meaning of the German Banking Law (and hence the Own Funds Directive), on the basis of which the solvency ratio of a bank is calculated. Therefore, they also underpin WestLB's competitive business.

(43) On the occasion of the transfer, WestLB's owners changed the covering agreement (Mantelvertrag) and agreed that the assets earmarked for housing promotion must always be preserved, even if WestLB suffered losses which absorbed the original capital. Internally, Wfa's capital should be subordinate in its liability only to WestLB's remaining equity. It was clarified in the agreement that WestLB's owners 'institutional responsibility' (Anstaltslast) also covers Wfa's special reserve. If WestLB were to be wound up, the Land would have a priority claim on Wfa's capital. It was also stated in this covering agreement that the increase in WestLB's equity base through the integration of Wfa constitutes an act in money's worth (geldwerte Leistung) by the Land and that the annual remuneration for this

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(17) See, for example, Document 11/2329 of the parliament of North Rhine-Westphalia.
act should be agreed on by the owners once the first financial results for the years from 1992 onwards were available (19). This was done in a protocol note to the covering agreement dated 11 November 1993. Notwithstanding the internal agreement to guarantee Wfa's assets and the internal subordination of Wfa's capital, no distinction is drawn in WestLB's external relationships between Wfa's housing promotion activities and its function as a provider of own funds to WestLB. The transferred assets are fully and instantaneously available to WestLB to cover losses or, in the event of bankruptcy, to cover creditors' claims.

(44) The management contract regarding the housing promotion law (Geschäftsförderungsvertrag zum Wohnungsbauförderungsgesetz) concluded between the Land and WestLB lays down that WestLB will use the special reserve to underpin its own business activities only in so far as fulfilment of Wfa's legally binding tasks is guaranteed.

(45) Although Wfa lost its legal independence by becoming a housing promotion division of WestLB and is integrated into WestLB's accounts, it was not integrated operationally into WestLB but remained a distinct entity within WestLB under the name Wohnungsbauförderanstalt Nordrhein-Westfalen — Anstalt der Westdeutschen Landesbank Girozentrale. This new housing promotion division of WestLB is included in WestLB's accounts but also publishes separate ones. WestLB's existing housing promotion department was merged with Wfa.

(46) Wfa's transferred capital, reserves, other assets and future profits are still earmarked for housing promotion and must therefore be administered separately from WestLB's other commercial activities. At the same time this separation is a prerequisite for continuing recognition of the housing promotion activities as non-profit-making under German tax legislation. Since the German authorities assumed that the integrated Wfa did indeed remain a non-profit-making entity, the tax exemptions mentioned at point II.2 were not abolished.

(47) WestLB's competitors also opposed the merger of the monopoly-like Wfa and WestLB because they feared that WestLB would be able to take advantage of information gathered in the housing promotion field to acquire new customers for its commercial business. The authorities responsible have undertaken to ensure that no distortions of competition are caused by such proximity, in particular by separating the housing promotion division from the commercial divisions of WestLB in terms of personnel, information, etc. (20).

(b) Value of Wfa

(48) As at 31 December 1991 the nominal value of Wfa's capital transferred to WestLB was about DEM 24,900 million (EUR 12,730 million), of which nearly DEM 24,700 million (EUR 12,680 million) was accounted for by the Land housing promotion fund. However, these resources served to finance housing promotion loans, which are either non-interest-bearing or low-interest loans and often have long grace periods. Therefore, in order to establish its actual value, the nominal capital had to be heavily discounted.

(49) On 1 January 1992 WestLB commissioned a valuation of Wfa which was delivered on 30 April 1992. It should be noted that the valuation was carried out only after the Land had decided on the transfer of Wfa.

(50) As to the valuation method, the auditors stated that, because of the continuing obligation to reinvest all future income of Wfa in low-interest or non-interest-bearing housing promotion loans, the institution would in fact have no capitalised earnings value. However, this obligation would cease in the event of the realisation of Wfa. The advantage of Wfa for WestLB was said to consist, firstly, in the increase in own funds and the resulting ability to expand business and, secondly, in the increase in its credit standing following the considerable strengthening of its equity capital. Since WestLB received no advantage from Wfa's normal activities, the latter's value had to be established as the possible proceeds in the event of its sale — without the reinvestment obligations that exist only in the internal relationship. The assets had to be valued at an amount which would result in a normal return, i.e. they had to be discounted to a value which could serve as a basis for considering their nominal return flows as a normal market return.

(51) The auditors revalued various items of Wfa's assets and liabilities — the housing loans were adjusted from DEM 30,700 million (EUR 15,700) to DEM 13,500 (EUR 6,900 million), i.e. by 56% and arrived at a net asset value for Wfa of DEM 5,900 million (EUR 3,020 million). This corresponds to an overall discount of 76% when compared with the nominal net asset value of Wfa of DEM 24,900 million (EUR 12,700 million) at

(19) According to the German Government, the expression 'act in money's worth' used there is in fact imprecise and was clarified later.

(20) Section 13 of the law concerning the asset transfer states that the housing promotion division must carry out its tasks in a manner that is neutral in its effect on competition (führt ihre Aufgaben wettbewerbsneutral durch). The actual measures to be taken to this end are laid down in an agreement between WestLB and the Land authorities.
Both valuations of the transferred assets were based on the situation after the waiver of Wfa's liability vis-à-vis the Land, which they valued at around DEM 7 300 million (EUR 3 730 million).

(c) Effects of Wfa's transfer on WestLB

On 31 December 1991 WestLB's recognised own funds came to DEM 5 100 million (EUR 2 600 million), of which DEM 500 million (EUR 260 million) were profit participation certificates (Genussrechte). The bank's solvency ratio was around [...] % on the basis of the provisions of the German Banking Law before its adaptation to the EU Banking Directives, i.e. [...] percentage points above the minimum level stipulated by that Law.

As a result of the acceptance of Wfa's capital as own funds of WestLB by BAKred, WestLB's total own funds were boosted to DEM 9 100 million (EUR 4 650 million), an increase of 79 %. Taking into account an allocation of DEM 100 million (EUR 50 million) to reserves from profits, WestLB's own funds amounted to DEM 9 200 million (EUR 4 700 million) at 31 December 1992. This corresponded to a solvency ratio of [...] %, including Wfa's capital and the risk-adjusted assets.

Table 3: Capital requirements and own funds of WestLB and Wfa (based on data provided by the German authorities) (million DEM)

<table>
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<tr>
<th></th>
<th>1991</th>
<th>1992</th>
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<tr>
<td>Risk-adjusted assets of WestLB (without Wfa)</td>
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<td>Risk-adjusted assets of Wfa</td>
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<tr>
<td>Risk-adjusted assets of WestLB (with Wfa) (*)</td>
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<tr>
<td>Required own funds of WestLB (**) (= a)</td>
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<td>Required own funds of WestLB without Wfa (**) (= b)</td>
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<tr>
<td>WestLB own funds (=c)</td>
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<td>9 190</td>
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<td>West LB own funds without Wfa (=d)</td>
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<tr>
<td>Utilisation rate of WestLB own funds (=a/c)</td>
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<tr>
<td>Utilisation rate of WestLB own funds without Wfa (=b/d)</td>
<td>[...] %</td>
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</table>
(58) This solvency ratio of [...] % includes an increase in WestLB's risk-adjusted assets unrelated to housing promotion of some DEM [...] (EUR [...] ), or 9.9 %, in 1992. If this increase had taken place without the transfer of Wfa, WestLB's solvency ratio would have fallen to [...] % by 31 December 1992 [...].

(59) Whereas all of Wfa's capital is tied up in its housing promotion activities, only part of its own funds within the meaning of the solvency rules is needed to underpin its risk-adjusted assets. According to information provided by the German authorities, DEM 1 500 million (EUR 770 million) was needed for this purpose at the time when the new capital requirements entered into force. This means that the remaining DEM 2 500 million (EUR 1 280 million) could be used by WestLB at that time as own funds to underpin its competitive business.

(60) On 31 December 1991 the solvency ratio of the WestLB group was [...] %, i.e. [...] percentage points above the minimum. One year later, after Wfa's capital had been accepted by BAkred, the ratio was about [...] %, including Wfa's risk-adjusted assets. If the asset transfer had not taken place and the group had increased its non-housing-related risk-bearing assets as it actually did, the group's solvency ratio would have fallen to [...] %, or [...] percentage points [...] the minimum level required at the time.

(61) On 30 June 1993, when German credit institutions had to comply with the new capital requirements set by the Own Funds Directive and the Solvency Ratio Directive, the group's solvency ratio (including Wfa's capital requirements), calculated on the basis of the new provisions, was [...] %, i.e. [...] percentage points above the minimum level. (The original own funds accounted for [...] percentage points, additional own funds for [...] percentage points.) Excluding Wfa's capital contribution and its risk-adjusted assets, the group would have had a solvency ratio of about [...] % as at 30 June 1993. The ratio of [...] % was achieved by raising more additional own funds in the form of subordinated loans amounting to some DEM 2 900 million (EUR 1 480 million) in early 1993. Over the whole of 1993 WestLB raised DEM 3 100 million additional own funds, bringing the total own funds of the group within the meaning of the German Banking Law to DEM 12 900 million (EUR 6 600 million) by the end of that year. The solvency ratios had fallen slightly by the end of 1993, compared with 30 June.

(62) Table 4: Capital requirements and own funds of the WestLB group (based on data provided by the German authorities) (million DEM)

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<td>Total assets</td>
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<td>Required original own funds (=a)</td>
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<td>Required total own funds (=b)</td>
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<td>Original own funds (=c)</td>
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<td>Additional own funds</td>
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<td>Total own funds (=d)</td>
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<td>Utilisation rate of original own funds (=a/c)</td>
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<td>[...] %</td>
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<tr>
<td>Utilisation rate of total own funds (= b/d)</td>
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<td>[...] %</td>
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(*) Anomalies in this year should be attributed to changes in the method of showing Wfa's assets in the balance sheet, to changes in the definition of own funds and in the solvency ratios, and to the timing of the acceptance of Wfa's capital by BAkred.

(63) In absolute figures, the original own funds of DEM 4 000 million (EUR 2 050 million) increased by DEM 72 000 million (EUR 36 800 million) the theoretical capacity to extend business volume with 100 % risk-adjusted assets under the former German Banking Law (5.6 % minimum solvency ratio). On the basis of the minimum solvency ratio of 8 % applicable since 30 June 1993, the relevant figure would be DEM 50 000
milllion (EUR 25 600 million). Assuming that DEM 2 500 million (EUR 1 280 million) of Wfa’s capital was available to the WestLB group’s competitive business, its 100% risk-adjusted lending capacity was increased by DEM 31 300 million (EUR 16 000 million).

(64) However, since a bank’s assets are normally not 100% risk-adjusted, the actual credit volume capacity increased by a greater amount. At the end of 1993 the WestLB group’s risk-adjusted assets (including Wfa’s business) amounted to DEM [...] (EUR [...]). The balance-sheet total came to DEM 3 326 600 million (EUR 170 100 million). This indicates an average risk-weighting of [...] % (23). Given a constant risk structure, the DEM 2 500 million (EUR 1 280 million) of original own funds available permitted a total expansion (or coverage of existing business) of about DEM [...] (EUR [...] on the basis of the 8% threshold laid down in the EU Banking Directives. Since the increase in original own funds allowed WestLB to raise further additional own funds (up to an amount equal to the original own funds), its actual lending capacity was indirectly increased even further.

(65) Several conclusions can be drawn. Firstly, without a capital increase, WestLB would have had difficulties remaining above the minimum solvency ratio under the German Banking Law before its adaptation to the EU Banking Directives. Secondly, without Wfa’s transfer, the WestLB group would have satisﬁed the minimum solvency ratio under the Solvency Ratio Directive only by reducing its risk-adjusted assets or by mobilising other sources of own funds (e.g. disclosure of hidden reserves). The raising of additional own funds could have provided only temporary relief because the level of such funds is limited by the amount of original own funds available. Thirdly, the capital increase, together with the fresh additional own funds raised in 1993, exceeded the amount needed by the group to meet the stricter capital requirements of the revised German Banking Law.

(66) As regards the supervisory restrictions on individual large loans, the 50% threshold laid down by the former German Banking Law was equivalent to about DEM 2 500 million (EUR 1 280 million) before the acceptance of Wfa’s capital. After acceptance of Wfa’s capital and a DEM 100 million (EUR 50 million) allocation to reserves from proﬁts, the threshold rose to nearly DEM 4 600 million (EUR 2 350 million). The 15% threshold stipulated on large loans, which in total may not be higher than eight times the bank’s own funds, was equivalent to about DEM 760 million (EUR 390 million) at 31 March 1992. One year later, i.e. after the acceptance of Wfa’s capital, the threshold had risen to nearly DEM 1 400 million (EUR 720 million). WestLB’s capacity to grant such large loans was increased by DEM 32 000 million (EUR 16 400 million) (i.e. eight times the increase of own funds) as a result of the transfer of Wfa (23).

(d) Remuneration for the transfer of Wfa

(67) The transfer of Wfa did not lead to a change in the ownership structure of WestLB. Therefore, the Land is not remunerated for the capital provided, either by way of a higher share in dividends paid or by way of a higher share in the capital gains of the holdings in WestLB.

(68) As already mentioned, the agreement governing the relationship between the owners of WestLB (Mantelvertrag) was amended on the transfer of Wfa. Under Section 5(2) of that agreement, the owners agree that the enlargement of WestLB’s capital base by the Land constitutes a financial advantage for them. The level of remuneration for the capital provided was to be fixed after WestLB’s first ﬁnancial results for 1992 were known, i.e. a short time after the transfer. The grounds of the law on the transfer contain similar wording as regards the value of the transfer and the remuneration.

(69) The remuneration for the capital provided was ﬁnally ﬁxed at an annual rate of 0.6%. It must be paid by WestLB from proﬁts after tax, giving a pre-tax burden or around 1.1% for WestLB (23). It is payable only if proﬁts are made.

(70) The basis for this remuneration is the capital of Wfa recognised by BAKred as original own funds, i.e. DEM 4 000 million (EUR 2 030 million). The remuneration is paid only on the part of this capital not needed by Wfa to underpin its housing promotion activities and thus available to WestLB to underpin its commercial business. This part amounted to DEM 2 500 million (EUR 1 280 million) after the new capital requirements entered into force and has been increasing since then (24).

(23) It should be borne in mind that, under the new rules, not only the ratios changed but also the deﬁnitions of ‘own funds’ and ‘risk-adjusted assets’.

(24) According to a study submitted by the German Government on the remuneration paid by WestLB, the corporation tax rate was 46% until 1993 and 42% thereafter. To this must be added a solidarity surcharge of 3.75% in 1992, 0% in 1993 and 7.5% thereafter.

(25) For the sake of clarity, where the amount on which the remuneration is to be paid is discussed, reference is always made to the situation at the end of 1993, i.e. the split between DEM 1 500 million (EUR 770 million) and DEM 2 500 million (EUR 1 280 million), irrespective of the fact that the division between the capital tied up in Wfa business and the amount available for WestLB changes.

(21) This calculation leaves out of account the risk-bearing off-balance-sheet transactions.
Table 5: Special capital reserve for housing promotion and own fund requirements of Wfa (based on data provided by the German authorities)

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<tbody>
<tr>
<td>Special reserve for housing promotion</td>
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<td>5 900</td>
<td>5 900</td>
<td>5 900</td>
<td>5 900</td>
<td>5 900</td>
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<tr>
<td>Of which accepted as original own funds</td>
<td>4 000</td>
<td>4 000</td>
<td>4 000</td>
<td>4 000</td>
<td>4 000</td>
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<tr>
<td>Needed for housing promotion loans of Wfa</td>
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<td>Available for WestLB</td>
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(*) Since BAKred accepted Wfa's capital only on 30 December 1992, the capital share of DEM [...] (EUR [...] was available for WestLB in 1992 for two days only. This results in an average available capital for WestLB of DEM [...] (EUR [...] for that year.

III. COMMENTS FROM INTERESTED PARTIES

1. Complaint and observations by BdB

BdB submits that the application of the ‘market economy investor principle’ is not limited to enterprises which are loss-making or in need of financial restructuring. Such an investor is not guided by the question of whether the enterprise in question is profitable at all but rather by whether the profitability corresponds to the market rate. If capital injections by the public authorities were examined only in the case of loss-making enterprises, this would discriminate against private enterprises and thus infringe Article 86(1) of the EC Treaty.

It also submits that Article 295 of the EC Treaty cannot be used to exempt the transfer of Wfa’s assets from the competition rules, arguing that the Article in question may well protect the freedom of the Land to create such a special asset but, as soon as it is transferred to a commercial enterprise, the competition rules must be applied.

(a) Appropriate remuneration for the capital

BdB argues that, like any other original own funds, the recognised original own funds of DEM 4 000 million (EUR 2 050 million) can be used to underpin business activities and, at the same time, to raise additional own funds for solvency reasons. Thus, by way of the transfer, the Land enabled WestLB, which was operating at the very edge of its equity base, to avoid reducing its business activities and even to expand those business activities open to risk. Furthermore, the amount by which the own funds exceed actual requirements also influences the funding costs on the financial markets.

According to BdB, a market economy investor would not inject capital into his company if that company’s financial results had been consistently poor for years and there were no signs of a considerable improvement, i.e. no indications that a higher return could be expected in the future.

(i) Level of the remuneration

BdB stresses that WestLB was in urgent need of original own funds and that the transfer of Wfa nearly doubled WestLB’s original own funds from DEM 4 700 million (EUR 2 400 million) to DEM 8 700 million (EUR 4 450 million). No private investor would have brought such a huge amount of equity capital into WestLB, given its weak financial performance at that time. In return for providing capital under such conditions, a private investor would have demanded a premium of at least 0,3 percentage point on top of the normal return on equity capital. BdB quotes WetLB’s profitability as an average of 5,6 % before tax for the ten years prior to the transfer. This compares with profitability figures for large private German banks of between 12,4 % and 18,6 %, with an average of 16,8 % (before tax) for the same period. Other Landesbanks are said to have generated profits of between 9 % and 11 %. BdB submitted a calculation of the return on equity of German banks made on its behalf by an external consultancy.

As regards the appropriate method of calculating a comparison of returns on equity, BdB submits that historical rates of return should be calculated as an arithmetic average, not as a compound annual growth rate. The latter method implies that the investor reinvests dividends and takes the additional income from these reinvestments into account for the calculation. However, the way in which dividends are reinvested cannot influence the original investment
(77) If, however, the compound annual growth rate method is used, the average return of some large German private banks for the period 1982 to 1992 comes to 12.54% after tax. In calculating this figure, BdB took into account all possible holding periods for investments and sales between 1982 and 1992 in order to avoid any possible bias as a result of taking only one base year, if share prices were unusually high or low in that year. Applying many holding periods simultaneously is said to smoothen the effect of stockmarket fluctuations. BdB submits that the corresponding figures given by WestLB are too low because income from the sale of subscription right is not taken into account.

(78) As regards the capital asset pricing model, which is used in the central study provided by WestLB to justify the remuneration of 0.6%, BdB submitted its own external study, which arrives at returns on equity of 12.21% (on the basis of the normal risk premium on the German market for the period 1982 to 1991) and 14.51% (on the basis of a higher expected risk premium), these figures being higher than the ones provided by WestLB. The difference can be attributed to two factors. Firstly, BdB applies a higher risk premium for equity (3.16% and 5% respectively). Secondly, it applies a higher beta factor for credit institutions (1.25%). The risk-free base rate used is the same as in WestLB's calculation. Considering the various methods of calculating return on equity, BdB finally quotes a range of 14% to 16% as a normal return on equity.

(79) BdB further states that a private minority shareholder would not inject any additional capital without requesting an increase of his share in the company. Only with such an increase could he duly participate in the profit of, and exercise greater influence on, the company.

(80) BdB also stresses that the agreement between WestLB's shareholders, whereby Wfa's capital should only be subordinate in its liability to the other equity of WestLB, has in fact no real effect because the Land must, by virtue of its institutional responsibility (Anstaltsslast), step in if WestLB is in difficulties. In fact, as owner of WestLB, the Land now guarantees not only WestLB's entire liabilities but also Wfa's equity it itself injected, without receiving any remuneration. This means that any reduction in the risk attaching to the transferred capital is merely the result of an increased risk for the Land as WestLB shareholder. Thus, the risk profile of Wfa's equity is no different from that of normal equity.

(81) As regards the comparison with equity instruments on the financial market submitted by the German Government and WestLB (see later), BdB argues that profit participation certificates (Genugbeichte) and cumulative perpetual stocks cannot be compared to Wfa's capital. Firstly, they are not accepted as original own funds. (Cumulative perpetual stocks are not even accepted as additional own funds in Germany.) Because it qualifies as original own funds, Wfa's capital allows WestLB to increase further its own funds by raising additional own funds. Secondly, the instruments referred to are limited in time and profit participation certificates lose their additional own funds character two years before maturity. Wfa's capital is, however, at WestLB's disposal for an unlimited period. Thirdly, such instruments normally provide only a limited part of a Bank's own funds and require a considerable share of original own funds. Fourthly, capital market instruments can be traded on the markets, which means that an investor can terminate his investment whenever he wants. The Land does not have this opportunity. In return for accepting such a lack of trading possibilities, a private investor would demand a premium of at least 0.5 percentage point on his normal return.

(82) BdB also provided the Commission with data on the equity components and solvency ratios of some large German private banks from 1990 onwards. These data show that, at the beginning of the 1990s, no hybrid original own funds instruments were in fact available to (or at least used by) German banks. It also transpires from that information that these credit institutions generally had solvency ratios well above the minimum requirements of 4% for original own funds and 8% for total own funds.

(83) BdB also comments on the covering agreement between the shareholders of WestLB, which stipulates that, internally, Wfa's capital is subordinate in its liability only to the other liable equity capital. Since the expression other liable equity capital also covers additional own funds instruments like profit participation certificates and subordinated loans and is therefore detrimental to their position, it argues that the agreement is a contract at the expense of third parties (Vertrag zu Lasten Dritter) and thus void. The risk profile of Wfa's special reserve is therefore said to be higher than that of profit participation certificates and subordinated loans.
(84) For all these reasons, BdB assumes that the remuneration of 0.6% paid by WestLB does not constitute a market rate. Taking into account WestLB's need to raise liquid funds in order to use Wfa's capital in full and the lack of participation in the accumulated reserves because the Land's share in WestLB did not increase, BdB suggests a rate within the range of 14% to 17% as correct remuneration. This rate should be paid on the total accepted amount of DEM 4 000 million (EUR 2 050 million).

(ii) Liquidity costs

(85) In its complaint BdB accepted the 'liquidity costs' (described later), so that a reduction of about 7 percentage points should be applied when calculating the appropriate remuneration for the capital. However, it claimed that, because the equity also served to underpin off-balance-sheet business not requiring liquid funds, this figure should in fact be lower.

(86) In its observations on the Commission decision to initiate the procedure laid down in Article 88(2) of the EC Treaty, BdB argues that 'liquidity costs' should not be taken into account in calculating the appropriate return on Wfa's capital. These costs are said to have been taken into account already when discounting Wfa's assets to the value of DEM 5 900 million (EUR 3 020 million). Moreover, several banking activities, for example guarantees, do not require any liquidity at all. So, if any costs at all are taken into account, then it should only be a small margin of 2.7 percentage points in order to offset the fact that Wfa's assets are locked up in unprofitable business. BdB submitted an outside expert's opinion on this point.

(87) The 7.5% figure for refinancing costs claimed by WestLB is also said to be too high in any case. On the basis of an analysis of the average market rates in the different years for the various refinancing instruments and in accordance with WestLB's balance-sheet structure, the actual rate for WestLB's refinancing on the markets is said to be an average of between 6.07% and 6.54% for the years 1992 to 1996. BdB also provided the Commission with figures for the refinancing costs of some large German private banks at the time of the transfer, which were considerably lower than the 7.5% claimed by WestLB as appropriate refinancing costs at an earlier stage of the procedure. Moreover, according to BdB, a distinction must be drawn between figures before tax and figures after tax. Refinancing costs reduced the taxable profit. So, if any refinancing costs are taken into account, only the rates applied after tax should be considered.

(iii) Capital basis for the calculation of the remuneration

(88) As already mentioned, BdB suggests that a rate within the range of 14% to 17% should be paid on the total accepted amount of DEM 4 000 million (EUR 2 050 million). However, it claims in its observations that not only this amount, recognised by BAKred as original own funds, but also the excess amount of DEM 1 900 million (EUR 970 million), which cannot be used to underpin business but is nevertheless shown as equity in the balance sheet, benefits WestLB. Rating agencies and investors did not look at the accepted original own funds but at the total equity shown in the balance sheet, as the latter forms the basis for commercial estimates of what is available to cover losses. This amount therefore increases WestLB's credit standing and a remuneration comparable to a guarantee premium should be paid for it.

(iv) Synergy effects

(89) According to BdB, the claimed synergy effects did not constitute the real reason for the transfer. This is said to be apparent from the fact that the law on the transfer justifies the measure on the grounds of the need to strengthen WestLB's competitive position and from the agreement that a remuneration should be paid for the act in money's worth.

(90) Furthermore, BdB questions how synergy effects can be achieved while Wfa's and WestLB's commercial businesses are separated from each other in economic, organisational and personnel terms, as provided for in the relevant legal provisions. If synergies did emerge in Wfa's activities, they would reduce the costs of housing promotion but could not be regarded as remuneration for the Land from WestLB.

(b) Tax aspects

(91) BdB points out that Wfa remained exempt from property tax, tax on business capital and corporation tax even after the transfer. Tax exemptions for public-law credit institutions are justified only as long as these institutions are engaged exclusively in promotional activities and thus do not operate in competition with private taxable institutions.

(92) According to BdB, a normal bank increasing its capital would each year have to pay 0.6% property tax and 0.8% tax on business capital on this additional capital. WestLB is therefore in a favourable position compared
with other banks. The exemption from corporation tax is said to benefit WestLB indirectly. The waiver of tax income constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

(c) Waiver of liability

(93) Prior to the transfer, Wfa was released from liabilities of DEM 7 100 million (EUR 3 770 million) vis-à-vis the Land waived these liabilities without asking for any consideration for this either from Wfa or from WestLB. A market economy investor would have asked for a consideration for such a waiver. The waiver was also a decisive prerequisite for the acceptance by BAKred of original own funds of DEM 4 000 million (EUR 2 500 million). WestLB therefore profited directly from the waiver.

3. Observation by WesLB

(98) Following publication of the Commission decision to initiate the procedure laid down in Article 88(2) of the EC Treaty, WestLB submitted as its position a copy of the German Government's observations on the same question and declared itself fully in agreement with that statement. Thus, the arguments of the German Government generally reflect the position of WestLB, which is therefore presented only briefly.

2. Observations by other interested parties

(94) Besides WestLB and BdB, two other interested parties commented on the Commission decision to initiate the procedure laid down in Article 88(2) of the EC Treaty.

(a) Association Francaise des Banques

(95) Association francaise des Banques argues that the transfer of own funds to WestLB, for which only an insignificant remuneration was sought, and the continuing guarantee for the bank from the Land lead to distortions of competition to the detriment of French credit institutions. Since WestLB's owners demanded a return on their capital that was clearly below the normal level, WestLB could offer its services at below cost (dumping). As it benefits from guarantor liability, WestLB has a triple-A rating which allows it to refinance on the markets on very favourable terms.

(96) These advantages place French banks operating in Germany at a disadvantage. At the same time, WestLB can, under these special conditions, develop its business in France, especially in the sector of municipal finance. Competition within the banking sector is distorted in Germany, France and other Member States.

(b) British Bankers' Association

(97) The British Bankers' Association argues that WestLB is an active competitor against non-German banks within Germany and across the European market. Therefore, any aid granted to WestLB has a distorting effect on trade within the Community. It calls on the Commission to uphold the principles of the single market and not to exempt publicly owned banks from the competition rules of the Treaty.

(a) General observations on the transfer

(99) According to WestLB, the market economy investor principle is not applicable to investments in economically sound and profitable enterprises. This is said to have been confirmed by the Court, which had in the past applied that principle only in cases where, at the time of the investment decision, the enterprise in question had already been operating at a loss for a considerable time and was active in a sector characterised by structural overcapacity. It is claimed that there is no basis in case-law for applying the principle to sound and profitable enterprises.

(100) WestLB submits that, given Wfa's special purpose, its assets are not comparable to normal funds. The transfer to WestLB of the otherwise unusable Wfa assets represents the most commercially sensible use of these assets. By means of the transfer the Land had optimised the use of funds earmarked for housing promotion. A private owner would have acted in the same way.

(101) According to WestLB, an increase in the Land's participation following the transfer would be not only unnecessary but also incompatible with the particular risk profile of Wfa's capital. Because of the lack of liquidity, the transfer cannot be compared to other capital injections. Other equity instruments on the market also do not carry voting rights.

(102) It is claimed that, since the remuneration received by the Land was a reasonable price, there was no need to ask for any increase in WestLB's profitability. Furthermore, it was not apparent why a market economy investor would require a certain target profit if he invested in a profitable company. Because WestLB
had made a profit in the past, there was also no need to establish any restructuring plan. Such a plan was required by the Court only in cases of restructuring aid for loss-making enterprises.

(b) Appropriate remuneration for the capital

According to WestLB, the remuneration paid for the capital in question is appropriate. In support of this opinion, WestLB submitted a report from an investment bank which was commissioned by WestLB to assess the remuneration. The expert report compares the risk profile of Wfa's capital with that of other equity instruments on the capital markets and, on the basis of this comparison, identifies a rate within the range of 0.9 % to 1.4 % as appropriate remuneration for Wfa's capital. This compared with costs of about 1.1 % (before tax) for WestLB for the use of Wfa's capital. WestLB stresses that, in order to be used in full, the capital requires additional refinancing costs, which are given in different documents in the range of 7.5 % to 9.3 %.

WestLB also submits that the figures presented by BdB for the return on equity of German banks are not correct for several reasons. Because of specific stock exchange developments, the investment period used by BdB for the calculation led to particularly high returns. The arithmetical average used by BdB did not produce correct results, as the compound annual growth rate method should be used for such calculations. BdB included in its calculation investment periods which were not relevant for an investment decision in 1992 and, because it took into account all possible holding periods, it counted individual years several times over. The banks used by BdB for computing an average rate of return on equity for large German banks could not be compared to WestLB because of differing core businesses. According to WestLB, the average return on equity of 16.6 % presented by BdB falls to 5.8 % after adjustments for all these factors.

c) Synergy effects

According to WestLB, the integration of Wfa into WestLB led to considerable cost savings for Wfa. In the first two years Wfa's staff of 588 (staff within the old Wfa and in the housing promotion division of WestLB, the costs of which had to be borne by Wfa before the transfer) were reduced by 53. In the early years the transfer led to annual savings of DEM 13 million (EUR 7 million) for Wfa as a result of synergies. The reduction in staff numbers should continue and annual savings are expected to increase to around DEM 25 million (EUR 13 million) from 1997 onwards. These amounts are said to benefit exclusively the housing promotion business of the Land. Another document refers to a synergy effect of at least DEM 35 million (EUR 18 million) annually.

Furthermore, in the course of the merger, changing the pension system for Wfa employees cost WestLB DEM [...] (EUR [...] in payments to the pension institution of the Federal State and the Länder. The payments would reduce Wfa's subsequent expenses.

d) Synergy effects

According to WestLB, Wfa's exemptions from certain taxes correspond to the system of German tax law whereby the taxes in question do not apply to institutions which serve public purposes and are not in competition with tax-paying institutions. WestLB itself is fully liable to all these taxes and does not benefit from the exemptions applicable to Wfa. It also notes that property tax and tax on business capital have not been levied since 1 January 1997 and 1 January 1998 respectively.

(e) Waiver of liability

As WestLB points out the waiver of the liabilities in question was made before the transfer and subsequent valuation of Wfa's assets. The value of DEM 4 000 million (EUR 2 050 million) therefore reflects the situation without liabilities. Since the remuneration is based on this value, WestLB does not receive any advantage from the waiver.

IV. COMMENTS FROM THE GERMAN GOVERNMENT

The German Government submits that the transaction does not include any elements of State aid for WestLB within the meaning of the EC Treaty. The Land receives an appropriate remuneration which corresponds to the terms of the market. Nor does the transaction constitute State aid for the other shareholders of WestLB as the preservation of the shareholder structure after Wfa's transfer is justified by the appropriate remuneration paid by WestLB. Furthermore, the tax exemptions for Wfa did not include elements of State aid for WestLB, as they did not affect the commercial business of the bank.

In the opinion of the German Government, the Commission may examine the case only on the basis of the circumstances obtaining at the time of the investment decision, i.e. at the end of 1991. Only these circumstances could have been the basis for the Land's investment decision. Subsequent questions and
developments such as the acceptance of own funds by BAKred or the yearly valuation and integration of Wfa's assets and liabilities into WestLB's accounts fall outside the scope of the Commission's investigation.

(111) According to the German Government, plans to integrate Wfa into WestLB date back to the 1970s and the 1980s and were prompted by the view that housing promotion could be made more efficient. Before the transfer, the procedure for receiving a housing loan was very complicated as both Wfa and WestLB were involved, alongside the relevant public authorities. Within WestLB a special housing promotion department was set up, with the costs being borne by Wfa. This structure led to duplication of posts and files and other inefficiencies. Since the transfer, the beneficiaries of housing loans have to deal with only one party instead of two.

(112) The Federal Government states further that WestLB could also have met the new solvency criteria by raising additional own funds but that, with a view to securing the long-term functioning of the bank, it seemed reasonable to increase the original own funds. All this shows that the prime reason for the transfer was not to increase WestLB's equity but to achieve potential synergy effects and improve housing promotion procedures. The change in solvency rules merely triggered the process.

(113) The legislative initiative in question already laid down that the resources of the Land housing promotion fund would have to remain earmarked, that its substance would have to be secured and that the instruments for housing promotion would have to be maintained. In accordance with these principles, Wfa must be managed by WestLB as an organisationally and economically independent entity which draws up its own annual accounts. In the event of WestLB being wound up, the Land has a preferential claim on Wfa's net assets. All of Wfa's income is still given over to housing promotion. Only that part of Wfa's own funds, which it does not itself need to underpin its assets, can be used by WestLB for solvency purposes. The Land retains a special influence over Wfa by way of specific supervisory, information and cooperation rights.

(114) Externally, liability in respect of Wfa's special reserve is unlimited. In the event of WestLB's Liquidation or bankruptcy, creditors would have direct access to it. Losses could also be offset against the special reserve without limitations. Internally, however, WestLB's owners have laid down other arrangements regarding the order in which liable capital is called on, with Wfa's capital being ranked after the remaining equity capital of WestLB. Because this internal agreement does not affect external legal liability, BAKred accepted the special reserve as original own funds amounting to DEM 4 000 million (EUR 2 050 million) on 30 December 1992.

1. Market economy investor principle

(115) The German Government notes that the Land was in no way obliged to consider privatisation as an alternative to the transfer. Privatisation would have allowed WestLB to approach the capital markets in order to raise the necessary equity. The Land was not obliged to open up WestLB to private investors. Such an argument would infringe Article 295 of the EC Treaty.

(116) An increase in the total return on WestLB's equity is said to be unnecessary, as measures to increase the return are required only if the State invests in loss-making companies. The German Government claims that the Court applied the market economy investor principle in the past only to State interventions in loss-making companies and sectors characterised by structural overcapacity. It cannot be inferred from case-law that the Commission may examine State investments in sound and profitable public enterprises in order to determine whether they generate at least an average return. The State may take into account long-term strategic considerations and enjoys a certain latitude for entrepreneurial decisions within which the Commission is not allowed to examine such decisions. Therefore, the Commission may not require a certain minimum return as long as it can be assumed that the enterprises in question will not be loss-making in the long run. The concept of average returns necessarily implies that the profitability of many enterprises is below the average in their industry. Furthermore, it is not clear which enterprises and which periods of time should be used as a basis for computing average returns. The State is not required to be guided only by profitability considerations when taking entrepreneurial decisions. Even a private investor might take other aspects into account. It is part of entrepreneurial freedom to continue to operate enterprises with a below-average return and to inject additional capital into them. The limit for the State is reached only when such behaviour can no longer be economically justified under the private-investor test.

(117) However, the transaction can also be justified on the basis of the market economy investor principle as a measure which would also have been taken by a private owner. By virtue of being earmarked for a special purpose, the injected capital is not comparable with a normal equity injection and the transfer constitutes in commercial terms the most sensible and efficient utilisation of Wfa's capital. The Land has optimised the
value of Wfa’s assets by the transfer. If Wfa is compared to a private, non-profit-making entity (e.g. a foundation), the private owner of such an entity would have acted in the same way in order to put the assets, which cannot be used for any other purpose, to a commercial use.

(118) According to the German Government, the public purpose of Wfa’s assets constitutes a task of general economic interest which, under Article 295 of the EC Treaty, is not subject to Commission supervision. The Member States are free to create such special-purpose assets.

(119) The German Government submits that the way in which an adequate remuneration is paid is of no relevance under the State aid rules. Since the Land received an adequate remuneration, an increase in its participation in WestLB was neither necessary nor justified and would in fact have provided the Land with an additional economical advantage without additional consideration. Nor would such a redistribution of shares correspond to the special nature of Wfa’s assets (lack of liquidity, internal subordinate liability). Equity instruments on the capital markets, which are comparable to Wfa’s assets, do not carry voting rights either. Since the agreed remuneration is adequate, the other owners of WestLB receive no additional income which they would not receive under normal market economy conditions and WestLB’s attractiveness for other investors is not therefore increased. Moreover, because the shareholder structure of WestLB is fixed and no new (private) shareholders are possible, a remuneration which was hypothetically too low would in fact have no influence on possible private investors. Even if the other shareholders received an advantage, any effect on the savings banks would be too small to be perceptible.

(120) Since the Land receives a fixed and adequate remuneration and WestLB was and is a profit-making enterprise which can undoubtedly pay the agreed remuneration, the actual level of WestLB’s total return on capital is in fact of no relevance and there was no need for the Land to require an increase in the bank’s profitability.

2. Appropriate remuneration for the capital

(121) The German Government submits that WestLB pays an appropriate remuneration for the transferred assets. The fact that a remuneration would have to be paid by WestLB for the capital provided has always been regarded by the Land as a prerequisite for the transfer. The level of and basis for assessing such remuneration was intensively discussed between the parties involved. Since it was not yet clear in 1991 what amount would be accepted by BAKred as original own funds. Only the principle, and not the actual level of, remuneration was fixed at the time of the transfer. The actual level of 0.6 % was fixed in 1993 after negotiations with the other owners of WestLB(25). The German Government did not provide the Commission with any documents explaining how this figure was determined. Instead, it argues that the decisive factor from a State aid point of view is not the considerations on which the rate was based but only the result, which is said to be appropriate. The fixed remuneration was to be paid from distributable profits, i.e. before any dividends were paid. If, owing to a lack of profits, the remuneration was not paid in any one year, there was no right to recovery payments in future years(26). The figure of 0.6 % corresponds to pre-tax costs of about 1.1 % for WestLB.

(122) The following table shows the payments made by WestLB to the Land as remuneration for the capital transferred:

(123) Table 6: Remuneration paid by WestLB for the transfer of Wfa (data provided by the German authorities)

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<td>Payment for pension entitlements of Wfa staff</td>
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<td>Total remuneration paid to the Land</td>
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(25) The 0.6 % rate was laid down in a protocol note to the covering agreement dated 11 November 1991.

(26) The German Government has explained that there was an agreement between the owners that such recovery payments should be made but that there was no corresponding legal obligation on WestLB.
(124) The German Government presented studies by an external consultancy that had been commissioned by WestLB to assess what would have been an adequate remuneration in 1991 for a capital investment with the same risk profile as Wfa's assets. These expert opinions examine the external and internal risk exposure of the capital and the conditions governing the remuneration payments, comparing these features to various equity instruments found on the international capital markets, in order to determine an appropriate remuneration. This comparison is explained in the following section. The studies arrive at a spread of between 0.9 % and 1.4 % as an appropriate remuneration. Since the pre-tax costs for WestLB of the 0.6 % remuneration rate amount to 1.1 %, this rate is regarded as adequate. In addition to this direct remuneration, the synergy effects arising from the transfer have to be taken into account (see later).

(a) Comparison with other equity instruments

(125) The studies state that the return on an equity instrument is determined by risk profile. The higher the risk, the higher the risk premium, i.e. the interest difference which has to be paid in relation to secure government bonds. In analysing the risk profile, three elements are particularly important: the arrangements for current interest payments, the investor's position in the event of current losses and his position in the event of liquidation or bankruptcy. The studies describe various features (27) of several equity capital instruments on the market (ordinary shares, dormant holdings, profit participation certificates, perpetual preferred shares, trust preferred securities and subordinated bonds) and compare them to Wfa's capital. According to the studies, Wfa's capital can best be compared to profit participation certificates, perpetual preferred stock and dormant holdings (28). Of the instruments mentioned above, trust preferred securities and perpetual preferred shares are not accepted in Germany. According to the studies, at the end of 1991 the following capital instruments qualifying as original own funds were available in Germany; ordinary shares, preferred shares (Vorzugsaktien) and dormant holdings (stille Beteiligungen).

(126) The studies stress that Wfa's assets would be available for WestLB's creditors in the event of bankruptcy of WestLB (liability function — Haftungsfunktion). At the same time WestLB can offset losses without limitations against Wfa's special reserve (loss compensation function — Verlustausgleichsfunktion). The internal agreements and the earmarking of Wfa's assets are of no relevance in this connection. However, internally the special reserve is subordinate in its liability to the other equity of WestLB and this internal situation would be decisive for the decision of an investor.

(127) As regards the loss compensation function, Wfa's special reserve can be compared to perpetual preferred shares. However, since it would be used, in parallel with profit participation certificates (which are additional own funds), only once, WestLB’s other original own funds had been exhausted and since some of the profit participation certificates would already have been used in paralles, it is less risky than the profit participation certificates. The same applies to dormant holdings.

(128) As regards the liability function, the special reserve would be used after the other original own funds but before dormant holdings, profit participation certificates and other additional own funds. Wfa's special reserve is therefore said to have a higher risk level than profit participation certificates and dormant holdings. Once again it can be compared in terms of its risk to perpetual preferred shares. However, according to the studies, because of the extremely low probability of a bankruptcy of WestLB, this risk can in fact be disregarded and an investor would heavily discount the corresponding risk costs.

(129) In the case of Wfa's capital, interest payments would be made from distributable profit and have priority over dividends. If the profit is not sufficient, no remuneration is paid. This arrangement corresponds in principle to that of perpetual preferred stock. Profit participation certificates are less risky because missed interest payments would be deferred and paid on a cumulative basis in later years. For dormant holdings too, cumulative repayments are possible. In the case of Wfa's capital, the risk of non-payment is limited to the risk premium (because of the liquidity costs; see later) whereas, in the case of the other two instruments, the full coupon (i.e. risk-free return plus risk margin) is at risk. Therefore, as regards interest payments, the risk of Wfa's capital is slightly lower than that of the other three instruments.

(130) The studies conclude that the risk premium for Wfa's special reserve should be below that for profit participation certificates and dormant holdings as well as below that for perpetual preferred shares. A historical margin before tax of between 1.0 % and 1.2 % is quoted for profit participation certificates, one of between 1.1 %
and 1.5 % for dormant holdings and one of between 1.5 % and 2.0 % for perpetual preferred shares. The historical risk margin for ordinary shares is given as between 2.8 % and 3.3 %. For Wfa's special reserve a remuneration of 1.1 % is calculated for the years 1993 to 1996. For 1992 a rate of 255 % is quoted. Synergy effects should also be taken into account. The studies conclude that the remuneration paid by WestLB was too high in 1992 and appropriate in the years 1993 to 1996.

(b) Liquidity costs

A cash injection increases own funds and provides liquidity. This liquidity can be reinvested and earn interest for which the investor would receive a remuneration. The transfer increases WestLB's own funds but does not provide liquidity. Wfa's capital is locked up in the housing promotion business. Unlike what happens with a cash injection, WestLB cannot reinvest the liquidity but has to raise liquidity on the capital market to achieve the same result. This results in additional interest expenses. Because of this lack of liquidity, the Land can, as shown by the expert opinions provided, demand a remuneration corresponding only to the risk margin, i.e. the difference between the total return on an investment and the return on a corresponding government bond.

Furthermore, it is stated that practically all risk-related assets-side banking business requires some liquidity, for example swap contracts, forward contracts and derivatives. Only guarantees and sureties do not require liquidity, but the corresponding transactions are not shown in the credit institution's balance sheet.

The relevant refinancing costs which have to be taken into account should be based on the return of long-term (i.e. ten-year) risk-free German Government bonds. The secondary market rate of such bonds at the end of 1991 was 8.26 %. The actual average refinancing costs of WestLB in November 1991 stood at […] %.

(c) Capital basis for the calculation of the remuneration

According to a protocol note to the covering agreement, the remuneration has to be paid on the annual average portion of Wfa's special reserve used by WestLB to underpin its own business. The first payment was to be made in 1993. However, in reality WestLB pays the remuneration not on the amount used but on the amount usable, i.e. the portion not needed to underpin Wfa's own business.

The remainder of the special reserve, i.e. the part needed for Wfa's own business plus the sum of DEM 1 900 million (EUR 970 million) entered as equity in WestLB's balance sheet but not accepted by BAKred, is of no economic use to WestLB because it cannot be used to underpin additional risk-bearing assets. The balance-sheet entry of DEM 1 900 million (EUR 970 million) is only the result of a difference in valuation. Since rating agencies and experienced investors look only at the accepted amount, the DEM 1 900 million (EUR 970 million) is of no economic relevance for WestLB. No private investor could demand remuneration for it on the market because the bank would always have alternative possibilities to raise equity capital on the market that would be accepted as original own funds (e.g. normal cash injection).

(d) Synergy effects

According to the Federal Government, Wfa's assets and liabilities would be newly discounted each year in order to be entered in WestLB's balance sheet at their actual value. Since repayments and interest would be granted again as new long-term, lower-interest housing loans, it is possible that the nominal amount of Wfa's assets would increase while the discounted value and the risk-adjusted amount would decrease.

(29) Data from the American and British markets were used for perpetual preferred shares, as these instruments are not available in Germany.

(30) The study uses the capital asset pricing model to calculate these rates. This model starts with a risk-free interest rate (here that of German Government bonds with a remaining period to maturity of 10 years, i.e. 8.26 % at the end of 1991) and adds to this a risk premium for equity which is derived from historical market data (here 3.0 % to 4.0 %); this figure is adjusted by a factor reflecting the systematic risk of the respective enterprises in comparison with the total market (here 0.77 %, derived from the market performance of two German banks, BHF-Bank and IKB).

(31) This is based on the rate of 0.6 %, a corporation tax rate of 46 % until 1993 and 42 % thereafter, plus a solidarity surcharge rate of 3.75 % in 1992, 0 % in 1993 and 7.5 % thereafter.

(32) This is based, firstly, on the fact that the special reserve was accepted by BAKred only on 30 December 1992, resulting in a figure for usable capital (for calculation purposes) of only DEM […] (EUR [...]). and, secondly, on the payment in 1992 by WestLB of DEM […] (EUR [...] for future pension entitlements of Wfa staff, which is taken as remuneration paid by WestLB to the Land in that year.

(33) According to the German Government, the Land expected synergies from the transfer amounting to more than DEM 30 million (EUR 15 million) annually in the longer term. These were to come from a simplification of housing promotion procedures, for example the elimination of duplication of activities, easier and faster
communication and less need for coordination. Since the transfer, Wfa needs fewer staff and saves on compensation payments for work carried out in the past by WestLB's housing promotion department for Wfa. It is claimed that the Land's expectations were indeed fulfilled and that, from a management point of view, the merger of Wfa with WestLB was the only way to achieve these synergy effects. Furthermore, the way in which synergies are achieved falls within the economic freedom of the Land, as protected by Article 295 of the EC Treaty.

3. Tax exemptions

Wfa's exemption from property tax (Vermögenssteuer), tax on business capital (Gewerbe kapitalsteuer) and corporation tax (Körperschaftssteuer) is provided for in the German tax system. Wfa and other public-law entities are exempt because they do not compete with taxable financial institutions but are used by the State to pursue certain objectives. Because of the tax savings, the State has to provide fewer funds for Wfa's activities. WestLB is fully taxed on its income (and thus also on the commercial activities underpinned by Wfa's capital) and does not receive any financial advantage from Wfa's exemption because the amount accepted as original own funds is not increased as a result. Even if the tax exemption were to lead to an increase in accepted capital, WestLB would not benefit as it would then have to pay an adequate remuneration on any additional amount.

4. Waiver of liability

According to the German Government, the waiver of liability serves to avoid a situation where the Land housing promotion fund is constantly reduced because of the liability created each year. The waiver does not reduce the Land's assets because, in the event of Wfa's liquidation, the housing promotion fund would be correspondingly higher. Since the liability of Wfa which has been waived would have fallen due only in the event of such liquidation, the waiver does not change the Land's overall economic position. In fact, the Land is only waiving a liability against itself.

5. Observations on the comments from interested parties

As to the comments of the two bankers' associations, the German Government remarks that the general accusations made are not substantiated by facts or any actual cases of complaints by credit institutions against WestLB's operation on the markets. The question of Anstaltslast and Gewährträgerhaftung raised by one of the associations is not linked to the present case and should be considered separately.

As to the comments by BdB, the German Government stresses that the transfer of Wfa was no ad hoc solution but the result of long-term strategic considerations, in particular the increase in Wfa's efficiency. The case-law of the Court contains no ruling whereby investment by the State in a sound and profitable enterprise has been regarded as State aid. The case referred to by BdB concerns companies which were loss-making. In view of the fact that WestLB has been a profitable enterprise since its formation, the market economy investor principle is not applicable. The German Government believes that this is confirmed by the case-law of the Court, where that principle is never applied to sound and profitable enterprises. Moreover, a private investor not only looks at the return but takes other, strategic
considerations into account. In the case of rescue and restructuring aid, other considerations have to be weighed up than in the case of a capital injection into a profitable enterprise. Investments by the State cannot be assessed simply by looking at the average return in a given sector. Otherwise, State investment in a bank with a below-average return would constitute State aid even though at the same time private investors were in fact investing in that enterprise. An investor is guided by prospects rather than sectoral averages.

which includes two periods when the market rose. Shortening the reference period would thus further lower the return figures.

(145) The State aid rules allow an examination only of the terms of the asset transfer, not of the particularities of Wfa's assets, which are protected by Article 295 of the EC Treaty. As the special nature of Wfa's assets is protected by that Article, the capital transferred cannot be compared to a normal liquid capital injection. A private-law foundation could be used in the same way as Wfa without any effect on the use of its revenues for its special purpose.

(146) Regarding the risk profile of Wfa's capital, a distinction must be drawn between the role of the Land as the owner of WestLB and as an investor in Wfa's special reserve. As an investor in Wfa, the Land bears a lower risk because of the internal subordination agreement between WestLB's shareholders. The risk borne by the Land as an investor in Wfa is limited to the assets transferred and is not higher, as claimed by the BdB.

(147) The German Government submits that the return calculations provided by BdB (and taken from an outside expert's opinion) are incorrect and supports this view with reference to another study commissioned by WestLB. According to this study, the main errors are the wrong calculation method (arithmetic average instead of compound annual growth rate) and the use of irrelevant investment periods. After adjustment for these errors, the return of 16.86% before tax for large private banks in Germany comes down to 7.0%. Furthermore, the five German private banks taken into consideration cannot be compared to WestLB because of their differing business emphasis. Taking banks which are comparable, the return on equity falls to 5.8%. Furthermore, the study for BdB is said to use a representative reference period from 1982 to 1992.

(148) As to the liquidity aspect, the German Government rejects BdB's argument that, on account of a lack of liquidity, no refinancing costs would arise because the discounting of Wfa's assets already took that liquidity cost into account. It states that this discount is in no way connected to the liquidity aspect but is the result of the low- or non-yielding character of Wfa's assets and liabilities. It also rejects BdB's argument that, if any refinancing costs are accepted, only a small rate or 2.7% before tax is justified. The expert opinion submitted by BdB in this connection is said to be wrong because it confuses in an inadmissible manner the revenues of the bank with the revenues of an external investor. Furthermore, the BdB study looks at gross revenues whereas net revenues should be compared, and it applies an interest rate that is much too low (6.35%) instead of the rate on long-term Federal bonds at the end of 1991 (8.26%). The German Government submitted its own study produced by an outside consultancy.

(149) The synergies were said to arise only within Wfa, and not within WestLB, as the duplication of work and existence of parallel departments could be eliminated (transfer of the former housing division of WestLB). These effects were therefore entirely independent of the separation between Wfa and WestLB in economic, organisational and personnel terms. They led to a reduction in the capital grants by the Land to Wfa and were the direct result of the transfer of Wfa to WestLB.

(150) The difference between Wfa's special reserve shown in the balance sheet and the amount accepted by BAKred was clearly communicated to the outside world. According to the German authorities, creditors do not assign a liability function to the part not accepted for solvency purposes. Since only the part which can be used by WestLB to underpin its business is of economic use to the bank, the Land cannot ask for remuneration in respect of the excess amount.

(151) The waiver of the liability was taken into account in the valuation of Wfa's assets by BAKred, and it is on this basis that WestLB pays the remuneration. Furthermore, the overall economic position of the Land is not affected by the waiver and the tax exemption does not yield any benefit for WestLB.
V. ASSESSMENT OF THE MEASURE

(152) The first step in appraising the measure under the State aid rules of the EC Treaty is to assess whether it constitutes State aid within the meaning of Article 87(1) of the Treaty.

1. State resources and favourable treatment of a certain undertaking

(153) As described earlier, Wifa was a public-law institution owned entirely by the Land of North Rhine-Westphalia and with the task of promoting housing by granting low-interest or non-interest-bearing loans. The Land guaranteed its total liabilities under Anstaltslast und Gewährträgerhaftung. Wifa’s main source of financing, the Land housing promotion fund, had been created by annual cash injections from the Land budget and by interest income from housing loans.

(154) If State assets of this kind, which have a commercial value, are transferred to an enterprise without sufficient remuneration being paid, it is clear that State resources within the meaning of Article 87(1) of the EC Treaty are involved.

(155) In order to verify whether the transfer of State resources to a public enterprise favours the latter and is therefore liable to constitute State aid within the meaning of Article 87(1) of the EC Treaty, the Commission applies the market economy investor principle. This principle has been accepted (and developed) by the Court in a number of cases. The assessment under that principle will be made at point V.3 below. If State aid is involved, WestLB, i.e. a certain undertaking within the meaning of Article 87(1) of the EC Treaty, will clearly have been favoured.

2. Distortion of competition and effect on trade between Member States

(156) As a result of the liberalisation of financial services and the integration of financial markets, banking within the Community has become increasingly sensitive to distortions of competition. This development is intensifying in the wake of economic and monetary union, which is dismantling the remaining obstacles to competition in the financial services markets.

(157) In its 1997 annual report, WestLB defines itself as a universally and internationally active commercial bank, a central bank for the savings banks and the bank of the Land and its municipalities. It describes itself as a European banking group within the wholesale banking sector with activities in important financial and economic centres around the world. Its presence abroad is concentrated in Europe, where it has subsidiaries, branches and representative offices in all major countries. WestLB is present in over 35 countries worldwide.

(158) Therefore, despite its name, tradition and legally stipulated tasks, WestLB is not at all a local or regional bank. Its presence in Europe and on international markets has already been described at point II.1. In 1997 the group's foreign business contributed 48% of non-consolidated revenues. According to the 1997 annual report, the bank's growth in that year can be attributed mainly to the expansion of its foreign business.

(159) These facts clearly show that WestLB offers its banking services in competition with other European banks outside Germany and, since banks from other European countries are active in Germany, inside Germany. This has been confirmed by the observations of the bankers' associations of two Member States. It is clear, therefore, that aid given to WestLB distorts competition and affects trade between Member States.

(160) It should also be recalled that there is a very close link between the equity of a credit institution and its banking activities. Only on the basis of sufficient accepted equity capital can a bank operate and expand its commercial operations. As the State measure provided WestLB with such equity capital for solvency purposes, it directly influenced the bank's business possibilities.

3. Market economy investor principle

(161) In deciding whether elements of State aid are involved in a financial measure taken by a public owner of an enterprise, the Commission applies the market economy investor principle. This principle has been applied by the Commission in many cases and has been accepted and developed by the Court in several decisions(1). It allows the Commission to bear in mind the specific circumstances of each case, for example to take into account certain strategies of a holding company or group of companies or to distinguish between the short- and long-term interests of an investor. The market economy investor principle will also be applied to the case at hand.

(162) According to the principle, no State aid is involved if funds are made available on terms which a private investor would find acceptable in providing funds to a comparable private undertaking when the private investor is operating under normal market economy conditions \(^{(14)}\). In particular, a financial measure must be considered unacceptable to a market economy investor if the financial position of the company is such that a normal return (in dividends and capital gains) cannot be expected within a reasonable period of time \(^{(15)}\).

(163) The Commission has, of course, to base its appraisal of a particular case on the data available to the investor at the time he took his decision on the financial measure in question. The transfer of Wfa was decided in 1991 by the relevant public bodies. The Commission has therefore to assess the transaction on the basis of the data available and economic and market circumstances obtaining at that time. The data in this decision that relate to later years are used only to show the effects of the transfer on WestLB's situation and in no way to justify or question the transaction after the event.

(164) The German Government reminded the Commission to examine the case purely on the basis of the situation at the time of the transfer decision, i.e. the end of 1991, and not to take later developments into account. Such a view might imply that the Commission cannot take into account either the fact that only DEM 4 000 million (EUR 2 050 million) of original own funds instead of the requested DEM 5 900 million (EUR 3 020 million) was accepted by BAKred or the fact that a remuneration of 0.6% was agreed in 1993. However, at the time of the transfer, although the value of Wfa agreed by the Land and WestLB was DEM 5 900 million (EUR 3 020 million), no level of remuneration was fixed. The Commission therefore considers it appropriate, when assessing the operation, also to take into account the situation prevailing when the parties finally fixed the remuneration.

(165) The Commission does not agree with the German Government and WestLB that the market economy investor principle is not applicable to sound and profitable firms and that this is supported by case-law. The fact that the principle has in the past been applied mainly to firms in difficulty in no way restricts its application to this category of firm.

(166) Restructuring aid for firms may be granted only in cases where a restructuring plan restores the firm's viability, i.e. leads to a 'normal' rate of return that allows the aided firm to continue by its own efforts, because this 'normal' market rate of return is acceptable to a market economy investor. In cases where such matters have been brought before the Court, it has never called into question the fact that the Commission required not only a break-even situation or a token return but also a full normal market rate.

(167) There is no provision to the effect that, if a company makes a profit, this rules out a priori the possibility that the provision of capital contains elements of State aid. Even if a company is profitable, a market economy investor might refrain from injecting (further) capital if he could not expect an appropriate return on his capital contribution (in the form of dividends or an increased value of the investment). Should the company not show the appropriate expected return at the time of the investment, a market economy investor would call for measures to increase the return. Therefore, the market economy investor principle is applicable in the same way to all public enterprises whether profitable or loss-making.

(168) The adequacy of the likely return on capital depends in turn on what a market economy investor can expect from similar investments with a similar exposure to risk. It is evident that a constantly underperforming enterprise showing no signs of recovery is not viable in the long term. New investors would decline to meet the company's demand for further capital and existing investors would eventually disinvest, even accepting a loss, if necessary, in order to redirect their capital to more profitable investments. Thus, in a communication to the Member States on the application of the State aid rules to public undertakings, the Commission states that, when comparing the actions of the State with those of a market economy investor, 'in particular when a company is not making a loss', it will evaluate the financial position of the company at the time an additional capital injection is proposed \(^{(16)}\).

(169) It should also be borne in mind that 'sound and profitable firms' cannot be equated with firms which do not make a loss. A firm which generates only small profits or generates neither profits nor losses cannot in

\(^{(14)}\) Commission communication to the Member States: Application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13.11.1993, p. 3, point 11). While this communication deals explicitly with the manufacturing sector, the principle can undoubtedly be applied in the same way to all other sectors. As regards financial services, this has been confirmed by a number of Commission decisions, e.g. in the cases Crédits Lyonnais (OJ L 221, 8.8.1998, p. 28), and GAN (OJ L 78, 16.3.1998, p. 1).

\(^{(15)}\) Public authorities' holdings in company capital — Commission Position (Bull. 9 — 1984, pp. 93-95).

fact be regarded as sound and profitable. It is certainly difficult to determine ‘average profitability’, as this is dependent on a number of factors, for example the level of risk in the industry in which the firm operates. However, firms which, over a certain period, generated a profit lower than that generated by firms with a similar risk structure would, as mentioned, be eliminated from the market in the long run. The position taken by the German Government and WestLB would lead to a situation where the State could invest in firms operating with an annual profit of EUR 1, regardless of the State aid rules in the Treaty.

(170) It is clearly not the Commission’s task to initiate procedures systematically and immediately if a public enterprise shows below-average profitability. Even private firms may from time to time have lower-than-average profitability. (The existence of an average logically implies deviations in both directions.) However, in such circumstances a normal firm operating on the market would try to increase its profitability and carry out restructuring and other measures in order to prevent this situation from becoming chronic. Market investors would expect appropriate measures to be taken in this respect.

(171) Furthermore, as already indicated above, a distinction must be drawn between existing and new investments because the starting points for the investment decision in question are different, but not the basic principle. In the case of an existing investment, the investor might be more willing to accept a lower (or even negative) return in the short run if he expects the situation to improve. Certainly, an investor might also increase his investment in a firm with low profitability. However, he would not do so unless he expected an improvement in the situation and a reasonable return in the long term. If, on the other hand, he expects the combination of risk and return to be poorer than in comparable firms, he will consider terminating his investment. In the case of a new investment, the investor may be less willing to accept lower profitability from the very outset(174). However, as already stated, the principles are the same in all decision-making situations: the return expected from the investment in the long run (taking into account the risk and other factors) must at least be equal to that from comparable investments. Otherwise, the company will not be able to find the necessary funds and will therefore not be viable in the long run.

(172) According to WestLB, the question of whether the bank generated average profits in the years before the transfer can in principle remain unanswered if a fixed and appropriate remuneration is agreed and profitability is sufficient to maintain this remuneration in the long run. This view can be accepted in principle. However, it should also be borne in mind that viability in the long run depend on the company achieving an average rate of return on its equity capital.

(173) With respect to the probable behaviour of a market economy investor, it is of no relevance that other banks also had to raise additional capital as a consequence of the stricter rules of the Solvency Ratio Directive. The Directive does not impose any obligation on banks to raise additional capital. It merely stipulates a minimum ratio of capital to risk-adjusted assets, i.e. it establishes a legal presumption of what is necessary for a bank's viability. In other words, under certain conditions a market economy investor might have urged his bank to restructure its risks in order to comply with the new solvency rules instead of increasing the bank's capital. Such a step would directly reduce the bank's volume of business and hence its market presence.

(174) If a public shareholder decides that a capital injection is an appropriate way for the bank to meet the capital requirements, the question is whether the particular circumstances under which the capital is provided would be acceptable to a market economy investor. If a capital measure is needed to meet the solvency requirements, a market economy investor might be willing to carry out this measure in order to preserve the value of investments already made. But he would insist on receiving an appropriate return on the newly injected capital. It is likely that a market economy investor would expect a higher return on a capital investment in a bank whose capital resources are depleted and which is in urgent need of new capital because this circumstance exposes him to higher risk.

(175) In the light of the market economy investor principle, the key question is whether such an investor would have supplied WestLB with capital that had the specific characteristics of WA's assets and under the same conditions, especially in view of the probable return on the investment. This question will be examined below.

(174) It cannot be said that investments are made only in profitable companies on the market. High-risk investments, e.g. in innovative or new technology companies, are quite common. However, in these cases too the investor invests his capital on the expectation that the start-up losses and the risks involved can subsequently be offset by high profits. Even in the case of such investments, the benchmark is the expected long-term return.
(a) Article 295 of the EC Treaty

(176) The German Government argues that the Land of North Rhine-Westphalia was not obliged to consider privatising WestLB in order to increase the latter's equity, that the Land was in principle free to transfer Wfa to WestLB in order to achieve synergies and that the Land was not obliged under Community law to consider the transfer of Wfa to a private credit institution. This argument can be accepted. The German Government also claims that Wfa's public remit constitutes a task of general economic interest and that Wfa is therefore not subject to supervision by the Commission under Article 295.

(177) As long as public entities carry out only public tasks and do not compete with commercial enterprises, the competition rules do not apply to them. The situation changes when there are implications for competition. Article 86(2) of the EC Treaty deals with situations where it might be necessary to deviate from the competition rules in order to ensure the provision of services of general economic interest. It is discussed at point V.6. On the other hand, Article 295 of the EC Treaty protects the national systems of property ownership but this cannot justify any infringement of the Treaty's competition rules.

(178) The German authorities and WestLB claim that, because of the constraints imposed by the special purpose assigned to Wfa's assets, as laid down by the housing promotion law, the only possible profitable use of these resources was to transfer them to a similar public-law entity. Thus, the transfer represented the most commercially sensible use of the assets in question. It is therefore argued that any remuneration for the transfer, i.e. any additional return on Wfa's capital, is sufficient to justify the transfer in view of the market economy investor principle. This argument cannot be accepted. It may be true that Wfa's transfer to WestLB, which subsequently allowed WestLB to use part of Wfa's capital for solvency purposes, was the most commercially sensible use. Member States are free to use public funds for public sovereign purposes, demanding no or low profits in return. The Commission does not question the right of the Member States to create special-purpose funds in order to fulfil tasks or general economic interest. However, as soon as such public funds and assets are used for commercial competitive activities, they must be subject to normal market economy rules. This means that, as soon as the State decides to assign public-purpose assets to a commercial use, it should seek a remuneration corresponding to market terms.

(b) Specific nature of the measure

(179) In carrying out the above transfer operation in response to WestLB's need to expand its original own funds, the Land authorities chose a method of increasing capital that had very special features. The general idea was to merge a non-profit credit institution pursuing a particular task (Wfa) with a normal commercial bank operating under conditions of competition, with the aim of utilising surplus capital (from the point of view of the solvency rules) within the non-profit institution for the purposes of the entity exposed to competition. At the same time, the assets transferred remained earmarked for their original purpose. Consequently, the approach of an entity within an entity was chosen, with Wfa's assets constituting an independent and closed circuit in which profits generated by Wfa accrue to and are retained by that institution only.

(180) The Commission is not aware of any precedents for a capital increase involving such an 'imperfect' merger in so far as this might be relevant from a State aid point of view. In its opinion, however, if a mechanism like the one at issue is chosen by a Member State, a thorough analysis of its financial and economic impact on the competitive part of the entity is imperative so as to ensure that non-transparent mechanisms are not used to circumvent the Treaty's State aid rules. It is necessary to assess whether and to what extent the integration carried out is economically advantageous to the competitive divisions of WestLB despite the creation of 'closed circuits'.

(181) It should be pointed out here that the complexity of the case and the lack of directly comparable transactions on the free market makes this judgment a rather difficult one. Therefore, the Commission devoted a considerable amount of time to gathering information and analysing the case. Furthermore, it arranged for an outside expert to deliver an opinion on the transaction and on the remuneration that can be regarded as corresponding to market terms. Only on the basis of all the data available and after a careful examination has the Commission finally drawn its conclusions and come to the present decision.

(c) No change in ownership structure

(182) When injecting equity capital into a bank, a market economy investor requires an appropriate share in the bank's profits. One way of ensuring such participation is a corresponding change in the structure of ownership, giving him an appropriate share in the bank's dividends and in a possible increase in its disclosed and non-disclosed value as a result of its enhanced earning capacities. Therefore, one way of ensuring an adequate return on the capital provided would have been to increase the Land’s participation in WestLB accordingly, provided that the bank’s overall profitability corresponds to the normal rate of return that a market economy
investor would expect from his investment. This would have avoided the discussion of whether the 0.6 % rate of remuneration is appropriate. However, this course was not adopted by the Land.

(183) According to the German authorities, a redistribution of shares in WestLB was not possible because of the specific nature of the transaction, especially the closed-circuit arrangement and the Land's prerogative (only valid internally) as regards the net assets of Wfa in the event of the liquidation of WestLB, which was agreed by WestLB's shareholders.

(184) In this case, however, the Land should have demanded appropriate remuneration in another form for the transfer, in accordance with the market economy investor principle. Otherwise, if the Land forgoes a remuneration which the market normally demands, it is not behaving like a market economy investor and is thereby granting an advantage to WestLB which constitutes State aid.

(d) Capital basis for the calculation of the remuneration

(185) The German Government and WestLB submit that only the part of the accepted original own funds which can be used by WestLB to underpin its commercial business has an economic value for the bank, with the result that a remuneration can be demanded by the Land in respect of this part only. BdB claims that the whole amount of DEM 5 900 million (EUR 3 020 million) is at risk and therefore a remuneration should be paid on that amount. The level of this remuneration should be different for the accepted original own funds of DEM 4 000 million (EUR 2 050 million) and the remaining amount of DEM 1 900 million (EUR 970 million).

(186) The Commission's consultants based their assessment on the assumption that, at the time of the transfer, the value of Wfa was established by the Land and WestLB at DEM 5 900 million (EUR 3 020 million) and that a market economy investor would therefore in principle seek a remuneration in respect of that figure, regardless of any later developments such as acceptance of the capital (or only part of it) as original own funds by BAkred. The only decisive factors for the fixing of a remuneration for a capital investment are the circumstances obtaining at the time of the investment decision, and not subsequent events. However, the Commission's consultants also accept that the transaction would have taken a different course if normal commercial practice had been followed.

(187) In the Commission's view, the sequence of steps in which the transfer was carried out could in fact point to an equal remuneration for the whole capital shown in WestLB's balance sheet. The transfer was first decided and carried out, and then BAkred was requested to accept Wfa's special reserve as original own funds and the remuneration was fixed only close on two years after the transfer decision. However, under normal market conditions, no bank would have agreed to include Wfa in its balance sheet for the sum of DEM 5 900 million (EUR 3 020 million) and to pay a uniform remuneration on that amount before first checking whether that amount would also be accepted as original own funds by the supervisory authority. Furthermore, as is also stressed by the Commission's outside experts, a rational investor would certainly not behave in this way; i.e. consent to a substantial capital injection, without first agreeing on an appropriate remuneration mechanism. However, in the Commission's view, the sequence of events can be explained by the special circumstances of the case. The Land had long-term financial relations with the bank and was its main owner. There were only a small number of shareholders (all of them public), which means in practice less need for transparency and openness compared with a company that has a large number of (outside) shareholders or is listed on the stock exchange. These special circumstances made it possible to decide on the transfer while leaving the decision on the final remuneration open until it was established that Wfa's capital could actually be used for commercial banking purposes.

(188) For the purpose of establishing an appropriate remuneration, a distinction should be made between the different parts of Wfa's special reserve according to their use to WestLB. An amount of DEM 5 900 million (EUR 3 020 million) was entered as equity on WestLB's balance sheet. An amount of DEM 4 000 million (EUR 2 050 million) was accepted by BAkred as original own funds. Of these amounts only DEM 2 500 million (EUR 1 280 million) allows WestLB to expand its activities and should be the primary basis of a remuneration for the Land. The remaining DEM 1 500 million (EUR 770 million) of the accepted original own funds is shown in the balance sheet but is needed to underpin Wfa's housing promotion business. An amount of DEM 1 900 million (EUR 970 million) is shown in the balance sheet but not accepted as own funds for solvency purposes. Therefore, the amount shown in WestLB's balance sheet but not usable by WestLB to expand its commercial business totals DEM 3 400 million (EUR 1 740 million).

(189) However, equity is necessary not only for supervisory reasons. The amount of equity shown in the balance sheet is also an indication for the bank's lenders of its soundness and thus influences the conditions under which the bank is able to raise outside funds. Contrary to the arguments of the German Government and WestLB, creditors and rating agencies look not only at accepted own funds but also at the overall economic and financial situation of the bank. Accepted own funds form only part of such an analysis of the bank's credit standing. An amount of DEM 5 900 million (EUR 3 020
million) was set by the Land and WestLB as a probable value which could be achieved in the event of Wfa being sold to a third party. If this assessment had not been reasonable, WestLB auditors would not have allowed it to stand in the balance sheet. The amount of DEM 4 000 million (EUR 2 050 million) accepted by BAKred reflects the supervisory body's very cautious approach in its valuation. It should be borne in mind that the valuation made for BAKred also gives a spread of between DEM 4 000 million (EUR 2 050 million) and DEM 5 400 million (EUR 2 760 million). Thus, the total amount of DEM 5 900 million (EUR 3 020 million) would be viewed by a potential creditor as security for his monies and would increase the credit standing of WestLB. This positive effect of the transfer on the bank's creditworthiness was also stated in the valuation of Wfa made for WestLB in 1992. Since the amount of DEM 3 400 million (EUR 1 740 million) cannot be used to expand business but improves the bank's appearance in the eyes of creditors, its economic function may be compared in that respect to at least that of a guarantee even if it is shown as equity in the balance sheet.

(190) Since the amount of DEM 3 400 million (EUR 1 740 million) is also of economic use to WestLB, a market economy investor would have asked for a remuneration to be paid on it. Certainly, the level of this remuneration will be lower than that for the DEM 2 500 million (EUR 1 280 million), which is of greater use to WestLB since it can also be used under the solvency rules as own funds to expand its commercial business.

(e) Appropriate remuneration for the capital

(191) Investments of differing economic quality require differing returns. In analysing an investment's acceptability to an investor acting under normal market conditions, it is important therefore to bear in mind the special economic nature of the financial measure in question and the value of the capital provided for WestLB.

(192) The complainant originally claimed that the transaction at issue constituted a State guarantee by the Land for WestLB's debt. But WestLB shows the transferred assets as equity capital in its accounts and BAKred accepted an amount of DEM 4 000 million (EUR 2 050 million) as original own funds within the meaning of the Own Funds Directive, of which DEM 2 500 million (EUR 1 280 million) can be used by WestLB to underpin its commercial business. Consequently, a coherent appraisal of the financial measure in the light of Article 87(1) of the EC Treaty calls for its principal classification as capital injection and for appropriate remuneration to be paid. The very same financial measure cannot be regarded as a capital injection under banking supervisory rules and as a guarantee under the Treaty's State aid rules. This principal classification does not, however, rule out the possibility that the Commission might, because of its particularities, liken part of that equity which cannot be used by WestLB in the same way as 'normal' equity to a guarantee for the purpose of calculating an appropriate remuneration.

(j) Comparison with other equity instruments

(193) The German Government claims that, since no direct comparison with other transactions is possible, the appropriate remuneration for the capital provided should be established by comparing the transfer with various equity instruments on the markets. To this end, it submitted outside studies the findings of which are given above and which conclude that Wfa's capital can best be likened to profit participation certificates, perpetual preferred stock and dormant holdings.

(194) In the Commission's opinion, it is in fact difficult to liken Wfa's transfer to any instrument available on the market because of its special nature. The transfer might resemble certain instruments in some respects, but there are also enough differences compared with each instrument to assign only a limited value to this comparison. Moreover, the studies submitted by the German Government are not really comprehensive as they leave out several relevant instruments such as non-voting shares.

(195) It should be borne in mind that the instruments used for the comparison by the German authorities normally provide a bank with only a very limited part of own funds. They are additional instruments, supplementing the 'basic equity capital', which consists mainly of share capital and open reserves. By contrast, Wfa's capital boosted WestLB's own funds for solvency purposes from DEM 5 090 million (EUR 2 600 million) to DEM 9 090 million (EUR 4 650 million), i.e. by 80%. Even if one takes account only of the increase of DEM 2 500 million (EUR 1 280 million) usable by WestLB to underpin its commercial business, this still represents an increase of 50%. Hybrid instruments were usually issued up to a maximum level of 20%. It would not have been possible to increase WestLB's capital in the same way, and on a permanent basis, by one of the instruments compared (196).

(196) This point is also stressed by the Commission's outside experts, who criticise the fact that the studies submitted by the German authorities omit any reference to the size of the transaction and compare the transfer to what are (in terms of size) marginal instruments. According to those experts, Wfa's capital should therefore be compared instead to original own funds instruments like non-voting shares.
In 1998 the Basle Committee underlined the de facto subordinate character of hybrid equity instruments, including those which are in principle accepted as original own funds (at least by some national authorities). It decided that such instruments (‘lower tier-I capital’) should in future be allowed only up to a level of 15% of core capital, i.e. up to 0.6 percentage points of the 4% core capital requirement. Of course, this decision — taken in 1998 — cannot influence the original assessment of Wfa’s transfer and the remuneration to be demanded. However, it confirms the need for credit institutions to have a solid base of core capital in order to make use of hybrid equity instruments. For banking supervisory purposes, Wfa’s capital does not constitute ‘hybrid’ capital but ‘basic’ own funds. It should also be noted that in the past rating agencies pressed for some sort of ‘voluntary restriction’ to be applied regarding the share of equity from hybrid instruments, which they monitored closely. The reaction of the Basle Committee also reflects the concerns of the supervisory authorities and the ‘market’, i.e. the financial community, with regard to the gradual development of such instruments.

In this connection, it should also be stressed that the relatively wide range of hybrid equity instruments now available to credit institutions in several countries for use as original own funds and additional own funds did not exist in Germany back in 1991, when the transfer of Wfa was decided, or in 1993, when WestLB had to comply with new, stricter capital requirements. Some of these instruments were developed in the meantime, while others already existed but were not accepted in Germany. In practice, the main instruments which were available and used were profit participation certificates and subordinated loans (both of which are additional own funds, the latter being accepted only since 1993). It is therefore inappropriate to compare Wfa’s capital to such hybrid instruments, most of which have developed in the meantime and some of which are available only in other countries. The German Government itself (indirectly) rejects such a comparison, claiming that the Commission must examine the case on the basis of the facts available at the time of the decision at the end of 1991.

The German Government’s studies claim that, in the case of WestLB, the likelihood of bankruptcy is so low that it could in fact be practically disregarded. However, if this argument were followed strictly, it would mean that an investor should not require any top-up on the rate of return on risk-free government bonds when investing in companies considered as safe investments. This certainly does not correspond to market reality. Even though the risk of bankruptcy might be low in the case of a particular investment, it is taken into account by a market economy investor, who will demand a significant top-up for such investment in banks, as in the case of any other ‘safe’ equity investment.

As to the two instruments which, as the closest benchmarks, play the central role in the German authorities’ comparison, namely perpetual preferred shares and profit participation certificates, a number of specific points should be stressed. Perpetual preferred shares constitute original own funds (core capital) in some countries but are still not accepted in Germany. Profit participation certificates constitute only additional own funds, whereas Wfa’s capital qualifies as original own funds. The latter is therefore of much greater use to WestLB because it can be used to raise additional own funds (such as profit participation certificates) up to the same amount in order to increase the bank’s own funds. Moreover, if profitable years followed loss-making ones, profit participation certificates would be replenished before Wfa’s capital. In addition, Wfa’s capital is available to WestLB without any time limitation, while profit participation certificates are usually issued for a period of ten years. It is also worth recalling the enormous, atypical size of the capital injection and the fact that the ranking in the event of losses must be seen in this context. Since the share of Wfa’s capital is rather large, it will be used relatively quickly when major losses occur.

For all these reasons, the Commission believes that, because of the peculiarities of Wfa’s capital, the comparison with hybrid equity instruments submitted by the German Government is not a suitable way to determine the appropriate remuneration to be paid for Wfa’s capital.

As to the relationship between Wfa’s capital and other equity instruments, BdB claims that the subordination agreement in the covering agreement between WestLB’s shareholders is void because it encroaches on the rights of third parties by laying down that, in the event of losses at WestLB that this agreement covers only the relationship between Wfa’s special reserve and the other original own funds provided by shareholders, i.e. in

The outside study drawn up for it supports the Commission’s view and comments on various individual assessments in the study submitted by the German Government. For example, it sheds a different light on the ‘coupon effect’ by stating that, in the event of ongoing losses or liquidation, the whole capital and not only part of it would be lost. The study also points to two subjective elements of the study submitted by the German Government: market data are said to be used selectively and in some places are simply replaced by data from the authors’ own experience, without this being stated explicitly.
practice nominal capital and reserves, but that there was no intention to make Wfa's capital subordinate to additional own funds like profit participation certificates and subordinated loans.

(ii) Liquidity costs

(202) The arguments of the German Government and WestLB regarding the liquidity costs can in principle be accepted. A 'normal' capital injection into a bank supplies it both with liquidity and with an own funds base which it requires for supervisory reasons to expand its activities. In order to use the capital in full, i.e. to expand its 100 % risk-adjusted assets by a factor of 12.5 (i.e. 100 divided by a solvency ratio of 8) of the capital provided, the bank must refinance itself on the financial markets 11.5 times over. Put simply, the difference between 12.5 times the interest received and 11.5 times the interest paid minus other costs of the bank (e.g. administration) gives the profit on the equity (40). Since Wfa's capital does not provide WestLB with initial liquidity because the assets transferred and all the income of Wfa remain earmarked by law for housing promotion, WestLB faces additional funding costs equal to the amount of the capital if it is to raise the necessary funds on the financial markets to take full advantage of the business opened up by the additional capital, i.e. to expand risk-adjusted assets by 12.5 times the capital amount (or to maintain existing assets at that level) (41). Because of these extra costs, which do not arise in the case of normal equity capital, the appropriate remuneration must be reduced accordingly. A market economy investor could not expect to be remunerated in the same way as for a cash injection.

(203) However, in the Commission's view and contrary to the opinion of WestLB and the German Government, the entire refinancing interest rate does not have to be taken into account. Refinancing costs constitute operating expenses and therefore reduce taxable income. This means that the bank's net result is not reduced by the amount of additional interest expenses incurred. These expenses are offset in part by reduced corporation tax. Only the net costs should be taken into account as an additional burden on WestLB because of the special nature of the capital transferred. Overall, the Commission accepts that WestLB incurs additional 'liquidity costs' to the extent of 'refinancing costs minus tax'.

(204) As regards the actual interest rate to be used for the calculation, the parties agree that the long-term risk-free rate (10-year German Government bonds) at the end of 1991 was 8.26 %. Two 30-year German Government bonds issued in 1986 had secondary market yields of 7.8 % and 7.6 % at the time. WestLB claims that its actual refinancing costs on the basis of its financial structure at the time of the transfer were about [...] %. In the course of the investigation, refinancing rates of 7.0 % and 7.5 % were suggested by WestLB and the German Government in several documents and at several meetings (42). Given these rates and assuming that WestLB raised long-term funds to offset the lack of liquidity in Wfa's original own funds (also available in the long term), it is reasonable to take the government bond rate of 8.26 % as an appropriate rate. The studies submitted by the German Government on the level of remuneration also quote this figure as an appropriate long-term refinancing rate. Applying German tax rates, this gives a rate for net refinancing costs of 4.2 % (43). In any event, no refinancing costs higher than those of the private banks can be accepted, as WestLB with its triple-A rating should normally pay lower-than-average interest rates.

(205) It should also be pointed out that, in its complaint, BdB accepted the arguments of the German Government and WestLB and assumed that, in calculating the appropriate remuneration, a reduction corresponding to the amount of WestLB's refinancing costs must be made. It was only later, as part of the formal consultations, that BdB challenged this argument. The Commission, however, believes that the 'closed circuit' in the use of Wfa revenues, as asserted by the German Government, presents liquidity spilling over into WestLB's commercial activities

(40) Of course, in reality the situation is much more complex because of off-balance-sheet items, different risk weightings of assets or zero-risk items etc. However, the principal reasoning holds.

(41) The situation does not change if one takes into account the possibility of raising additional own funds up to the same amount of original own funds (a factor of 25 instead of 12.5 for original own funds).

(42) In the decision to initiate the procedure laid down in Article 88(2) of the Treaty, the Commission provisionally indicated a rate of 7 % on the basis of information submitted at that time by WestLB.

(43) According to documents provided by the German Government, the corporation tax rate was 46 % in 1992, plus a solidarity surcharge of 3.75 %, i.e. 49.75 % in total. This gives net refinancing costs of 4.15 %. The overall tax rate fell to 46 % in 1993 and has stood at 49.5 % since 1994, giving net refinancing costs of 4.46 % and 4.17 % respectively. The 4.2 % rate is therefore justified not only for 1992 but also as an average.
(iii) Appropriate remuneration for the amount of DEM 2 500 million (EUR 1 280 million)

(206) In theory, there are no doubt different ways of calculating the appropriate remuneration for the equity capital provided. The German Government and WestLB suggest using the capital asset pricing model in order to calculate only the risk premium for Wfa's special reserve, while simply disregarding the risk-free base rate because of the liquidity costs. BdB and the Commission's outside experts argue that the basis should be the normal rate of return on investment in the banking sector adjusted for a number of specific features of the transaction.

(207) The capital asset pricing model was in fact developed for the purpose of pricing shares held in a portfolio of a well-diversified investor. By contrast, the investment decision in question was a one-off decision and did not involve one particular stock within a diversified portfolio. Furthermore, it is also questionable whether the two banks used by WestLB's consultants to arrive at a beta factor for WestLB are really the best choice, as WestLB is much more complex and more internationally oriented. However, in principle, the two approaches should lead to similar conclusions.

(208) As has also been pointed out in the documents submitted by the German Government, even experienced investors normally use data from past years as a basis for their assessment of likely returns in the future. However, it should be stressed that, in principle, a market economy investor bases his decisions on the expected return and not on past performance.

(209) The Commission has taken into consideration, alongside its own experience, several statements and studies by investment banks and consultancies regarding actual and expected returns on equity and investments, as well as the statements submitted by the different parties involved in the case. On the basis of this information, its own relevant experience, market statistics and decisions taken in the past on capital provided by the State({superscript 46}), the Commission assumes an expected minimum remuneration of 12 % after tax({superscript 47}) for this type of equity investment at the time of the transfer({superscript 48}). It should again be recalled that historical average returns are only one factor in an investor's investment decision. In fact, investors use as a guide the expected future rate of return. By so doing, they are in fact not only aiming for an average return but also endeavouring to achieve an even better return while taking into account the risk of the investment. In practice, companies therefore have to convince investors that they will at least be able to generate average returns on the equity injected. If a company cannot satisfy these expectations of at least average returns, the investor will consider investing in another company with better prospects. The Land obviously did not explore such other possibilities. In any case, such investment decisions and assessments by investors cannot be challenged by using retrospective market data on the actual performance of the markets since the time of the relevant decision.

(210) However, three features of the transaction in question are crucial for fixing the appropriate remuneration and have thus to be taken into account accordingly: firstly, the fact that the transfer constitutes a very substantial investment in a company with a significant capital shortage, low profits and no restructuring plan; secondly, the absence of new shares and associated voting rights; thirdly, the fact that it is a permanent investment in unquoted stock (i.e. with no exit possibility).

(211) The size of the amount transferred and its decisive effect on WestLB from the point of view of solvency regulations has already been mentioned. WestLB was making a profit in 1991 but was underperforming when compared with other banks. On this basis, a market economy investor would have demanded a

({superscript 46}) The same rate was used by the Commission in its decision on State aid for the French bank Crédit Lyonnais, where it stated that the relevant rate must be 'the rate that the capital markets would have used in order to assess the return on their contribution.

({superscript 47}) According to estimates made by a number of experts, including Crédit Lyonnais, the appropriate rate of return for capital invested in a bank is of the order of 12 % 'OF L 308, 21.12.1995, p. 92, Section 6.3).

({superscript 48}) It is worth pointing out that, in principle, investors primarily look at net returns when comparing investments.

({superscript 49}) This assessment is borne out by the study by the Commission's outside experts, who assume a rate of between 12 % and 13 % after tax as a minimum remuneration for equity at the time of the transaction. They add that investors were likely at that time to have had higher expectations (by around 1 percentage point) because of the European convergence process.
significant premium for an injection of capital as large in relative and absolute terms as Wfa's assets.\(^{(47)}\)

(212) Following the transfer of Wfa, the Land has been exposed to a higher risk in the event of WestLB becoming insolvent. On the other hand, the transfer of Wfa did not provide the Land with additional voting rights. By forgoing voting rights, the investor renounces a say in decisions taken by the bank's board. To compensate for this acceptance of a higher risk without a corresponding increase in influence over the company, a normal market economy investor would demand a higher remuneration (even if the potential risk were cushioned by internal agreements with the other shareholders). The situation can be compared to non-voting shares, which normally pay higher dividends than ordinary shares. A market economy investor would demand compensation to offset the renunciation of influence.\(^{(48)}\)

(213) Normally, an investor can at any time sell any of the various equity instruments mentioned earlier on the markets and thereby end his investment. The special circumstances of Wfa's transfer do not give the Land such an opportunity. This statement does not challenge the public purpose of housing promotion pursued by the Land and the earmarking of Wfa's assets for this purpose. However, even if the Land wanted to remove the housing promotion division from WestLB, for example because it considered that the public task in question could be fulfilled more efficiently by another arrangement, it could not do so. In fact, the Land is forgoing at least part of its right of disposal over the housing promotion fund. Because of the tied nature of the investment, a market economy investor in the same situation would demand an increase in the remuneration.

(214) In the case of shares, the remuneration depends directly on the performance of the company and is expressed mainly in the form of dividends and a share in the increased value of the company. The Land receives a fixed remuneration the level of which should reflect these two aspects of remuneration for 'normal' equity injections. It could be argued that the fact that the Land receives a fixed remuneration instead of one directly linked to WestLB's performance constitutes an advantage which justifies a reduction in the rate of the remuneration. Whether such a fixed rate actually constitutes an advantage as compared with a variable, profit-linked rate depends on the company's performance. If the performance is poor, a fixed rate benefits the investor but, if the performance is above expectations, it places him at a disadvantage. However, subsequent developments cannot be used to judge the investment decision, which was based on certain expectations on the part of the investor about the bank's future performance. It should also be borne in mind that, in the event of losses, no remuneration is paid at all and a decision on cumulative recovery payments is a matter for WestLB. In that respect too, the fixed nature of the rate does not benefit the investor. In aggregate, the Commission believes that the rate of remuneration should not be changed for this reason.

(215) The Commission is of the opinion that, because of the particularities of the transaction discussed above, a market economy investor would have demanded a premium on top of the normal market return on the capital provided. It regards a premium of 1.5 percentage points as the minimum reasonable rate.\(^{(49)}\)

(216) On the basis of the above considerations, the Commission concludes that an appropriate remuneration for the investment in question would be 9.3 %, namely, a 12 % normal return on equity plus a premium of 1.5 percentage points for the particularities of the transaction minus 4.2 percentage points on account of the financing costs resulting from the transferred assets' lack of liquidity for WestLB.

(217) It should also be mentioned that the remuneration of equity injected is normally a matter to be agreed between the company and the investor. However, in the case at hand, the level of the remuneration to be paid by WestLB was obviously agreed on between WestLB's shareholders, which seems unusual. It should not depend on what the other shareholders are willing to accept but on the risk for the Land and the usability for WestLB. The German Government moreover did not provide any documents about the negotiations on the remuneration or the way in which the level was calculated. It is certainly right in claiming that only the result, i.e. the level of the remuneration, is decisive for the Commission's assessment under the State aid rules.

\(^{(47)}\) The study by the Commission's consultants provides an example of a loss-making bank in the United States which suffered from a serious capital shortage and put together a robust restructuring plan. In order to attract an investor, it had to grant a considerable one-off discount on the quoted share price. Certainly, the case is not directly comparable to the one at issue (and the discount applied only once, at the time of the injection), but it shows that, where large amounts of capital are urgently needed, an investor asks for a premium.

\(^{(48)}\) The principle that non-voting shares should yield a preferential dividend above the normal level has been established by the Commission in past decisions (see, for example, the Commission's letter to Belgium dated 25 July 1984 regarding the firm Sidmar).

\(^{(49)}\) The study by the Commission's outside experts stresses that a market economy investor would expect a premium to be paid for each of these special circumstances and proposes for all three aspects together a premium of 1 to 2 percentage points.
and not the way in which this result was achieved. However, in the Commission’s view, the way in which the remuneration was fixed and the considerations that played a part in that respect can certainly provide pointers to the extent to which the Land behaved like a market economy investor.

Furthermore, it was agreed between the shareholders of WestLB that the remuneration should be fixed only once WestLB’s financial results for 1992 onwards were available. In the Commission’s view, the bank’s financial result should not in fact be of any relevance in determining the level of the fixed remuneration, which should be based not on the profits actually generated by WestLB but on the risk for the Land and the potential benefits of the transfer for the bank. A market economy investor would not be prepared to accept a lower level of remuneration because the results of the company in question were poor. This agreement does not therefore suggest behavior corresponding to that of an investor acting under normal market economy conditions.

During the Commission’s preliminary investigations, negotiations took place between the complainant and WestLB with a view to finding a solution, i.e. to establish on a common basis a remuneration regarded as being in line with the market, without recourse to the procedure laid down in Article 88(2) of the EC Treaty. These negotiations were not successful. During them, however, WestLB proposed that, in the event of its liquidation, the Land should be granted the right to receive, in addition to the existing fixed remuneration of 0.6 %, an adequate consideration for the increase in value of WestLB due to the additional business made possible by the transfer of Wfa, i.e. the Land would be given an additional share in WestLB’s open and hidden reserves. This fact suggests that the value to WestLB of the transferred capital actually exceeded the agreed remuneration. However, no such share in the break-up value was agreed. Nor would a market economy investor accept such a hypothetical remuneration since, in the case of a perpetual company like WestLB, he would never be able to cash it; it would thus have no value.

The German authorities claim that the real reason for the transfer was to achieve potential synergies and not to increase WestLB’s equity. It might well be true that a discussion on the efficiency of housing promotion had already begun in the 1970s. However, despite this lengthy debate, the transfer did not take place until 1991, when WestLB’s capital requirements forced its public owners to take such action. It is clear from the documents — especially the relevant material on the Transfer Law, such as the grounds of the Law and the minutes of the parliamentary debates — that the actual purpose of the transfer was to provide WestLB with the equity base needed to comply with the new solvency rules. Synergy effects were seen as a positive side-effect but were certainly not the main driving force behind the transaction at the time.

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promotion division of WestLB, which led to an organisational streamlining of the Land's housing promotion activities and a reduction in staff.

(224) Synergy effects are normal consequences of a merger. However, it is not clear how such synergies dovetail with the closed-circuit approach claimed by the Land and the competitive neutrality of Wfa. In so far as they were achievable after the transfer, despite the clear separation between the two entities, and arise from the merger of Wfa with the housing promotion division of WestLB, which had already in the past worked exclusively for Wfa, it is difficult to understand why it should not also have been possible to obtain such synergies without the transfer.

(225) Furthermore, if such synergies and cost savings accrue to Wfa, this will help the housing promotion activities (and hence the Land) by reducing costs but cannot be regarded as consideration paid by WestLB for the provision of the original own funds. Since these synergies neither reduce the usability of the transferred capital for WestLB nor increase WestLB's costs from the transfer, they should also not influence the level of remuneration for the equity provided which a market economy investor can demand from the bank. Even if there were an actual benefit accruing to the Land as a result of synergies, any competitor would have been forced by competition to pay to the Land on top of the appropriate consideration for the equity provided, a 'remuneration' in the form of benefits for the financial instrument (Wfa).

(226) For the rest, synergy effects as a result of a merger operation normally arise in both merged entities. It is difficult to understand why WestLB should not profit at all from such advantages.

(227) If WestLB made payments for Wfa's pension obligations which reduce Wfa's annual costs, such payments cannot be regarded as synergies from the merger. Nevertheless, they can be regarded as indirect remuneration for the Land paid by WestLB. The benefits should arise within the housing promotion business and therefore increase the funds available there.

(228) The Commission takes the view, therefore, that the claimed synergy effects do not represent a remuneration paid by WestLB for the transfer of Wfa, but it is prepared to regard the amount of DEM 33 million (EUR 17 million) paid by WestLB in 1992 for Wfa's pension costs as part of the remuneration paid by WestLB for the transfer.

(f) Aid element

(229) As calculated above, the Commission considers the following remuneration to be in line with market conditions: 9,3 % after tax for the part of the capital which can be used by WestLB to underpin its commercial business, i.e. DEM 2 500 million (EUR 1 280 million) at the end of 1993, and 0,3 % after tax for the difference between this part and the amount of DEM 5 900 million (EUR 3 020 million) shown as equity in WestLB's balance sheet, i.e. DEM 3 400 million (EUR 1 740 million) at the end of 1993.

(230) Currently, WestLB pays a remuneration of 0,6 % — and this only on the amount which it can use for underpinning its commercial business. This remuneration was first paid for 1993. As explained above, the Commission also accepts the payments by WestLB in 1992 for Wfa's pension claims as additional remuneration for the Land.

(231) The aid element can be calculated as the difference between the actual payments and the payments which would correspond to market conditions.

(232) Table 7: Calculation of the aid element

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4. Tax exemptions

(233) As stated in the Commission decision to initiate the procedure laid down in Article 88(2) to the EC Treaty, State aid may be involved if a particular enterprise is exempt from taxes whereas its competitors are subject to normal taxation. If the construction of an 'entity within an entity' involves a non-profit, tax-exempt entity, steps have to be taken to ensure that the economic effects of tax privileges are strictly limited to the non-profit entity and do not spill over to the enterprise in the competitive sector.

(234) WestLB is subject to neither property tax (Vermögenssteuer) nor tax on business capital (Gewerbekapitalsteuer) on the transferred capital. Furthermore, the profit from Wfa's activities exempt from corporation tax (Körperschaftsteuer) after the transfer. According to the German Government, these tax provisions are not intended to favour and do not favour WestLB over other taxable persons.

(235) Profits accruing within WestLB's competitive business as a result of the use of Wfa's capital for solvency calculations are taxed normally. Only profits in the housing promotion sector are exempt from tax. Similarly, the exemptions from taxes on business capital and on property are limited to the housing promotion business. It is not the Commission's task to decide whether the German tax laws regarding exemptions for non-profit-oriented activities have been infringed, but only to assess the measure under the State aid rules of the Treaty.

(236) The exemption from property tax, tax on business capital and corporation tax enjoyed by Wfa within WestLB boosts Wfa's profits (or reduces its losses), reduces the potential need for the Land to inject additional funds into housing promotion and could subsequently increase Wfa's net assets. Since Wfa needs only a certain part of this (enlarged) capital base as original own funds for its own business, the part available to WestLB to underpin its competitive activities might also increase over time. However, if this share increases, the basis for the remuneration to be paid to the Land will also increase. If this remuneration is fixed at an appropriate level, there will be no distortion of competition in favour of WestLB as a result of the tax exemptions for the housing promotion business. According to the above calculations, an appropriate level would be 9.3 % and 0.3 % respectively.

5. Waiver of liability

(237) The German Government argues that the waiver of liability does not adversely affect the Land's financial position and does not constitute any competitive advantage for Wfa or WestLB. Following the transfer, Wfa's assets (the Land housing promotion fund) are not reduced each year by this liability, so that higher proceeds are possible in the event of Wfa being wound up, with such higher proceeds accruing to the Land. The German authorities also state that, without the waiver, BAKred would not have accepted DEM 4 000 million (EUR 2 050 million) as original own funds of Wfa.

(238) The Commission accepts the argument of the German authorities that the Land's economic position has in principle not been changed by the waiver. Redemptions and interest for the debts in question had to be paid by the Land in any event. The waiver of liability increases Wfa's current value and its potential break-up value. The waiver of a debt of a public enterprise by its public owner could in principle constitute State aid. Here, however, the entity in question is not engaged in commercial activities.

(239) It should be noted though that, as a result of the transfer, the Land lost the latitude it enjoyed to change its housing promotion policy and to put Wfa into liquidation. Since Wfa's capital functions as equity of WestLB, this capital cannot simply be withdrawn by the Land. This fact was taken into account by the Commission when considering the appropriate level of remuneration for the transfer.

(240) The waiver has certainly increased Wfa's value. However, since the remuneration to be paid by WestLB is based on the valuation of Wfa after the waiver, i.e.
taking into account this increase in its value, the waiver does not constitute an advantage for WestLB if the remuneration is in line with the market.

6. Compatibility of the measure with the EC Treaty

(241) On the basis of all these considerations, it can be stated that all the criteria laid down in Article 87(1) of the EC Treaty are met and the transfer of Wfa therefore involves State aid within the meaning of that Article. On this basis, an assessment must be made as to whether that aid can be considered compatible with the common market. It should be pointed out that the German Government did not invoke any exemption clause of the Treaty with regard to possible State aid elements in connection with the transfer of Wfa.

(242) None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid is not of a social character, is not granted to individual consumers, does not make good the damage caused by natural disasters or exceptional occurrences, and does not compensate for economic disadvantages caused by the division of Germany.

(243) Given that the aid has no regional objective — it is designed neither to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment nor to facilitate the development of certain economic areas — neither Article 87(3)(a) nor (c) of the EC Treaty, as regards the latter's regional aspect, is applicable. Nor does the aid promote the execution of an important project of common European interest. The aid not aimed either at promoting culture or heritage conservation.

(244) Since the economic survival of WestLB was not at stake when the measure took place, there is no need to consider whether the collapse of a single large credit institution like WestLB could lead to a general banking crisis in Germany, which might possibly justify aid to remedy a serious disturbance in the German economy under Article 87(3)(b) of the EC Treaty.

(245) Under Article 87(3)(c) of the EC Treaty, aid may be found compatible with the common market if it facilitates the development of certain economic activities. This might in principle also apply to restructuring aid in the banking sector. However, in the case at hand the conditions for the application of this exemption clause are not met. WestLB is not described as an undertaking in difficulty whose viability must be restored with the support of State aid.

(246) Article 86(2) of the EC Treaty, which allows exemptions from the State aid rules of the Treaty under certain conditions, is in principle also applicable to the financial services sector. This has been confirmed by the Commission in its report on Services of general economic interest in the banking sector (10). However, it is clear that the transfer was effected in order to enable WestLB to comply with the new own funds requirements and with no regard to any services of general economic interest. Furthermore, the German Government did not claim that the transfer of Wfa was designed to indemnify WestLB for the provision of certain services of general economic interest. Therefore, this exemption clause does not apply either in the case at hand.

(247) Since no exemption from the principle of the ban on State aid pursuant to Article 87(1) of the EC Treaty applies, the aid in question cannot be found compatible with the Treaty.

VI. CONCLUSIONS

(248) The Commission finds that Germany has unlawfully implemented the aid in question in breach of Article 88(3) of the EC Treaty. This aid is therefore illegal.

(249) The aid cannot be found compatible under either Article 87(2) or (3) or under any other provision of the Treaty. The aid is therefore declared incompatible with the common market and must be discontinued and the aid element of the measure illegally put into effect must be recovered by the German Government.

HAS ADOPTED THIS DECISION:

Article 1

The State aid which Germany has implemented for Westdeutsche Landesbank Girozentrale in the years 1992 to 1998, amounting to DEM 1 579,7 million (EUR 807,7 million), is incompatible with the common market.

(10) This report was presented to the Ecofin Council on 23 November 1998 but has not been published. It can be obtained from the Competition Directorate-General of the Commission and can also be found on the Commission’s website.
Article 2

1. Germany shall take all necessary measures to discontinue and recover from the beneficiary the aid referred to in Article 1 and unlawfully made available to the beneficiary.

2. Recovery shall be effected in accordance with the procedures of national law. The aid to be recovered shall include interest from the date on which it was at the disposal of the beneficiary until the date of its recovery. Interest shall be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid.

Article 3

Germany shall inform the Commission, within two months of notification of this decision, of the measures taken to comply with it.

Article 4

This decision is addressed to the Federal Republic of Germany.

Done at Brussels, 8 July 1999.

For the Commission
Monika WULF-MATHIES
Member of the Commission