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COMMISSION

COMMISSION DECISION

of 20 October 2004

on State Aid implemented by Germany for Landesbank Berlin — Girozentrale

(notified under document number C(2004) 3924)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/736/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 the Member State and other interested parties to submit their comments pursuant to the provisions cited above ([1]) and having regard to their comments,

Whereas:

I. PROCEDURE

(1) The subject of these proceedings is the transfer, by the *Land* of Berlin, of Wohnungsbau-Kreditanstalt Berlin, with its assets, to Landesbank Berlin — Girozentrale. There are a further six cases in which proceedings have been initiated against Germany in connection with transfers of assets to Landesbanks, and in particular to Westdeutsche Landesbank — Girozentrale ('WestLB').

(2) By letter of 12 January 1993, the Commission asked Germany for information on the circumstances and reasons which had given rise to a capital increase in WestLB through the incorporation of the housing organisation Wohnungsbauförderanstalt ('WfA') and on similar increases in the own funds of the Landesbanks of other *Länder*. Germany replied in March and September 1993, providing a description of the transfer of Wohnungsbau-Kreditanstalt Berlin to Landesbank Berlin — Girozentrale. The Commission requested further information in November and December 1993, which Germany provided in March 1994. Berlin was explicitly mentioned in the first of the two requests.

(3) By letters of 31 May and 21 December 1994, the Bundesverband deutscher Banken e.V. ('BdB'), an association representing private banks established in Germany, informed the Commission that, as at the close of 31 December 1992, Wohnungsbau Kreditanstalt Berlin ('WBK') had been transferred, with its assets, to Landesbank Berlin — Girozentrale ('LBB'), while the tasks previously assigned to WBK had been transferred to the recently set-up Investitionsbank Berlin ('IBB'), which was operating as a division of LBB. This increased the own funds at LBB's disposal, and, in the BdB's view, distorted competition in LBB's favour since the parties had not agreed any remuneration which might be in line with the principle of the market-economy investor. In its second letter, the BdB accordingly lodged a formal complaint and called on the Commission to initiate proceedings against Germany under Article 93(2) of the EC Treaty (now Article 88(2)). The complaint also related to similar transfers of assets to Westdeutsche Landesbank, Norddeutsche Landesbank, Landesbank Schleswig-Holstein, Hamburger Landesbank and Bayerische Landesbank. In February and March 1995 and December 1996 several banks associated themselves individually with the complaint lodged by the BdB.

([1]) OJ C 239, 4.10.2002, p. 12.

(4) The Commission first examined the transfer of assets to WestLB. In Decision 2000/392/EC finally adopted in 1999 ([2]), it found that the difference between the remuneration paid and the normal market remuneration constituted state aid which was incompatible with the common market, and ordered its recovery. This decision was annulled by the Court of First Instance of the European Communities in a judgment handed down on 6 March 2003 ([3]) for not giving sufficient reasons as regards two of the factors used to calculate the appropriate remuneration, but it was confirmed in all other respects. At the same time as the decision in the present proceedings, and having been informed of an understanding between the complainant and all seven Landesbanks concerned, the Commission is adopting a new decision taking account of the Court's criticisms.

(5) On 1 September 1999 the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks, including LBB.

(6) By letter of 8 December 1999, Germany submitted information on the transfer of WBK to Landesbank Berlin, which it supplemented by letter of 22 January 2001. Representatives of Germany and the Commission also discussed the question of the transfer and possible recovery of any aid in connection with the examination of restructuring aid to Bankgesellschaft Berlin ('BGB'), to which Landesbank Berlin has belonged since 1994.

(7) By letter of 2 July 2002, the Commission informed Germany of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.

(8) After having requested, and been granted, an extension of the deadline, Germany submitted its comments and provided additional information by letter of 9 September 2002. Further questions were discussed at meetings with representatives of Germany on 27 September 2002.

(9) The Commission decision to initiate the procedure was published on 4 October 2002 in the Official Journal of the European Communities ([4]). The Commission called on interested parties to submit comments. It received comments from a competitor and from the BdB, which it forwarded to Germany for its opinion in November 2002. Germany replied by letter of 16 December 2002.

(10) At the Commission's request, Germany sent further details about the potential aid by letters of 22 and 27 January, 28 February and 19 August 2003.

(11) By decision of 18 February 2004, the Commission approved the restructuring aid for Bankgesellschaft Berlin AG, to which LBB belongs. The decision also covered an agreement concluded on 23 December 2002 by the *Land* of Berlin and the BGB on the treatment of any claims to repayment brought by the *Land* of Berlin and arising out of the state aid case at issue here; this agreement was regarded as restructuring aid ([5]).

(12) By letter of 7 April 2004 the Commission asked Germany for further information on all the Landesbank cases, which Germany sent on 1, 2 and 28 June respectively.

(13) On 31 August 2004 Investitionsbank Berlin (formerly WBK) was hived off from LBB's assets. Germany sent the Commission detailed documentation on the related legal and other provisions on 25 August 2004.

(14) On 27 September 2004 Germany submitted the draft of an understanding between the complainant (the BdB), the *Land* of Berlin and Landesbank Berlin, the signed version of which reached the Commission on 8 October 2004. This understanding covers the appropriate remuneration for the assets transferred to LBB on 1 January 1993. Similar understandings reached in five other cases involving transfers of assets to Landesbanks were also submitted to the Commission.

II. DETAILED DESCRIPTION OF THE MEASURES

1. *LANDESBANK BERLIN — GIROZENTRALE ('LBB')*

(15) LBB was set up in 1990 and, at the same time, the West Berlin Savings Bank (Sparkasse der Stadt Berlin West) was transferred to it by way of universal succession. Shortly afterwards, the East Berlin Savings Bank (Sparkasse der Stadt Berlin) was also transferred to LBB. Since then, the savings bank business in the city of Berlin has been conducted by a separate, legally dependent division of LBB called 'Berliner Sparkasse'.

(16) LBB is a public-law institution (*Anstalt des öffentlichen Rechts*) for which the *Land* of Berlin bears institutional and guarantor liability. At the time of the transfer of WBK at the end of 1992, LBB was solely owned by the *Land* of Berlin and had a balance-sheet total of some DEM 85 billion and just under 7 000 employees. LBB is an all-purpose bank with business in personal and corporate banking (retail banking), real-estate financing and lending to the public sector. It also conducts business abroad. In 1992 its main line of business was the Berliner Sparkasse's retail business.

([2]) OJ L 150, 23.6.2000, p. 1.

([3]) Joined Cases T-228/99 and T-233/99 [2003] ECR II-435.

([4]) OJ C 239, 4.10.2002, p. 12.

([5]) Paragraphs 32 *et seq*. and 141 of the Commission decision on restructuring aid for Bankgesellschaft Berlin AG (not yet published in the Official Journal).

(17) Since 1994 LBB has belonged to the BGB group, a group of institutions set up in that year by merging a number of credit institutions previously owned by the *Land* of Berlin. BGB is the holding company, with an atypical silent partnership which since 1994 has given it about 75 % of the assets and the profits of LBB, with the exception of the central *Land* promotion institution, IBB. In 1998 the *Land*, as LBB's guarantor, made over its claim to a share of LBB's profits to BGB; this made BGB the 100 % beneficial owner. The BGB group had a balance-sheet total of just under €190 billion in 2001, some €175 billion in 2002 and some €153 billion in 2003. LBB's balance-sheet total was some €87 billion in 2001, some €85 billion in 2002 and some €93 billion in 2003. The *Land* of Berlin currently holds about 81 % of the shares in BGB. Other shareholders are Norddeutsche Landesbank with around 11 % and Gothaer Finanzholding AG (Parion insurance group) with around 2 %. Some 6 % of the shares are dispersed among small shareholders.

(18) In 2001 BGB found itself in serious difficulty, mainly as a result of high-risk real-estate transactions in the past; its own funds and core capital ratios were insufficient, which meant that supervisory measures might have to be taken by the Federal Banking Supervisory Authority (Bundesaufsichtsamt für das Kreditwesen — 'BAKred', now 'BAFin') ([6]). In August 2001 it received a capital injection of €2 billion, of which some €1,8 billion came from the *Land* of Berlin and was initially authorised by the Commission as short-term rescue aid. After new risks were identified, BGB received further assistance from the *Land* of Berlin, which, together with the capital investment, was notified to the Commission as restructuring aid and examined in detail by it ([7]).

(19) On 18 February 2004 the Commission closed its investigation and approved aid with a total financial value of some €9,7 billion. Besides the capital injection and the extensive guarantees in the form of a 'risk shield', the decision also covered an agreement concluded on 23 December 2002 by the *Land* of Berlin and the BGB on the treatment of any claims to repayment brought by the *Land* of Berlin and arising out of the present state aid investigation ('repayment agreement') ([8]).

(20) This agreement governs the undertaking given by the *Land* of Berlin that, in the event of a Commission decision requiring repayment in the present case, it would provide as a contribution to LBB's capital a reorganisation grant to the value necessary to prevent the threatened repayment requirement from forcing LBB or the BGB group, or both, to fall below the minimum capital ratios specified in the agreement ([9]). This measure was considered necessary in 2002 in view of the considerable risk represented by possible repayment to the restoration of the BGB group's profitability. It was not possible in the BGB decision to determine the precise financial value of the measure as the present proceedings had not yet been completed. For the purpose of assessing the restructuring aid under the competition rules, and in particular the appropriateness of the compensatory measures proposed by Germany to reduce the group's market presence, the theoretical ceiling for this measure was set at €1,8 billion.

(21) To sum up, the repayment agreement was taken into account as additional aid to the BGB group in setting Germany's compensatory measures, although its scope was restricted to a situation where the Commission ordered repayment and where this resulted in the bank's capital ratios falling below the levels set in the agreement.

2. *TRANSFER OF WBK TO LBB*

(22) The restructuring of the *Land* of Berlin's banking holdings, which culminated in the setting up of the BGB group in 1994, began in 1990 with the setting up of LBB; the savings banks, first of West Berlin and then of East Berlin, were then transferred to LBB. In 1992 IBB was set up by, among others, the *Land* as a public-law institution within LBB which was independent in organisational and economic terms but had no authority to act in its own right; it was to act as the central promotion institution of the *Land*. WBK had until then been an independent public-law institution, with the *Land* of Berlin bearing institutional and guarantor liability for it. It had been assigned a task in the public interest, namely the provision and maintenance of housing. WBK was now to be transferred with its tasks to IBB, which was given broader promotion-related assignments, e.g. in the fields of infrastructure and environmental protection. The transaction took place on 31 December 1992: WBK was transferred to LBB, with all its assets, by way of universal succession.

(23) This increased LBB's nominal capital by the former nominal capital of the WBK worth DEM 187,5 million. This amount was thereafter no longer attributed to IBB's assets. WBK's revenue reserves stood at DEM 1 905 800 million on 31 December 1992. These revenue reserves were and are shown as a special-purpose reserve for IBB.

(24) BAKred set LBB's liable equity capital as at 31 December 1992 at DEM 3 127 714 million, which corresponded to an increase of DEM 1 902 714 million. BAKred took account of the DEM 187,5 million increase in nominal capital and of WBK's revenue reserves without the net

([6]) Since 1 May 2002 following the merger of the banking, insurance and stock market regulators: Bundesanstalt für Finanzdienstleistungsaufsicht (BAFin).

([7]) OJ C 141, 14.6.2002, p. 2.

([8]) Paragraphs 32 *et seq*. and 141 of the Commission decision on restructuring aid for Bankgesellschaft Berlin AG (not yet published in the Official Journal).

([9]) Paragraphs 32 *et seq*. and 141 of the Commission decision on restructuring aid for Bankgesellschaft Berlin AG (not yet published in the Official Journal).

profit for 1992. In the years that followed, IBB's liable equity capital in the form of the special-purpose reserve continued to grow.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS AND SOLVENCY DIRECTIVES*

(25) The German Banking Act (Kreditwesengesetz, or KWG) was amended for the fourth time in 1993 in line with Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions ([10]) (the 'Solvency Directive') and Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions ([11]) (the 'Own Funds Directive'), which require banks to have a level of own funds equal to 8 % of their risk-adjusted assets. At least 4 percentage points of that amount must consist of what is termed core capital, or 'tier 1' capital, meaning capital items which are at the credit institution's disposal without restriction and immediately in order to cover risks or losses as soon as they arise. The core capital is of decisive importance because additional capital, or 'tier 2' capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital. Under the fourth KWG Amending Act, German banks had to adapt their own funds to the new requirements by 30 June 1993.

4. *EFFECTS OF THE TRANSFER ON LBB'S CAPITAL BASE*

(26) According to Germany, the new rules were not the reason for WBK's transfer to LBB as the latter clearly met the new capital requirements even without WBK's revenue reserves. However, in the early 1990s a surge in growth was expected as a result of unification especially in Berlin, which would open up the potential for business expansion in the financial sector too. If banks wanted to increase their business volume significantly, a larger capital base was needed, especially in the light of the new solvency rules. The transfer of WBK gave LBB a considerably stronger capital base for its commercial, competitive lending business, allowing it to extend its operations significantly.

(27) LBB paid or pays 0,25 % ([12]) on average for calling on IBB's special-purpose reserve, but only on the amount actually used. Payment is made not to the *Land* of Berlin, but to IBB. Account should be taken of the fact that the part of IBB's special-purpose reserve which could be used as liable equity capital was far higher than the amount actually used. Recourse was had to it for the first time in 1995.

III. GROUNDS FOR INITIATING THE PROCEDURE

(28) The starting point for the investigation was the principle of the market-economy investor. According to this principle, the fact that undertakings are publicly owned and receive funding from the public authorities does not in itself constitute state aid. The provision of public money confers an advantage only if own funds are made available to such an undertaking on terms which it would not have obtained under normal market conditions.

(29) The Commission took the view that the investigation in this case therefore had to examine whether the resources had been made available by the *Land* of Berlin on terms which a private investor — an 'investor operating in a market economy' — would also have found acceptable in providing funds to a private company. Such a market investor would not be prepared to provide funds in particular if a normal return could not be expected within a reasonable time from the capital invested.

(30) In the Commission's view, a rate of 0,25 % on average payable on the sums actually used could hardly be regarded as appropriate remuneration for the *Land*, when even the long-term risk-free rate (for 10-year Federal bonds) was a good 7 % in 1992. The Commission also noted that the remuneration was not paid directly to the *Land*, but to IBB, which is a division of LBB even though, as a dependent public-law institution and central promotional institution for the *Land*, it operates as an organisationally and financially separate unit within LBB. Moreover, the sums used, as far as the Commission knew, lay well below the amounts of the special-purpose reserve available to LBB for use as liable equity capital. However, the increased equity base allowed LBB to expand its lending capacity and thus its business.

(31) The Commission established in its preliminary assessment that the data regarding the amount of IBB's capital available for covering liabilities, the amount used and the remuneration paid were incomplete or even unavailable and took as

([10]) OJ L 386, 30.12.1989, p. 14; replaced by Directive 2000/12/EC of the European Parliament and of the Council (OJ L 126, 26.5.2000, p. 1).

([11]) OJ L 124, 5.5.1989, p. 16; replaced by Directive 2000/12/EC.

([12]) 0,25 % before tax and 0,11 % after tax according to a remark in the relevant table submitted for the period 1995-98; however, there is no indication as to which taxes are concerned.

an initial, provisional amount for the transferred and usable funds a figure of 'approximately DEM 2 billion'.

(32) However, the Commission acknowledged that the special-purpose reserve did not provide LBB with any liquidity because, under the Act of 25 November 1992 setting up IBB, WBK's revenue reserve, which now became a special-purpose reserve earmarked for IBB, was to be used in the first place to finance IBB's promotional work, notwithstanding its function as own funds within the meaning of the Banking Act, and LBB could not use the funds transferred directly for its banking business. In order to be able actually to expand its business, LBB therefore had to refinance the additional volume of credit in full on the capital markets, meaning that the *Land* could not expect the same return as a provider of liquid capital could.

(33) As regards the calculation of a remuneration in conformity with the market-economy investor principle, the Commission stated that, at this stage, it intended to apply the methodology set out in Decision 2000/392/EC, while taking into account the specific circumstances of the case in question.

(34) According to this methodology, the appropriate remuneration for the capital usable to underpin the bank's commercial business is calculated starting from the market remuneration for liquid ordinary capital investment. A premium or a discount is then applied, in order to take account of the particularities of the measure concerned (before investor taxes). So as to take into account the liquidity cost arising from the lack of liquidity of the capital investment in question, the net refinancing costs (total refinancing costs minus applicable taxes, in particular corporation tax) are deducted from this rate.

(35) Germany had stated that in the years both before and after the transfer LBB was a high-return institution, with a return on equity stated to be 5,37 % in 1991, 13,5 % in 1992 and 30,83 % in 1993. The Commission commented that the basis for this calculation had not been clarified. Without further information, it was unable to assess this argument regarding the absence of any aid element in the measure. The German authorities had also argued that the *Land* of Berlin had secured proper remuneration for the function of IBB's capital as liable own funds for supervisory purposes on the basis of the *Land*'s sale to BGB of its silent partnership in 1994 and of its claim to profits in 1998, excluding IBB in both cases. However, further details had not been given.

(36) The Commission summed up by stating that it lacked important information for a proper and sufficiently detailed assessment of the capital injection and the remuneration paid. In its decision initiating the formal investigation procedure, it therefore asked Germany to provide this information, including a full statement of all the resources transferred, the amount recognised as liable equity capital for LBB, the take-up and remuneration, the basis on which the remuneration was determined, the basis for the calculation of LBB's return on equity, updated figures and all the factors which, in Germany's opinion, ensured a normal market return.

(37) However, on the basis of the information available, the Commission expressed serious doubts about whether the *Land* of Berlin had received a normal market remuneration or rate of interest for the transfer of some DEM 2 billion, almost all of which appeared to be available to LBB as a liable capital base and which placed it at an advantage over its competitors. The Commission drew the provisional conclusion that it was likely that competition was being, or might be, distorted and that, in view of the increasing integration in the financial services sector, trade between Member States was being affected. The measure therefore probably constituted state aid within the meaning of Article 87(1) of the EC Treaty. Since none of the exemption clauses contained in Article 87(2) and (3) of the EC Treaty were applicable to this case, the Commission supposed that, if aid were present, there was reason to doubt that it was compatible with the common market.

(38) Since neither Germany nor any other legal or natural person had indicated that LBB provided services of general economic interest within the meaning of Article 86(2) of the EC Treaty, the Commission was unable to conclude that the aid could be approved under that provision. In the absence of any change in this situation, it assumed that this point would not be relevant for a final decision on an assessment of the measure at issue.

(39) The Commission also explained that, in making its preliminary assessment and in accordance with Article 1 (b) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [13], it had assumed that, inasmuch as it constituted state aid, the measure was new and not existing aid. In this connection, it also referred to Article 15(2) of the above Regulation, pointing out that the limitation period had been interrupted by the actions described in the decision initiating the procedure, such as the Commission's letters dated 12 January, 10 November and 13 December 1993 and 1 September 1999, the decision initiating the procedure in this case, as well as the decision initiating the procedure and Decision 2000/392/EC closing the procedure in *WestLB*. Since the potential aid had not been notified and had been effective since its implementation, the Commission also found that the decision to initiate the procedure added nothing to the suspensory effect of the third sentence of Article 88(3) of the EC Treaty with regard to Germany's obligation to refrain from putting the measure into effect until such time as the Commission has reached a final decision.

[13] OJ L 83, 27.3.1999, as amended by the 2003 Act of Accession.

IV. COMMENTS FROM GERMANY

(40) In its comments, Germany began by outlining the reasons for the transfer of the former WBK (later IBB), stating that the *Land*'s objectives at the time were geared towards establishing a 'strong banking group' in the interests not only of the merged credit institutions but also of the *Land* as owner and of its banking sector. It again stressed that for LBB, unlike in the WestLB case, satisfying the capital ratios under the new solvency rules played no role in the transfer, as demonstrated by the fact that LBB did not have recourse to IBB's (formerly WBK's) liable equity capital until late 1995.

(41) Germany confirmed that DEM 1,902714 million of LBB's liable equity capital determined by the banking regulator as at 31 December 1992 corresponded to the increase brought about by the transferred funds. DEM 187,5 million of that amount corresponded to the increase in LBB's nominal capital ([14]) and some DEM 1,715214 million corresponded to WBK's revenue reserves, without the net profit for the year of DEM 190,586 million. As at the close of 31 December 1992, so with effect on 1 January 1993, all WBK's responsibilities were transferred to IBB, which was itself transferred to LBB. The transferred capital and special-purpose reserve were available to LBB for use as liable core capital as at the close of 31 December 1992 or on 1 January 1993.

(42) According to Germany, in the years which followed, IBB's special-purpose reserve continued to grow. However, it was not fully available to LBB since part of it was needed each year to underpin IBB's promotional activities. Germany submitted precise data for each year from 1993 to 2003 (which can be found in the table at paragraph 142).

(43) With IBB's hive-off from LBB on 1 September 2004, the special-purpose reserve was transferred back to the *Land* of Berlin, and €1,1 billion of it was transferred to two silent partnerships held by the *Land* in LBB.

(44) IBB's nominal capital of DEM 187,5 million incorporated at the time remained in the nominal capital of LBB. LBB was in turn sold to BGB in 1994 (75,01 % of the shares) and 1998 (24,99 % of the shares).

(45) Germany also completed the other data. It again stated that only part of the special-purpose reserve had actually been used to cover liabilities. The amount taken up in this way, starting in December 1995, had varied between about DEM 212 million in 1995 and over DEM […] (*) billion in recent years. The remuneration paid to IBB for the amounts used as of December 1995 (between a good DEM 1 million for 1995/96 and DEM […] million in 2001) was calculated monthly on the basis of an interest rate which ranged over the period from 0,2 % (1998) to 0,35 % (1996). The precise figures provided by Germany can be found in the table at paragraph 149.

(46) As the basis for determining the remuneration for any use made of IBB's special-purpose reserve, Germany provided a management board resolution dating from June 1993. This resolution states that '… remuneration should be paid to Investitionsbank Berlin for this capital charge (take-up) in an amount equivalent to the cost of raising subordinated liable capital'. This resolution was given practical effect in 1995, when the remuneration was equated to a subordination premium. The reason given was that LBB could have raised alternative subordinated capital on the market which would have been fully available not only in its guarantee function but also in an earnings function.

(47) However, since the IBB special-purpose reserve performed only a guarantee function, the difference between the interest rate for ordinary outside capital, which does not perform that function, and capital which also performs a guarantee function was set as the 'price' for the utilisation function. This premium was calculated in basis points by comparison with LIBOR (London Interbank Offered Rate) on the basis of specific terms or external market data for subordinated loans. The bases for the calculation and statistical data were attached.

(48) Germany justifies the decision to require remuneration only for the part of the IBB special-purpose reserve actually taken up *inter alia* on the grounds that the reserve was available primarily to IBB and that, if it were insufficient, it was first LBB which was obliged to reduce its risk assets or raise subordinated capital on the market. As owner of IBB, the *Land* of Berlin was entitled to withdraw parts of the special-purpose reserve at any time.

(49) Germany also commented in this connection that the liquidity of the special-purpose reserve was tied up in IBB's existing business and was not available to LBB for financing purposes. IBB had to underpin its lending itself with own funds and, in so doing, to have recourse to the special-purpose reserve. Germany stated that, in the light of these specific factors, WBK's assets could not be equated with freely available financial assets and that, therefore, only the guarantee function and thus the business expansion function were at issue.

(50) Whether the remuneration was paid to the *Land* or to IBB was immaterial here since the *Land* as guarantor would, in any event, profit from both IBB and LBB, either through LBB's increase in value and distribution of profits or through inflows into IBB's special-purpose reserve, on which the *Land* had a claim.

([14]) This amount was no longer attributed to assets.

(*) Confidential information, hereinafter […].

(51) Besides these comments on the direct remuneration, Germany also argued that it was not a factor, or not the only factor, in an investment decision and that 'in accordance with the case law, … an investor who does not hold or seek to hold a significant share in the relevant company but who is interested in a rapid return on his investment must be distinguished from investors geared to the long term, such as holding companies'. The latter were interested in long-term return expectations and would also take account of strategic considerations.

(52) As sole owner of LBB, the *Land* assumed at the time of the investment that it would benefit fully and directly from the increase in LBB's value brought about by WBK's transfer. Taking the assessment criterion applied by the Commission in Decision 2000/392/EC [15] as a basis, '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'. At issue, therefore, were the return expectations at the time of the investment decision.

(53) Germany initially indicated that LBB's return-on-equity ratio was 13,5 % in 1992 and 30,83 % in 1993. These figures, submitted back in 1999, related to the ratio 'earnings before (income) tax/equity capital shown in the balance sheet at the start of the same year'. However, in supplying these figures, Germany had not included IBB's special-purpose reserve in LBB's equity capital from 1993 onwards. At the Commission's request, this was corrected with the sending of data series covering a longer period. For the period 1985-1992 these figures gave an average return on equity of about 13 %.

(54) Germany stated that these figures would fall within the range of values obtained by private German banks in the same period, but it did not initially provide data produced by a similar method for other banks. It subsequently submitted its own calculations based on the published profit and loss statements of 35 German banks [16]. Taking 'earnings before tax as a percentage of equity capital shown in the balance sheet at the start of the same year', this gave an average return-on-equity ratio for these banks of around 11 % in 1992 and just under 13 % for the period from 1988 to 1992.

(55) Germany also stated that, from a business point of view, earning capacity was a decisive factor in an investment decision and that, in the case of banks, it could best be derived from profit from ordinary business or from operating result as a percentage of equity capital shown in the balance sheet since extraordinary earnings and expenditure would then be excluded. In the years 1990-92 LBB faced extraordinary circumstances, in particular the integration of the East Berlin Savings Bank and the related setting up of its own pension scheme, at the same time as it had to pay a compensation fee for withdrawing from the Federal and *Länder* Pension Institution and to make provision for the general banking risks of the former East Berlin Savings Bank.

(56) As regards obtaining methodologically comparable return-on-equity ratios for other banks in the same period, Germany stated that banks were required only as of 1993 to enter extraordinary result and profit from ordinary business separately in the profit and loss account, and that this cannot be compared with the pre-1993 method, when extraordinary income and expenditure were included, together with other items, under 'other income and expenditure' and therefore could not be identified precisely. For the period pre-1993, Germany submitted its own calculations. In the course of the proceedings Germany also made corrections and additions to the method for calculating LBB's return on equity, in order to render the figures for LBB comparable with the Bundesbank's official survey of German banks. According to Germany, this did not change the basic assessment that LBB's return on equity was in line with the average for the sector.

(57) In Germany's view, all the data showed that, at the time of the capital injection, LBB had a high earning capacity. The *Land* of Berlin was the sole owner and would alone benefit from the bank's commercial success, whether in the form of dividends or an increase in value. In this respect, the *Land* would not have to share the expected increase in return with other shareholders and the almost 'intra-group' investment was sound conduct from the point of view of an investor operating in a market economy. The question of whether and how large a remuneration was paid by LBB for the capital injection was therefore irrelevant to an assessment of the transfer's market-economy status.

(58) According to Germany, the Commission expressly laid down this assessment criterion in Decision 2000/392/EC: '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

[15] Paragraph 162 of the Decision, see footnote 2.

[16] Profit and loss statements published in the Hoppenstedt company database; the 35 banks selected include 4 large private banks, 5 other private banks, 17 public-sector institutions, 2 cooperative banks and 7 mortgage-lending institutions.

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* ([17]).'

(59) In this connection, Germany also stated that LBB's increase in value as a result of WBK's assets benefited the *Land* after LBB's incorporation into BGB. The transfer, undertaken in three stages in 1994 and 1998, of 100 % of the beneficial ownership in LBB to BGB was carried out on the basis of expert reports by various chartered accountants and one investment bank on the value of the *Land*'s silent partnership in LBB and on whether the quid pro quo — the BGB shares transferred, including in relation to other shareholders — equated to an acceptable market price. Germany provided relevant extracts from these reports and the related correspondence with the accountants. According to these documents, the value of LBB was set at some DEM 3,5 billion in 1993 (excluding IBB itself, but taking account of LBB's higher core capital ratio as a result of the special-purpose reserve) and, by a further expert, at just under DEM 6 billion at 31 December 1997.

(60) Germany also suggested, in the alternative, that the method used by the Commission in Decision 2000/392/EC was faulty in that it assumed comparability with liquid ordinary capital investment. This approach failed to take account of the particularities of the transaction at issue in these proceedings. It was proper to use comparable equity instruments as a basis for calculating even the starting amount. While this might be difficult, as the Commission had explained in the WestLB case, the difficulties would not be overcome by using a completely unsuitable equity capital instrument, almost as a 'way around' the problem.

(61) It was also mistaken to use average return as a benchmark. Only a return below the range available to investors for assessment purposes was no longer acceptable to a private investor. Lastly, it was erroneous to deduct only net refinancing costs instead of total refinancing costs. Any tax savings by the company were immaterial from the investor's point of view. A further consideration showed that this approach was unacceptable since with non-liquid provision of capital the earnings function of the capital was still available to the investor and could be re-invested by him to obtain at least the risk-free rate of interest, and he would thus achieve 'double' earnings.

(62) Germany also argued that the limitation period had expired (pursuant to Article 15(1) of Regulation (EC) No 659/1999) and that the Commission therefore had no power to order recovery of any aid. The basic resolution on WBK's transfer had been adopted on 16 June 1992, i.e. more than ten years before the decision initiating the investigation procedure was served on 4 July 2002. The resolution expressed the basic intention to merge the *Land*'s bank holdings and WBK into one holding company (later BGB), provided that WBK's promotional activities could continue and that the assumption of sovereign tasks and the tax exemption were guaranteed. The resolution had been in the public domain since then, and the Commission had been informed of its date in 1999.

(63) In a number of decisions, the Commission had already taken the declaration of intent by the relevant body, even subject to conditions, as marking the point at which the aid was implemented. This was also the position adopted by the Commission in the decision on rescue aid for BGB ([18]), even though the resolution concerned, adopted on 22 May 2002, had still required the approval of Parliament and of the Commission.

(64) Moreover, in Germany's view, the limitation period had not been interrupted pursuant to the second sentence of Article 15(2) of Regulation (EC) No 659/1999, which states that only action taken by the Commission can interrupt the period. The first such Commission action was the letter regarding the initiation of the procedure dated 4 July 2002, and not the requests for information, which were not measures taken by the Commission or the relevant Commission Member. Account should moreover be taken of the fact that the limitation period existed in the interests of legal certainty, not only in relations between the Commission and the Member States but also for the recipients of state aid. As Germany was asked for the first time in the decision initiating the procedure to forward a copy of the letter to the aid recipient, which it did on 9 July 2002, the limitation period was interrupted only as of that date. Since the measure subject to state aid monitoring was the resolution of 16 June 1992, it constituted, if it were aid at all, existing aid pursuant to Article 15(3) of Regulation (EC) No 659/1999.

V. COMMENTS FROM OTHER INTERESTED PARTIES

(65) After the decision initiating the procedure had been published in the Official Journal ([19]), the Commission received comments from the Berliner Volksbank ('BV') and the Bundesverband deutscher Banken ('BdB') in October and November respectively.

(66) The BV took the view that the transfer of WBK was aid because the capital had been made available on terms which a market-economy investor would not have accepted. Payments were made by LBB to IBB, which was itself managed as a division of LBB; moreover, the agreed interest rate of 0,25 % lay well below the normal market rates, as illustrated by Decisions 2000/392/EC (WestLB), 95/547/EC ([20]) and 98/490/EC ([21]) (Crédit Lyonnais), where a likely return on capital of at least 12 % was taken as a basis. This

([17]) Paragraph 182 of the Decision, see footnote 2.

([18]) NN 53/2001; Commission decision of 25 July 2001.

([19]) See footnote 1.

([20]) OJ L 308, 21.12.1995, p. 92.

([21]) OJ L 221, 8.8.1998, p. 28.

aid led to a serious distortion of Community-wide competition, but with particularly serious consequences in Berlin, where BGB, including LBB (and Berliner Bank and Berliner Sparkasse), led the market in personal and corporate retail banking. By comparison, BV was a small competitor with market shares of 5-7 % and was thus particularly affected by the negative impact of the aid. It closed its statement by calling on the Commission to order recovery of the aid.

(67) The BdB began by stating that the proceedings at issue formed part of a series of investigations by the Commission involving the transfer of *Land* housing promotion institutions to the Landesbanks, which carried on competitive business. In LBB's case too, contrary to the statements by Germany, the higher own funds requirements under the Solvency Directive were decisive. Evidence that this was the case were the timing of the transfer and the comments by the relevant Member of the *Land* Government at the time, who referred to the European own funds requirements, which were expected to become stricter. In this respect, there was no relevant difference in state aid terms between the transfer of WBK to LBB at issue here and the transfer of WfA to WestLB, which meant that the method used by the Commission in Decision 2000/392/EC could be applied here.

(68) The BdB went on to comment that it was not only the special-purpose reserve which was at issue here but also the transfer of WBK's capital of DEM 187,5 million, which was assigned to LBB's subscribed capital; this constituted a financial advantage as it influenced the rating and the terms for raising external capital. However, of much greater significance was the increase in core capital recognised for supervisory purposes as a result of the transfer. As this had been available in full as liable capital, despite the special-purpose reserve's being used primarily for promotional activities, its purpose was not the issue. The key factor was the economic advantage of the business expansion function, especially since the core capital had powerful leverage (lending capacity increased by 12,5 times for 100 % risk-weighted assets such as lending to companies and by 25 times for 50 % risk-weighted assets such as loans to public authorities). If additional capital were raised, with a core capital of (hypothetically) €1 billion and a risk weighting of 50 %, loans amounting to as much as €50 billion could be given.

(69) For the calculation of what constituted a normal market remuneration, the BdB referred to the tried-and-tested method applied by the Commission in Decision 2000/392/EC and the benchmark of 12 % for a normal market return, to which, in a second stage, premiums and discounts had been applied to take account of the particularities of the transaction. In any event, neither the 0,25 % paid to IBB nor the sale to BGB of the silent partnership and the claims to profits in 1994 and 1998 could be regarded as normal market remuneration.

(70) For one thing, it was not appropriate for payment to be made only on the amount taken up and, for another, IBB belonged to LBB, with the result that LBB had almost paid itself, rather than the *Land*. Moreover, Germany's argument that the guarantee function of the special-purpose reserve had been properly remunerated by the establishment of an atypical silent partnership holding in LBB for BGB in 1994 was not convincing, since important data on values were not available and, in principle, it was erroneous to confine the assessment to the aid donor's point of view. Of relevance to the state aid assessment was the transfer of WBK to LBB on 31 December 1992, the advantages conferred thereby on LBB and the resulting distortions of competition, and not whether the aid debt had been discharged subsequently. Moreover, the transfer of LBB to BGB was an internal transaction since BGB was also majority-owned by the *Land*. The same applied to the transfer to BGB of the remaining claims to 24,99 % of profits in 1998. In any event there had been no complete abolishment of the aid element since 1998.

(71) Subsequently, and a long time after the period for submitting comments laid down in Regulation (EC) No 659/1999 had expired, the BdB supplemented these remarks, stating in particular that the sales value calculated for LBB and for the silent partnership in LBB for the purpose of setting up BGB had not included IBB, with the result that the guarantee function of IBB's special-purpose reserve could not, in the BdB's view, have been taken into account in the sales value of the silent partnership in LBB.

(72) On the limitation period of ten years pursuant to Article 15 (1) of Regulation (EC) No 659/1999, the BdB stated that it had begun only with the Act establishing IBB on 31 December 1992 and could have come to an end at the earliest on 31 December 2002. However, the period had been interrupted pursuant to Article 15(2) of Regulation (EC) No 659/1999 by action taken by the Commission. This provision was broad in scope and covered any action taken by the Commission in connection with its investigations, including requests for information. A basis for the further interpretation of this provision was Regulation (EEC) No 2988/74 of the Council of 26 November 1974 concerning limitation periods in proceedings and the enforcement of sanctions under the rules of the European Economic Community relating to transport and competition ([22]), pursuant to which interruption is linked to 'action taken … for the purpose of the preliminary investigation or

([22]) OJ L 319, 29.11.1974, p. 1. Regulation as amended by Regulation (EC) No 1/2003 (OJ L 1, 4.1.2003, p. 1).

proceedings in respect of an infringement'. For the rest, Germany had itself asked the Commission to wait for clarification of the issues in *WestLB* and, for that reason alone, could not invoke the limitation period.

VI. GERMANY'S RESPONSE TO THE COMMENTS OF OTHER INTERESTED PARTIES

(73) In its comments dated 16 December 2002, Germany essentially referred to its own comments on the decision initiating the procedure and its argument that no state aid was involved in this case. Otherwise, it restricted itself to a brief response to the individual points made in the two sets of comments.

(74) Regarding the BV's and the BdB's classification of WBK's transfer as aid, Germany stated that it was not enough to look only at the monthly remuneration. Rather, reference values such as — depending on the capital injection — return (on a loan), including collateralisation, dividends or capital growth should be considered. However, in the relevant period (1992/93) LBB was an institution with high earning capacity, and the transfer of WBK's assets to LBB's liable equity capital was therefore a sound business decision. WestLB and LBB, contrary to what was claimed by the BdB and the BV, were therefore in no way comparable with one another. Apart from this, it was inappropriate for the BdB to speak of the method used in *WestLB* as tried and tested in view of the (at the time) pending court proceedings in that case.

(75) Contrary to what was argued by the BdB, it was undisputed and clearly stated in the decision initiating the procedure that, besides the use of the special-purpose reserve's guarantee function by LBB, the transfer of WBK also increased LBB's equity capital shown in the balance sheet by DEM 187,5 million and that this amount had been recognised as liable equity capital for supervisory purposes. The question of the extent to which equity capital shown in the balance sheet conferred a financial advantage did not arise here, unlike in *WestLB*, since it was not necessary to distinguish between recognised and unrecognised parts of the capital. No aid was involved in the increase in equity capital shown in the balance sheet or the transferred reserves (see paragraphs 40 to 64).

(76) Moreover, it was erroneous to assume that, with a hypothetical core capital of €1 billion, loans totalling €50 billion could be made. Whereas it was undisputed that IBB's special-purpose reserve performed a guarantee function and a business expansion function on account of its recognition for supervisory purposes, the advantage was confined to the amount actually taken up by LBB. The hypothetical leverage of 1:50 was also groundless.

(77) In applying the principle of the market-economy investor, the analysis should be geared to an investor in a comparable situation. In the case at issue, the *Land* as investor decided to tie the special-purpose reserve's liquidity into IBB's operations and not to make it available to LBB in its financing capacity. The *Land*'s objective with respect to this capital was its own return (see paragraphs 40 to 64). Moreover, only the *Land* continued to have a claim on IBB's special assets, even after LBB's transfer to BGB. It was therefore also wrong to claim that the remuneration which LBB paid to IBB was paid to itself. Moreover, it was usual for a market-economy investor to assign remuneration claims to third parties, especially when the third party was a company or an asset wholly owned by that investor.

(78) Lastly, with respect to the BV's comments on its market share relative to that of BGB, Germany stated that BV had a larger market share in Berlin than it had indicated. It was the second-largest credit institution and its market shares had to be 60-70 % of those of BGB; as regards deposits by private customers alone, it had some 1/3 of BGB's market share.

VII. UNDERSTANDING BETWEEN THE BDB, THE LAND OF BERLIN AND LBB

(79) On 7 October 2004, Germany informed the Commission of the outcome of an understanding between the complainant (the BdB), the *Land* of Berlin and LBB. Notwithstanding their remaining fundamental legal positions, the parties had agreed on what they themselves regarded as suitable parameters for determining an appropriate remuneration for WBK's assets. The parties asked the Commission to take account of this understanding in its decision.

(80) First, the parties determined, on the basis of the approach detailed in Decision 2000/392/EC, a minimum remuneration for WBK's special-purpose reserve of 10,19 %. As the *Land* of Berlin was the sole owner, no further premium, such as to allow for the lack of voting rights, was agreed. A discount of 3,62 % was then applied on account of the capital's lack of liquidity (on the basis of the risk-free interest rate taken as gross refinancing costs, with some 50 % in corporation tax plus a solidarity surcharge deducted to determine net refinancing costs). This produced an appropriate remuneration of 6,57 %.

(81) The understanding makes no mention of any remuneration for the part of WBK's assets not available for LBB's competitive business.

(82) For IBB's nominal capital of DEM 187,5 million transferred to LBB's nominal capital no discount on the basis of refinancing costs was calculated as this capital constituted liquid funds. As the nominal capital had been transferred to

BGB in two stages in 1994 and 1998, the parties agreed that remuneration should be paid for it only up to these two points in time (proportionally in each case).

(83) The parties were unable to agree on whether any increase in LBB's value as a result of the transfer should be taken into account. In the Landesbank's view, an increase in value had been achieved by the transfer of LBB in 1994 and 1998.

VIII. **ASSESSMENT OF THE MEASURES**

1. *ON THE GENERAL QUESTION OF THE LIMITATION PERIOD*

(84) Germany stated that the relevant date with respect to any limitation period applicable to recovery was 16 June 1992 when the Berlin *Land* Government adopted a resolution establishing a Berlin bank holding company. However, this resolution, which is in the Commission's possession, laid down only that 'Berlin's bank holdings will be restructured'. It provided for the 'establishment of the Berliner Banken-Holding AG, which would bring together under its roof the Landesbank Berlin-Girozentrale, Berliner Bank AG and the … Berliner Pfandbrief-Bank'. It did not bring about a transfer of assets.

(85) The measure at issue, namely the transfer of WBK's assets to LBB, was completed only at the close of 31 December 1992. The economic effect of the measure, i.e. the increase in LBB's equity capital and the resulting increase in its lending capacity, therefore kicked in only on 1 January 1993. In the present case, no state aid can have been granted before that date.

(86) Even if the date on which the measure was awarded were none the less fixed as 16 June 1992, several months before the date of the transfer, it cannot be assumed, as argued by Germany, that the Commission's powers to recover the aid are subject to the limitation period laid down in Article 15(1) of Regulation (EC) No 659/1999. Germany takes the view that the decision of 4 July 2002 initiating the procedure was the first Commission action to interrupt the limitation period, among other reasons because in that decision Germany was asked for the first time to forward a copy of the letter to the aid recipient.

(87) The Commission rejects this view. Article 15(2) of Regulation (EC) No 659/1999 refers to 'any action' taken by the Commission and not merely to a formal decision initiating the procedure. In the present case, the various steps taken by the Commission, in particular its various requests for information referring to LBB, and at any rate its request of September 1999, suffice to interrupt the limitation period. It is not necessary for LBB to have been aware of the steps taken by the Commission. In its judgment of 10 April 2003 in Case T-366/00 *Scott SA v Commission* [23], the Court of First Instance ruled that the mere fact that the aid recipient was not aware of the existence of the Commission's requests for information does not have the effect of depriving them of legal effect vis-à-vis the aid recipient. The Commission is not obliged to warn potentially interested persons, including the beneficiary of the aid, of the measures which it is taking in respect of unlawful aid before it initiates the administrative procedure. The Court accordingly found that the relevant requests for information constituted, under Article 15 of Regulation (EC) No 659/1999, a measure interrupting the limitation period before that period expired, even though the aid recipient was not at the time aware of the existence of such correspondence [24]. Moreover, it seems unlikely that LBB was unaware of the Commission's request for information when Germany replied to it in December 1999.

(88) In conclusion, the Commission has the power in this case to order recovery of any aid.

2. *STATE AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE EC TREATY*

(89) Article 87(1) of the EC Treaty states that, save as otherwise provided in that Treaty, any aid granted by a Member State or through state resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, insofar as it affects trade between Member States.

2a. STATE RESOURCES

(90) The transfer was decided on by the *Land* of Berlin in order to increase LBB's capital by transferring to it the public-service institutions WBK/IBB, whose guarantor and owner the *Land* was. The transfer increased LBB's liable equity capital recognised for supervisory purposes by letter of 24 February 1993 by some DEM 1,9 billion. DEM 187,5 million of that amount corresponded to an increase in LBB's nominal capital by the nominal capital of the former WBK [25] and some DEM 1,715 billion to WBK's revenue reserves (without the net profit for 1992 of just under DEM 200 million), which from that point on were shown as a special-purpose reserve belonging to IBB and continued to grow each year.

(91) The transfer of some DEM 1,9 billion and its recognition as core capital for supervisory purposes significantly increased LBB's lending capacity and thus its scope for expanding its competitive business. With a risk weighting of 100 % for all claims (e.g. from loans to non-banks) and without any further raising of additional capital, the business expansion potential theoretically lies at 12,5 times the additional liable equity capital (in this case just under DEM 24 billion). It is not possible to give a precise figure for this potential in

[23] [2003] ECR II-1763.

[24] Ibid paragraph 60.

[25] This amount has since no longer been attributed to IBB's assets.

individual cases, as it depends on customer structure, strategic planning and unforeseeable external influences. However, the question of whether and how a credit institution employs new own funds is not a matter for this investigation.

(92) Irrespective of the fact that IBB still needed part of the funds to underpin its promotion activities, the transferred assets were recognised by the supervisory authority and could thus be used by LBB, which was competing with other credit institutions, to cover its liabilities. There is therefore no doubt that this case involves the transfer to LBB of state resources which were such as to give it an economic advantage over its competitors to the extent that the resources concerned were not obtained on market terms.

2b. FAVOURING OF A PARTICULAR UNDERTAKING

(93) In order to verify whether the transfer of state resources to a publicly-owned undertaking 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'. The Court of First Instance has accepted and developed this principle in a number of cases, most recently in its judgment of 6 March 2003 regarding a similar transfer to WestLB ([26]).

(1) ***Market-economy investor principle***

(94) According to the market-economy investor principle, no state aid is involved where 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' ([27]). In contrast, the undertaking is being favoured within the meaning of Article 87(1) of the EC Treaty if the proposed remuneration arrangement and/or the financial position of the undertaking is such that a normal return on investment cannot be expected within a reasonable period of time.

(2) ***Article 295 of the EC Treaty***

(95) Article 295 of the EC Treaty lays down that the system of property ownership in the various Member States must not be affected. However, this cannot justify any infringement of the Treaty's competition rules.

(96) Germany claims that, because of the constraints imposed by the special purpose assigned to the WBK assets, the only possible profitable use of these resources was to transfer them to a similar public-law institution. Consequently, the transfer represented the commercially most sensible use of those assets. Germany therefore argues that any remuneration for the transfer, i.e. any additional return on WBK's capital, is sufficient to justify the transfer in the light of the market-economy investor principle.

(97) This line of argument cannot be accepted. It may be true that WBK's transfer to LBB, which subsequently allowed LBB to use part of WBK's capital for underpinning its competitive business, was the commercially most sensible use. However, as soon as public funds and other assets are used for commercial, competitive activities, the normal market rules must be applied. This means that the State, once it decides to assign public-purpose assets to a commercial use, must demand a remuneration in line with normal market conditions.

(3) ***Ownership structure***

(98) The key question, as formulated by the Court of First Instance in its judgment in *WestLB* with reference to the previous case law, is whether, in similar circumstances, a private investor operating in normal conditions of a market economy and of a comparable size to that of the bodies operating in the public sector could have been prompted to make the capital contribution in question ([28]). Lastly, as the Court also points out with reference to other case law, 'the comparison between the conduct of public and private investors must be made by reference to the attitude which a private investor would have had at the time of the transaction in question, having regard to the available information and foreseeable developments at that time' ([29]). This makes it clear that the assessment must focus on the time of the investment and on the expectations which an investor might reasonably, i.e. on the basis of the available information, have had at that time. These expectations essentially relate to the likely return.

(99) The *Land* of Berlin was the sole shareholder of LBB (and of WBK). Even if this circumstance should make it possible to depart from an approach which takes account only of the fixed, agreed rate of remuneration (on average 0,25 % on the part of the special-purpose reserve used by LBB as of December 1995), in the present case ownership by the *Land* of Berlin cannot be used to justify the low direct remuneration.

(100) To cite the *Land*'s ownership as justification, there would have to be an adequate business plan, expert valuation or assessment of the likely return from the investment at issue. None was produced at the time. The Commission therefore has no means of verifying the *Land*'s statements.

([26]) See footnote 3.

([27]) Commission communication to the Member States on the 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. Crédit Lyonnais (OJ L 221, 8.8.1998, p. 28) and GAN (OJ L 78, 16.3.1998, p. 1).

([28]) Paragraph 245 of the judgment, see footnote 3.

([29]) Paragraph 246 of the judgment, see footnote 3.

(101) The Commission accordingly takes the view that, in this case, the appropriate return must be established on the basis of the direct market return.

(4) ***Remuneration and elements of remuneration***

Capital basis for calculating the remuneration

(102) In principle, remuneration is payable on the entire value of the transferred assets. This approach was applied in Decision 2000/392/EC and upheld by the Court of First Instance. As BAKred directly recognised the full amount as core capital, the funds were available to LBB to cover liabilities from 1 January 1993 onwards, except for the amount required each year for the promotion-related business itself. The capital needed to underpin the promotion-related business and which LBB could not use has to be deducted from the amounts which grew each year from then on.

(103) The values for the WBK/IBB special-purpose reserve and for the capital needed for IBB's promotion-related business varied, or continually increased, as of early 1993. They are shown in the table at paragraph 142.

(104) The nominal capital of WBK/IBB worth DEM 187,5 million and transferred to LBB's nominal capital was liquid capital. 75,01 % of LBB's shares were sold to BGB in 1994, and the remaining 24,99 % in 1998 at a price of DEM 1,5 billion. The nominal capital was therefore attributed to BGB as of 1998.

(105) There are therefore three bases for calculating an appropriate remuneration: first, the liquid capital of DEM 187,5 million for 1993, with a value of DEM 46,9 million (corresponding to 24,99 % of shares) for the years 1994 to 1997; second, the special-purpose reserve and third, the funds needed for the promotion-related business. As the same minimum return applies to the first two elements, they can initially be considered together in what follows.

Appropriate remuneration for the nominal capital and the special-purpose reserve

(106) 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 LBB.

Comparison with other equity instruments

(107) In establishing an appropriate remuneration, it is important to determine to which other equity instruments the transfer of WBK's assets may be compared since market remuneration differs from one instrument to another. For the purposes of their understanding, the BdB, the *Land* and LBB assume that it can be compared to a share capital investment.

(108) The Commission likewise takes the view that the transfer most closely resembles a share capital investment. For the nominal capital, this can undisputedly be assumed to be the case and does not require any further discussion here. However, it also applies to the special-purpose reserve, which was equally recognised by BAKred as core capital.

(109) In this connection, it should be noted that the relatively broad range of innovative equity instruments now available to credit institutions in several countries did not exist in Germany back in 1993 when it was decided to transfer WBK to LBB. Some of these instruments have been developed in the meantime, while others already existed but were not accepted in Germany. It would therefore be inappropriate to compare the special-purpose reserve to such innovative instruments, most of which have developed in the meantime and some of which are available only in other countries.

(110) The Commission also takes the view that it is not appropriate to compare the special-purpose reserve recognised as core capital to a silent partnership contribution when determining the appropriate remuneration, precisely because the transfer did not take the form of a silent partnership contribution but of a special-purpose reserve. BAKred too recognised the transfer as a reserve and not as a silent partnership contribution pursuant to Section 10 of the German Banking Act. The fact that the German supervisory authority treated the capital made available as a reserve suggests that it resembles share capital rather than a silent partnership.

(111) Moreover, the risk that the transferred capital might at least partially be lost in the event of insolvency or liquidation is no less than the risk associated with a share capital investment since WBK's assets make up a considerable part of LBB's equity capital and LBB used it extensively for many years to cover risk-bearing assets.

Liquidity costs of the special-purpose reserve

(112) 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), 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 ([30]).

([30]) 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.

(113) Apart from the nominal capital of DEM 187,5 million, the transfer of WBK's assets did not provide LBB with initial liquidity. LBB therefore faced additional funding costs equal to the amount of the capital if it was 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) ([31]).

(114) Because of these extra costs, which do not arise in the case of other forms of injected 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.

(115) The Commission does not believe that the entire refinancing interest rate has 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 LBB because of the special nature of the capital transferred. Overall, the Commission accepts that LBB incurs additional 'liquidity costs' to the extent of 'refinancing costs minus corporation tax'.

(116) In the negotiations on their understanding, the parties, as in the Hamburgische Landesbank case, in which the transfer took place at the same point in time, took as a basis the long-term risk-free rate of 7,23 %. They also agreed to assume a flat 50 % tax rate ([32]). This produces a net refinancing rate of 3,62 % and thus a corresponding liquidity discount. This discount applies only to the special-purpose reserve.

Determination of a likely minimum remuneration for the special-purpose reserve and the nominal capital

(117) A market-economy investor bases his return expectations on historical average returns, which generally also give him an idea of what the company's future performance is likely to be, as well as on the conclusions he draws from an analysis of the company's business model for the period of the investment, the strategy and quality of its management and the prospects for the economic sector concerned. Companies in need of capital have to convince potential investors that, over the long term, they will be able to earn at least the average rate of return that can be expected of companies with a comparable level of risk and operating in the same economic sector. If a company cannot fulfil these expectations of an at least average return, the investor will refrain from investing in it and will consider investing in another company which offers better prospects for the same risk.

(118) There are various methods of determining an appropriate minimum return. They range from differing variants of the financing approach to the Capital Asset Pricing Model (CAPM) method. For the purposes of describing the various approaches, it is helpful to distinguish between two components, namely the risk-free return and a project-specific risk premium: the appropriate minimum return for a high-risk investment = the risk-free base rate + a risk premium for the high-risk investment. The appropriate minimum return on a high-risk investment can therefore be described as the sum of the risk-free rate of return and the additional risk premium for assuming the specific investment risk.

(119) Accordingly, the basis for any return determination is the existence of a default-risk-free form of investment with an assumed risk-free return. The expected return on fixed-rate securities issued by state issuers (or an index based on such securities) is usually taken to determine the risk-free base rate since such securities represent a form of investment with comparatively little risk. The various methods differ, however, when it comes to determining the risk premium:

— *Financing approach*: an investor's expected return on capital represents, from the point of view of the bank using the capital, future financing costs. Under this approach, the historic capital costs incurred by comparable banks are first of all determined. The arithmetic average of the historical capital costs is then compared with the future expected equity capital costs and hence with the investor's expected return requirement.

— *Financing approach with Compound Annual Growth Rate*: at the heart of this approach stands the use of the geometric rather than the arithmetic mean value.

— *CAPM*: the CAPM is the best-known and most frequently tested model of modern financial economics, by which the return expected by an investor can be determined using the following formula: expected return = risk-free interest rate + (market risk premium x beta). The beta factor is used to quantify the risk of a company relative to the overall risk of all companies. The risk premium for the specific investment is obtained by multiplying the risk premium of the market by the beta factor.

([31]) 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).

([32]) 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. The overall tax rate fell to 46 % in 1993 and stood at 49,5 % from 1994 to 2000. From 2001 the overall tax rate was 30 %.

(120) The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since LBB is not a listed company, it is not possible directly to infer its beta value. The CAPM can be used only on the basis of an estimate of the beta factor.

(121) Germany generally takes a critical view of the use of the CAPM. In the end, the parties none the less used it as a basis in their understanding, obtaining an appropriate rate of remuneration for the transfer of the nominal capital and the special-purpose reserve to LBB of 10,19 %.

(122) Using the CAPM, the parties applied a risk-free base rate of 7,23 % at 31 December 1992 for LBB, on the assumption that WBK's assets were to be made available to LBB on a permanent basis. The parties thus decided not to use a risk-free rate obtaining on the market on a given reference date for a fixed investment period at the time of the transfer (e.g. 10-year return on government bonds) since such an approach would disregard the reinvestment risk, i.e. the risk that it would not be possible to invest again at the level of the risk-free rate once the investment period had expired. In the view of the parties, a total return index was the best way of taking the investment risk into account. They opted, therefore, for the REX10 Performance Index of Deutsche Börse AG, which tracks the performance of an investment in 10-year Federal bonds. The index series used in the present case contains the relevant year-end levels of the REX10 Performance Index after 1970. The parties then calculated the rate of return per annum, which reflects the trend tracked by the REX10 Performance Index in the period 1970 to 1992 and, in this way, arrived at the risk-free base rate of 7,23 % (at 31 December 1992).

(123) Since the contribution was to be made available to LBB on a permanent basis, the method of determining the risk-free base rate seems appropriate in this specific case. Moreover, the REX10 Performance Index is a generally recognised data source. The risk-free base rate calculated by the parties thus appears appropriate here.

(124) The beta factor of 0,74 was estimated on the basis of a KPMG report, of which the Commission has a copy, on adjusted beta factors for all listed credit institutions in Germany. In the light of the report and of LBB's business profile, this beta factor may be regarded as appropriate.

(125) The Commission also regards the market-risk premium of 4,0 % as acceptable. The so-called general long-term market-risk premium, i.e. the difference between the long-term average return on a normal share portfolio and the return on government bonds, was applied on several occasions in the proceedings leading to Decision 2000/392/EC. The expert reports relating to that case applied margins of around 3 % to 5 %, depending on the method used, the reference period and the underlying data. For example, one report commissioned by the BdB calculated alternative figures of 3,16 % and 5 %, while another, commissioned by WestLB in the same case, arrived at calculations of 4,5 % and 5 %, and Lehman Brothers, which was also working for WestLB, calculated a rate of 4 %. Against this background, the Commission here sees no reason to depart from the market-risk premium used in the understanding. On the basis of the CAPM, the Commission has no doubt that the minimum remuneration determined by the parties can be regarded as appropriate.

(126) Accordingly, it sets the minimum remuneration at 10,19 % per annum (after corporation tax and before investor tax).

No return premium on account of the 100 % ownership

(127) It must be examined whether there are grounds for adjusting the minimum remuneration calculated. Based on the approach used in the other Landesbank cases, the following three particularities of the transaction may justify such a premium: first, the non-issuance of new shares in the company with the associated voting rights; second, the exceptional volume of the asset transfer; and third, the lack of fungibility of the assets.

(128) As in the other proceedings, the Commission does not consider a premium to be justified in relation to the last two aspects. Nor is it possible to apply a premium in relation to the failure to issue new shares with voting rights given that the *Land* of Berlin owned 100 % of the voting shares.

No reduction in the remuneration to take account of the agreement of a fixed amount

(129) 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 (e.g. expressed in share price increases). 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 LBB'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 in the future. If the performance declines, a fixed rate benefits the investor, but if it improves it places him at a disadvantage. However, actual performance cannot be used retrospectively to assess the investment decision. Taking all these factors into consideration, the Commission believes that the rate of remuneration should not be reduced for this reason.

Overall remuneration for the nominal capital and the special-purpose reserve

(130) In view of all of the above observations, the Commission comes to the conclusion that a normal market minimum remuneration for the capital and the special-purpose reserve would have been 10,19 % per annum. On account of the lack of liquidity in the special-purpose reserve, 3,62 % should be deducted from this figure for net refinancing costs.

Appropriate remuneration for the amounts needed for the promotion-related business

(131) The amounts needed for the promotion-related business were also of material value to LBB and their economic function may be compared to that of a guarantee. A market-economy investor would demand an appropriate remuneration in return for exposing himself to a risk of this sort. This question is not addressed in the understanding between the BdB, the *Land* and LBB.

(132) In *WestLB* ([33]), Germany considered a rate of 0,3 % per annum before tax to be an appropriate starting rate. Since WestLB and LBB are fundamentally comparable and for want of any other points of reference, the Commission assumes that this rate corresponds to the remuneration which LBB would have had to pay on the market in the early 1990s for a bank guarantee in its favour.

(133) However, the grounds cited for increasing the starting rate in Decision 2000/392/EC do not apply here. In that Decision, a premium of a further 0,3 % per annum was added to the above-mentioned rate of 0,3 % per annum (before tax) because first, bank guarantees are normally associated with certain transactions and limited in time (which was not the case in *WestLB*) and second, the amount of DEM 3,4 billion made available to WestLB exceeded what was normally covered by such bank guarantees.

(134) An increase in the rate of 0,3 % to take account of the particularly extensive scope of the 'guarantee' seems unnecessary for an annual amount of some DEM 170 to 350 million. Raising the rate on account of the fact that WBK's assets were in principle available to LBB without restriction is also of doubtful value for the same reasons as those for which no premium was applied to the remuneration for the capital available for competitive business since the *Land* was entitled to withdraw the assets from LBB and indeed did so at the end of August 2004.

(135) The guarantee premium counts as an operating expense for LBB and therefore reduces taxable profit. The remuneration for WBK's assets is paid out of profits after tax. The rate of 0,3 % must therefore be adjusted for the tax rate. As in relation to the refinancing costs, the Commission, here in LBB's favour, assumes a uniform overall tax rate of 50 %. Consequently, it sets a rate of 0,15 % per annum after tax.

([33]) Paragraph 221, see footnote 2.

(5) ***Aid element***

(136) The Commission accordingly regards 10,19 % per annum after tax as an appropriate market remuneration for the nominal capital, 6,57 % per annum after tax for the part of the special-purpose reserve which could be used by LBB to underpin its commercial activities and 0,15 % after tax for the amounts needed for the promotion-related business but still shown as equity capital in the balance sheet.

(137) On the basis of the above assessment criteria and remunerations for the various types of capital transferred, the amounts shown in the table at paragraph 142 should be paid as appropriate remuneration for the individual elements and years.

(138) Against these amounts should be set the elements of remuneration agreed at the time of the investment, which, in the Commission's view, consist only of the agreed remuneration in varying amounts (see table at paragraph 142) on the take-up of the special-purpose reserve. Other elements, such as the increases in value put forward by Germany, or the dividend payout of DEM 238 million in 1993, cannot be offset against the appropriate remuneration.

(139) Germany argued that the increases in value achieved by the sales in 1994 and 1998 and the dividend payout of DEM 238 million should be deducted from the remuneration owed. However, payments made or increases in value achieved after the investment cannot be taken into account when applying the principle of the market-economy investor, who, on the basis of the information available to him at the time of the investment, either expects an appropriate return or agrees a direct remuneration. Dividends or increases in value which cannot be calculated in advance are not relevant. Nor is it relevant whether proceeds derive from an increase in value achieved through a sale. Lastly, it is not clear why the dividend payout of DEM 238 million should have been made on the basis of the transferred special-purpose reserve; at most, proportional account could be taken of the payment based on the ratio of the special-purpose reserve to the rest of LBB's own funds.

(140) Germany also claimed that one reason for the transfer was the potential synergies to be achieved, rather than an increase in equity capital for LBB. Since these synergies neither reduce the usability of the transferred capital for LBB nor increase LBB'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 such benefits for the financial instrument. The Commission therefore takes the view that any synergy effects do not constitute remuneration paid by LBB for the transfer of WBK.

(141) The difference between the agreed remuneration of about 0,25 % per annum and the appropriate remuneration of 6,57 % per annum (for the part of IBB's special-purpose reserve which can be used for competitive business) or 10,19 % per annum (for WBK's nominal capital) and 0,15 % per annum (on the part of the capital which is equivalent to a bank guarantee) accordingly constitutes state aid within the meaning of Article 87(1) of the EC Treaty.

(142) The aid element is therefore made up as follows:

	Values (DEM million at year end)	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 (1)	Total	Total €
1.	IBB special-purpose reserve	1 715,2	2 005,8	2 105,8	2 206,0	2 306,0	2 356,0	2 406,0	2 456,5	2 600,0	2 623,8	2 625,4	2 625,4		
	Amount used for promotion business	168,7	180,1	273,2	323,8	346,4	233,6	[…]	[…]	[…]	[…]	[…]	[…]		
	Special-purpose reserve remaining	1 546,5	1 825,7	1 832,6	1 882,2	1 959,6	2 122,4	[…]	[…]	[…]	[…]	[…]	[…]		
	Interest rate	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %	6,57 %		
	Remuneration payable	101,6	119,9	120,4	123,7	128,7	139,4	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
2.	WBK's nominal capital	187,5	46,9	46,9	46,9	46,9									
	Interest rate	10,19%	10,19%	10,19%	10,19%	10,19%									
	Remuneration payable	19,1	4,8	4,8	4,8	4,8								38,2	19,5
	Guarantee fee	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %	0,15 %		
	Remuneration payable	0,253	0,270	0,410	0,486	0,520	0,350	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
3.	Remuneration already paid	0,0	0,0	0,0	1,2	3,4	3,6	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
4.	Remuneration still owed	121,0	125,0	125,6	127,7	130,6	136,2	[…]	[…]	[…]	[…]	[…]	[…]	1 584,5	810,14

(1) 1.1.-31.8.2004. Afterwards €1,1 billion of IBB's special-purpose reserve converted into silent partnership contribution by Land to LBB with normal market remuneration
Since 1.1.1999 DEM converted to euro at 1,95583. Figures in DEM must be converted to euro accordingly.

(143) With IBB's hive-off from LBB on 1 September 2004, the special-purpose reserve was transferred back to the *Land* of Berlin, and €1,1 billion of it was transferred to two silent partnerships held by the *Land* in LBB. This brought the advantage at issue to an end as at 1 September 2004.

2c. DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATES

(144) 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.

(145) Landesbank Berlin carries on regional and international banking business. It defines itself as an all-purpose commercial bank, central bank for the savings banks and the bank of the *Land* and its municipalities. Despite its name, tradition and legally stipulated tasks, LBB is much more than a mere local or regional bank.

(146) These facts clearly show that LBB 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.

(147) 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 LBB with such equity capital for solvency purposes, it directly influenced the bank's business possibilities.

(148) It is clear, therefore, that aid given to LBB distorts competition and affects trade between Member States.

3. *COMPATIBILITY OF THE MEASURE WITH THE EC TREATY*

(149) On the basis of all these considerations, it can be stated that the transfer of WBK's capital is caught by all the criteria laid down in Article 87(1) of the EC Treaty and therefore that it 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 Germany did not invoke any exemption clause with regard to possible state aid elements in connection with the transfer of assets.

(150) None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(151) 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 is not aimed either at promoting culture or heritage conservation.

(152) Since the economic survival of LBB 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 LBB 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.

(153) 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. LBB is not described as an undertaking in difficulty whose viability must be restored with the support of state aid.

(154) Article 86(2) of the EC Treaty, which allows exemptions from the Treaty's state aid rules 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 ([34]).

(155) Germany has not argued that any advantage conferred on LBB by the transfer of WBK's assets was merely compensation for the costs incurred by LBB in the performance of its public-service tasks. In the Commission's view, it is clear that the transfer was carried out in order to enable LBB to meet the new capital requirements, and not to compensate it for public-service tasks.

(156) 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.

([34]) 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.

4. *NO EXISTING AID*

(157) The transfer of WBK's assets cannot be regarded as being covered by the existing state aid scheme for 'institutional liability' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*).

(158) First, *Gewährträgerhaftung* is a default guarantee offered to creditors in the event that the bank's assets are no longer sufficient to satisfy their claims, and this is not the case here. The capital injection is not intended to satisfy LBB's creditors and the bank's assets have not been exhausted.

(159) Nor does *Anstaltslast* apply. *Anstaltslast* requires the guarantor to provide LBB with the resources it needs to function properly for as long as the former decides to maintain it in existence. However, at the time of the capital injection, LBB was far from being in a situation where it was no longer able to operate properly. The capital injection was not needed in order to keep LBB in business. The conscious economic calculation by the *Land* as joint owner also enabled LBB to seize future opportunities in its competitive business. The 'necessity requirement' for *Anstaltslast* does not apply to such a normal economic decision by the *Land*. In the absence of another applicable existing state aid scheme pursuant to Articles 87(1) and 88 (1) of the EC Treaty, the capital injection must be classed as new aid within the meaning of Articles 87(1) and 88(3) of the EC Treaty.

5. *CONCLUSION*

(160) The aid resulting from the transfer of WBK/IBB on 1 January 1993 cannot be found compatible with the common market under either Article 87(2) or (3) of the EC Treaty or under any other provision of that Treaty. The aid is therefore declared incompatible with the common market and must be discontinued. The aid element must be recovered by Germany,

HAS ADOPTED THIS DECISION:

Article 1

The state aid amounting to €810,14 million which Germany implemented for Landesbank Berlin — Girozentrale from 1 January 1993 to 31 August 2004 is incompatible with the common market.

Article 2

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

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of this Decision.

The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient until the date of its recovery.

Interest shall be calculated in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 ([35]).

Article 4

Germany shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it, using the questionnaire attached in the Annex to this Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

([35]) OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION

1. **Calculation of the amount to be recovered**

1.1. Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient (if the measure consists of several instalments and reimbursements, use separate rows).
(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2. Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. **Recovery measures planned or already taken**

2.1. Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain what alternative measures exist in national law to bring about recovery. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2. By what date will the recovery of the aid be completed?

3. **Recovery already effected**

3.1. Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2. Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

on aid from Germany for Westdeutsche Landesbank — Girozentrale (WestLB), now WestLB AG

(notified under document number C(2004) 3925)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/737/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:

I. PROCEDURE

1. *ADMINISTRATIVE 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 institute proceedings under Article 226 of the EC Treaty against 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 when accepting assets of the *Wohnungsbauförderungsanstalt des Landes North Rhine-Westphalia* ('Wfa'), 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 proceedings against Germany under Article 88(2) of the EC Treaty. In February and March 1995 and in December 1996 ten individual banks associated themselves with the complaint of their association.

(3) By letters dated 12 January, 9 February, 10 November and 13 December 1993 and 16 January 1996, the Commission asked the German authorities for further information in order to determine whether the asset transfer constituted state aid. The German authorities replied by letters dated 9 February and 16 March 1993, 8 March 1994, 12 April and 26 April 1996 and 14 January 1997. A number of further letters and documents were submitted by the different parties. Commission representatives met representatives of the German authorities, WestLB and other Landesbanks as well as of the complainant at various meetings during the period 1994-97.

(4) After this exchange of information, the Commission considered it necessary to initiate proceedings under Article 88(2) of the EC Treaty. This decision was taken on 1 October 1997. In it the Commission concluded that the measure in question probably constituted state 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 (the 'Land') to ensure its proper participation in 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 aspect 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 Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* [2]. 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 of 15 June 1998 it forwarded them to Germany for its

[1] OJ C 140, 5.5.1998, p. 9.

[2] See footnote 1.

reaction, which it duly received by letter of 11 August 1998 after an extension of the deadline.

(6) Meetings took place with representatives of BdB on 15 January and 16 September 1998 and with representatives of WestLB on 9 September 1998. By letters of 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 of 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 letters of 16 November 1998.

(7) By letter dated 14 January 1999, BdB submitted the information requested after an extension of the deadline. The German authorities submitted some information by letters dated 15 January and 7 April 1999 after an extension of the deadline.

(8) Since the German authorities refused to provide certain information, the Commission enjoined Germany by decision of 3 March 1999, which was sent to Germany by letter dated 24 March 1999, to submit that information. Germany complied with this injunction by letter dated 22 April 1999 after an extension of the deadline.

(9) 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 and submitted the study to the Commission on 18 June 1999. On 8 July 1999 the Commission adopted Decision 2000/392/EC on the measure implemented by Germany for WestLB in question (the 'challenged decision') [1]. The decision was notified to Germany on 4 August 1999. Germany forwarded it to the Land by letter of 6 August 1999. The Land informed WestLB by letter of 9 August 1999, which arrived the same day. Articles 1, 2 and 3 of the Decision read as follows:

'*Article 1*

The State aid which the Federal Republic of Germany has implemented for Westdeutsche Landesbank Girozentrale in the years 1992 to 1998, amounting to DEM 15 797 million (EUR 8 077 million), is incompatible with the common market.

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 affected 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.'

2. *COURT PROCEDURE*

(10) On 12 October 1999 WestLB and the Land of North Rhine-Westphalia challenged this decision before the Court of First Instance of the European Communities. WestLB, the Land and Germany as intervening party requested that the challenged decision be annulled and that the Commission bear the procedural costs. In addition, the Land requested that BdB bear its own costs. The Commission and the BdB as intervening party requested that both legal challenges be rejected as unfounded and that the complainants bear the procedural costs (the BdB here included its own costs).

(11) In addition, Germany challenged this decision before the Court of Justice of the European Communities on 8 October 1999, likewise requesting that it be annulled and that the Commission bear the procedural costs. The challenge was, however, suspended on account of the substantially identical procedure before the Court of First Instance.

(12) The Court decided on 22 August 2000 to admit Germany as intervening party supporting the applicants and the BdB as intervening party supporting the Commission. By decision of the Court of 11 July 2001, the two cases were joined for the purposes of an oral hearing and ruling. The hearing took place on 5 and 6 June 2002.

(13) On 6 March 2003 the Court of First Instance delivered a ruling [2] annulling the challenged decision and ordering the Commission to pay the costs of the applicants and to bear its own costs and Germany and the BdB to bear their own costs.

(14) The Court annulled the Commission decision on the ground of insufficient justification of two points regarding calculation of the appropriate remuneration. Firstly, the annulment was based on the reasons stated for the remuneration for liquid equity capital as the starting point

(1) OJ L 150, 23.6.2000, p. 1.

(2) Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale and Land Nordrhein-Westfalen* v *Commission* [2003] ECR II-435.

for the calculation, for which the Commission had set a rate of 12 % per annum (after corporation tax and before investor taxes). Secondly, it was based on the reasons stated for the top-up for this remuneration, for which the Commission had set a rate of 1,5 % per annum (after corporation tax and before investor taxes). These points apart, the Court confirmed in full the Commission decision.

3. *RESUMED ADMINISTRATIVE PROCEDURE*

(15) By letters of 20 and 29 January, 6 February and 28 May 2004, the Commission asked the German authorities for an update of the relevant information for this decision. This was provided on 10 March and 14 June 2004 after an extension of the deadline and orally discussed on 28 July 2004. A further letter from the Land of North Rhine-Westphalia was received on 26 August 2004. By letter of 6 October 2004, Germany provided additional information that had been requested.

(16) In July 2004 the complainant BdB, the Land of North Rhine-Westphalia and WestLB AG reached a preliminary understanding on the proper return that was submitted to the Commission on 19 July and that should, in their view, be used for the two points criticised by the Court. The definitive version of this understanding was submitted to the Commission on 13 October 2004.

(17) In the present new decision, the Commission has rectified in line with the Court's indications the two points criticised by it (justification for the basic remuneration and a possible top-up). These two points apart, it maintains in principle the basic assessment given by it in the original decision. However, the Commission has taken into account the results of the talks between the complainant BdB, the Land of North Rhine-Westphalia and WestLB AG regarding the appropriate remuneration. For the rest, it has updated as necessary the decision with respect to developments since the previous decision regarding the procedure, the description of the undertaking and the calculation of the aid element, including the fixing of the end of the state aid situation, using the new data provided by Germany for the years following the original decision. The Commission has also shortened a few passages no longer necessary for the new decision.

II. DETAILED DESCRIPTION OF THE MEASURE

1. *WESTDEUTSCHE LANDESBANK GIROZENTRALE (WESTLB)*

(18) During the relevant period for this decision, i.e. from the injection of Wfa on 31 December 1991 to the splitting up of WestLB on 1 August 2002, which ended the state aid situation, WestLB was a public-law institution (*Anstalt des öffentlichen Rechts*) under the law of the Land of North Rhine-Westphalia. On 31 December 1991 its recognised own capital amounted to DEM 5,1 billion. By law, three functions had been assigned to WestLB: it acted as central bank for the local savings banks in North Rhine-Westphalia and, since 17 July 1992, also as the central institution for savings banks in the Land of Brandenburg; it was engaged in the issuing of debt instruments and the handling of financial transactions for its public shareholders (state-bank function); it operated as a normal commercial bank in its own right. Irrespective of special provisions of the Land, WestLB was subject to banking supervision under the German Banking Law (*Kreditwesengesetz*).

(19) WestLB was 100 % publicly owned. The largest single stake in the nominal capital was held by the Land (43,2 %). Other shareholders were 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 remained unchanged through the relevant period from 31 December 1991 to 1 August 2002.

(20) As a public-law institution, WestLB benefited from two forms of guarantees from its public owners: 'institutional liability' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*). *Anstaltslast* means that the owners of WestLB are responsible for securing the economic basis of the institution and its function for the entire duration of its existence. This guarantee does not create a liability on the part of the owners vis-à-vis the creditors of the bank but only governs the relationship between the public authorities and the bank. Under the terms of the *Gewährträgerhaftung*, the owners meet all the liabilities of the bank 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 were limited neither in time nor in value.

(21) Originally, WestLB was a regional institution that 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, savings banks had long since developed into all-purpose credit institutions. Likewise, over the last few decades WestLB developed increasingly into an independent commercial bank and was a strong competitor on the German and European banking markets.

(22) When measured by balance-sheet total, the WestLB group ranked among the five largest German credit institutions during the relevant period. It offered financial services to enterprises and public institutions and was 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 held stakes in financial and non-financial enterprises. It also transacted a substantial part of its business activities outside Germany.

(23) Furthermore, under special legal provisions, WestLB, unlike private banks but in the same way as other public credit institutions, was able, until it was split up in August 2002, to conduct mortgage banking and building and loan association

business under one organisational roof along with its other operations. It ranked therefore, during the relevant period until it was split up, as one of Germany's most comprehensive all-purpose banks.

(24) On the other hand, WestLB did not operate a dense network of retail branches. This market segment was covered by the local savings banks, for which WestLB acted as the central institution.

(25) 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 (1984-91) and showed no clear upward tendency. This performance was substantially below the German as well as the European average.

(26) The WestLB group increased its balance-sheet total between 1991, i.e. before the transfer, and the end of 2001, when its last annual accounts before it was split up were prepared, from over DEM 270 million to over DEM 840 million, i.e. by more than 300 %.

(27) By the law of 2 July 2002, the Land of North Rhine-Westphalia split up WestLB as of 1 August 2002 (with retroactive effect under the accounting rules to 1 January 2002) into a public-law parent company, Landesbank Northrhein-Westfalen, and a private-law subsidiary, WestLB AG. WestLB AG took over the commercial activities of the former WestLB, while Landesbank Northrhein-Westfalen took over its public activities. According to Germany, WestLB AG is legally identical to WestLB and is to be considered the debtor for the entire recovery claim [1]. Wfa was incorporated into Landesbank Northrhein-Westfalen at the time of the split-up and therefore withdrawn from the commercial activities taken over by WestLB AG. The rules of Landesbank Northrhein-Westfalen also stipulated that Wfa's capital cannot be used to underpin the mortgage bonds business remaining within the Landesbank and that, in future, a remuneration of 0,6 % per annum was to be paid to the Land in respect of a possible liability function.

2. *WOHNUNGSBAUFÖRDERUNGSANSTALT (WFA)*

(28) 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 a 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-Westphalia Law on the promotion of housing (*Wohnungs-Wohnungsbauförderungsgesetz) [2], 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 (Körperschaftssteuer), property tax (Vermögenssteuer) and tax on business capital (Gewerbekapitalsteuer).*

(29) As a public-law institution, Wfa was covered by the Land's 'institutional liability' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*) for all its liabilities. These guarantees remained in place as a result of the transfer.

(30) 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.

(31) 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 3 780 million) by the end of 1991 and were not shown directly in the balance sheet but only 'below the line'.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS DIRECTIVE AND THE SOLVENCY RATIO DIRECTIVE*

(32) Under Council Directive 89/647/EEC on a solvency ratio for credit institutions [3] ('Solvency Ratio Directive') and under the Own Funds Directive, banks must have own

[1] Submission by Germany of 10 March 2004, p. 2.

[2] *Wohnungsbauförderungsgesetz*, in the version published on 30 September 1979 (Official Gazette of North Rhine-Westphalia, p. 630).

[3] OJ L 386, 30.12.1989, p. 14 (as repealed and replaced by Directive 2000/12/EC (OJ L 126, 26.5.2000)).

funds equivalent to at least 8 % [1] of their risk-adjusted assets and risk-bearing off-balance-sheet transactions [2]. 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 [3]. Until that date German credit institutions were obliged to have own funds equivalent to 5,6 % of their risk-adjusted assets [4].

(33) As for the new threshold of at least 8 %, half of these own funds have to be 'original own funds' (*Basiseigenmittel*), 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 since 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.

(34) Furthermore, 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) stipulated that no single loan granted may exceed 50 % of a bank's own funds and that the total of such loans exceeding 15 % of 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 [5] reduced the maximum loan to 25 % of a bank's own funds and stipulated 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 [6].

(35) Moreover, Article 12 of the 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 [7] limits the size of qualifying holdings in other credit and financial institutions. Furthermore, a special provision in the German Banking Law (Section 12), not based on Community 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 weak before transposal of the Solvency Ratio Directive into German law. According to test calculations made by *Deutsche Bundesbank* in December 1991 on the basis of the provisions of the Directives, the Landesbanks had an average solvency ratio of 6,3 %, compared with the 8 % required from 30 June 1993 [8]. Therefore, there was 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 since 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 [9]. 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 the Law governing the promotion of housing (*Gesetz zur Regelung der Wohnungsbauförderung*) [10], 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 in order 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 falling on the Land's 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 Section II, point 2).

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[1] The capital requirements must be met by credit institutions on a consolidated, a subconsolidated and an unconsolidated basis.
[2] The term 'risk-adjusted assets' is used below to describe all risk-bearing and risk-adjusted items.
[3] In fact, the new capital requirements should already have entered into force on 1 January 1993 but were implemented late in Germany.
[4] However, this figure was based on a definition of own funds that was narrower than the one set out in the Own Funds Directive.
[5] Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions (OJ L 29, 5.2.1993, p. 1).
[6] It should, however, be pointed out that not only the thresholds were changed but also the definitions of 'own funds' and 'risk-adjusted assets'.
[7] OJ L 386, 30.12.1989, p. 1.
[8] Deutsche Bundesbank, Monthly Report, May 1993, p. 49.
[9] See, for example, Document 11/2329 of the Parliament of North Rhine-Westphalia.
[10] *Gesetz zur Regelung der Wohnungsbauförderung* of 18 December 1991 (Official Gazette of the Land of North Rhine-Westphalia, No 61, 30 December 1991, p. 561).

(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 *Gewährträgerhaftung*.

(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 serve at the same time as liable equity capital within the meaning of the German Banking Law (and hence the Own Funds Directive), on the basis of which a bank's solvency ratio is calculated. Therefore, they also underpin WestLB's competitive business.

(43) On the occasion of the transfer, WestLB's owners amended the covering agreement (*Mantelvertrag*) and agreed that the assets earmarked for housing promotion must always be preserved, even if WestLB suffered losses that 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 owners' 'institutional liability' (*Anstaltslast*) also covered 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 the agreement that the increase in WestLB's equity base through the integration of Wfa constituted an act in money's worth (*geldwerte Leistung*) by the Land and that the annual remuneration for this act should be agreed on by the owners once the first financial results for the years from 1992 onwards were available ([1]). 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 made 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 Law governing the promotion of housing (*Geschäftsbesorgungsvertrag 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.

([1]) According to Germany, the expression 'act in money's worth' used there is in fact imprecise and was clarified later.

(45) Although Wfa lost its legal independence by becoming a housing promotion division of WestLB and was integrated into WestLB's accounts, it was not integrated operationally into WestLB. Wfa remained a distinct entity within WestLB under the name *Wohnungsbauförderungsanstalt 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, assets and future profits are still earmarked for housing promotion and must therefore be administered separately from WestLB's other commercial activities. This separation is, at the same time, 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 in Section II, point 2 above 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 competent authorities have undertaken to ensure that distortions of competition are not caused by such proximity, in particular by separating the housing promotion division from the commercial divisions of WestLB in terms of personnel, information, etc ([2]).

(48) With the splitting up of WestLB on 1 August 2002 (with retroactive effect under the accounting rules to 1 January 2002) under a law of the Land of North Rhine-Westphalia of 2 July 2002, Wfa was allocated to Landesbank Northrhein-Westfalen and thus withdrawn from the commercial activities grouped together in WestLB AG.

b) VALUE OF WFA

(49) 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. 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.

([2]) Section 13 of the Law concerning the asset transfer stipulates that the housing promotion division must carry out its tasks in a manner that is neutral in its effect on competition. The actual measures to be taken to this end are laid down in an agreement between WestLB and the Land authorities.

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

(51) As to the valuation method, the auditor 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 regular 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.

(52) The auditors revalued various items of Wfa's assets and liabilities — the housing loans were adjusted from DEM 30 700 million (EUR 15 700 million) 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 Wfa's nominal net asset value of DEM 24 900 million (EUR 12 700 million) at that time. Following this revaluation, the amount of DEM 5 900 million (EUR 3 020 million) was entered in WestLB's accounts as a special capital reserve for housing promotion (*Sonderrücklage Wohnungsbauförderungsanstalt*).

(53) After being asked by WestLB to accept the amount of DEM 5 900 million (EUR 3 020 million) as WestLB's original own funds, BAKred commissioned another auditing firm to carry out a valuation. This valuation was delivered on 30 September 1992. The valuation for BAKred examined the plausibility of the one made for WestLB and accepted its methodological approach. However, mainly because of the choice of a different discount rate and differing treatment of possible redemptions before maturity (*Vorfälligkeitstilgungen*), the valuation for BAKred arrived at a net asset value for Wfa ranging from DEM 4 000 million (EUR 2 050 million) to DEM 5 400 million (EUR 2 760 million).

(54) On the basis of this valuation, BAKred finally accepted on 30 December 1992 DEM 4 000 million (EUR 2 050 million) as WestLB's original own funds within the meaning of the German Banking Law. Neither the amount shown in WestLB's balance sheet — DEM 5 900 million (EUR 3 020 million) — nor the amount accepted as original own funds has been changed since then.

(55) Both valuations of the assets transferred 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

(56) On 31 December 1991 WestLB had recognised own funds of DEM 5 100 million (EUR 2 600 million), of which DEM 500 million (EUR 260 million) in profit participation certificates (*Genußrechte*). The bank's solvency ratio was around 6,1 % on the basis of the provisions of the German Banking Law before its adaptation to the Community Banking Directives, i.e. 0,5 percentage point above the minimum level stipulated by that Law.

(57) 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 8,7 %, including Wfa's capital and risk-adjusted assets.

(58) Table 1: Capital requirements and own funds of WestLB and Wfa (based on data provided by the German authorities)

(DEM million)

(at 31 December)	1991	1992
Risk-adjusted assets of WestLB (without Wfa)	83 000	91 209
Risk-adjusted assets of Wfa	13 497	14 398
Risk-adjusted assets of WestLB (with Wfa) (*)		105 607
Required own funds of WestLB (**) (= a)	4 611	5 867
Required own funds of WestLB without Wfa (**) (= b)		5 067
WestLB own funds (= c)	5 090	9 190
WestLB own funds without Wfa (= d)		5 190
Utilisation rate of WestLB own funds (= a/c)	91 %	64 %
Utilisation rate of WestLB own funds without Wfa (= b/d)		98 %

(*) The transfer of Wfa took effect on 1 January 1992.
(**) Based on the 5,6 % requirement in force at that time.

(59) This solvency ratio of 8,7 % included an increase in WestLB's risk-adjusted assets unrelated to housing promo-

tion of some DEM 8 200 million (EUR 4 190 million), or 9,9 %, in 1992. If this increase had taken place without the transfer of Wfa, WestLB's solvency ratio would have fallen to 5,7 % by 31 December 1992, i.e. to a level very close to the minimum requirement of 5,6 %.

(60) Whereas all of Wfa's capital is tied up in its housing promotion activities, only some of its own funds within the meaning of the solvency rules are 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.

(61) On 31 December 1991 the solvency ratio of the WestLB group was 5,8 %, i.e. 0,2 percentage point above the minimum. One year later, after the Wfa's capital had been accepted by BAKred, the ratio was about 8,1 %, 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 5,3 %, or 0,3 percentage point below the minimum level required at the time.

(62) On 30 June 1993, when the 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 9 %, i.e. 1 percentage point above the minimum level. (The original own funds accounted for 6,3 percentage points, additional own funds for 2,7 percentage points.) Excluding Wfa's capital contribution and its risk-adjusted assets, the group would have had a solvency ratio of about 7,2 % as at 30 June 1993. The ratio of 9 % 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 (EUR 1 590 million) of 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.

(63) Table 2: Capital requirements and own funds of the WestLB group (based on data provided by the German authorities)

(DEM million)

Average amounts	1992 (*)	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002 (#)
Total assets	271 707	332 616	378 573	428 622	470 789	603 797	693 026	750 558	782 410	844 743	519 470
Risk-adjusted assets	126 071	120 658	151 482	156 470	173 858	204 157	259 237	[...] (+)	[...]	[...]	[...]
Required original own funds (= a)	4 758	4 827	6 060	6 259	6 954	8 167	10 370	[...]	[...]	[...]	[...]
Required total own funds (= b)	9 351	9 653	12 119	12 517	13 908	16 333	20 739	[...]	[...]	[...]	[...]
Original own funds (= c)	5 117	8 818	9 502	9 769	9 805	10 358	11 378	[...]	[...]	[...]	[...]
Additional own funds	500	2 495	4 513	4 946	5 270	7 094	10 170	[...]	[...]	[...]	[...]
Total own funds (= d)	5 617	11 313	14 015	14 715	15 075	17 452	21 548	[...]	[...]	[...]	[...]
Utilisation rate of original own funds (= a/c)	93 %	55 %	64 %	64 %	71 %	79 %	91 %	[...]	[...]	[...]	[...]
Utilisation rate of total own funds (= b/d)	166 %	85 %	86 %	85 %	92 %	94 %	96 %	[...]	[...]	[...]	[...]

(*) Anomalies in this year should be attributed to the change 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.

(#) Figures relate to WestLB AG, into which the commercial activities of former Westdeutsche Landesbank Girozentrale were regrouped in 2002.

(+) Confidential information is indicated below by [...].

(64) 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 million (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).

(65) However, since a bank's assets are normally not 100 % risk-adjusted, the actual credit volume capacity was increased by a greater amount. At the end of 1993 the WestLB group's risk-adjusted assets (including Wfa's business) amounted to DEM 148 600 million (EUR 76 000 million). The balance-sheet total came to DEM 332 600 million (EUR 170 100 million). This indicates an average risk weighting of 45 % ([1]). 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 69 400 million (EUR 35 500 million) on the basis of the 8 % threshold laid down in the EC 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.

(66) 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 EC 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.

(67) As regards the supervisory restrictions on individual large loans, the 50 % threshold stipulated 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 for 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 ([2]).

d) REMUNERATION FOR THE TRANSFER OF WFA

(68) 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.

(69) 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 basis 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 for the law on the transfer contain similar wording as regards the value of the transfer and the remuneration.

(70) 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 of around 1,1 % for WestLB ([3]). It is payable only if profits are made.

(71) The basis for this remuneration is the capital of Wfa recognised by BAKred as original own funds, i.e. DEM 4 000 million (EUR 2 050 million). The remuneration is paid only on the part of this capital not needed by Wfa to underpin its housing promotion activities. This part, available for WestLB to underpin its commercial business, amounted to DEM 2 500 million (EUR 1 280 million) after the new capital requirements entered into force and has been increasing since then ([4]).

([1]) This calculation leaves out of consideration the risk-bearing, off-balance-sheet transactions.

([2]) 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'.

([3]) According to a study submitted by Germany 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 rate of 3,75 % in 1992, 0 % in 1993 and 7,5 % thereafter.

([4]) 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.

(72) Table 3: Special capital reserve for housing promotion and own fund requirements needs of Wfa (based on data provided by the German authorities).

(DEM million)

(At 31 December)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Special reserve for housing promotion	5 900	5 900	5 900	5 900	5 900	5 900	5 900	5 900	5 900	5 900	5 900
Of which accepted as original own funds	4 000	4 000	4 000	4 000	4 000	4 000	4 000	4 000	4 000	4 000	4 000
Needed for housing promotion loans of Wfa	1 668	1 490	1 181	952	892	888	887	[...]	[...]	[...]	[...]
Available for WestLB	13 (*)	2 510	2 819	3 048	3 108	3 112	3 113	[...]	[...]	[...]	[...] (#)

(*) Since BAKred accepted Wfa's capital only on 30 December 1992, the capital share of DEM 2 322 000 million (EUR 1 200 million) was available for WestLB in 1992 for two days only. This results in an average available capital for WestLB of DEM 13 million (EUR 7 million) for that year.

(#) Since Wfa's capital could be used for underpinning commercial activities only until 1 August 2002 as a result of the split-up of WestLB, the difference of [...] between the total amount of recognised original own funds of [...] and the amount of DEM 632 million tied up by Wfa needs to be multiplied by a factor of 7/12. This gives the amount of [...] as the average capital available for the commercial activities of WestLB.

III. COMMENTS FROM INTERESTED PARTIES

1. *COMPLAINT AND OBSERVATIONS BY BDB*

(73) 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 guided not 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.

(74) 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

(75) BdB argued 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 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 its 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***

(76) BdB stressed 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 0,5 percentage point on top of the normal return on equity capital. BdB quoted WestLB's profitability as an average of 5,6 % before tax for the ten years prior to the transfer. This compared 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.

(77) As regards the appropriate method of calculating a comparison of returns on equity, BdB submitted that historical return rates 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 decision but has to be considered as a new, separate decision. A method based on an arithmetic average should therefore be used.

(78) If, however, the compound annual growth rate method is used, the average return of some large German private banks for the period from 1982 to 1992 comes to 12,54 % after taxes. 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 submitted that the corresponding figures given by WestLB were too low because income from the sale of subscription rights was not taken into account.

(79) 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 1982-91) and 14,51 % (on the basis of a higher expected risk premium), these figures being higher than the ones provided by WestLB. The difference could be attributed to two facts. Firstly, BdB applied a higher risk premium for equity (3,16 % and 5 % respectively). Secondly, it applied a higher beta factor for credit institutions (1,25). The risk-free basic rate used is the same as in WestLB's calculation. Considering the various methods of calculating return on equity, BdB finally quoted a range of 14 % to 16 % as a normal return on equity.

(80) BdB further stated that a private minority shareholder would not inject 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.

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

(82) As regards the comparison with equity instruments on the financial market submitted by Germany and WestLB, BdB stressed that profit participation certificates (*Genußrechte*) and cumulative perpetual stocks could not be compared to Wfa's capital. Firstly, they were not accepted as original own funds. (Cumulative perpetual stocks were not even accepted as additional own funds in Germany.) Because it qualifies as original own funds, Wfa's capital allowed WestLB to increase further its own funds by raising additional own funds. Secondly, the instruments referred to were limited in time and profit participation certificates lost their additional own funds character two years before maturity. Wfa's capital was, however, at WestLB's disposal for an unlimited period. Thirdly, such instruments normally provided only a limited part of a bank's own funds and required a considerable share of original own funds. Fourthly, capital markets instruments could be traded on the markets, which meant that an investor could terminate his investment whenever he wished. 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.

(83) 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.

(84) BdB also commented on the covering agreement between the shareholders of WestLB, which stipulated that, internally, Wfa's capital was subordinate in its liability only to the other liable equity capital. Since the expression 'other liable equity capital' also covered additional own funds instruments like profit participation certificates and subordinated loans and was therefore detrimental to their position, it argued that the agreement was a 'contract at the expense of third parties' (*Vertrag zu Lasten Dritter*) and thus void. Therefore, the risk profile of Wfa's special reserve was therefore said to be higher than that of profit participation certificates and subordinated loans.

(85) For all these reasons, BdB assumed that the remuneration of 0,6 % paid by WestLB did 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 suggested a rate within the range of 14 % to 17 % as correct remuneration. This rate was to be paid on the total accepted amount of DEM 4 000 million (EUR 2 050 million).

ii) ***Liquidity costs***

(86) In its complaint BdB accepted the 'liquidity costs' 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 of 7 percentage points should, in fact, be lower.

(87) 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 already been taken into account when discounting Wfa's assets to the value of DEM 5 900 million (EUR 3 020 million). Moreover, several banking activities, e.g. guarantees, do not need any liquidity at all. Therefore, 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 the Wfa assets are locked up in unprofitable business. BdB submitted an outside expert's opinion on this point.

(88) The BdB further mentioned that the 7,5 % for refinancing costs claimed by WestLB was questioned as being 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 was said to be an average of between 6,07 % and 6,54 % for the years 1992-96. 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 had to 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 rates applied after tax should be considered.

iii) ***Capital basis for the calculation of the remuneration***

(89) As already mentioned, BdB suggested that the appropriate remuneration should be paid on the total accepted amount of DEM 4 000 million (EUR 2 050 million). However, it claimed 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, benefited 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 formed the basis for commercial estimates of what was available to cover losses. This amount therefore increased WestLB's credit standing, and a remuneration comparable to a guarantee premium should be paid for it.

iv) ***Synergy effects***

(90) According to BdB, the claimed synergy effects did not constitute the real reason for the transfer. This was said to be apparent from the fact that the law on the transfer justified 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.

(91) Furthermore, BdB questioned how synergy effects could 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

(92) BdB pointed 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 were justified only as long as these institutions were engaged exclusively in promotional activities and thus did not operate in competition with private taxable institutions.

(93) According to BdB, a normal bank increasing its capital would each year have to pay on this additional capital 0,6 % property tax and 0,8 % tax on business capital. WestLB was therefore in a favourable position compared with other banks. The exemption from corporation tax was said to benefit WestLB indirectly. The waiver of tax income constituted state aid within the meaning of Article 87(1) of the EC Treaty.

c) WAIVER OF LIABILITY

(94) Prior to the transfer, Wfa was released from liabilities of DEM 7 300 million (EUR 3 730 million) vis-à-vis the Land, which waived them 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 DEM 4 000 million (EUR 2 050 million) of capital. WestLB therefore profited directly from the waiver.

2. *OBSERVATIONS FROM OTHER INTERESTED PARTIES*

(95) 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 FRANÇAISE DES BANQUES

(96) The *Association Française des Banques* states 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 detrimental to 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.

(97) 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

(98) 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. The Commission is called upon to uphold the principles of the single market and not to exempt publicly owned banks from the competition rules of the Treaty.

3. *OBSERVATIONS FROM WESTLB*

(99) 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 Germany's observations on the same question and declared itself fully in agreement with that statement. Thus, the arguments of Germany generally reflect the position of WestLB, which is therefore presented only briefly.

a) GENERAL OBSERVATIONS ON THE TRANSFER

(100) According to WestLB, the market-economy investor principle is not applicable to investments in economically sound and profitable enterprises. This is said to be confirmed by the Court, which had in the past applied this principle only in cases where, at the time of the investment decision, the enterprise in question had already been operating at a significant 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.

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

(102) 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. Given the lack of liquidity, the transfer cannot be compared to other capital injections. Other equity instruments on the market do not carry voting rights either.

(103) 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. Since 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

(104) 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 had been 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 %.

(105) WestLB also submits that the figures presented by BdB on the return on equity of German banks are not correct for several reasons. On account of specific stock exchange developments, the investment period used by BdB for the calculation led to particularly high returns. The arithmetic average used by BdB did not provide correct results as the compound annual growth rate method should be used for such calculations. BdB included in its calculations 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 adjustment for all these factors.

c) SYNERGY EFFECTS

(106) 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 (personnel within the 'old' Wfa as well as in the housing promotion division of WestLB, the costs of which had to be borne by Wfa before the transfer) was 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 were expected to increase to around DEM 25 million (EUR 13 million) from 1997 onwards. These amounts were 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.

(107) Furthermore, in the course of the merger, changing the pension scheme for Wfa employees cost WestLB DEM 33 million (EUR 17 million) in payments to the pension institution of the Federation and the Länder. The payments would reduce Wfa's subsequent expenses.

d) TAX EXEMPTIONS

(108) According to WestLB, the exemption of Wfa from certain taxes is in line with the system of German tax law, under which the taxes in question do not apply to institutions that serve public purposes and do not compete with other, tax-paying institutions. WestLB itself is liable in full to all these taxes and does not derive any benefit from the exemption of Wfa. It is also pointed out that property tax has not been levied since 1 January 1997 and tax on business capital not since 1 January 1998.

e) WAIVER OF LIABILITY

(109) 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 GERMANY

(110) Germany submitted that the transaction does not include any elements of state aid for WestLB within the meaning of the EC Treaty. The Land of North Rhine-Westphalia received an appropriate remuneration which corresponded to the terms of the market. Nor did the transaction constitute state aid for the other shareholders of WestLB as the preservation of the shareholder structure after Wfa's transfer was justified by the appropriate remuneration paid by WestLB. Furthermore, the tax exemptions for Wfa do not include elements of state aid for WestLB because they did not affect the commercial business of the bank.

(111) In Germany's opinion, the Commission may examine the case only on the basis of the circumstances obtaining at the time of the investment, 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 annual valuation and integration of Wfa's assets and liabilities into WestLB's accounts fell outside the scope of the Commission's investigation.

(112) According to Germany, the ideas on integrating Wfa into WestLB dated 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 had to deal with only one party and not two.

(113) Germany 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.

(114) 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.

(115) Externally, liability in respect of the 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. Since 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*

(116) Germany 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 for private investors. Such an argument would infringe Article 295 of the EC Treaty.

(117) An increase in the total return on WestLB's equity is said to be unnecessary because measures to increase the return are required only if the State invests in loss-making companies. Germany claims that the Court applied the market-economy investor principle in the past only to state interventions in loss-making companies and sectors suffering from structural overcapacity. It cannot be inferred from the 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 and strategic considerations and enjoys a certain latitude for entrepreneurial decisions and, within those confines, the Commission is not allowed to vet such decisions. Therefore, the Commission may not request 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 obliged 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 the 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 by the private-investor test.

(118) 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 capital cannot be compared to a normal equity injection and the transfer constitutes the commercially 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.

(119) According to Germany, 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.

(120) Germany submitted that the way in which an adequate remuneration is paid was 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 economic 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 would receive no additional income which they would not receive under normal market-economy conditions and WestLB's attractiveness for other investors is, therefore, not 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.

(121) Since the Land receives a fixed and adequate remuneration and since WestLB was and still 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 ask for an increase in the bank's profitability.

2. *APPROPRIATE REMUNERATION FOR THE CAPITAL*

(122) Germany submitted that WestLB paid an appropriate remuneration for the transferred assets. The fact that a remuneration would have to be paid by WestLB for the capital provided had 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, a remuneration was fixed only in

principle, but not in detail, at the time of the transfer. The actual level of 0,6 % was fixed in 1993 after negotiations with the other owners of WestLB [1]. Germany did not provide the Commission with any documents explaining how this figure was determined. Instead, it argued that the decisive factor from a state aid point of view was not the considerations on which the rate was based but only the result, which was 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 [2]. The figure of 0,6 % corresponds to pre-tax costs of about 1,1 % for WestLB.

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

(124) Table 4: Remuneration paid by WestLB for the transfer of Wfa (data provided by Germany)

(DEM million)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Remuneration (before tax)	0,0	27,9	30,8	33,4	33,9	34,0	34,0	[...]	[...]	[...]	[...]
Payment for pension entitlement of Wfa staff	33,1	0,0	0,0	0,0	0,0	0,0	0,0	[...]	[...]	[...]	[...]
Total remuneration paid to the Land	33,1	27,9	30,8	33,4	33,9	34,0	34,0	[...]	[...]	[...]	[...]

(125) Germany 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 examined the external and internal risk exposure of the capital and the conditions governing the remuneration payments, comparing these features to those of 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 remuneration of 0,6 % amount to 1,1 %, this rate is regarded as being adequate. In addition to this direct remuneration, the synergy effects arising from the transfer have to be taken into account.

a) COMPARISON WITH OTHER EQUITY INSTRUMENTS

(126) The studies state that the return on an equity instrument is determined by its risk profile. The higher the risk, the higher the risk premium, i.e. the interest spread that has to be paid over secure government bonds. In analysing the risk profile, three elements are therefore 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 [3] 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 participating certificates, perpetual preferred stock and dormant holdings [4]. 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*).

(127) The studies stress that Wfa's assets would be available for WestLB's creditors in the event of WestLB's bankruptcy (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

(1) The 0,6 % rate was laid down in a protocol notice to the covering agreement dated 11 November 1993.

(2) Germany has explained that there was an agreement between the owners that such recovery payments should take place but that there was no corresponding legal obligation on WestLB.

(3) The following features are described: country of issue and of issuer, treatment of the instrument by banking regulators, its typical maturity, treatment in the event of bankruptcy/liquidation and for loss absorption, whether it is callable, whether it is possible to defer interest/dividend payments and whether a cumulative deferral is possible.

(4) Wfa's capital is compared in one version only to profit participation certificates and perpetual preferred stock and in another to all three instruments.

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.

(128) 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 parallel, it is less risky than the profit participation certificates. The same applies to dormant holdings.

(129) 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 present a higher level of risk 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.

(130) 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 for perpetual preferred stock. Profit participation certificates are less risky because missed interest payments would be deferred on a cumulative basis and paid in later years. For silent 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 below) 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 attaching to Wfa's capital is slightly lower then that attaching to the other three instruments.

(131) 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 holidays and one of between 1,5 % and 2,0 % for perpetual preferred shares ([1]). For Wfa's special reserve a remuneration of 1,1 % is calculated for the years 1993 to 1996 ([2]). For 1992 a rate of 255 % is quoted ([3]). Synergy effects should also be taken into account. The studies conclude that the remuneration paid by WestLB was too high in 1992 and appropriate for the years 1993 to 1996.

b) LIQUIDITY COSTS

(132) According to Germany, a cash injection increases own funds and provides liquidity. This liquidity can be reinvested and earn interest, for which the investor would demand a remuneration. The transfer increases WestLB's own funds but does not provide liquidity. Wfa's liquidity is locked up in the housing promotion business. Unlike 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.

(133) Furthermore, it is stated that practically all risk-related, assets-side banking business requires some liquidity, e.g. 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.

(134) The relevant refinancing costs which have to be taken into account should be based on the return on long-term (i.e. ten-year) risk-free German Government bonds. The secondary-market rate for such bonds at the end of 1991 was 8,26 %. The actual average refinancing costs of WestLB in November 1991 stood at 9,28 %.

c) CAPITAL BASIS FOR THE CALCULATION OF THE REMUNERATION

(135) Germany takes the view that, 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. not needed to underpin Wfa's own business.

([1]) Data from the US and British markets were used for perpetual preferred shares because these instruments are not available in Germany.

([2]) 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.

([3]) 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 2 million (EUR 1 million) and, secondly, on the payment in 1992 by WestLB of DEM 33 million (EUR 17 million) for future pension entitlements of Wfa staff, which is taken as remuneration paid by WestLB to the Land in that year.

(136) The remainder of the capital, 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 simply 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).

(137) According to Germany, 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.

d) SYNERGY EFFECTS

(138) According to Germany, 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 procedure, e.g. the elimination of duplication, 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.

(139) Germany points out that in 1992 WestLB paid DEM 33 million (EUR 17 million) to cover existing and future pension entitlements of Wfa employees, which reduced the future costs of Wfa. These payments are depreciated in WestLB's accounts over a period of 15 years by DEM 1,6 million (EUR 0,8 million) annually.

3. *TAX EXEMPTIONS*

(140) The exemption of Wfa from property tax (*Vermögenssteuer*), tax on business capital (*Gewerbekapitalsteuer*) 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 exemptions because the amount accepted as original own funds is not increased as a result. Even if the tax exemptions 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.

(141) As regards property tax and tax on business capital, an asset can be subject to such taxation only once and is taxed where it is used directly. Since Wfa's assets are exempt regarding their primary use, i.e. the housing promotion business, they cannot be subject to taxation when put to an additional, secondary use. This would be contrary to the system underlying German tax law. The same applies to the integration of a private tax-exempt entity into a private bank. Since these exemptions do not provide WestLB with an unpaid-for advantage, they do not constitute state aid. Furthermore, tax on business capital and property tax have not been levied since 1997 and 1998 respectively as the Federal Constitutional Court ruled that they were anti-constitutional.

4. *WAIVER OF LIABILITY*

(142) According to Germany, 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 only have become due in the case of such liquidation, the waiver does not change the economic position of the Land. In fact, the Land is only waiving a liability against itself.

(143) The waiver was taken into account in the valuation of Wfa's equity capital by BAKred and, on this basis, WestLB was paying an adequate remuneration. The waiver therefore produces no financial benefit for WestLB.

5. *OBSERVATIONS ON THE COMMENTS FROM INTERESTED PARTIES*

(144) As to the comments from the two bankers' associations Germany remarks that the general accusations made are not substantiated by facts or any actual cases of complaints of credit institutions concerning the way in which WestLB operates on the markets. The questions regarding *Anstaltslast* and *Gewährträgerhaftung* raised in one of the two observations are in no way linked to the present case and should be regarded separately.

(145) As to the comments from BdB, Germany stresses that the transfer of Wfa was no ad hoc solution but the result of long-term strategic considerations, especially 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 enterprises which were loss-making. Since WestLB has been a profitable enterprise since its formation, the market-economy investor principle is not applicable. Germany believes that this is confirmed by the case law of the Court, where that principle has never been 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 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.

(146) The state aid rules allowed 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. Since the special character of Wfa's assets is protected by that Article, the capital transferred must not 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.

(147) Regarding the risk profile of Wfa's capital, a distinction must be drawn between the role of the Land as an 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 the shareholders of WestLB. 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.

(148) Germany submits that the return calculations provided by BdB (and taken from an outside expert's opinion) are incorrect and supports this view by reference to a study commissioned by WestLB. According to this study, the main errors are a 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 an unrepresentative reference period, viz. 1982-92, which includes two market rallies. Shortening the reference period would thus further lower the return figures.

(149) As to the liquidity aspect, Germany 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-interest or non-interest-bearing character of Wfa's assets and liabilities. It also rejects BdB's argument that, if any refinancing costs are accepted, only a small rate of 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 study of BdB compares gross revenues whereas net revenues should be compared. The German Government submitted its own study produced by an outside consultancy.

(150) 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, independent of the economic, organisational and personnel separation between Wfa and WestLB. 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.

(151) The difference between Wfa's special reserve shown in the balance sheet and the amount accepted by BAKred was clearly communicated to third parties. According to Germany, 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.

(152) 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. UNDERSTANDING BETWEEN BDB, THE LAND OF NORTH RHINE-WESTPHALIA AND WESTLB

(153) On 13 October 2004 the complainant BdB, the Land of North Rhine-Westphalia and WestLB AG submitted to the Commission an understanding on the state aid procedure in the WestLB case. Irrespective of their basic interpretations of the legal situation, which remained unchanged, the parties to the understanding agreed on what they themselves regarded as suitable parameters for determining an appropriate remuneration and on the appropriate remuneration itself. The parties asked the Commission to take account of this understanding in its decision.

(154) Applying the capital asset pricing model (CAPM), the parties first determined the minimum expected remuneration for a hypothetical own-capital investment in WestLB at the relevant transfer date. On this basis, the appropriate minimum remuneration for the part of Wfa's capital recognised by BAKred as core capital and not used by Wfa to underpin its housing promotion activities should amount to 10,19 %.

(155) In calculating this figure, the risk-free long-term interest rates computed by the Landesbanks on the basis of the REX10 Performance Index of the Deutsche Börse AG and the beta factors estimated on the basis of a KPMG study of 26 May 2004 commissioned by the Landesbanks were used. In practical terms, this resulted for WestLB in a risk-free interest rate of 7,15 % at the time of the transfer. On the basis of the KPMG study, a beta factor of 0,76 was determined for the time of the transfer. A market-risk premium of 4 % was determined across the board.

(156) The initial interest rate of 10,16 % (1 January 1991) was calculated as follows: risk-free interest rate of 7,15 % + (general market-risk premium of 4,0 % × beta of 0,76).

(157) A deduction was then made to take account of the lack of liquidity of the special fund. For this, the risk-free interest rate of 7,15 % was applied generally as gross refinancing costs. To determine the key net refinancing costs, the overall tax rate for WestLB is fixed at 50 %, resulting in a deduction for lack of liquidity of 3,57 %.

(158) Lastly, a premium of 0,3 % is added because no new voting rights were granted.

(159) This produces overall an appropriate remuneration of 6,92 % (after tax) for the part of Wfa's capital which was recognised by BAKred as core capital and was not used by Wfa to underpin its own housing promotion activities.

(160) Both parties agree that, with the parent-subsidiary model taking effect on 1 January 2002, the aid situation arising from the transfer of Wfa's capital has ceased.

VI. ASSESSMENT OF THE MEASURE

(161) 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 EC Treaty.

1. *STATE RESOURCES AND FAVOURABLE TREATMENT OF A CERTAIN UNDERTAKING*

(162) Wfa 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* and *Gewährträgerhaftung*. Wfa'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.

(163) 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.

(164) 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 decisions. The assessment under that principle will be made in Section 3 below. If state aid is involved, WestLB, i.e. an 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*

(165) 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 on financial services markets.

(166) In its 1997 annual report, WestLB defines itself as a universally and internationally active commercial bank, as a

central bank for the savings banks and as the bank for the Land and the municipalities. It describes itself as a European banking group in the wholesale banking sector with activities in the 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.

(167) 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 in Section II, point 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.

(168) 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.

(169) 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. Since 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*

(170) 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, e.g. 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 in the case at hand.

(171) 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' ([2]). 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 the form of dividends and capital gains) cannot be expected within a reasonable period of time ([3]).

(172) The Commission has, of course, to base its appraisal of a 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 with the benefit of hindsight.

(173) Germany 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 could not 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) were 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 on 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.

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

(175) 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

([1]) See, for example, Cases C-303/88 *Italy* v *Commission* [1991] ECR I-1433 and C-305/89 *Italy* v *Commission* [1991] ECR I-1603.

([2]) 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. Crédit Lyonnais (OJ L 221, 8.8.1998, p. 28) and GAN (OJ L 78, 16.3.1998, p. 1).

([3]) Public authorities' holdings in company capital — The Commission's position, Bull. EC 9-1984, pp. 93 and 94.

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.

(176) 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 and an increase in the 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.

(177) 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 reallocate 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 stated 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 would evaluate the financial situation of the company at the time an additional capital injection is proposed ([1]).

(178) 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 fact be regarded as sound and profitable. It is certainly difficult to determine 'average profitability' as this is dependent on a number of factors, i.e. 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 Germany 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 EC Treaty.

(179) 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.

(180) 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 principles. 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 ([2]). However, as already stated, the principles are the same in all decision-making situations: the return expected in the long run from the investment (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.

(181) 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 if 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 depends on the company achieving an average rate of return on its equity capital.

(182) 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

([1]) OJ C 307, 13.11.1993, p. 3, point 37.

([2]) 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 can subsequently be offset by high profits. Even in the case of such investments, the benchmark is the expected long-term return.

what is necessary for a bank's viability. In other words, 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 step would directly reduce the bank's volume of business and hence its market presence.

(183) 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 for 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.

(184) 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 Wfa's assets and under the same conditions, especially in view of the probable return on the investment. This question will be examined below.

a) ARTICLE 295 OF THE EC TREATY

(185) Germany 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. Germany 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.

(186) 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.

(187) 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 of general economic interest. However, as soon as such public funds and assets are used for commercial competitive activities, normal market-economy rules have to be applied. This means that, as soon as the State decides to assign public-purpose assets (also) to a commercial use, it should seek a remuneration corresponding to market terms.

b) SPECIFIC NATURE OF THE MEASURE

(188) 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 forming an independent and 'closed' circuit in which profits generated by Wfa accrue to and are retained by that institution only.

(189) 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 viewpoint. In its opinion, however, if a construction 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 EC Treaty's state aid rules. It is necessary to assess to what extent the integration carried out is economically advantageous to the competitive divisions of WestLB despite the creation of 'closed circuits'.

(190) It should be pointed out here that the complexity of the case and the lack of directly comparable transactions on the free market make this judgement 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

(191) When injecting equity capital into a bank, a market-economy investor demands an appropriate share in the bank's profits. One way of ensuring such participation is via 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 taken by the Land.

(192) According to the German authorities, a redistribution of shares in WestLB was not possible owing to the specific character 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 on by WestLB's shareholders.

(193) In this case, however, the Land should have demanded appropriate remuneration for the transfer in another form, 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

(194) Germany 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).

(195) 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 the acceptance of the capital (or only part of it) as original own funds by BAKred. The only decisive factor for the fixing of a remuneration for a capital investment is 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.

(196) 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.

(197) 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 are shown in the balance sheet but are 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).

(198) 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 Germany 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. The amount of DEM 5 900 million (EUR 3 020 million) has been established 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's 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 to 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). Therefore, 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 shown as equity in the balance sheet.

(199) Since, therefore, 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

(200) 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.

(201) The complainant originally claimed that the transaction at issue constituted a state guarantee by the Land of North Rhine-Westphalia for WestLB's debt. But WestLB shows the assets transferred as equity capital in their 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 a capital injection and for payment of an appropriate remuneration. The very same financial measure cannot be regarded as a capital injection under banking supervisory rules and as a guarantee under the EC 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.

i) ***Comparison with other equity instruments***

(202) Germany 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.

(203) In the Commission's opinion, it is, in fact, difficult to liken Wfa's transfer to any instrument available on the market at that time 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. Furthermore, the studies submitted by Germany are not really comprehensive because they leave out several relevant instruments such as non-voting shares.

(204) It should be borne in mind that the instruments used for the comparison by Germany 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 %. Taking into account only 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 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 [1].

[1] This point is also stressed by the Commission's outside experts, who criticise the fact that the studies submitted by the German Government 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.

(205) It should also be noted that rating agencies pressed for some sort of 'voluntary restriction' to be applied regarding the share of equity from hybrid instruments, which they monitored closely.

(206) In this connection, it should 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 been developed in the meantime and some of which are available only in other countries. Germany itself also (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.

(207) Germany'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.

(208) As to the two instruments which, as the closest benchmarks, play the central role in the comparison undertaken by Germany, 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 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.

(209) For all these reasons, the Commission is of the opinion that, because of the peculiarities of Wfa's capital, the comparison with hybrid equity instruments submitted by Germany is not a suitable way to determine the appropriate remuneration to be paid for Wfa's capital [1].

(210) 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, Wfa's special reserve can be used only subordinate to WestLB's other equity capital. However, the argument by Germany and WestLB can be followed, namely that this agreement covers only the relationship between Wfa's special reserve and the other original own funds provided by shareholders, i.e. in 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***

(211) The arguments of Germany and WestLB on the liquidity costs can, in principle, be accepted. A 'normal' capital injection into a bank provides 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.

[1] The external study carried out for the Commission supports this view and comments on various individual assessments in the study submitted by Germany. 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 studies submitted by Germany: market data are said to be used selectively and, in some places, they are simply replaced by data from the authors' own experience, without this being stated explicitly.

administration) gives the profit on the equity [1]. 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 in order to take full advantage of the business opportunities 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) [2]. 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.

(212) However, in the Commission's view and contrary to the opinion of WestLB and Germany, 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 therefore that WestLB incurs additional 'liquidity costs' to the extent of 'refinancing costs minus tax'.

iii) ***Appropriate remuneration for the amount of DEM 2 500 million (EUR 1 280 million)***

(213) There are no doubt different ways of calculating the appropriate remuneration for the amount of DEM 2 500 million made available. However, as will be shown, all the methods for calculating the remuneration for capital made available apply the same basic principles. Taking these basic principles, the Commission here carries out the calculation in two stages: first, it determines the minimum remuneration that an investor would expect for a (hypothetical) investment in WestLB's capital. It then examines whether, in view of the particularities of the transaction at issue, the market would have agreed on a premium or a discount and, if so, whether it can produce a sufficiently robust quantification of that amount.

Determination of a likely minimum remuneration for an investment in the capital of WestLB

(214) The expected return on an investment and the risk attaching to the investment are essential determinants of the decision to invest on the part of a market-economy investor. In order to determine the level of these two elements, the investor takes into consideration all available company and market information. He here bases himself on historical average returns, which generally also give him an idea of what the company's future performance is likely to be, as well as — among other things — on the analysis of the company's business model for the period of the investment, the strategy and quality of its management, and the prospects for the economic sector concerned.

(215) A market-economy investor will invest only if the investment permits a higher return or a lower risk compared with the next-best alternative use of the capital. Accordingly, an investor will not invest in a company whose expected returns are lower than the average expected returns of other companies with a similar risk profile. In such a case, it can be assumed that there are sufficient alternatives to the alleged investment that promise a higher expected return with the same risk profile.

(216) There are various methods for determining the appropriate minimum remuneration, ranging from different versions of the financing approach to the CAPM method. For the purpose of illustrating the different approaches, it makes sense to differentiate between two components: a risk-free return and a project-specific risk premium:

appropriate minimum return on a risky investment

=

risk-free basic rate + risk premium for the risky investment

The appropriate minimum return on a risky investment is therefore the sum of the risk-free rate of return and the additional risk premium for assuming the investment risk.

(217) Accordingly, the basis for any determination of return is the existence of a default-risk-free form of investment with an assumed risk-free return. The expected return on fixed-rate securities issued by the State is normally used to determine the risk-free basic rate (or an index based on such securities) since those constitute a similarly low-risk form of investment. The risk premium, however, is determined differently depending on the method used:

— *Financing approach*: from the point of view of the bank using the capital, an investor's expected return on capital represents future financing costs. Under this

(1) 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.

(2) 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).

approach, the historical capital costs incurred by comparable banks are first determined. The arithmetic average of the historical capital costs is then compared with the future expected equity capital costs and thus with the investor's requirement as to the expected return.

— *Financing approach with the compound annual growth rate*: At the heart of this approach stands the use of the geometric rather than the arithmetic mean value (compound annual growth rate).

— *Capital asset pricing model (CAPM)*: The CAPM is the best-known and most frequently tested model of modern financial economics, by which the return expected by an investor can be determined using the following formula:

minimum return on capital

=

risk-free basic rate + (market risk premium × beta)

The risk premium for the equity investment is obtained by multiplying the risk premium on the market by the beta factor (market risk premium × beta). The beta factor is used to quantify the risk of a company relative to the overall risk of all companies.

(218) The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since WestLB is not a listed company, it is not possible to derive its beta value directly. The CAPM can be used therefore only on the basis of an estimation of the beta factor.

(219) The Commission possesses six expert reports in which the risk premium and the minimum return on capital were calculated using different approaches, with all of them calculating the risk premium for the transfer of Wfa's capital to WestLB not directly but on the basis of a (hypothetical) investment in WestLB's capital.

— *Ernst&Young studies* of 11 September 1995 and 28 August 1997: In the Ernst&Young studies (1995), which apply the financing approach, the actual capital costs stemming from changes in last-trading-day prices (gains and losses) and dividends paid (dividend returns) are determined for the period 1982-92. The arithmetic average of the historical capital costs is then compared to the investor's requirement as to the expected return.

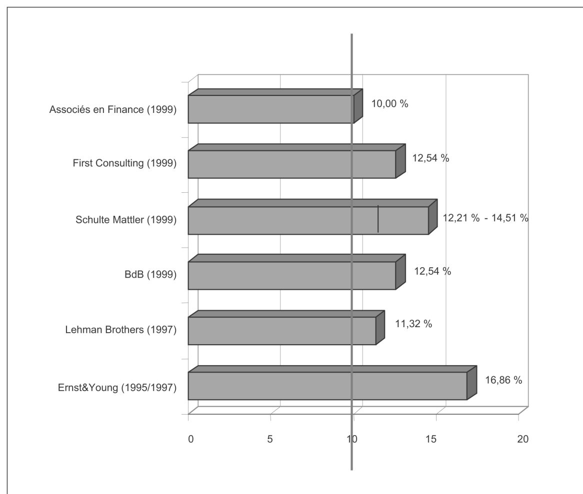
— The study by *Associés en Finance* (October 1999), which had been commissioned by BdB, arrived on the basis of the Securities Market Line Model at a minimum return of 10 %-11 % for an investment akin to a share capital investment in WestLB at the relevant time.

— *BdB study* of 14 January 1999: In line with the financing approach, BdB determined, using the compound annual growth rate and the data pool of Ernst&Young, the geometric mean values of the capital costs of the four leading German commercial banks (Deutsche Bank, Dresdner Bank, Commerzbank and Bayerische Vereinsbank) for all conceivable investment periods between 1982 and 1992. The average capital costs of these banks (12,54 %) correspond to the investor's expected return.

— *Lehman Brothers study* of 8 July 1997 commissioned by WestLB, *expert opinion of Professor Schulte-Mattler* of 14 January 1999 commissioned by BdB, and *First Consulting study* of 18 June 1999 carried out on behalf of the Commission: These consultants, who all apply the CAPM, first determined a general market-risk premium for the German share market at the end of 1991. They arrived on average at a premium of 4 %-5 % (Lehman Brothers 4 %, Professor Schulte-Mattler 5 % and First Consulting 4 %-5 %). In their understanding submitted to the Commission on 13 October 2004, the Land of North Rhine-Westphalia, WestLB and the complainant BdB took as the basis a market-risk premium of 4 %. The consultants then estimated the beta value, i.e. the individual risk premium for WestLB. Using this value, the general market-risk premium was adjusted for WestLB. Since WestLB was not a listed company at the end of 1991, its beta value could not be statistically estimated. For this reason, the consultants assumed that WestLB's beta value was the same as that for comparable listed banks. Professor Schulte-Mattler determined, using Deutsche Bundesbank data, a beta factor for commercial banks in Germany at the end of 1991 of 1,25 (on the basis of annual data) and of 1,1 (on the basis of monthly data). By contrast, the consultant commissioned by WestLB, Lehman Brothers, took as a basis the betas not of all German credit institutions but of IKB Deutsche Industriebank and BHF-Bank, which was 0,765. Lehman Brothers thus arrived at altogether lower risk premium for WestLB. The complainant too accepted in the understanding submitted on 13 October 2004 a beta value of 0,76 as still appropriate and thus arrived at a minimum remuneration of 10,19 %, which differed from the figure given in its statement of 14 January 1999.

(220) The following table summarises the findings of these studies. If the methods mentioned above for deriving the

expected return on a risky investment are applied, the following minimum returns on an investment in the share capital of WestLB are obtained:



(221) The studies and opinions submitted come to the conclusion that a minimum return for a (hypothetical) investment in the share capital of WestLB at the relevant time ranges from 10 % to 13 % ([1]). Only two studies arrive at a much higher figure. In the discussions between the complainant BdB, the Land of North Rhine-Westphalia and WestLB in July 2004, the parties agreed on a rate of 10,19 % as the appropriate remuneration. This figure falls within the market range just identified. Deviating from its first WestLB decision in 1999, which set a minimum of 12 %, the Commission has therefore decided to use the rate of 10,19 % per annum as the appropriate market remuneration for an investment in the share capital of WestLB at 31 December 1991. As a result, the Commission determines a rate of 10,19 % per annum (after corporation tax and before investor tax) as the appropriate minimum remuneration for the transfer of Wfa's capital.

Return discount on account of lack of liquidity

(222) During the proceedings, WestLB first claimed that its refinancing costs on the basis of its financial structure at the time of the transfer were 9,2 %. Subsequently, refinancing rates of 7,0 % and 7,5 % were suggested in several documents and at several meetings by WestLB and Germany ([2]). In the understanding, the parties agreed, on the basis of the long-term risk-free basic interest rate at 31 December 1991 determined by them, to use a rate of 7,15 %. They also agreed to apply an overall tax rate of 50 %. Accordingly, the parties arrived at a net refinancing rate of 3,57 % for the part of Wfa's capital available to underpin commercial business, resulting in a liquidity discount.

(223) Since the figures mentioned are still within the range indicated by Germany, the Commission does not see any grounds for not regarding them as appropriate and therefore bases its calculation of the aid element on them. Although the Commission had, in its first WestLB decision, accepted as the minimum gross refinancing costs the long-term, risk-free interest rate for 10-year Federal Government bonds, which stood at 8,26 % at the end of 1991, this rate is a balance-sheet date that ignores the fact that Wfa's assets were to be at the disposal of WestLB on a long-term basis. In their discussions about the long-term, risk-free basic interest rate, the parties thus abandoned the use of a risk-free return observable on the market at the time of the investment in favour of a fixed investment period, the reasoning being that such an approach would take no account of the reinvestment risk, i.e. the risk of not being able to invest at the same risk-free interest rate after the investment period had expired. The parties consider that the investment risk is best taken into account using a total return index. They have therefore used the REX10 Performance Index of Deutsche Börse AG, which shows the performance of an investment in 10-year Federal Government bonds. The index series used contains the year-end value of the REX 10 Performance Index as of 1970. The parties have then determined the per annum return reflecting the trend as it is depicted in the period 1970-91 and, in this way, arrived at the aforementioned risk-free basic interest rates of 7,15 % (31 December 1991).

(224) Since the investment in WestLB was indeed to be made available on a permanent basis, it seems fitting in this special case to apply this method of determining the risk-free basic interest rates. In addition, the REX 10 Performance Index used is a generally recognised data source. The risk-free basic interest rates determined thus seem appropriate.

(225) The Commission has therefore decided in this case to take as a basis the long-term, risk-free interest rate of 7,15 % at 31 December 1991 determined by the parties as the minimum gross refinancing costs. Assuming an overall tax rate of 50 % ([3]) at the time of the investment, it arrives at a net refinancing rate and thus at a liquidity discount of 3,75 % per annum for Wfa's capital that was available for underpinning commercial business.

Return premium on account of the particularities of Wfa's transfer

(226) In practice, when remuneration is determined, atypical circumstances which depart from a normal investment in the share capital of the company concerned generally give rise to discounts or premiums. It must therefore be

([1]) The chosen minimum remuneration is also supported by statements and studies on actual and expected returns on equity made by investment banks and consultancy firms. Salomon Brothers puts the equity return for most European banks at between 10 % and 14 %, Merryl Lynch estimates a figure of some 11,8 % for different German banks and WestLB Panmure gives a figure of between 11,8 % and 12,3 %.

([2]) In the decision to initiate proceedings under Article 88(2) of the EC Treaty, the Commission, on the basis of information provided at the time by WestLB, indicated a provisional rate of 7 %.

([3]) According to documents provided by the German Government, the corporate income tax rate was 42 % in 1995 and 1996, with a solidarity surcharge of 7,5 %, i.e. 49,5 % in total. The overall rate dropped to 47,5 % in 1998. It is only since 2001 that the overall tax rate has been 30,5 %.

examined whether the particularities, and especially the specific risk profile of the transfer of Wfa's capital, constitute grounds for adjusting the minimum remuneration of 10,19 % — determined above — which a private investor would expect for a (hypothetical) investment in the capital of WestLB and whether the Commission can produce a methodically robust quantification of that adjustment. In this connection, three aspects should be considered: first, the non-issuance of new shares in the company with the associated voting rights; second, the exceptional volume of the asset transfer; and, third, the non-marketability of the assets.

(227) The Land did not obtain any additional voting rights through the transfer. By forgoing voting rights, an investor renounces a say in decisions taken by the bank's board. If the Land's voting rights had been increased, it would have possessed more than 70 % of those rights, moving from being a minority (with 42 % of shares) to a majority shareholder. To compensate for this acceptance of a higher risk of loss without a corresponding increase in influence over the company, a market-economy investor would demand a higher remuneration (even if the potential risk were cushioned by internal agreements with the other shareholders). This is clearly so in the case of non-voting preference shares. A higher remuneration is demanded as well as preferential ranking for forgoing voting rights. On the basis of the higher remuneration for preference shares compared with ordinary shares and in agreement with the complainant BdB, the Land of North Rhine-Westphalia and WestLB, which, after their discussions in July 2004, consider a rate of 0,3 % per annum (after tax) as appropriate remuneration, the Commission considers a premium of at least 0,3 % per annum (after corporation tax) to be appropriate.

(228) The size of the amount transferred and its effect on WestLB from the point of view of the Solvency Directive have already been mentioned. Through the transfer of Wfa's capital, WestLB's core capital doubled without any acquisition or administration costs. In the present case, however, the large volume of Wfa's capital was viewed as an indication — albeit not sufficient on its own — that the transfer was akin to an injection of share capital. To that extent, applying a top-up (premium) in respect of the volume of Wfa's transfer would inadmissibly allow for this aspect twice over. Thus, in the present case and departing from its position as expressed in the first WestLB decision, the Commission rejects the idea of a premium for the volume of Wfa's capital.

(229) Lastly, attention must be drawn to the non-marketability of the assets, i.e. the impossibility of withdrawing the invested capital at any time from the company. Normally, an investor can sell an equity instrument on the market to third parties, thereby terminating his investment. To be more precise, a normal transfer of capital takes place as follows: The investor brings in assets (either in cash or in kind) which are entered on the assets side of the balance sheet. As a rule, these are matched on the liabilities side by a tradable interest registered in the name of the investor and taking the form, in the case of a limited company for example, of shares. The investor can sell these shares to a third party. He cannot withdraw the assets he originally brought in as these now form part of the net worth of the company and are no longer at his disposal. But by selling the shares he can realise their economic countervalue. His assets have thereby become marketable. Because of the special circumstances surrounding the transfer of Wfa's assets, this option was not available to the Land. Nevertheless, departing from the first WestLB decision, the Commission does not see any grounds for a further top-up. Although the Land did not have the possibility of trading the assets freely and receiving the economic countervalue, it always had the possibility, at least in principle, of withdrawing Wfa's capital from WestLB by law and reinvesting in other institutions offering higher returns.

(230) Overall, the Commission considers a premium of at least 0,3 % per annum (after tax) to be appropriate for forgoing additional voting rights [1].

No reduction in the remuneration on account of the agreement of a fixed amount

(231) 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 (e.g. expressed by share price increases). 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 in the future. If the performance deteriorates, a fixed rate benefits the investor but, if it improves, it places him at a disadvantage. However, actual developments cannot subsequently be used

[1] The study from First Consulting quoted in footnote 49 of the first WestLB decision had taken a flat-rate top-up of 1 %-2 % for the various above-mentioned aspects. It had, however, not acknowledged that the volume should have been taken into consideration when determining what was akin to share capital. In so far as the fungibility aspect is concerned, First Consulting had, in the view of the Commission, not recognised that the asset was not sellable but that, by law, it was possible to withdraw it from WestLB and reinvest it elsewhere.

to assess the investment decision. 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. The fixed nature of the rate accordingly does not benefit the investor in such a way that he would have agreed to a reduction in the remuneration. In aggregate, the Commission believes that the rate of remuneration should not be reduced for this reason.

(232) 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 the shareholders of WestLB, 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. Germany moreover did not provide any documents about these negotiations on the remuneration and the way in which it 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 and not the way in which this result was achieved. However, in the Commission's view, the way 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.

(233) Furthermore, it was agreed between the shareholders of WestLB that the remuneration should be fixed once WestLB's financial results for 1992 onwards were available. In the Commission's view, the financial results of the bank 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 fixed remuneration because the results of the company in question were poor. This agreement does not therefore suggest behaviour corresponding to that of an investor acting under normal market-economy conditions.

(234) During the Commission's preliminary investigations, negotiations took place between the complainant and WestLB with a view to finding a solution, i.e. to establishing 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 appropriate 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 encash it; it would thus have no value.

Total remuneration

(235) On the basis of the above considerations and in agreement with the complainant BdB, the Land of North Rhine-Westphalia and WestLB, the Commission considers that an appropriate remuneration for the investment in question would be 6,92 % (after corporation tax), i.e. 10,19 % (after corporation tax) normal return on equity plus a premium of 0,3 percentage point (after corporation tax) on account of the particularities of the transaction less 3,75 percentage points (after corporation tax) on account of the financing costs resulting from the transferred assets' lack of liquidity for WestLB.

iv) ***Appropriate remuneration for the amount of DEM 3 400 million (EUR 1 740 million)***

(236) As already mentioned, the equity of DEM 3 400 million (EUR 1 740 million) is also of material value to WestLB and its economic function may be compared to that of a guarantee. A market-economy investor would demand an appropriate remuneration in return for exposing himself to a risk of this sort.

(237) In the decision to initiate the procedure laid down in Article 88(2) of the EC Treaty, the Commission quoted a rate of 0,3 % as having been indicated by Germany as the appropriate commission on a bank guarantee ('*Avalprovision*') for a bank like WestLB. However, two factors in particular must be taken into account here. Firstly, the amount of DEM 3 400 million (EUR 1 740 million) exceeds what is normally covered by such bank guarantees. Secondly, bank guarantees are normally associated with certain transactions and limited in time. By contrast, Wfa's special reserve is at WestLB's disposal without any time limit. These two factors require an increase in the premium to about 0,5 % 0,6 %. Guarantee premiums normally count as operating expenses and therefore reduce taxable profit, but the remuneration for Wfa's capital is paid to the Land from after-tax profits, so the rate must be adapted accordingly. In view of all this, the Commission is of the opinion that a rate of 0,3 % after tax is a correct remuneration for this kind of capital.

v) ***Synergy effects***

(238) 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 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 that time.

(239) The German authorities and WestLB claim that the Land had not only received the payment of 0,6 % on the amount of DEM 2 500 million (EUR 1 280 million) but also benefited from synergy effects worth about DEM 30 million (EUR 15 million) annually as a result of the transfer and integration of Wfa and WestLB's takeover of Wfa's pension obligations totalling DEM 33 million (EUR 17 million). The cost savings from synergies arise from the merger of Wfa with the former housing promotion division of WestLB, which led to an organisational streamlining of the Land's housing promotion activities and a reduction in staff.

(240) Synergy effects are the normal consequence 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 arose 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.

(241) 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 an actual benefit accrued 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).

(242) For the rest, synergy effects as 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.

(243) 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.

(244) 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) INCLUSION OF THE YEAR 2002

(245) Contrary to the view taken by the parties to the agreement, the Commission furthermore came to the conclusion that the year 2002 needs to be taken into account when determining the aid element, on a proportional basis up to 1 August 2002. Germany, it is true, has stated repeatedly that, because of the retroactive accounting effect of the merger on 1 January 2002 of Wfa and Landesbank Nordrhein-Westfalen, which was ordered by law, the state aid element was to be regarded as having ceased to exist on that date. However, irrespective of the accounting effect, Wfa's capital was at the disposal of WestLB for underpinning its competitive business until 1 August 2002. This is the decisive point as regards the question to be addressed here.

(246) In particular, it has been argued that not only the profits of Wfa and the areas assisted but also the entire business involving public bonds were transferred to the Landesbank on 1 January 2002 as part of the reorganisation, with the result that the losses of WestLB regarded as being linked directly to the solution for the future of Wfa have been considerably higher than the appropriate remuneration for Wfa's capital, and this should be recognised as appropriate compensation. However, this argument is unconvincing. The Commission has thus come to the conclusion that the disadvantage stemming from the separation of the areas assisted as well as of the business involving public bonds does not represent remuneration for the use of Wfa's capital up to 1 August 2002. It is precisely not only the areas assisted and the business involving public bonds that are underpinned by Wfa's capital but also the full range of WestLB's competitive activities. WestLB will therefore have to pay a remuneration of 6,92 % on a pro rata basis until 1 August 2002.

g) AID ELEMENT

(247) As calculated above, the Commission considers the following remuneration to be in line with market conditions: 6,92 % per annum after tax for the part of the capital which could 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.

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

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

(250) Table 5: Calculation of the aid element

(DEM million)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1. Part of special reserve available to WestLB	13	2 510	2 819	3 048	3 108	3 112	3 113	[...]	[...]	[...]	[...]
2. Remainder (difference vis-à-vis DEM 5 900) in 2002 at a proportional rate of 7/12	5 887	3 390	3 081	2 852	2 792	2 788	2 787	[...]	[...]	[...]	[...]
Remuneration of 6,92 % (after tax) on point 1	0,9	173,7	195,1	210,9	215,1	215,4	215,4	[...]	[...]	[...]	[...]
Remuneration of 0,3 % (after tax) on point 2	17,7	10,2	9,2	8,6	8,4	8,4	8,4	[...]	[...]	[...]	[...]
Total remuneration in line with market conditions	18,6	183,9	204,3	219,5	223,5	223,8	223,8	[...]	[...]	[...]	[...]
Actual remuneration (after tax)	33,1	15,1	16,9	18,3	18,6	18,7	18,7	[...]	[...]	[...]	[...] [1]
Aid element	- 14,5	168,8	187,4	201,2	204,9	205,1	205,1	208,6	209,3	209,3	128,6

(Amount: DEM 1 913,80 million = EUR 978,51 million)

[1] According to Germany, WestLB paid DEM [...] for the whole of 2002. In terms of the relevant period from 1 January to 1 August 2002 ([...] multiplied by the factor of 7/12), an amount of [...] was thus paid as remuneration.

4. *TAX EXEMPTIONS*

(251) As stated in the Commission decision to initiate the procedure laid down in Article 88(2) of 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 limited strictly to the non-profit entity and do not spill over to the enterprise in the competitive sector.

(252) WestLB was subject to neither property tax (*Vermögenssteuer*) nor tax on business capital (*Gewerbekapitalsteuer*) on the transferred capital. Furthermore, the profit from Wfa's activities remained exempt from corporation tax (*Körperschaftssteuer*) after the transfer. According to Germany, these tax provisions are not intended to favour and do not favour WestLB over other taxable persons.

(253) Profits accruing within WestLB's competitive business as a result of the use of Wfa's capital for solvency calculations are being 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 EC Treaty.

(254) The exemption from property tax, tax on business capital and corporation tax enjoyed by Wfa within WestLB boosted Wfa's profits (or reduced its losses), alleviated the

potential need for the Land to inject additional funds into housing promotion and subsequently increased Wfa's net assets. Since Wfa needed 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 also increased over time. However, had this share increased, the basis for the remuneration to be paid to the Land would also have increased. If the remuneration were fixed at an appropriate level, there would have been 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 6,92 % per annum and 0,3 % per annum respectively.

5. *WAIVER OF LIABILITY*

(255) Germany argues that the waiver of liabilities did not adversely affect the Land's financial position and did not confer any competitive advantage on Wfa or WestLB. Following the transfer, Wfa's assets (the Land housing promotion fund) were not reduced each year by this liability, so that higher proceeds would have been 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.

(256) The waiver has certainly increased Wfa's value. However, since the remuneration to be paid by WestLB was based on the valuation of Wfa after the waiver, i.e. taking into account this increase in its value, the waiver did not confer an advantage on WestLB in so far as the remuneration was in line with the market.

6. *COMPATIBILITY OF THE MEASURE WITH THE EC TREATY*

(257) On the basis of the foregoing 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 has to 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 EC Treaty with regard to possible state elements in connection with the transfer of Wfa.

(258) 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.

(259) 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 Article 87(3)(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 is not aimed either at promoting culture or heritage conservation.

(260) 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.

(261) Under Article 87(3)(c) of the EC Treaty, aid may be found compatible 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 should be restored with the support of state aid.

(262) 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' ([1]). However, it is clear that the transfer was effected in order to allow WestLB to comply with the new own funds requirements and with no regard to any services of general economic interest. Furthermore, Germany 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.

(263) 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.

VII. **CONCLUSIONS**

(264) 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.

(265) The aid cannot be found compatible either under Article 87 (2) or (3) or under any other provision of the EC Treaty. It

([1]) This report was presented to the ECOFIN Council on 23 November 1998 but has not been published. It can be obtained from Competition Directorate-General IV of the Commission and can also be found on the Commission's website.

is therefore declared incompatible with the Treaty 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 implemented for Westdeutsche Landesbank-Girozentrale, now WestLB AG, between 1 January 1992 and 1 August 2002, amounting to EUR 978,51 million, is incompatible with the common market.

Article 2

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

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision.

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 in accordance with the provisions laid down in Chapter V of Commission Regulation (EC) No 794/2004 [1].

Article 4

Germany shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it, using the questionnaire attached in the Annex to this Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

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(1) OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION

1. **Calculation of the amount to be recovered**

1.1 Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient; if the measure consists of several instalments and reimbursements, use separate rows.
(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2 Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. **Recovery measures planned or already taken**

2.1 Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain which alternative measures are available in national legislation to bring about recovery of the aid. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2 By what date will the recovery of the aid be completed?

3. **Recovery already effected**

3.1 Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2 Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

on State Aid implemented by Germany for Norddeutsche Landesbank — Girozentrale

(notified under document number C(2004) 3926)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/738/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 the Member State and other interested parties to submit their comments pursuant to the provisions cited above ([1]) and having regard to their comments,

Whereas:

I. PROCEDURE

(1) The subject of these proceedings is the transfer of three *Land* trust agencies (*Landestreuhandstellen* ('LTS')) to Norddeutsche Landesbank — Girozentrale ('NordLB') by the *Land* of Lower Saxony. There are a further six cases in which proceedings have been initiated against Germany in connection with transfers of assets to Landesbanks, and in particular to Westdeutsche Landesbank — Girozentrale ('WestLB').

(2) By letter of 12 January 1993, the Commission asked Germany for information on a capital increase in WestLB resulting from the incorporation of the housing organisation *Wohnungsbauförderanstalt* ('WfA') and on similar increases in the own funds of the Landesbanks of other *Länder*. It also asked which Landesbanks had benefited from a transfer of publicly owned promotion-related assets and for information on the reasons for those transactions.

(3) Germany replied by letters dated 16 March and 17 September 1993. The Commission requested further information by letters of 10 November and 13 December 1993, to which Germany replied by letter of 8 March 1994.

(4) By letters of 31 May and 21 December 1994, the *Bundesverband deutscher Banken e.V.* ('BdB'), an association representing private banks established in Germany, informed the Commission among other things that, under a law adopted on 17 December 1991, the *Land* of Lower Saxony's shares in assets used to promote housing, agriculture, trade and industry had been transferred to NordLB with effect from 31 December 1991. This increased the own funds at NordLB's disposal and, in the BdB's view, distorted competition in its favour since the parties had not agreed remuneration consistent with the market-economy investor principle. In its second letter, the BdB accordingly lodged a formal complaint and called on the Commission to initiate proceedings against Germany under Article 93(2) of the EC Treaty (now Article 88(2)). In February and March 1995 and December 1996 several banks associated themselves individually with the complaint lodged by the BdB.

(5) The Commission investigated first the transfer of assets to WestLB but announced that it would examine the transfers to the other Landesbanks, including NordLB, in the light of the findings in that case. ([2]) By Decision 2000/392/EC ([3]), it finally declared in 1999 that the aid measure (the difference between the remuneration paid and the normal market remuneration) was incompatible with the common market and ordered that the aid should be recovered. This decision was annulled by the Court of First Instance of the European Communities on 6 March 2003 as insufficient reasons had been given for two of the factors used to calculate the appropriate remuneration, but it was confirmed in all other respects. On 20 October 2004 the Commission, having become aware of an understanding between the complainant, WestLB and the Land of North-Rhine Westphalia, issued a new decision which took account of the Court's criticisms.

(6) On 1 September 1999, following Decision 2000/392/EC, the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks. By letter

([1]) OJ C 81, 4.4.2003, p. 2.

([2]) OJ C 140, 5.5.1998, p. 9.

([3]) OJ L 150, 23.6.2000, p. 1; actions challenging that decision have been brought by Germany (Case C-376/99), by North Rhine-Westphalia (Case T-233/99) and by WestLB (Case T-228/99). The Commission has also brought proceedings for infringement of the Treaty (Case C-209/00).

of 8 December 1999, Germany supplied information on the transfer of the LTS to NordLB which it supplemented in a letter dated 22 January 2001 in response to the Commission's requests for further information.

(7) On 1 March 2001 the Commission asked for more information, in particular on the transfers of capital by the *Niedersächsische Sparkassen und Giroverband* ('NSGV'). Germany replied on 15 May 2001.

(8) By letter of 13 November 2002, the Commission informed Germany of its decision to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the transfer to NordLB of the promotion-related assets of the *Land* of Lower Saxony. At the same time, it launched the investigation procedure in respect of similar transfers of assets to Bayerische Landesbank — Girozentrale, Landesbank Schleswig-Holstein — Girozentrale, Hamburgische Landesbank — Girozentrale and Landesbank Hessen-Thüringen. It had already opened an investigation into a further similar transfer of assets by the *Land* of Berlin to Landesbank Berlin back in July 2002.

(9) The decisions initiating the procedure were published in the *Official Journal of the European Union* [1]. The Commission called on interested parties to submit comments.

(10) By letter of 11 April 2003, Germany submitted its comments on the initiation of the procedure in the NordLB case.

(11) By letter of 29 July 2003, the BdB submitted comments on all the decisions taken on 13 November 2002 to initiate the investigation procedure. On 30 October 2003 Germany forwarded a reply by the *Land* Government of North Rhine-Westphalia and WestLB AG to the BdB's comments on the proceedings concerning the transfer of LTS to NordLB.

(12) In response to the Commission's request for further information dated 1 September 2003, Germany supplied additional information and replied to the BdB's comments on NordLB on 28 October.

(13) On 7 April and 3 May 2004 the Commission sent Germany further requests for information, to which the latter replied by letters dated 27 May and 28 June 2004. On 16 August and 9 September 2004 Germany sent further comments supplementing its previous position.

(14) On 19 July 2004 the complainant (the BdB), the *Land* of North Rhine-Westphalia and WestLB AG submitted a provisional understanding on the appropriate remuneration for the transferred assets. In their view, this remuneration should form the basis for the Commission's decision. Likewise, the BdB, the *Land* of Lower Saxony and NordLB submitted a proposal for an understanding on appropriate remuneration for the transfer of the LTS assets. These parties and Germany subsequently addressed several letters to the Commission. The final version of the understanding on the transfer of the LTS assets to NordLB reached the Commission on 7 October 2004.

II. DETAILED DESCRIPTION OF THE MEASURES

1. *NORDDEUTSCHE LANDESBANK — GIROZENTRALE*

(15) NordLB, to which the LTS were transferred, is a publicly owned credit institution operating in the form of a public-law institution (*Anstalt des öffentlichen Rechts*) with registered offices in Hanover, Braunschweig, Magdeburg and Schwerin. With a group balance-sheet total of EUR 193 000 million (at 31 December 2003), it is one of Germany's largest banks. NordLB currently employs around 9 500 staff.

(16) NordLB was formed in 1970 by the union of four publicly owned credit institutions (Niedersächsische Landesbank, Braunschweigische Staatsbank (including Braunschweigische Landessparkasse), Hannoversche Landeskreditanstalt and Niedersächsische Wohnungskreditanstalt-Stadtschaft).

(17) When the capital transfer under investigation took effect, 60 % of NordLB by the *Land* of Lower Saxony and 40 % by NSGV, a public-law corporation.

(18) Under two State Treaties of 1991 and 1992, the *Länder* of Lower Saxony, Saxony-Anhalt and Mecklenburg-Western Pomerania agreed to operate NordLB as a joint *Land* institution. With effect from 12 January 1993, the ownership and guarantor structure was altered as follows: *Land* of Lower Saxony 40 %, NSGV 26,66 %, *Land* of Saxony-Anhalt 10 %, *Land* of Mecklenburg-Western Pomerania 10 %, Sparkassenbeteiligungsverband Sachsen-Anhalt ('SBV') 6,66 %, and Sparkassenbeteiligungszweckverband Mecklenburg-Vorpommern ('SZV') 6,66 %.

(19) Under the terms of its articles of association, NordLB is required to operate as a *Land* bank, a central savings bank and a commercial bank. It may also engage in any other business that serves the purposes of the bank, its owners and the municipal corporations in the *Länder*. In the Braunschweig area it operates as a savings bank. NordLB offers financial services to private customers, businesses, institutions and public authorities 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, NordLB holds a number of stakes in financial and non-financial enterprises.

[1] OJ C 81, 4.4.2003, p. 2.

(20) NordLB has a presence in the world's major financial and trading centres. It has a stock-exchange office in Frankfurt, branches in London, New York, Singapore, Stockholm, Helsinki and Shanghai, representative offices in Oslo, Tallinn and Beijing and subsidiaries in London, Zürich, Luxembourg, Riga, Vilnius and Warsaw.

(21) In 2003 NordLB's equity ratio was 11,5 % at institutional level and 10,1 % at group level; its core-capital ratio was 7,1 % at institutional level and 6,3 % at group level. Its income-to-equity ratio stood at [...] (*) % in 2003.

2. *LAND TRUST AGENCIES ('LTS')*

(22) In 1948 the *Land* of Lower Saxony set up a trust agency with the task of promoting social housing. On the basis of a 'trustee agreement' between the *Land* and NordLB, the bank took over the administration of the promotion-related assets and the tasks carried out by the trust agency. On the basis of this and two other, similar trustee agreements, NordLB became the owner — in legal but not in financial terms — and the trustee administrator of the assets for promoting housing, agriculture and industry on the *Land*'s behalf. It granted promotional loans in its own name, but on the *Land*'s financial account.

(23) The three LTS are not legally independent but are managed within NordLB as autonomous and — in operational, personnel and organisational terms — separate business divisions. The three LTS are exempt from corporation tax, property tax and tax on business capital.

(24) The *Land* housing trust agency (*LTS-Wohnungswesen*) manages assets specifically earmarked for housing and *Land* guarantees for the promotion of housing construction. In particular, it promotes the construction and modernisation of owner-occupied homes and rented homes and the purchase and acquisition of owner-occupied homes.

(25) The *Land* agriculture trust agency (*LTS-Agrar*) administers public loans and grants to promote agriculture, in particular agricultural investment and forestry measures.

(26) The *Land* industry trust agency (*LTS-Wirtschaft*) issues and administers loans and grants for the promotion of industry, specialising in investment by small and medium-sized enterprises and in business start-ups. It looks after the EU's Interreg Initiative and is recognised as a financial intermediary under the Joint European Venture (JEV).

(*) Confidential information.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS DIRECTIVE*

(27) The German Banking Act (*Kreditwesengesetz*, or KWG) was amended in line with Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions ([1]) (the 'Solvency Directive') and Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions ([2]) (the 'Own Funds Directive'), which require banks to have a level of own funds equal to 8 % of their risk-adjusted assets, of which at least four percentage points must consist of what is termed core capital, or 'tier I' capital, meaning capital items which are at the credit institution's disposal without restriction and immediately in order to cover risks or losses as soon as they arise. In determining the total own funds available to a bank for supervisory purposes, the core capital is of decisive importance because additional capital, or 'tier II' capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital.

(28) By 30 June 1993 German banks had to adapt their own funds to the new requirements of the Solvency Directive and the Own Funds Directive ([3]).

(29) The own-funds cushion of many Landesbanks was comparatively small even before transposal of the Solvency Directive into German law. They now had to strengthen their own-funds base as a matter of urgency in order to avoid restrictions on their business expansion or at least to maintain their current level of activities.

(30) However, because the budgetary situation was tight, the public shareholders were unable to provide any fresh capital but were not prepared to contemplate privatisation and to raise additional capital on capital markets. It was therefore decided to undertake transfers of assets and capital: for example, in WestLB's case the assets of WfA and in NordLB's case the above-mentioned promotion-related assets of the three LTS.

([1]) OJ L 386, 30.12.1989, repealed and replaced by Directive 2000/12/EC (OJ L 126, 26.5.2000).

([2]) OJ L 124, 5.5.1989, repealed and replaced by Directive 2000/12/EC (OJ L 126, 26.5.2000).

([3]) Under the Solvency Directive, credit institutions must have own funds equivalent to at least 8 % of their risk-adjusted assets, whereas the old German legislation required a ratio of 5,6 %; however, this ratio was based on a narrower definition of own funds than that which has applied since the entry into force of the Own Funds Directive.

4. *TRANSFER OF THE LTS AND ITS EFFECTS*

(a) THE TRANSFER

(31) By the Act on the contribution of the promotion-related assets of the *Land* of Lower Saxony to the liable equity capital of Norddeutsche Landesbank — Girozentrale, adopted by the Lower Saxony Parliament on 17 December 1991 ([1]), the *Land*'s Finance Ministry was empowered to transfer at their market value the *Land*'s shares of the promotion-related assets of the three LTS to NordLB as equity capital. The *Land* also undertook to maintain the total market value of the transferred assets at not less than DEM 1 500 million.

(32) On the basis of this Act, the *Land* of Lower Saxony and NordLB concluded a transfer agreement on 20 December 1991 by which the *Land* transferred to NordLB as liable equity capital its entire shares of the respective promotion-related assets. The purpose of transferring the assets was to increase by DEM 1 500 million the equity capital of NordLB recognised for supervisory purposes.

(b) VALUE OF THE LTS

(33) On 21 February 1992 NordLB charged the audit firm Treuarbeit AG with the task of determining the value of the transferred assets at 31 December 1991. Treuarbeit AG concluded that the total value of the assets transferred came to DEM 1 754 million and confirmed that the special-purpose reserve of DEM 1 500 million, formed in connection with the transfer and shown on NordLB's balance sheet at 31 December 1991 as equity capital, should be regarded as containing value.

(34) The value of the assets transferred to NordLB by the *Land* of Lower Saxony is continually updated. The table below shows the values established up to the end of 2003:

Date	Value (DEM million)
31.12.1991	1 754,4
31.12.1992	[...]
31.12.1993	[...]
31.12.1994	[...]
31.12.1995	[...]
31.12.1996	[...]
31.12.1997	[...]
31.12.1998	[...]
31.12.1999	[...]
31.12.2000	[...]
31.12.2001	[...]
31.12.2002	[...]
31.12.2003	[...]

(35) On the basis of Treuarbeit AG's report, NordLB applied to the German Banking Supervisory Authority (*Bundesaufsichtsamt für das Kreditwesen* — 'BAKred') on 26 February 1992 asking for the special-purpose reserve of DEM 1 500 million to be recognised for supervisory purposes as liable equity capital within the meaning of the second sentence of Section 10(2) KWG.

(36) On 26 July 1993 BAKred provisionally recognised the DEM 1 500 million as liable equity capital. In response to a request by BAKred, the *Land* of Lower Saxony again confirmed its undertaking to maintain the value of the promotion-related assets at not less than DEM 1 500 million. On 22 November 1993 BAKred finally gave notice that it was withdrawing its initial reservations regarding the value of the special-purpose reserve. Before formally recognising the promotion-related assets of the LTS as core capital, BAKred allowed them to be used to cover liabilities, in so far as was necessary to comply with the solvency rules in force at the time.

(37) From the time of the transfer, the sum of DEM 1 500 million was shown under NordLB's equity capital as a combined special-purpose reserve, while the difference vis-à-vis the value of the assets was booked as a provision for commitments arising from the transfer agreement.

(38) Germany has stated that each year around DEM 100 million of the assets transferred was required to underpin promotion-related business. All the remaining assets were available to NordLB to underpin its competitive business from the time when BAKred granted its recognition. Until BAKred granted its final recognition, only the portion of the assets that was actually necessary to comply with solvency rules was available for competitive business.

(39) In detail, the following amounts were available for competitive business:

1992	Value of assets available for competitive business, according to Germany (DEM million)
January	120
February	101
March	145
April	109
Mai	71
June	0
July	0
August	0
September	0
October	19
November	63
December	162

([1]) Lower Saxony Official Gazette [*Niedersächsisches Gesetz- und Verordnungsblatt*], No 47/1991, p. 358.

1993	Value of assets available for competitive business, according to Germany (DEM million)
January	133
February	133
March	207
April	147
May	174
June	1 143
July	1 222
August	1 071
September	1 176
October	1 204
November	1 149
December	1 197

Irrespective of the use to which the assets may be put for the purposes of banking supervision, NordLB is committed by agreement to inform the *Land* before the beginning of each business year how much of the LTS promotion-related assets it plans to use ('earmarking of capital'). For 1992 NordLB notified the use of DEM 180 million. For 1993 the figure was DEM 1 400 million. Since 1994 the amount of capital notified to the *Land* has coincided with the maximum value available for competitive business (the different amounts totalling DEM 1 500 million were needed for promotion-related activities).

Date	Earmarked capital (DEM million)
31.12.1991	—
31.12.1992	180
31.12.1993	1 400
31.12.1994	1 400
31.12.1995	1 390
31.12.1996	1 390
31.12.1997	1 390
31.12.1998	1 390
31.12.1999	[...]
31.12.2000	[...]
31.12.2001	[...]
31.12.2002	[...]
31.12.2003	[...]

(c) EFFECTS OF THE TRANSFER OF THE LTS ASSETS ON NORDLB

(40) Germany states that, as at 31 December 1991, NordLB had core capital of DEM 2 043 million and additional capital of DEM 543 million. The promotion-related assets of DEM 1 500 million therefore increased the total equity capital base of DEM 2 586 million by 58 %.

(41) The scope for business expansion using 100 % risk-adjusted assets was increased by a factor of 12,5, i.e. by around DEM 17 500 million. In reality, however, an increase in own funds of around DEM 1 400 million can expand the permissible credit volume by much more, as a bank's assets are normally not 100 % risk-adjusted. Since the increase in core capital allowed NordLB to raise further additional capital, there was an even greater indirect increase in its actual lending capacity.

(d) REMUNERATION FOR THE TRANSFER OF THE LTS

(42) Under Section 7(1) of the transfer agreement of 20 December 1991, a remuneration of 0,5 % per annum after tax was agreed for the transfer of the promotion-related assets of all three LTS. The remuneration is payable each subsequent year. In this context NordLB must determine the amount of remuneration for the following business year by 31 January. According to the terms of the agreement, the rate of remuneration is based on the notified use of the reserves formed pursuant to the transfer agreement, i.e. only on the capital actually earmarked. Accordingly, the following amounts have been paid:

Date	Earmarked capital (DEM million)	Interest rate	Remuneration paid (DEM million)
31.12.1992	180	0,5 %	0,9
31.12.1993	1 400	0,5 %	7
31.12.1994	1 400	0,5 %	7
31.12.1995	1 390	0,5 %	6,95
31.12.1996	1 390	0,5 %	6,95
31.12.1997	1 390	0,5 %	6,95
31.12.1998	1 390	0,5 %	6,95
31.12.1999	[...] (*)	0,5 %	[...]
31.12.2000	[...]	0,5 %	[...]
31.12.2001	[...]	0,5 %	[...]
31.12.2002	[...]	0,5 %	[...]
31.12.2003	[...]	0,5 %	[...]

(43) Under the transfer agreement, the *Land* of Lower Saxony also has the right to withdraw interest payments and amortisations that flow back to the promotion-related assets, in so far as the market value of the assets exceeds DEM 1 500 million. Germany stated that, up to March 2003, a total of DEM 473,88 million (EUR 242,29 million) was withdrawn, which, it argues, corresponds to an interest

(*) Confidential information.

premium of around 2,79 %-2,85 % per annum on top of the agreed 0,5 % per annum.

e) CAPITAL CONTRIBUTIONS BY THE OTHER SHAREHOLDER (NSGV)

(44) In preliminary discussions on the transfer of the LTS promotion-related assets to NordLB, the *Land* of Lower Saxony made it clear to the only other guarantor at that time, namely NSGV, that, in its view, both guarantors bore joint financial responsibility and that NSGV would have to make its own contribution in accordance with its 40 % share of capital. If this were to pose problems, a change in ownership structure would have to be discussed.

(45) A draft agreement to be concluded between the two guarantors was annexed to the draft law of 15 October 1991. According to Germany, the only obstacle to this 'guarantor agreement' being signed immediately was the fact that it had to be co-signed by the *Land* of Saxony-Anhalt and SBV, and the latter had not yet been set up at that time. On concluding the transfer agreement on 20 December 1991, the assembled guarantors, consisting at that time of the *Land* of Lower Saxony and NSGV, decided to reach such a guarantor agreement which was then duly concluded on 5 March 1992 — after the entry into force of the State Treaty — with the participation of the *Land* of Saxony-Anhalt and SBV.

(46) According to Germany, NSGV subsequently honoured its undertakings under the guarantor agreement of 5 March 1992 and in July and October 1994 increased NordLB's own funds recognised for supervisory purposes by a total of DEM 1 000 million (in line with its 40 % share of NordLB's capital at that time) by means of two measures described in more detail below.

(i) ***LBS special-purpose reserve of DEM 450 million***

(47) Following negotiations between the *Land*, NSGV and NordLB at the end of 1993, the Landesbausparkasse (LBS), previously incorporated in NordLB, was hived off by an Act adopted on 6 June 1994 and turned into an independent public-law institution (*Anstalt des öffentlichen Rechts*) with legal capacity, with effect from 1 July 1994.

(48) Up to then, LBS had been 60 %-owned by the *Land* of Lower Saxony and 40 %-owned by NSGV. Their value was estimated at DEM 900 million. It was agreed that NordLB would withdraw DEM 450 million from LBS before it was hived off and that NSGV would inject the same amount into LBS. This last measure was effected by deducting DEM 450 million from NGSV's commitment under the guarantor agreement to inject DEM 1 000 million into NordLB, on condition that NSGV would make a further capital contribution of DEM 550 million.

(49) NordLB booked the sum of DEM 450 million it had withdrawn to a revenue reserve in the form of a special reserve as additional liable equity capital within the meaning of the banking supervisory rules. The special reserve yielded cumulative interest before tax of 7,5 % per annum and was owned jointly by the guarantors in accordance with their internal relationship, i.e. 60 % by the *Land* and 40 % by NGSV.

(ii) ***Silent partnership contribution of DEM 550 million***

(50) Germany states that on 10 October 1994 NSGV and NordLB concluded an agreement concerning a capital contribution under Section 10(4) KWG. Under that agreement, NSGV undertook to make a capital contribution to NordLB in the form of a silent partnership amounting to DEM 550 million, with effect from 10 October 1994, in return for payment of a profit-linked remuneration the amount of which would be derived from the interest rate (specified in more detail) on 10-year bearer bonds amounting to 7,91 % plus a margin of 1,2 % per annum. This produces a total interest rate of 9,11 %, which, according to the German authorities, corresponds to the normal market remuneration for silent partnerships and at the same time to the remuneration payable to the *Land* of Lower Saxony for contributing the promotion-related assets as liable equity capital. The German authorities state that the contribution was made in accordance with the agreement and was recognised for supervisory purposes as liable equity capital of NordLB.

III. COMMENTS FROM INTERESTED PARTIES

1. *COMPLAINT AND OBSERVATIONS BY THE COMPLAINANT (THE BDB)*

(51) In BdB's view, the transfer of the LTS promotion-related assets and the associated increase in NordLB's capital distorted competition in favour of NordLB since the latter did not pay remuneration consistent with the market-economy investor principle.

(52) The 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. 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.

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

(54) The BdB states that the question of what remuneration was appropriate for the transfer of the promotion-related assets, particularly in the case of NordLB, should be determined

using the method employed by the Commission in its WestLB decision of 8 July 1999. The first step is therefore to compare the capital provided with other equity instruments. The second step is to determine the minimum remuneration which an investor would expect for a real equity-capital investment in the Landesbank. Finally, a calculation must be made of any premiums and discounts applied by virtue of the particularities of the transfer.

Comparison with other equity instruments

(55) The BdB comes to the conclusion that the transfer of the LTS promotion-related assets to NordLB — and the transfer of capital in all the other Landesbank cases — can be compared to an injection of share capital.

(56) It argues that the promotion-related assets transferred cannot be compared with capital in the form of profit participation certificates, as profit participation rights constitute only additional capital. At the time of the respective transfers, in particular at the end of 1991, only share capital (and reserves within the meaning of Section 10(2) KWG) and silent partnership contributions were recognised as core capital in Germany. Any comparison with silent partnership contributions could be ruled out across the board. First, such contributions were made available by an investor for a limited period only. An investor could not therefore expect to receive the same return on a silent partnership contribution as for equity instruments recognised for supervisory purposes for an unlimited period, in particular a injection of share capital.

(57) Second, although it was asserted that the transferred capital was subordinate in liability to share capital pursuant to agreements between the Landesbanks' owners, this did not necessarily mean a lower risk for the investor. The injected capital made up a significant proportion of the total core capital, making it extremely likely that it would be drawn on — at least in part — in the event of losses ([1]).

(58) Third, the BdB submits that the difference in quality between silent partnership contributions and the capital transferred to the Landesbanks as promotion-related assets is confirmed by the definition of core capital for supervisory purposes adopted by the Basle Committee for Banking Supervision. According to this definition, silent partnership contributions must be recognised for supervisory purposes as no more than lower tier I capital, which may account for no more than 15 % of the requisite core-capital ratio. In other words, where the core-capital ratio is 4 %, 3,4 % must be made up of nominal capital and open reserves (e.g. the special-purpose reserves transferred to the Landesbanks). Furthermore, banks only ever took up subordinate equity instruments such as preference shares or profit participation rights in small volumes. Under pressure from the rating agencies, such instruments hardly ever accounted for more than 10 % of a bank's total core capital — a very different situation from that in the cases under examination. Against this background, silent partnership contributions could not be used for large volumes invested by a single investor.

Minimum remuneration for a share-capital investment in a Landesbank

(59) The BdB argues that all methods of determining an appropriate remuneration (return) for the provision of share capital start from a risk-free return and add a risk premium. These methods can be traced back to the following basic principle:

Expected return on a risky investment

=

risk-free return + risk premium for the risky investment

(60) To determine the risk-free return, the BdB uses the returns on long-term government bonds, fixed-rate securities issued by state bodies being the form of investment with the least or no risk. To offset the effects of inflation, the rate of return on a long-term government bond should be determined for each transfer period, initially disregarding the inflation expectations. Then, to estimate the long-term risk-free basic rate, the estimated figure for average long-term inflation expectations (3,6 %) is added to the 'real basic rate' at the time in question.

(61) According to the BdB, the first step in working out the *market-risk premium* is to determine the difference between the long-term average return on shares and that on government bonds.

(62) As a second step, the BdB determines the beta value for the Landesbanks, i.e. the individual risk premium for the banks by which the general market-risk premium was to be adjusted.

Premiums and discounts on account of the particularities of the transactions

(63) The BdB notes that the Commission's deduction, in Decision 2002/392/EC, from the minimum remuneration to allow for the *lack of liquidity* of Wfa's assets was upheld by the Court of First Instance. It therefore sees no reason to depart from this method in the present case, with the result that a deduction for liquidity should also be made here. The amount of this discount would be calculated using the WestLB method, on the basis of net refinancing costs (gross

([1]) Moreover, a risk or liability premium was paid primarily because of the risk of loss in the event of insolvency. If this were to happen, the capital would be irretrievably lost. In the event of ongoing (partial) losses, i.e. outside insolvency, there was always a chance that the equity capital might be replenished through profits.

refinancing costs minus the applicable corporation taxes).

(64) The Court of First Instance also upheld the premium applied by the Commission in Decision 2000/392/EC. If the circumstances leading to an increase in risk compared with a 'normal share-capital investment' are also present in the other Landesbank cases (the in part exceptionally high volume of assets transferred, the failure to issue new shares in the company and the related forgoing of additional voting rights, and the lack of fungibility of the investment, i. e. the impossibility of withdrawing the invested capital from the company again at any time), the BdB considers that a premium is also justified here.

2. *COMMENTS BY THE LAND OF NORTH RHINE-WESTPHALIA AND WESTLB*

(65) On 30 October 2003 Germany forwarded a response from the *Land* of North Rhine-Westphalia and WestLB to the Commission's decision to initiate the investigation procedure in which they disputed the statement that the assets transferred to the Landesbanks, including NordLB, could be compared to share-capital. They argued that silent partnership contributions and 'perpetuals' had in fact been recognised as core capital in Germany since 1991, adding that remuneration for an investment depended not on how it was classified by the banking supervisory authorities, but on its risk profile. Since the assets were junior-ranking, the risk pattern had more in common with silent partnership contributions or 'perpetuals' than with share-capital investments.

(66) WestLB had no objections to the Capital Asset Pricing Model (CAPM) method for calculating the minimum remuneration for a share-capital investment but felt that the beta values determined by the BdB — at well over 1 — were inappropriate. A beta factor of more than 1 meant that a company's shares represented a higher risk than the market as a whole. Yet the risk of investing in a Landesbank was well below the overall market risk because of the institutional liability (*Anstaltslast*) and guarantor liability (*Gewährträgerhaftung*) which it enjoyed and which were not challenged at the time.

(67) Moreover, they argued that, in the specific case of the Landesbanks, it was a mistake to use as a benchmark the return expected at the time that the assets were transferred to the banks. Although this was generally a sensible approach to adopt in relation to the private-investor test, it here meant using as a basis the returns expected in 1991. But for an investor to receive in 2003 the return expected in 1991, which was much higher than the returns actually achieved, flew in the face of all economic realities. Permanently and systematically applying a rate of return placed the Landesbanks at an unjustifiable disadvantage compared with private competitors.

(68) As regards the discount for the lack of liquidity of the transferred assets, WestLB and the *Land* of North Rhine-Westphalia considered that the rate for risk-free government bonds should be deducted in full from the basic return. They argued that the Landesbanks had received no liquidity as a result of the asset transfers. It was not defensible in economic terms to reduce this rate by the tax savings since the remuneration for capital market instruments was independent of the tax situation. Otherwise the price of a capital market instrument would have to differ according to tax considerations.

(69) Finally, the fact that the assets' lack of liquidity did not pose a risk to the liquidity position should be seen as reducing the risk — and hence the remuneration — and should be taken into account by applying a corresponding deduction. Likewise, a discount should be granted on account of the 'owner effect' since an investor who already owned shares in a company took a different view of an additional investment from that of a new investor.

3. *COMMENTS BY NORDLB AND THE LAND OF LOWER SAXONY*

(70) Since the observations made by NordLB and by the *Land* of Lower Saxony were also presented by the Federal Government, they are included here together with the comments by Germany.

4. *COMMENTS BY GERMANY*

(71) Germany argues that, even after the decision by the Court of First Instance, there are still fundamental doubts as to whether investments in profitable undertakings by public authorities can be assessed using the private investor test. It is also convinced that the transfer of promotion-related assets to NordLB by the *Land* of Lower Saxony does not constitute aid according to the principles applied by the Commission in Decision 2000/392/EC.

(72) In NordLB's case, the only other partner besides the *Land* at the time the assets were transferred, i.e. NSGV, undertook to make a contribution corresponding in volume to that of the *Land* — proportionate to its own shareholding — and under similar conditions. It duly made such a contribution. In this respect, the *Land* already acted like a private investor in its transfer of the promotion-related assets to NordLB.

(73) Moreover, Germany argued, NordLB also paid an appropriate remuneration. It pointed out here that the remuneration paid (0,5 % after tax or 1,2 % before tax) corresponded to an indicative interest rate of around 9,5 % before tax (1,2 % + 8,3 %), taking into account the refinancing costs of around 8,3 % which the *Land* as investor had saved. Furthermore, in addition to the remuneration of 0,5 % after tax, the *Land* of Lower Saxony had also obtained continuous revenue flows from the promotion-related assets amounting to EUR 242,29 million (DEM 473,88 mil lion).

(74) Germany argues that the BdB and the Commission were mistaken in the way they calculated the minimum remuneration in the Decision 2000/392/EC. The CAPM method is said to be unsuitable for determining the market return for a number of reasons. First, the assets transferred to NordLB were not freely available. This meant that the investment alternatives assumed under the CAPM method were practically non-existent. The risk assumed in the CAPM to account for market fluctuations did not exist either, as the Landesbanks were not quoted on the stock exchange, the investment was remunerated at a fixed rate and at that time the Landesbanks still benefited from *Anstaltslast* (institutional liability) and *Gewährträgerhaftung* (guarantor liability). There were therefore no historical data series for beta factors.

(75) Among the special circumstances of the asset transfer, consideration should be given to the fact that the liability of the promotion-related assets is limited in accordance with the proportion of NordLB's share capital held by the *Land* of Lower Saxony and that the *Land* is entitled to compensation from NordLB's other guarantors. In deciding to invest, an investor would pay particular attention to the fact that, although externally the promotion-related assets were exposed to loss without limitation, internally their liability was restricted to an amount corresponding to the share of NordLB's capital held by the *Land* of Lower Saxony. The *Land* was therefore entitled to compensation from NordLB's other guarantors — all of them public-law corporations — which ran no risk of insolvency.

(76) With regard to a premium on account of the exceptionally high volume of the transaction, Germany cannot understand how such a volume is to be defined or why such a premium is justified. In 1992 the assets transferred represented only 34,89 % of the total equity of the NordLB group recognised for supervisory purposes. This proportion had fallen to a mere 9,62 % by 2001. The figures for NordLB's equity capital used as a basis for these calculations are DEM 4 298 million in 1992 and DEM 15 596 million in 2001. They already include the LTS assets.

(77) Germany also argues that no premium is justified on account of the failure to issue new shares to the *Land* of Lower Saxony. At the time of the transfer, NSGV gave an undertaking to inject capital in line with its share of NordLB, which it subsequently did. There was therefore no reason to increase the shares held by the *Land*.

(78) Finally, in Germany's view, no premium is justified either for the lack of fungibility of the promotion-related assets. For the purposes of calculating the minimum return, the BdB and the Commission compared the asset transfer to a share-capital investment. But the fungibility of share-capital investments was just as low as that of the LTS promotion-related assets.

(79) If NordLB were indeed favoured by the transfer of the promotion-related assets, the favourable treatment consisted only in compensation for NordLB for the costs it incurred for carrying out its public mandate. NordLB was not only the *Land* bank but also a savings bank in the Braunschweig area. It therefore performed not only the traditional public tasks of a *Land* bank, with the attendant costs, but also the function of a savings bank.

(80) If, nevertheless, there were aid in this case, it was in any event existing aid since the promotion-related assets had been transferred on the basis of *Anstaltslast*, on which a final settlement was reached by the Brussels compromise of 17 July 2001.

5. *UNDERSTANDING BETWEEN BDB, THE LAND OF LOWER SAXONY AND NORDLB*

(81) On 7 October 2004 the Commission was informed of the outcome of an understanding reached between the complainant BdB, the *Land* of Lower Saxony and NordLB. Irrespective of their basic interpretations of the legal situation, which remained unchanged, the parties to the understanding agreed on what they themselves would regard as suitable parameters for determining an appropriate remuneration and as an appropriate remuneration. The parties asked the Commission to take account of the outcome of the understanding in its decision.

(82) Applying the CAPM, the parties first determined a minimum remuneration for a hypothetical share-capital investment in NordLB. They arrived at an appropriate minimum remuneration of 10,03 % for the LTS promotion-related assets. They took as their basis the risk-free interest rates of the REX1O Performance Index of Deutsche Börse AG and, for the beta factors, a KPMG report of 26 May 2004 drawn up on behalf of the Landesbanks (and now in the Commission's possession). In practical terms, a risk-free basic interest rate of 7,15 % was calculated for NordLB as at 31 December 1991 and a beta value of 0,72 was applied on the basis of the KPMG study. The market-risk premium was set at 4 % (for all Landesbanks).

(83) A deduction was then determined for the capital's lack of liquidity on the basis of the risk-free interest rate of 7,15 % as gross refinancing costs. To determine the net refinancing costs, the standard tax burden of NordLB at the transfer date was fixed at a flat rate of 50 %, giving a liquidity discount of 3,75 %.

(84) Lastly, a premium of 0,3 % was added to allow for the failure to issue voting rights.

(85) This resulted overall in an appropriate remuneration of 6,76 % per annum after tax for that portion of the LTS proportion-related assets that could be used for the

competitive activities of NordLB. This remuneration was payable as of the end of the month when the assets were recognised as core capital (30 November 1993).

(86) The understanding makes no mention of any remuneration for that portion of the LTS promotion-related assets that could not be used for the competitive activities of NordLB (bank guarantee — *Avalprovision*).

IV. ASSESSMENT OF THE MEASURE

(87) 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 EC Treaty.

1. *STATE RESOURCES AND FAVOURING OF A PARTICULAR UNDERTAKING*

(88) As described above, the *Land* of Lower Saxony's shares in the promotion-related assets of the three LTS were transferred to NordLB as equity capital. If state assets of this kind, which have a commercial value, are transferred to an undertaking, then state resources within the meaning of Article 87(1) of the EC Treaty are involved.

(89) In order to verify whether the transfer of state resources to a publicly owned undertaking 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 in paragraph 93 *et seq*. below.

2. *DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATES*

(90) 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, especially since remaining obstacles to competition in the financial services markets are being gradually dismantled.

(91) NordLB is an all-purpose bank and an important player on the international capital markets. It offers banking services in competition with other European banks inside and outside Germany. Aid given to NordLB therefore distorts competition and affects trade between the Member States.

(92) It should also be recalled that there is a 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 NordLB with such equity capital for solvency purposes, it directly influenced the bank's business possibilities.

3. *MARKET-ECONOMY INVESTOR PRINCIPLE*

(93) In deciding whether a financial measure taken by a public owner of an enterprise constitutes aid within the meaning of Article 87(1) of the EC Treaty, 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 of Justice of the European Communities in several decisions. ([1]) It allows the Commission to bear in mind the specific circumstances of each case, e.g. 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.

(94) 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'. ([2]) In particular, a financial measure must be considered unacceptable to a market-economy investor if the proposed remuneration arrangements are less attractive than the market-rate remuneration paid for comparable investments.

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

(a) ARTICLE 295 OF THE EC TREATY

(96) Article 295 of the EC Treaty lays down that the system of property ownership in the various Member States must not be affected. This does not, however, justify any infringement of the competition rules of the Treaty.

(97) Germany claims that, because of the constraints imposed by the special purpose assigned to the LTS assets, the only possible profitable use of these resources was to transfer them to a similar public-law institution. Consequently, the transfer represented the commercially most sensible use of

([1]) See, for example, Cases C-303/88 Italy v Commission [1991] ECR I-1433 and C-305/89 Italy v Commission [1991] ECR I-1603.

([2]) Commission communication to the Member States on the 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. Crédit Lyonnais (OJ L 221, 8.8.1998, p. 28) and GAN (OJ L 78, 16.3.1998, p. 1).

those assets. So any remuneration for the transfer, i.e. any additional return on the LTS capital, would be sufficient to justify the transfer in the light of the market-economy investor principle.

(98) This line of argument cannot be accepted. It may be that the transfer of the three LTS to NordLB, which subsequently allowed NordLB to use part of the LTS capital to underpin its competitive business, was the commercially most sensible use. However, simply taking the view of a public investor would leave out of account the fundamental question of whether the recipient benefited from preferential treatment. The presence of such treatment can be ascertained only by checking whether the price paid by the recipient corresponds to the market price. As soon as public monies and other assets are used for commercial, competition-oriented activities, the normal market rules must be applied.

(b) NO CHANGE IN OWNERSHIP STRUCTURE

(99) One way of ensuring an adequate return on the capital provided would have been to increase the *Land*'s participation in NordLB 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. However, this course was not taken by the *Land* of Lower Saxony.

(100) Germany also attributes the failure to increase the *Land*'s shares in NordLB to the fact that, at the time of the asset transfer, NSGV undertook to inject capital in proportion to its share in NordLB, which it then did by creating the LBS special-purpose reserve of DEM 450 million and making the silent partnership contribution of DEM 550 million. Moreover, Germany argues that, in *Alitalia*, the Court held that a capital injection from public funds would always satisfy the private investor principle if another shareholder made an investment and that in such a case no state aid was involved. ([1])

(101) It should be pointed out that the Court of Justice's ruling in *Alitalia* referred to investments by private parties. But, in the case of NSGV, we are dealing not with a private party but with a public-law entity. The contributions by NSEV were, moreover, not comparable to the transfer of the LTS assets either in timing or in content.

(102) Whereas the LTS assets were transferred to NordLB with effect from 31 December 1991, it was only with effect from 1 July 1994 that LBS was hived off from NordLB and the LBS special-purpose reserve of DEM 450 million was formed. The silent partnership contribution of DEM 550 million took effect only from 10 October 1994. In the Commission's view, this difference in timing between the transactions already shows that they did not take place under similar conditions.

(103) Moreover, the investments in question took a different form, at least in the case of the silent partnership. At that time, all silent partnership contributions constituted 'lower tier I capital', i.e. additional capital which could not be drawn on to the same extent as share capital in order to comply with solvency regulations. Also, in contrast to share-capital investors, silent partners do not share in a company's increases in value, but are remunerated entirely by means of direct payments, which are normally lower than those for share-capital investments.

(104) Even if one assumes that a higher remuneration should have been paid for the (liquid) silent partnership contribution of DEM 550 million than for the (non-liquid) promotion-related assets of the LTS, the transfers of assets by the *Land* and by NSGV are not comparable given the differences in remuneration. Each year a payment of 7,5 % (before tax) is made for the LBS special-purpose reserve, while, according to the Federal Government, the silent partnership contribution yields interest of around 9,11 % (before tax). By contrast, the LTS assets yield interest of 0,5 % after tax (around 1,2 % before tax). So the remuneration for the LTS assets is much lower than that for the measures taken by the NSGV.

(105) Given such marked differences between the transactions carried out by the *Land* and by NSGV, the question can ultimately be left open as to whether, at the time when the LTS assets were transferred to NordLB, NSGV was in fact bound by an obligation to inject into NordLB an amount of capital corresponding to its shareholding or whether this obligation was laid down only later.

(106) It can therefore be concluded that there was no proportional, comparable capital injection by a private investor, so that the conditions underlying the *Alitalia* case are not met here. The investment was made by another public shareholder, NSGV, and the conditions of the capital injection are not comparable since the two contributions took place at different times and the terms also differed.

(c) OWNER EFFECT

(107) Germany believes that, in calculating the remuneration, a market-economy investor would have taken into account the increase in value in its own holding in NordLB. At the time when the LTS assets were transferred, the *Land* of Lower Saxony had a 60 % share in NordLB, the value of which increased as a result of the transfer. Moreover, according to Germany, the *Land* ensured that NSGV also injected capital commensurate with its own holding in order to prevent NSGV from sharing in an increase in value brought about solely by the *Land*.

([1]) Judgment given by the Court of Justice on 12 December 2000 in Case T-296/97.

(108) For the reasons set out in paragraph 102 *et seq.*, no importance can be attached to the fact that the *Land* had shares in NordLB and NSGV's capital injection cannot be regarded as a comparable investment. By means of that injection NSGV shared in the increase in value without having made a corresponding contribution. No market-economy investor would agree, as a joint owner, to bear the entire cost of an investment if it were then to realise only part of the gains from it. The Court of First Instance has specifically confirmed this view in its judgment in *WestLB* ([1]).

(d) CAPITAL BASIS FOR CALCULATING THE REMUNERATION

(109) Germany submits that only the part of the accepted original own funds which can be used by NordLB to underpin its commercial business has an economic value for the bank, so that a remuneration can be demanded by the *Land* in respect of this part only. BdB claims that the whole amount of DEM 1 754.4 million is at risk and therefore a remuneration must be paid on that amount.

(110) As determined in Decision 2000/392/EC and confirmed by the Court of First Instance, remuneration is, in principle, payable on the entire value of the transferred assets. This approach was applied in the WestLB case and upheld by the Court. However, the remuneration may differ for the different parts of the transferred assets.

(111) For the purpose of determining an appropriate remuneration, a distinction should be made between the different parts of the LTS assets according to their use to NordLB.

(112) The value of the assets is determined every year. At the end of 1991 it stood at DEM 1 754.4 million. However, only DEM 1 500 million was entered as equity on NordLB's balance sheet. The difference between this amount and the value of the LTS assets was booked as a provision for commitments arising from the transfer agreement. Such provisions are built up against imminent liabilities and do not constitute equity capital. As a consequence, they generally do not improve a firm's credit standing. The *Land* of Lower Saxony is also entitled to withdraw interest payments and amortisations which flow back to the promotion-related assets, in so far as the market value of the assets exceeds DEM 1 500 million. Since NordLB is therefore unable to use the capital that exceeds the value of DEM 1 500 million either to expand its business or to cover liabilities, the Commission assumes that an investor could not demand a remuneration for this portion of the promotion-related assets.

(113) Since the time of the transfer, a value of DEM 1 500 million has been booked as equity capital in NordLB's balance sheet. However, the LTS assets could not be used in full as equity capital until recognised by BAKred. Until the amount was provisionally recognised on 26 July 1993, the use of the promotion-related assets was tolerated by BAKred only in so far as was necessary in order to comply the solvency rules in force at the time. The full amount of DEM 1 500 million could be used only after it was provisionally recognised on 26 July 1993. However, of this DEM 1 500 million, only around DEM 1 400 million — the exact amount fluctuates from year to year — can be used by NordLB to expand its competitive business activities since the remainder is needed for its promotion-related business. The main basis for determining the remuneration payable to the *Land* should therefore be, for 1992 and up to August 1993, only the capital actually used and, from August 1993, the capital earmarked for use, i.e. around DEM 1 400 million each year.

(114) Although the remaining original own funds (around DEM 100 million a year from August 1993, previously a higher amount) cannot be used to expand competitive business, they are of use to NordLB since the amount of own funds shown in the balance sheet is an indication to the bank's lenders of its soundness and thus influences the conditions under which the bank is able to raise outside funds. Creditors and ratings agencies look at the bank's overall economic and financial standing. Since the amount of around DEM 100 million each year 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.

(115) Since the amount of around DEM 100 million each year is also of economic use to WestLB, a market-economy investor would have asked for a remuneration to be paid on it. The level of this remuneration will certainly be lower than that for the DEM 1 400 million, which is of greater use to NordLB, since it can also be used under the solvency rules as own funds to expand its commercial business.

(116) A final point to be made here is that the text of the understanding between the *Land* of Lower Saxony, NordLB and BdB states that remuneration is payable for the transferred assets only as of the end of the month in which they were finally recognised as core capital by BAKred, i.e. 30 November 1993. On this point, however, the Commission cannot agree with the understanding. The transferred LTS assets were available for use by NordLB following the transfer on 31 December 1991 at least to the extent that their use was tolerated by BAKred, and NordLB did indeed use a considerable portion of the assets before they were finally recognised by BAKred.

([1]) OJ L 150, 23.6.2000, p. 1, paragraph 316.

(e) APPROPRIATE REMUNERATION FOR THE CAPITAL

(117) 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 to NordLB of the capital provided.

(i) ***Comparison with other equity instruments***

(118) Germany believes that the remuneration for share capital is not the correct benchmark for calculating an appropriate remuneration for the LTS assets. While acknowledging that, for supervisory purposes, share capital counts as core capital, it points out that not all of a bank's capital that qualifies as core capital is at the same time share capital. In particular, share capital which is fully at the bank's disposal for it to invest is entirely different in quality from the transferred LTS assets, which continue to be available to the *Land* for specific promotion-related purposes and are therefore not profitable for NordLB itself.

(119) At the time of their transfer, the LTS assets were most comparable to capital in the form of profit participation certificates. At that time, NordLB and the *Land* of Lower Saxony compared the remuneration for the promotion-related assets with remuneration for profit participation certificates. Profit participation capital is additional capital which may, in principle, be taken into account only up to the extent of the core capital. At 31 December 1991, NordLB is said to have had core capital of DEM 2 043 million and additional capital of DEM 543 million. The need for equity capital could therefore have been covered by issuing profit participation certificates amounting to DEM 1 500 million, instead of the promotion-related assets recognised as core capital.

(120) In their comments, the *Land* of North Rhine-Westphalia and WestLB also dispute the assertion that the various transfers of assets to the Landesbanks, i.e. also in the case of NordLB, could be compared to share capital. They argue instead that the transfers are comparable to silent partnership contributions or so-called 'perpetuals'. Silent partnership contributions and 'perpetuals' had been recognised as core capital in Germany since 1991. Moreover, remuneration for an investment depended not on how it was classified by the banking supervisory authorities, but on its risk profile. Since the LTS assets were junior-ranking, the risk pattern had more in common with silent partnership contributions or 'perpetuals' than with share-capital investments.

(121) The Commission shares the BdB's view that the transfer of the LTS assets, which were recognised by BAKred as core capital, is most comparable to a share-capital investment.

(122) In this connection, it should first be stressed that the relatively wide range of innovative equity instruments now available to credit institutions in several countries did not exist in Germany back in 1991, when a decision was taken on transferring the LTS to NordLB or, in 1993, when NordLB 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 at that time were profit participation certificates and subordinated loans (both of which are merely additional own funds, the latter being accepted only since 1993).

(123) It is therefore inappropriate to compare the LTS capital to such innovative instruments, most of which have developed in the meantime and some of which are available only in other countries. Germany 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.

(124) As regards perpetual preferred shares and profit participation certificates, a number of specific points should be stressed. Perpetual preferred shares count as core capital in some countries but are still not accepted in Germany. Profit participation certificates constitute only additional own funds, whereas the LTS capital qualifies as core capital. The latter is therefore of much greater use to NordLB 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 base. Moreover, if profitable years followed loss-making ones, profit participation certificates would be replenished before the LTS capital. In addition, the LTS capital is available to NordLB without any time limitation, while profit participation certificates are usually issued for a period of ten years. Furthermore, the enormous size of the capital injection would be atypical for profit participation certificates, and the ranking in the event of losses must be seen in this context. Since the share of the LTS capital is rather large, it will be used relatively quickly when major losses occur.

(125) The Commission considers that a comparison with silent partnership contributions is not suitable either for determining the appropriate remuneration for the special-purpose reserve recognised as core capital. In its view, an important factor here is that the LTS assets were transferred precisely not in the form of a silent partnership contribution but as a special-purpose reserve. BAKred too recognised the transfer as a reserve and not as a silent partnership contribution under Section 10 KWG. The fact that the German supervisory authority treated the transfer as a reserve suggests that the capital made available is more akin to share capital than to a silent partnership contribution.

(126) In addition, there is no less risk that at least part of the transferred capital might be lost in the event of insolvency or liquidation than would be the case for a share-capital investment, as the LTS assets make up a considerable proportion of NordLB's equity capital and NordLB has used a substantial amount of those assets to cover risk-bearing assets over many years.

(127) For all these reasons, the Commission believes that, because of the peculiarities of the LTS capital, a comparison with perpetuals, profit participation certificates and silent partnership contributions is not a suitable way to determine the appropriate remuneration to be paid for the LTS capital. Instead, the transfer of the LTS assets has most in common with a share-capital investment.

(ii) ***Right to compensation and low liability risk***

(128) The liability in respect of the promotion-related assets is limited internally to the share of the *Land* of Lower Saxony in NordLB's capital, and the *Land* is entitled to seek compensation from all of NordLB's other guarantors. Germany argues that an investor would have given this due consideration in his investment decision and his demand for remuneration.

(129) However, the internal restriction on liability cannot justify any reduction in remuneration since, from NordLB's point of view, it remains the case that the advantage obtained by means of the capital transfer must be adequately remunerated in order to avoid distortions of competition. The *Land*'s right to compensation from the other guarantors constitutes an agreement between guarantors and not a concession by NordLB that might justify a lower remuneration. If, for example, the other guarantors had agreed to assume full liability for the promotion-related assets internally, this could not have led to a situation where NordLB had to pay no remuneration at all.

(130) Moreover, from the Commission's point of view, it is irrelevant whether the LTS assets were used continuously and fully in order to meet solvency requirements. Even if this were not the case, a market-economy investor would have insisted on remuneration in full since the bank was free to employ all the capital in its competitive business according to its economic discretion.

(iii) ***Appropriate remuneration for the amount of DEM 1 400 million***

(131) There are no doubt different ways of calculating the appropriate remuneration for the amount of DEM 1 400 million which was available to NordLB each year for its competitive business. However, as will be shown, all the methods for calculating the remuneration for capital made available follow the same basic principles. Taking these basic principles, the Commission here does the calculation in two steps: first, it determines the minimum remuneration that an investor would expect for a (hypothetical) investment in the share capital of NordLB. It then examines whether, in view of the particularities of the transaction at issue, the market would have agreed on a premium or a discount and, if so, whether it can produce a methodically robust quantification of that amount.

Determination of a likely minimum remuneration for an investment in the share capital of NordLB

(132) The expected return on an investment and the investment risk are key determinants in the decision of a market-economy investor to invest. In order to determine their level, the investor incorporates all available firm-related and market-related information into his calculation. He bases himself on historical average rates, which, generally speaking, are also a point of reference for a firm's future efficiency, and *inter alia* on an analysis of the company's business model for the investment period in question, the strategy and quality of management or the relative prospects for the sector in question.

(133) A market-economy investor will undertake an investment only if it produces a higher return or a lower risk than the next-best alternative use of his capital. Similarly, he will not invest in a company whose expected return is lower than the average return expected for other companies with a similar risk profile. It can be assumed in the present case that there are sufficient alternatives to the assumed investment project that promise a higher expected return with the same risk.

(134) Various methods exist for determining the minimum appropriate remuneration. They range from differing variants of the financing approach to the CAPM method. In describing the various approaches, it makes sense to distinguish between two components, viz. a risk-free return and a project-specific risk premium:

Minimum appropriate return on a risky investment

=

risk-free base rate + risk premium for the risky investment.

Consequently, the minimum appropriate remuneration for a risky investment can be described as the sum of the risk-free rate of return and the additional risk premium for assuming the investment-specific risk.

(135) The basis for any determination of return is thus the existence of a default-risk-free form of investment with an assumed risk-free return. The expected return on fixed-interest government securities is normally used in determining the risk-free basic rate (or, as the case may be, an index based on such securities), but these represent forms of investment with a comparably low risk. The various methods differ, however, when it comes to determining the risk premium:

— *Financing approach*: An investor's expected return on capital represents, from the point of view of the bank using the capital, future financing costs. Under this approach, the historical capital costs incurred by comparable banks are first of all determined. The arithmetic average of the historical capital costs is then compared with the future expected equity capital costs and hence with the investor's expected-return requirement.

— *Financing approach with compound annual growth rate*: At the heart of this approach stands the use of the geometric rather than the arithmetic mean (compound annual growth rate).

— *Capital Asset Pricing Model (CAPM)*: The CAPM is the best-known and most frequently tested model of modern finance, by which the return expected by an investor can be determined using the following equation:

Minimum return

=

risk-free base rate + (market-risk premium × beta)

The risk premium for the equity investment is obtained by multiplying the risk premium on the market by the beta factor (market-risk premium × beta). The beta factor is used to quantify the risk of a company relative to the overall risk of all companies.

(136) The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since NordLB is not a listed company, it is not possible directly to infer its beta value. The CAPM can be used only on the basis of an estimate of the beta factor.

(137) In its comments of 29 July 2003, the BdB, using the CAPM, concluded that the minimum remuneration to be expected for an investment in the share capital of NordLB at 31 December 1991, when the LTS assets were transferred, was 13,34 % per annum. Germany raised objections in principle to the use of the CAPM. It also argued that the BdB started from a high beta value and was incorrect in its calculation of the risk-free base rate, and that the market-risk premium of 4,6 % was too high. Had the BdB applied the CAPM correctly, it would have arrived at a much lower minimum remuneration for a hypothetical investment in the share capital of NordLB.

(138) In their understanding on the normal market remuneration, the *Land* of Lower Saxony, NordLB and the BdB concluded that a minimum remuneration of 10,03 % was appropriate.

(139) In their calculations, the parties based themselves on the CAPM and applied a risk-free basic interest rate of 7,15 % for NordLB. Determination of this interest rate was based on the assumption that the LTS special-purpose assets were to be made available on a permanent basis. The parties thus decided not to use a risk-free rate obtaining on the market at the time of the capital injection for a fixed investment period (e.g. 10-year return on government bonds) since such an approach would disregard the reinvestment risk, i. e. the risk that it would not be possible to invest again at the level of the risk-free interest rate once the investment period had expired. In the view of the parties, a total return index was the best way of taking the investment risk into account. They opted, therefore, for the REX10 Performance Index of Deutsche Börse AG, which tracks the performance of an investment in Federal loans over a period of ten years. The index series used in the present case contains the relevant end-of-year results of the REX10 Performance Index after 1970. The parties then determined the rate per annum, which reflects the trend tracked by the REXIO Performance Index in the period 1970-91 and, in this way, arrived at the risk-free basic interest rate of 7,15 % referred to above.

(140) Since NordLB's capital injection was made available on a permanent basis, the method of determining the risk-free basic interest rate appears appropriate in this specific case. Moreover, the REX10 Performance Index is a generally recognised source of data. The risk-free basic interest rate calculated thus appears appropriate here.

(141) The beta factor of 0,72 was estimated on the basis of a KPMG report on adjusted beta factors for all listed credit institutions in Germany that is available to the Commission. In the light of the report and of HLB's business profile, this beta factor is to be regarded as appropriate.

(142) The Commission also regards the market-risk premium of 4,0 % as acceptable. Previously, in Decision 2000/392/EC, the so-called general long-term market-risk premium, i.e. the difference between the long-term average return on a normal share portfolio and that on government bonds, was applied on several occasions. In the corresponding report on the procedure, a range of some 3 % to 5 % was applied,

depending on the method, the period under examination and the basic relevant data. A report prepared for BdB calculated figures of 3,16 % and 5 %. Another report on WestLB drawn up in the first procedure produced figures of 4,5 % and 5 %, while Lehman Brothers, also for WestLB, calculated a figure of 4 %. Against this background, the Commission has here no reason to depart from the market-risk premium used in the understanding. On the basis of the CAPM, the Commission considers there to be no doubt that the minimum remuneration determined by the parties can be regarded as appropriate.

(143) The Commission therefore has no reason to believe that the minimum remuneration determined by the parties for a hypothetical share-capital investment cannot stand up to a market test. Accordingly, it sets the minimum remuneration for the special-purpose reserve at 10,03 % per annum (after corporation tax and before investor tax).

(iv) ***Return discount for lack of liquidity***

(144) Germany believes that NordLB paid an appropriate remuneration, as a private investor would have deducted from the remuneration the refinancing costs he had saved. Since the investor saved the cost of refinancing the capital, Germany concludes that the LTS promotion-related assets yielded around 9,5 %.

(145) However, the Commission considers that the key question here is not how much the *Land* saved as an investor. The *Land* transferred the LTS assets to NordLB as non-liquid capital. The *Land* made no savings as it was not obliged to ensure the assets' liquidity.

(146) 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), 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 ([1]).

(147) Since the LTS capital does not provide NordLB with initial liquidity, NordLB faces additional financing 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) ([2]). Because of these extra costs, which do not arise in the case of equity capital in other forms, 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.

(148) The Commission does not believe that the entire refinancing interest rate has 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 NordLB because of the special nature of the capital transferred. Overall, the Commission accepts that NordLB incurs additional 'liquidity costs' to the extent of 'refinancing costs minus corporation tax'.

(149) On the basis of the REX10 Performance Index of Deutsche Börse AG, the risk-free interest rate stood at 7,15 % at the end of 1991. Two 30-year German Government bonds issued in 1986 had secondary-market yields of 7,8 % and 7,6 % at the time. Germany stated that NordLB's individual refinancing rate at 31 December 1991 was [...] %. In the understanding the parties used a long-term risk-free rate of 7,15 %. They also agreed to assume a flat 50 % tax rate ([3]). On this basis, they arrive at a net refinancing rate of 3,57 % and hence a corresponding deduction for liquidity.

(150) In view of that understanding and the fact that the amounts in question still fall below the range previously cited by Germany, the Commission sees no reason to regard 3,57 % as inappropriate and consequently uses this rate as a basis for determining the aid element.

(v) ***Return premium on account of the particularities of the transfer***

(151) In practice, when remuneration is determined, atypical circumstances which depart from a normal investment in the share capital of the company concerned generally give rise to discounts or premiums. It must therefore be examined whether the particularities, and especially the specific risk profile of the transfer of the LTS capital, constitute grounds for adjusting the determined minimum remuneration of 10,03 %, which a private investor would

([1]) 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.

([2]) 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).

([3]) According to documents provided by Germany, the corporation tax rate was 46 % in 1992, plus a solidarity surcharge of 3,75 %, i.e. 49,75 % in total. The overall tax rate fell to 46 % in 1993 and stood at 49,5 % from 1994 to 2000. From 2001 the overall tax rate was 30 %.

expect for a (hypothetical) investment in the capital of NordLB, and whether a methodically robust quantification of that adjustment can be produced. In this connection, three aspects should be considered: first, the non-issuance of new shares in the company with the associated voting rights; second, the exceptional volume of the asset transfer; and, third, the non-marketability of the assets.

(152) The transfer did not provide the *Land* with any additional voting rights. Nor was this disadvantage offset by a comparable investment by the other shareholder. By forgoing voting rights, an investor renounces a say in decisions taken by the bank's board. To compensate for this acceptance of a higher risk of loss without a corresponding increase in influence over the company, a market-economy investor would demand a higher remuneration (even if the potential risk were cushioned by internal agreements with the other shareholders). On the basis of the higher remuneration for preference shares compared with ordinary shares, the Commission considers a premium of at least 0,3 % p.a. (after corporation tax) to be appropriate. The parties to the understanding also regard a premium of 0,3 % as appropriate to take account of the failure to issue new voting rights.

(153) The size of the amount transferred and its effect on NordLB from the point of view of the Solvency Directive have already been mentioned (paragraph 40 *et seq*.). Through the transfer of the LTS, NordLB's core capital was increased substantially without any acquisition or administration costs. A market-economy investor would probably have demanded a premium for an injection of capital as large in relative and absolute terms as the LTS assets. On the other hand, in the light of the exceptional capital requirements of credit institutions in the EU laid down by the Solvency Directive, a capital injection of some DEM 1 500 million in one of the largest German all-purpose banks must not be regarded as completely alien to any normal business decision. Moreover, where an investment involves a large volume of assets, this suggests a similarity with share capital. When the transfer took place at the end of 1991, large silent partnership contributions were atypical on the market. So if the volume of assets transferred is used to justify a further premium in the case of an investment that is similar to share capital, this means that the volume is being unduly taken into account twice over. Consequently, the Commission is not imposing a premium linked to the volume of the asset transfer, something which works in NordLB's favour. The understanding between the parties also assumes that no premium should be applied on account of the high volume of assets transferred.

(154) Lastly, attention must be drawn to the lack of fungibility of the assets, i.e. the impossibility of withdrawing the invested capital at any time from the company. Normally, an investor can sell an equity instrument on the market to third parties, thereby terminating his investment. A normal transfer of capital takes place as follows: the investor brings in assets (either in cash or in kind), which are entered on the assets side of the balance sheet. As a rule, these are matched on the liabilities side by a tradable interest registered in the name of the investor, taking the form, in the case of a limited company for example, of shares. The investor can sell these shares to a third party. He cannot withdraw the assets he originally brought in since these now form part of the company's liable equity capital and are no longer at his disposal. But by selling the shares — at the prevailing exchange price — he can realise their economic countervalue. His assets have thereby become fungible. Because of the special circumstances surrounding the transfer of LTS assets, this option was not available to the *Land*. However, the Commission sees no reason for a further premium. Although the *Land* was unable to realise the economic countervalue by trading freely in the investment, it was and is able at any time to withdraw the special-purpose assets from NordLB by law and achieve possibly higher returns by reinvesting them in other institutions. Here too the understanding between the BdB, the *Land* and NordLB assumes that no premium should be applied on account of the lack of fungibility

(155) Overall, the Commission therefore considers a premium of 0,3 % per annum (after corporation tax) to be appropriate for forgoing additional voting rights.

(vi) ***No reduction in remuneration for agreement on a fixed amount***

(156) 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 (expressed, for example, in share price increases). The *Land* receives a fixed remuneration which should reflect these two aspects of remuneration for 'normal' capital injections. It could be argued that the fact that the *Land* receives a fixed remuneration instead of one directly linked to NordLB'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 in the future. If the performance declines, a fixed rate benefits the investor but, if it improves, it places him at a disadvantage. However, the actual trend cannot be taken into account subsequently when it comes to assessing the investment decision. Taking all these factors into consideration, the Commission believes that the rate of remuneration need not be reduced.

(vii) ***Total remuneration***

(157) On the basis of all these considerations, the Commission concludes that an appropriate remuneration for the investment in question would be 6,76 % per annum (after corporation tax), namely, a 10,03 % normal return on

equity plus a premium of 0,3 % for the particularities of the transaction minus 3,57 % on account of the financing costs resulting from the transferred assets' lack of liquidity for NordLB.

(viii) ***Appropriate remuneration for the amount of DEM 1 400 million***

(158) As already mentioned, the equity share of around DEM 100 million each year is also of material value to NordLB and its economic function may be compared to that of a guarantee. A market-economy investor would demand an appropriate remuneration in return for exposing himself to a risk of this sort. This question is not addressed in the understanding between the BdB, the *Land* and NordLB.

(159) In its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty, the Commission quoted a rate of 0,3 % per annum (after tax) as having been indicated by Germany as the appropriate commission on a bank guarantee (*Avalprovision*) for a bank like NordLB. It seems inappropriate to increase this remuneration on account of a particularly large 'guarantee', given that the amount involved is around DEM 100 million. Even for the two years in which a much higher amount was available (1992 and 1993), the Commission feels there is no justification for a premium. For the same reasons that no premium was applied on the remuneration of the capital available for competitive business, it is also doubtful whether this rate can be increased on the grounds that the LTS promotion-related assets were, in principle, available to NordLB without restriction.

(160) The guarantee premium counts as operating expenses for NordLB and hence reduces the taxable profit. The remuneration payable to the *Land* of Lower Saxony for the LTS assets comes out of after-tax profits. The rate of 0,3 % must therefore be adjusted for the tax rate. As with the refinancing costs, the Commission assumes a single overall tax rate of 50 %, in this case in NordLB's favour. Consequently, it sets a rate of 0,15 % per annum after tax.

(f) AID ELEMENT

(161) As calculated above, the Commission considers the following remuneration to be in line with market conditions: 6,76 % per annum after tax for the part of the capital which could be used by NordLB to underpin its commercial business, i.e. around DEM 1 400 million, and 0,15 % per annum after tax for the difference between this part and the DEM 1 500 million shown as equity in NordLB's balance sheet, i.e. around DEM 100 million.

(162) Currently, NordLB pays a remuneration of 0,5 % per annum after tax on the amount which it can actually use for underpinning its competitive business. This remuneration was first paid for 1992.

(163) In addition to the remuneration of 0,5 % per annum after tax, Germany argues that there is a further remuneration component, namely the *Land*'s right to withdraw interest payments and amortisations that flow back to the LTS promotion-related assets, in so far as the market value of the assets exceeds DEM 1 500 million.

(164) The Commission believes that a market-economy investor would not have consented to receive remuneration from income that depended on the behaviour of the bank administering the promotion-related assets. Furthermore, NordLB derived no economic advantage from the part of the assets exceeding DEM 1 500 million (consequently, no remuneration is payable for that part). Nor can amounts withdrawn from that portion of the LTS assets be viewed as additional remuneration since, as in economic terms, they belong not to NordLB but *a priori* to the *Land*.

(165) Germany also claims that one reason for the transfer was to achieve potential synergies rather than to increase NordLB's equity. Yet, at least part of the purpose of transferring the promotion-related assets was to satisfy the requirements of the Solvency Directive. If the LTS benefit from such synergies and cost savings, this will help them by reducing costs but cannot be regarded as a consideration paid by NordLB for the provision of the original own funds. Since these synergies neither reduce the usability of the transferred capital for NordLB nor increase the costs to NordLB arising from the transfer, they should also not influence the level of remuneration which a market-economy investor can demand from the bank for the equity provided. 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* for the financial instrument (the LTS) not only the appropriate consideration for the equity provided but also a 'remuneration' in the form of such benefits. Moreover, following a merger operation, synergy effects normally arise in both merged entities. It is difficult to understand why NordLB should not profit at all from such advantages. The Commission therefore takes the view that any synergy effects do not constitute remuneration paid by NordLB for the transfer of the LTS.

(166) Lastly, the 'owner effect' is not a reason to assume a remuneration of more than 0,5 % per annum. As pointed out above, a market-economy investor who already holds shares in a company will not forgo full direct remuneration if one or more shareholders profit from the capital injection without themselves having made a corresponding contribution. Since NSGV has not made a corresponding

capital contribution, the *Land* should therefore have insisted on comprehensive direct remuneration.

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

(168) Calculation of the aid element (DEM million)

1992

1992	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1. Amount available for competitive business	120	101	145	109	71	0	0	0	0	19	63	162
2. Remainder (difference vis-à-vis DEM 1 500 million)	1 380	1 399	1 355	1 391	1 429	1 500	1 500	1 500	1 500	1 481	1 437	1 338
Remuneration of 6,76 % per annum (after tax) on point 1	0,67	0,56	0,81	0,61	0,39	0	0	0	0	0,1	0,35	0,91
Remuneration of 0,15 % per annum (after tax) on point 2	0,17	0,17	0,16	0,17	0,17	0,18	0,18	0,18	0,18	0,18	0,17	0,16
Total remuneration in line with market conditions	0,84	0,73	0,97	0,78	0,56	0,18	0,18	0,18	0,18	0,28	0,52	1,07
												Σ 6,47
Actual remuneration (after tax) (0,5 %) for the whole of 1992												0,9
Aid element												5,57

1993

1993	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1. Amount available for competitive business	133	133	207	147	174	1,143	1,222	1 400	1 400	1 400	1 400	1 400
2. Remainder (difference vis-à-vis DEM 1 500 million)	1,367	1,367	1,293	1,353	1,326	357	278	100	100	100	100	100
Remuneration of 6,76 % per annum (after tax) on point 1	0,74	0,74	1,16	0,82	0,98	6,43	6,88	7,88	7,88	7,88	7,88	7,88
Remuneration of 0,15 % per annum (after tax) on point 2	0,17	0,17	0,16	0,16	0,16	0,04	0,03	0,01	0,01	0,01	0,01	0,01
Total remuneration in line with market conditions	0,91	0,91	1,32	0,98	1,14	6,47	6,91	7,89	7,89	7,89	7,89	7,89
												Σ 58,09
Actual remuneration (after tax) (0,5 %) for the whole of 1993												7
Aid element												51,09

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
1. Amount available for competitive business	1,400	1,390	1,390	1,390	1,390	[...]	[...]	[...]	[...]	[...]
2. Remainder (difference vis-à-vis DEM 1 500 mil- 1 500 million)	100	110	110	110	110	[...]	[...]	[...]	[...]	[...]
Remuneration of 6,76 % per annum (after tax) on point 1	94,64	93,96	93,96	93,96	93,96	[...]	[...]	[...]	[...]	[...]
Remuneration of 0,15 % per annum (after tax) on point 2	0,15	0,16	0,16	0,16	0,16	[...]	[...]	[...]	[...]	[...]
Total remuneration in line with market conditions	94,79	94,12	94,12	94,12	94,12	[...]	[...]	[...]	[...]	[...]
Actual remuneration (after tax) (0,5 %)	7	6,95	6,95	6,95	6,95	[...]	[...]	[...]	[...]	[...]
Aid element	87,79	87,17	87,17	87,17	87,17	87,17	85,88	85,88	85,88	85,88

Since 1 January 1999, marks have been converted into euros at a rate of EUR1 = DEM 1,95583. The figures in DEM must be converted accordingly.

(169) Thus, the difference between the agreed remuneration of 0,5 % per annum and the appropriate remuneration of 6,76 % per annum (for the portion of the LTS promotion-related assets which NordLB can use for its competitive business) and 0,15 % per annum (for the portion of the assets that can be likened to a bank guarantee) constitutes state aid within the meaning of Article 87(1) of the EC Treaty.

(170) The aid element for the period from the granting of the aid up to the end of 2003 amounts to DEM 923,82 million. Converted into euros this comes to EUR 472,34 million. As the LTS assets are still at NordLB's disposal, the amount of the aid element is continually increasing.

4. *COMPATIBILITY OF THE MEASURE WITH THE EC TREATY*

(171) It can therefore be stated that the transfer of the LTS promotion-related assets is caught by all the criteria laid down in Article 87(1) of the EC Treaty and thus involves state aid within the meaning of that Article. On this basis, an assessment must be made as to whether the aid can be considered compatible with the common market. However, it must be noted that Germany invoked only the exemption laid down in Article 86(2) of the EC Treaty in relation to any aid elements present in the transfer of the promotion-related assets.

(172) None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(173) 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 aspects, is applicable. Nor does the aid promote the execution of an important project of common European interest. The aid is not aimed either at promoting culture or heritage conservation.

(174) Since the economic survival of NordLB 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 NordLB 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.

(175) 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. NordLB is not described as an undertaking in difficulty whose viability must be restored with the support of state aid.

(176) Article 86(2) of the EC Treaty, which allows exemptions from the Treaty's state aid rules under certain conditions, is also applicable, in principle, to the financial services sector. This was confirmed by the Commission in its report on services of general economic interest in the banking sector [1].

[1] 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.

(177) Germany submits that, if the transfer of the LTS promotion-related assets did constitute favourable treatment for NordLB, it was no more than compensation for NordLB for the costs it incurred for carrying out its public mandate. It argues that NordLB is not only the *Land* bank but also a savings bank in the Braunschweig area. So it performs not only the traditional public role of a *Land* bank, with the attendant costs, but also the function of a savings bank.

(178) However, Germany has not quantified the costs to NordLB of the public tasks in question. On those grounds alone the Commission cannot allow an exemption from the application of Article 87(1) of the EC Treaty on the basis of Article 86(2). Moreover, it is clear that the transfer was made in order to enable NordLB to comply with the new own funds requirements, not as compensation for a public mandate carried out by NordLB.

(179) 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 common market.

5. *NO EXISTING AID*

(180) Contrary to the arguments put forward by Germany, the transfer of the LTS promotion-related assets cannot be regarded as being covered by the existing state aid scheme for *Anstaltslast* and *Gewährträgerhaftung*.

(181) *Gewährträgerhaftung* is a default guarantee offered to creditors in the event that the bank's assets are not sufficient to satisfy their claims, and this is not the case here. The capital injection is not intended to satisfy NordLB's creditors and the bank's assets have not been exhausted.

(182) Nor does *Anstaltslast* apply. *Anstaltslast* requires the guarantors (the *Land* of Schleswig-Holstein and NSGV) to provide NordLB with the resources it needs to function properly for as long as the *Land* decides to maintain it in existence. However, at the time of the capital injection, NordLB was far from being in a situation where it was no longer able to operate properly. The capital injection was not needed in order to keep NordLB in operation. Rather, it was made in order to enable the Landesbank to increase its capital in the light of the new capital requirements under the Solvency Directive so as to avoid an otherwise necessary reduction in its business volume and to enable it to expand in future. This conscious economic calculation by the *Land* as joint owner also enabled NordLB to seize future opportunities in its competitive business. The 'necessity requirement' for *Anstaltslast* does not apply to such a normal economic decision by the *Land*. In the absence of another existing applicable state aid scheme pursuant to Articles 87(1) and 88(1) of the EC Treaty, the capital injection must be classed as new aid within the meaning of Articles 87(1) and 88(3) of the EC Treaty.

VI. **CONCLUSION**

(183) The Commission finds that Germany has unlawfully implemented the new aid in question in breach of Article 88(3) of the EC Treaty.

(184) The aid cannot be found compatible with the common market either under Article 87(2) or (3) or under any other provision of the Treaty. It 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 Germany,

HAS ADOPTED THIS DECISION:

Article 1

1. The difference between the appropriate remuneration of 6,76 % per annum (after corporation tax and before investor tax) and the remuneration of 0,5 % per annum (after corporation tax and before investor tax) agreed by Norddeutsche Landesbank — Girozentrale and the *Land* of Lower Saxony for the part of the transferred capital which Norddeutsche Landesbank — Girozentrale was able to use to underpin its competitive business as of 1 January 1992 constitutes aid which is incompatible with the common market.

2. The waiver of an appropriate remuneration amounting to 0,15 % per annum (after corporation tax and before investor tax) for the part of the capital transferred to Norddeutsche Landesbank — Girozentrale which could be used as a guarantee as from 1 January 1992 constitutes aid which is incompatible with the common market.

3. The amounts of aid referred to in paragraphs 1 and 2 total EUR 472,34 million for the period from 1 January 1992 to 31 December 2003 taken for the calculation.

Article 2

1. Germany shall discontinue the aid referred to in Article 1(1) and (2) by not later than 31 December 2004.

2. Germany shall take all necessary measures to recover from the beneficiary the aid referred to in Article 1(1) and (2) and unlawfully made available.

The aid to be recovered and specified in Article 1(1) and (2) comprises:

(a) the amount specified in Article 1(3) for the period from 1 January 1992 to 31 December 2003;

(b) an amount determined in accordance with the methods of calculation referred to in Article 1(1) and (2) for the period from 1 January 2004 to the time at which the aid is discontinued.

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of the Decision.

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 in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 [1].

Article 4

Germany shall, by means of the questionnaire annexed hereto, inform the Commission, within two months of notification of this Decision, of the measures taken to implement the Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

(1) OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION ON STATE AID MEASURE

1. Calculation of the amount to be recovered

1.1. Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient; if the measure consists of several instalments and reimbursements, use separate rows.
(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2. Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. Recovery measures planned or already taken

2.1. Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain what alternative measures are available in national legislation to bring about the recovery of the aid. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2. By what date will the recovery of the aid be completed?

3. Recovery already effected

3.1. Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2. Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

on State Aid implemented by Germany for Bayerische Landesbank — Girozentrale

(notified under document number C(2004) 3927)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/739/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 the Member State and other interested parties to submit their comments pursuant to the provisions cited above ([1]) and having regard to their comments,

Whereas:

I. PROCEDURE

(1) The subject of these proceedings is the transfer of housing-promotion loans to Bayerische Landesbank — Girozentrale ('BayernLB') by the *Land* of Bavaria. There are a further six cases in which proceedings have been initiated against Germany in connection with transfers of assets to Landesbanks, and in particular to Westdeutsche Landesbank Girozentrale ('WestLB').

(2) By letter of 12 January 1993, the Commission asked Germany for information on a DEM 4 billion capital increase for WestLB resulting from the incorporation of the housing organisation *Wohnungsbauförderanstalt* ('Wfa') and on similar increases in the own funds of the Landesbanks of other *Länder*. It asked which Landesbanks had benefited from a transfer of promotion-related assets and for information on the reasons for those transactions.

(3) The German authorities replied by letters dated 16 March and 17 September 1993. The Commission requested further information by letters of 10 November and 13 December 1993, to which Germany replied by letter of 8 March 1994.

(4) By letters of 31 May and 21 December 1994, the *Bundesverband deutscher Banken e.V.* ('BdB'), an association representing private banks established in Germany, informed the Commission among other things that, under a law adopted on 23 July 1994, housing-promotion loans had been transferred to the liable equity capital of BayernLB. This increased the own funds at BayernLB's disposal and, in the BdB's view, distorted competition in its favour since the parties had not agreed remuneration consistent with the market-economy investor principle. In its second letter, the BdB accordingly lodged a formal complaint and called on the Commission to initiate proceedings against Germany under Article 93(2) of the EC Treaty (now Article 88(2)).

(5) The complaint also related to similar transfers of assets to Westdeutsche Landesbank, Norddeutsche Landesbank, Landesbank Schleswig-Holstein, Hamburger Landesbank and Landesbank Berlin. In February and March 1995 and December 1996 several banks associated themselves individually with the complaint lodged by the BdB.

(6) By letters of 6 August 1997 and 30 July 1998, the BdB informed the Commission of two further transfers of assets, to Landesbank Schleswig-Holstein in Schleswig-Holstein and Landesbank Hessen-Thüringen in Hessen.

(7) The Commission first examined the transfer of assets to Westdeutsche Landesbank ('WestLB') but announced that it would review the transfers to the other banks in the light of the findings in that case ([2]) . It finally adopted a decision on the WestLB case in 1999, concluding that there was a state aid component equal to the difference between the

([1]) OJ C 81, 4.4.2003, p. 13.

([2]) OJ C 140, 5.5.1998, p. 9 (opening decision).

remuneration paid and the normal market remuneration, which was incompatible with the common market and should be recovered ([3]) . This decision was annulled by the Court of First Instance on 6 March 2003 as insufficient reasons had been given for two of the factors used to calculate the appropriate remuneration ([4]) . On 20 October 2004, having been informed of the understanding between the complainant, all the Landesbanks concerned (with the exception of Landesbank Hessen-Thüringen) and the respective *Länder*, the Commission adopted a new decision that took account of the Court's criticisms.

(8) On 1 September 1999 the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks. By letter of 8 December 1999, the German Government supplied information on the transfer of *Land* housing-promotion loans to BayernLB, supplementing that information in letters of 22 January and 3 July 2001 in response to requests by the Commission for further information.

(9) By letter of 13 November 2002, the Commission informed Germany of its decision to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the transfer of the housing-promotion loans by the *Land* of Bavaria to BayernLB. At the same time, it launched the investigation procedure in respect of similar transfers of assets to Norddeutsche Landesbank — Girozentrale, Landesbank Schleswig-Holstein — Girozentrale, Hamburgische Landesbank — Girozentrale and Landesbank Hessen-Thüringen. It had already opened an investigation into a further similar transfer of housing-promotion assets by the *Land* of Berlin to Landesbank Berlin back in July 2002.

(10) The decisions initiating the procedure were published in the Official Journal of the European Union ([5]) . The Commission called on interested parties to submit comments.

(11) By letter of 15 April 2003, Germany submitted its comments on the initiation of the procedure in the BayernLB case.

(12) By letter of 29 July 2003, the BdB submitted comments on all the decisions taken on 13 November 2002 to initiate the investigation procedure.

(13) The Commission asked for further information on 5 September 2003. Germany replied on 24 October, commenting also on BdB's comments on BayernLB. On 30 October 2003, Germany forwarded comments by the Government of North Rhine-Westphalia and by WestLB on the BdB's remarks concerning the proceedings in connection with the transfer of housing-promotion loans to BayernLB.

(14) By letter of 15 March 2004, Germany informed the Commission of an amendment to BayernLB's articles of association on 5 March whereby, irrespective of their function as liable equity capital, the transferred assets could no longer be used to underpin BayernLB's competitive business. The Commission sent further requests for information on 7 April, 27 April and 23 June, to which Germany replied on 1 June and 6 July. The Commission's last request, dated 27 July, was answered by Germany on 18 August.

(15) On 19 July 2004 the complainant BdB, the *Land* of North Rhine-Westphalia and WestLB notified a provisional understanding concerning the appropriate remuneration for the transferred assets. In their view, this remuneration should form the basis of the Commission Decision. The definitive version of the understanding reached the Commission on 13 October 2004. On 10 September 2004, BdB, the *Land* of Bavaria and BayernLB also reached a provisional understanding on the appropriate remuneration for the special-purpose assets transferred. Several letters were subsequently sent to the Commission by these interested parties and by Germany. The definitive version of the understanding on the transfer of the special-purpose assets to BayernLB reached the Commission on 24 September 2004. Similar understandings relating to asset transfers to Landesbanks were also communicated to the Commission in the other cases, with the exception of Landesbank Hessen-Thüringen.

II. DETAILED DESCRIPTION OF THE MEASURES

1. *BAYERISCHE LANDESBANK — GIROZENTRALE*

(16) Bayerische Landesbank — Girozentrale (BayernLB), with its head office in Munich, has a group balance-sheet total of €313 billion (as at 31 December 2003), which makes it one of Germany's largest banks. It was formed in 1972 as a result of the merger between Landesbodenkreditanstalt ('LABO') and Bayerische Gemeindebank (Girozentrale) ([6]). It is a publicly owned credit institution operating in the form of a public institution (*Anstalt des öffentlichen Rechts*). It is indirectly owned by the *Land* of Bavaria and the Bayerische Sparkassen- und Giroverband (Sparkassenverband Bayern), each with a 50 % holding. In 2002 the two owners agreed to transfer their stakes in BayernLB, in exchange for shares, to BayernLB Holding AG, in which they each hold 50 % of the shares. BayernLB Holding AG is the sole owner of Bayerische Landesbank and is not a bank itself.

([3]) OJ L 150, 23.6.2000, p. 1; actions challenging that decision have been brought by Germany (before the Court of Justice, Case C-376/99), by North Rhine-Westphalia (before the Court of First Instance, Case T-233/99) and by WestLB (before the Court of First Instance, Case T-228/99). The Commission has also brought proceedings for infringement of the Treaty (before the Court of Justice, Case C-209/00).

([4]) Joined Cases T-228/99 and T-233/99 Westdeutsche Landesbank Girozentrale and Land Nordrhein-Westfalen v Commission [2003] ECR II-435.

([5]) Norddeutsche Landesbank: OJ C 81, 4.4.2003, p. 2; Bayerische Landesbank: OJ C 81, 4.4.2003, p. 13; Hamburgische Landesbank: OJ C 81, 4.4.2003, p. 24; Landesbank Hessen-Thüringen: OJ C 73, 26.3.2003, p. 3 and Landesbank Schleswig-Holstein: OJ C 76, 28.3.2003, p. 2.

([6]) Article 1 of the Act establishing the Bayerische Landesbank — Girozentrale (*Gesetz über die Errichtung der Bayerischen Landesbank — Girozentrale*).

(17) According to its annual report for 2003, BayernLB's core capital ratio was 7,8 %, and its equity ratio was 11,3 %. Its income-to-equity ratio stood at 4,3 % in 2002 and 4,9 % in 2003, much lower than in previous years (15,5 % in 2000 and 18,7 % in 1999).

(18) Given its ownership structure, BayernLB operates as the principal banker of the *Land* of Bavaria and as the central institution of Bavarian savings banks. It claims that it contributes, in close cooperation with its partners, to securing and enhancing on a sustained basis the attractiveness of Bavaria as a business location. It also operates as an international wholesale bank active in the area of investment and commercial banking. It also claims to be one of the largest German issuing houses. Its target customers are *Land* and municipal authorities, savings banks, multinational groups, domestic firms, private and commercial real-estate developers, institutional customers and financial institutions. BayernLB maintains LABO (an instrument of *Land* housing policy) and Landesbausparkasse Bayern ('LBS', the Bavarian home loan and savings bank) as legally dependent institutions.

(19) With more than 9 000 employees, the BayernLB group is present in the world's main financial centres. On its core European markets, including central and eastern Europe, in North America and in Asia, it offers its customers a comprehensive range of banking products via its own branches, representative offices and holdings. After streamlining its network in 2003, BayernLB today has, besides its two offices in Bavaria and 15 LBS-Bayern sales departments, four offices in Europe and nine offices worldwide.

(20) The 84 Bavarian savings banks (31 December 2003), the Versicherungskammer Bayern, Landesbausparkasse (LBS) and Bayerische Landesbank make up the Sparkassen-Finanzgruppe Bayern group, offering a full range of financial services in line with the concept of all-purpose banking.

2. *TRANSFER OF HOUSING-PROMOTION LOANS TO BAYERNLB*

(21) In view of BayernLB's growing competitiveness on the domestic and international markets, the Bavarian *Land* Parliament adopted on 23 July 1994 the Act on the formation of special-purpose assets through the transfer of the *Land* of Bavaria's trustee claims in respect of the liable equity capital of the Bayerische Landesbank — Girozentrale (the Special-purpose Assets Act) ([7]) . Under Article 1(1) of that Act, the *Land* Government is empowered to transfer the *Land* funds administered by LABO in the period 1957-1990 to BayernLB for the purpose of forming a special reserve. The special-purpose assets transferred are to continue to be used for the purposes of social-housing construction.

(22) According to the explanatory memorandum to the Act, BayernLB's equity capital needed to be increased in order to guarantee the continued success of its business operations ([8]) . Without such an increase, BayernLB's competitiveness might be harmed in the long term. In addition, its equity base was to be strengthened by transferring existing *Land* building loan claims to it ([9]).

(23) The first instalment of outstanding claims on promotion loans totalling some DEM 3 811 million was transferred to BayernLB on 31 December 1994 in accordance with the transfer agreement of 15 December 1994 ([10]) . A second instalment of outstanding claims on promotion loans totalling DEM 1 216 million was transferred to BayernLB with effect from 31 December 1995 in accordance with the transfer agreement of 28 December 1995 ([11]) . A total of DEM 5 027 million in housing-promotion assets was thus transferred to BayernLB.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS AND SOLVENCY DIRECTIVES*

(24) The German Banking Act (*Kreditwesengesetz*, or KWG) was amended in line with Council Directive 89/647/EEC on a solvency ratio for credit institutions ([12]) (the 'Solvency Directive') and Council Directive 89/299/EEC on the own funds of credit institutions ([13]) (the 'Own Funds Directive'), which require banks to have own funds equivalent to 8 % of their risk-adjusted assets, of which at least 4 percentage points must consist of what is termed core capital, or 'tier I' capital, meaning capital items which are at the credit institution's disposal without restriction and immediately in order to cover risks or losses as soon as they arise. In determining the total own funds available to a bank for supervisory purposes, the core capital is of decisive importance because additional capital, or 'tier II' capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital.

([7]) Bavarian Official Gazette [*Bayerisches Gesetz- und Verordnungsblatt*], No 18/1994, p. 602.

([8]) Bavarian Land Parliament, 12th session, document 12/15851 of 7 June 1994.

([9]) Bavarian Land Parliament, 12th session, document 12/15851 of 7 June 1994.

([10]) Transfer agreement between the *Land* of Bavaria and Bayerische Landesbank — Girozentrale of 15 December 1994.

([11]) Transfer agreement between the *Land* of Bavaria and Bayerische Landesbank Girozentrale of 28 December 1995, which refers entirely to the rules of the transfer agreement of 15 December 1994.

([12]) OJ L 386, 30.12.1989; repealed and replaced by European Parliament and Council Directive 2000/12/EC, OJ L 126, 26.5.2000.

([13]) OJ L 124, 5.5.1989; repealed and replaced by Directive 2000/12/EC.

(25) German banks had to adapt their own funds to the new requirements of the Solvency Directive and the Own Funds Directive by 30 June 1993 ([14]) . Even before the Solvency Directive was transposed into German law, many Landesbanks had relatively weak own-funds positions. They now had to strengthen their own-funds base as a matter of urgency in order to avoid restrictions on their business expansion and indeed to maintain their current level of activities.

(26) However, because the budgetary situation was tight, public shareholders were unable to provide any fresh capital but neither were they prepared to contemplate privatisation and to raise additional capital on the capital markets. It was therefore decided to undertake asset and capital transfers: in WestLB's case, for example, there was a transfer of the assets of the housing organisation Wohnungsbauförderungsanstalt des Landes Nordrhein-Westfalen ('Wfa'). However, in BayernLB's case the housing-promotion loans were transferred only afterwards, so that, apart from their role of strengthening its capital base, they also served to maintain and expand its general business activities.

4. *EFFECTS OF THE TRANSFER ON BAYERNLB'S CAPITAL BASE*

(27) The scale of a credit institution's business depends to a large extent on the amount of its equity capital. In BayernLB's case, this was increased to a not insignificant extent by the transfer of the housing-promotion loans.

(28) Before the transfer took place, the loans in question had been valued in two expert reports, dated 5 October 1994 and 30 April 1996, by the auditors […] ([15]), and the resulting cash value of the loan claims was paid to BayernLB as equity capital in the form of a capital reserve. The cash value of the first instalment made on 31 December 1994 stood at DEM 655 million, and that of the second instalment made on 31 December 1995 at DEM 542 million. This constituted a special-purpose reserve totalling DEM 1 197 million.

(29) By letter of 8 May 1996, the Federal Banking Supervisory Authority (*Bundesaufsichtsamt für das Kreditwesen*, or 'BAKred' ([16])) indicated that it recognised the full amount of the special-purpose reserve of DEM 655 million as liable equity capital within the meaning of Section 10 of the German Banking Act (KWG). Taking into account the entire special-purpose reserve of DEM 1 197 million, BAKred, in a letter dated 20 December 1996, fixed BayernLB's liable equity capital, including additional own funds, at DEM 14,6 billion as at 23 December 1996 ([17]) . Of this liable equity capital a total of DEM 8,8 billion was core capital.

(30) The capital injection by means of the special-purpose reserve therefore represented some 8 % of BayernLB's liable own funds of DEM 14,6 billion at 31 December 1995 and around 13 % of the recognised core capital of around DEM 8,8 billion.

(31) According to the information available, the funds could actually be used to cover liabilities as from the receipt of BAKred's decision, i.e. from 20 May 1996 in respect of DEM 655 million and from 23 December 1996 in respect of DEM 1 197 million.

(32) According to Germany, the only time BayernLB actually drew on the special-purpose reserve was in 1998, when it used DEM 14 million for a period of only one month.

(33) Germany also argued that the cash value of the special-purpose reserve recognised by BAKred as own funds (DEM 1 197 million) should be understood as merely as an upper limit on the amount available to cover risk assets and that it was not permanently available to the full extent of that amount to underpin lending. Indeed the cash value fluctuated, mainly because of the current use of liquid funds to grant loans afresh (on which the *Land* alone could decide in accordance with Section 1(3) of the transfer agreement) ([18]) , but also because of discounts granted on the outstanding principal for reasons to do with promotion. Thus, the cash value of the special-purpose assets was lower than the amount of DEM 1 197 million recognised for supervisory purposes by DEM […] in 1998 and by €[…] in 1999 and had to be offset by drawing on other items of capital. Germany argued that the full amount of the capital recognised by BAKred was therefore not available throughout to cover risk-bearing assets.

([14]) Under the Solvency Directive, credit insitutions must have own funds equivalent to at least 8 % of their risk-adjusted assets, whereas the previous German legislation required a ratio of 5,6 %; however, this ratio was based on a narrower definition of own funds than that which has applied since the entry into force of the Own Funds Directive.

([15]) Confidential information.

([16]) Now the *Bundesanstalt für Finanzdienstleistungsaufsicht* ('BaFin').

([17]) Letter of 20 December 1996 from BAKred.

([18]) As Germany has submitted, this could lower the cash value of the special-purpose assets where the average maturity was long and lead to a higher cash value where the average maturity was shorter. Where the actual cash value exceeded the sum of DEM 1 197 million recognised by BAKred and entered in the balance sheet, the difference was booked as a provision to offset risks arising from changes in the cash value.

(34) Germany provided the following figures on the actual fluctuations (Figure 1):

	1994 DEM 1000	1995 DEM 1000	1996 DEM 1000	1997 DEM 1000	1998 DEM 1000	1998 EUR 1000	1999 EUR 1000	2000 EUR 1000	2001 EUR 1000	2002 EUR 1000	2003 EUR 1000
Cash value of special-purpose assets	655 728	1 233 164	1 229 258	1 255 390	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Change in cash value of special-purpose assets		577 436	- 3 906	26 132	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Special-purpose reserve shown as equity	655 000	1 197 000	1 197 000	1 197 000	1 197 000	612 016	612 016	612 016	612 016	612 016	612 016
Difference between cash value and amount shown as equity	**728**	**36 164**	**32 258**	**58 390**	[…] [1]	[…]	[…]	[…]	[…]	[…]	[…]

[1] The only reason why this fall of DEM […] brought the cash value to a level that was only DEM […] million below the upper limit recognised for supervisory purposes (DEM 1 197 million) was the (chance) circumstance that the cash value had exceeded that upper limit in 1997.

5. *REMUNERATION FOR THE OWN FUNDS TRANSFERRED*

(35) Under Section 4(1) of the transfer agreement of 15 December 1994 between the *Land* of Bavaria and BayernLB, remuneration was agreed for the funds made available as a result of the transfer, but only on the amount actually used. The agreed rate was 0,6 % — payable out of income from banking business — on that portion of the transferred funds actually used to underpin competitive business, and the remuneration would fall due when the balance sheet for the relevant business year was established [19] . According to the information supplied by Germany, the rate was fixed taking into account the fact that the special-purpose reserve was being made available without liquidity, with the consequence that any actual business expansion would have to be refinanced entirely by borrowing liquid funds.

(36) Germany also stated that the remuneration for the special-purpose assets was treated for tax purposes as use of profits, could therefore not be deducted as operating expenditure and, as a result, was payable after tax.

(37) With regard to the basis of assessment for the remuneration payable, Germany stated during the proceedings that, in the event of the special-purpose reserve being used in full, the agreed remuneration of 0,6 % per annum [20] would have amounted to some DEM 7,2 million. As mentioned above, Germany stated that BayernLB actually drew on the special-purpose reserve only once: in 1998 it used DEM 14 million for a period of only one month, for which it paid remuneration of DEM 7 000.

(38) Moreover, under Section 6(2) of the transfer agreement of 15 December 1994, read in conjunction with Section 2 of the transfer agreement of 28 December 1995, BayernLB paid a fee of 0,05 % to the *Land* for a default guarantee for loans from the special-purpose assets. Germany provided detailed figures for the payments made.

III. GROUNDS FOR INITIATING THE PROCEDURE

(39) In its decision of 13 November 2002 initiating the procedure, the Commission concluded that the transfer of housing-promotion loans by the *Land* of Bavaria to BayernLB probably constituted state aid within the meaning of Article 87(1) of the EC Treaty.

(40) The starting point for its investigation was the principle of the market-economy investor. According to this principle, it is not the fact that undertakings are publicly owned and receive funding from the public authorities which constitutes state aid. The provision of public money confers an advantage only if funds are made available to such a public undertaking on terms which it would not have obtained under normal market conditions.

(41) In the present case, the Commission regarded the economic advantage conferred on BayernLB by the injection of own funds as consisting in particular in the increase in its commercial, competitive lending capacity (by dint of the business-expansion function of equity capital). Under normal market conditions, the capital contribution would be remunerated in line with the value of the contributed capital, taking account of its function and the risk incurred. One method of determining the normal market remuneration for the contributed capital was thus to take the long-term risk-free rate (for 10-year Federal bonds) and apply to

[19] Transfer agreement of 15 December 1994, Section 4(3).

[20] Transfer agreement of 15 December 1994, Section 4(1).

it a risk premium corresponding to the higher risk of equity capital. As Germany had already indicated that the rate of remuneration for a long-term, risk-free investment stood at 7,9 % per annum at the end of 1994, when the transfer of assets took place, the Commission had serious doubts as to whether a remuneration of 0,6 % per annum for the equity capital actually used could be deemed normal for the market, irrespective of any necessary risk premium.

(42) The Commission also doubted whether a market-economy investor would have agreed to limit remuneration to the portion of the funds actually used. It also seemed doubtful that the additional elements of remuneration cited by Germany, such as the fee equal to 0,05 % per annum of guaranteed transferred claims and payable to the *Land* for a default guarantee covering the loan claims, the interest payments made by borrowers (and also accruing to the *Land*) or the interest on intermediate investments abroad ([21]) , actually constituted remuneration for the business-expansion function of equity capital.

(43) However, the Commission acknowledged that the contributed capital's lack of liquidity should be taken into account when determining the normal market remuneration. Under Article 1 of the Special-purpose Assets Act, the housing-promotion loans forming the special-purpose reserve had to be used in the same way as prior to the transfer for the purposes of social-housing construction. The transfer of the housing-promotion assets therefore did not provide BayernLB with liquidity. Although the bank's non-liquid capital permitted an increase in the volume of its activities, it had to be borne in mind that BayernLB was able to achieve the full extent possible of any increase in its business volume only if it refinanced the additional lending in full on the capital market. The *Land* could not therefore expect exactly the same return as a provider of liquid capital, and the appropriate remuneration had to be reduced accordingly.

(44) The Commission could not see that the *Land*, when transferring the housing-promotion loans, had ensured that it was going to participate to an appropriate extent in the distribution of the bank's profits and the increase in its value. In particular, the *Land* did not insist on a change in the ownership structure in its favour, which it would have had to do in order to ensure that dividend payments and increases in value were consistent with the level of invested capital.

(45) As none of the exemptions provided for in Article 87(2) and (3) or Article 86(2) of the EC Treaty applied in the present case, the state aid appeared not to be compatible with the common market.

IV. COMMENTS FROM GERMANY

(46) In its comments on the decision initiating the procedure, Germany took the view that, unlike in the WestLB case, the transfer of the special-purpose assets to BayernLB was comparable not to an injection of share capital but to the contribution of a silent partner within the meaning of Section 10(4) of the German Banking Act, something which the Commission had failed to take into account.

(47) What was decisive in Germany's view was that, up to the end of 1996, when the special-purpose assets were recognised for supervisory purposes, the Bavarian savings banks and private investors had provided BayernLB with core capital of just under DEM 1 300 million (of which some DEM 900 million from the savings banks) in the form of silent partnerships. These silent partnership assets were recognised by BAKred as core capital within the meaning of Section 10(4) of the Banking Act. At the time of the transfer, therefore, silent partnerships already constituted a normal means of procuring core capital for BayernLB.

(48) Furthermore, the special-purpose assets were, by their nature, comparable to BayernLB's silent partnerships. In terms of their economic function, i.e. providing scope for business expansion, both forms of capital were identical since both were recognised as core capital. Neither would have contributed directly to increases in the bank's value or conferred additional voting rights. Nor was there any difference between them as far as the risk of loss was concerned since both could be used to offset any loss. The only difference was that the special-purpose assets had been made available for an unlimited period of time, whereas silent partnerships were typically limited in time. However, the special-purpose reserve should not necessarily be regarded as unlimited, but could be terminated by agreement at any time. Moreover, unlimited silent partnerships also existed. A comparison showed that there was no significant difference in price between limited and unlimited silent partnership contributions.

(49) Germany also argued that the special-purpose assets were not exposed to the risk of loss in the same way as share capital. Unlike in the WestLB case, where the transferred Wfa assets made up almost 50 % of the bank's equity capital, the transferred housing-promotion loans accounted for only around 8 % of BayernLB's equity capital at the time of the transfer. Moreover, unlike WestLB, BayernLB was not dependent on the core capital constituted by the housing assets. The bank had always been profitable and already had significant equity capital before the transfer, by virtue not least of the silent partnership contributions invested by the Bavarian savings banks and by private companies from 1991 onwards. Furthermore, the *Land* of Bavaria and

([21]) Transfer agreement of 15 December 1994, Section 2(1).

BayernLB had agreed that the special-purpose assets would be used to cover risk assets only when all other capital items had been used.

(50) Another reason why the *Land* faced a lower risk in transferring the assets than an investor in share capital was that, pursuant to Section 2 of the agreement between the *Land* of Bavaria and the Bavarian Sparkassenverband of 15 December 1994, the latter was required, as second shareholder, to bear half of any loss suffered by BayernLB in the event of the special-purpose reserve being depleted or used by BayernLB's creditors to cover losses.

1. *APPROPRIATE REMUNERATION FOR THE SPECIAL PURPOSE ASSETS*

(51) Based on the assumption that the capital made available was comparable — as a core capital instrument — to silent partnerships and not to a share capital investment, Germany came to the conclusion that appropriate remuneration was provided for the special-purpose assets and that, therefore, no advantage was conferred on BayernLB, thereby ruling out the presence of any state aid.

(52) According to Germany, the agreed remuneration took the form of the guarantee commission (*Haftungsprovision*) — dependent on capital used and paid out of income from banking business — equal to 0,6 % per annum of the value of the special-purpose reserve recognised for supervisory purposes as core capital.

(53) In Germany's view, the fee (*Bürgschaftsgebühr*) of 0,05 % per annum for the loan claims guaranteed by the *Land* can also be viewed as remuneration for the transfer of the special-purpose assets, as provision of the guarantee was directly linked to the aim of increasing the Landesbank's equity capital. According to the explanatory memorandum to the Act, the guarantee was necessary to ensure the desired strengthening of the Landesbank's equity capital by preventing the special-purpose assets from being reduced by defaults on loans ([22]) . With reference to the expert reports by […]dated 5 October 1994 and 30 April 1996, Germany argued that, without the default guarantee provided by the *Land*, the capitalisation interest rate of 7,5 % used to calculate the cash value of the claims would have had to have been increased by a risk premium. A lower cash value would have resulted and so only a lower amount could have been recognised by BAKred ([23]).

(54) In the course of the proceedings, Germany expressly abandoned its earlier standpoint that the interest on intermediate investments and the interest payments by borrowers accruing to the *Land* could be viewed as elements of remuneration.

(55) As for the normal market remuneration, Germany stated that, since the assets were comparable to BayernLB's silent partnerships, the initial rate should be that paid by BayernLB to its silent partners in the relevant period, i.e. some 7-8 % per annum of their nominal value.

(56) It argued that the lack of liquidity alone should lead to a considerable reduction in this initial rate. In this case, not only the net refinancing costs should be deducted, as in the WestLB case, but also the gross refinancing costs. Given that the capital injection into BayernLB made up only 8 % of equity capital and not 50 % as in the WestLB case, a private investor could not have deducted the net refinancing costs alone.

2. *FAILURE TO CHANGE OWNERSHIP STRUCTURE AND OWNER EFFECT*

(57) In its comments on the Commission's decision to initiate proceedings, Germany also pointed out that, given that the special-purpose assets only involved capital that was comparable to silent partnerships, Germany felt that a change in the ownership of BayernLB in favour of the *Land* was not necessary. Even so, the Sparkassenverband would scarcely have agreed to a change in ownership to its detriment since there was no need for additional capital at the time of the transfer and since it had itself previously invested DEM 900 million in the bank in the form of silent partnership contributions ([24]) , without the *Land* of Bavaria making a comparable contribution.

([22]) See explanatory memorandum to Article 3, on the default guarantee, of the Act of 23 July 1994 on the formation of special-purpose assets through the transfer of trustee claims belonging to the *Land* of Bavaria to the liable equity capital of Bayerische Landesbank — Girozentrale (Bavarian *Land* Parliament, document 12/15851).

([23]) Germany also argues that, without the guarantee, the assets would have been given a 100 % weighting in accordance with Principle 1 of the German Banking Act and would in principle have had to have been covered by 8 % of equity capital. The loan claims did not meet the particularly favourable conditions for a weighting as real-estate loans within the meaning of the Act. The transferred lending volumes would accordingly have had to be covered by some DEM 400 million in equity capital and would have reduced the recognised amount by the same figure.

([24]) At the end of 1995, when the second instalment was transferred, the figure was already DEM 1 100 million, according to the information in the Commission's possession.

(58) Germany also stated that, as a 50 % shareholder, the *Land* could assume that it would benefit from very favourable capital returns compared with other credit institutions. The *Land* would therefore not have been content with a limited return or no return at all. This should be taken into account by the Commission in its assessment of the investment.

V. COMMENTS FROM THE COMPLAINANT BDB

(59) The BdB submitted that BayernLB did not pay an appropriate remuneration for the transferred core capital and was therefore in receipt of state aid.

(60) In its comments of 29 July 2003 on the proceedings initiated in respect of the Landesbanks on 13 November 2002, the BdB stated that the question of whether the remuneration was appropriate should be determined using the method employed by the Commission in its WestLB decision of 8 July 1999.

(61) The first step is therefore to compare the capital provided with other equity instruments. The second step is to determine the minimum remuneration which an investor would expect for a real equity-capital investment in the Landesbank. Finally, a calculation must be made of any premiums and discounts applied by virtue of the particularities of the transfer.

1. *COMPARISON WITH OTHER EQUITY INSTRUMENTS*

(62) In its comments of 29 July 2003 the BdB came to the conclusion that the transfer of housing-construction and promotion assets in the BayernLB case and in the other above-mentioned Landesbank cases can be compared to an injection of share capital.

(63) Nearly all the Landesbanks are said to have required fresh core capital from 1992 onwards in order to meet the stricter requirements arising from the new Solvency Directive. Without these increases in capital, the Landesbanks would have had to scale down their business. It can therefore be concluded, the BdB argues, that the capital injected can be compared only with equity instruments that were recognised as core capital ('tier I capital') and available in Germany in the year of the transfer. This immediately excluded from any comparison non-voting preference shares, profit participation rights and perpetual preferred shares. In Germany these three equity instruments are recognised not as core capital but as additional capital ('tier II capital'). Moreover, perpetual preferred shares did not exist in Germany at the beginning of the 1990s.

(64) At the time of the respective transfers, only share capital and silent partnership contributions were recognised as core capital in Germany. Any comparison with silent partnership contributions could be ruled out across the board. First, unlike share capital, silent partnerships were valid for a limited period only or could be terminated and had to be paid back to the investor on maturity. An investor could not therefore expect to receive the same remuneration for a silent partnership contribution as for equity instruments recognised for supervisory purposes for an unlimited period.

(65) Second, although in some cases it was asserted that the transferred capital was subordinate in liability to share capital pursuant to agreements between the Landesbanks' owners, this did not necessarily mean a lower risk for the investor. In all the cases the transferred capital made up a significant proportion of the total core capital, sometimes even more than 50 %. This made it extremely likely that the injected capital could be drawn on — at least in part — in the event of losses ([25]).

(66) Third, the BdB submits that the difference in quality between silent partnership contributions and share capital is confirmed by the definition of core capital for supervisory purposes adopted by the Basle Committee for Banking Supervision. According to this definition, silent partnership contributions must be recognised for supervisory purposes as no more than lower tier I capital, which may account for no more than 15 % of the requisite core-capital ratio. In other words, where the core-capital ratio is 4 %, 3,4 % must be made up of nominal capital and open reserves (e.g. the special-purpose reserve transferred to the *Landesbanks*). Furthermore, banks only ever took up subordinate equity instruments such as preference shares or profit participation rights in small volumes. Under pressure from the rating agencies, such instruments hardly ever accounted for more than 10 % of a bank's total core capital — a very different situation from that in the cases under examination. Against this background, silent partnership contributions could not be used for large volumes invested by a single investor.

2. *MINIMUM REMUNERATION FOR A SHARE-CAPITAL INVESTMENT IN BAYERNLB*

(67) The BdB argues that all methods of determining an appropriate remuneration (return) for the provision of share capital start from a risk-free return and add a risk premium. They can be traced back to the following basic principle:

Expected return on a risky investment
= risk-free return + risk premium for the risky investment

([25]) Moreover, a risk or liability premium was paid primarily because of the risk of loss in the event of insolvency. If this were to happen, the capital would be irretrievably lost. In the event of ongoing (partial) losses, i.e. outside insolvency, there was always a chance that the equity capital might be replenished through profits.

(68) To determine the risk-free return, the BdB used the returns on long-term government bonds, fixed-rate securities issued by state bodies being the form of investment with the least or no risk ([26]).

(69) To derive the risk premium, the BdB first worked out the 'market risk premium', i.e. the difference between the long-term average return on shares and that on government bonds. In its comments of 29 July 2003, it assumed in the first place a long-term market risk premium of a uniform 4,6 %, with reference to a 1991 study by Stehle-Hartmond.

(70) The BdB then determined the beta value for the Landesbanks, i.e. the individual risk premium for the banks by which the general market risk premium was to be adjusted. The BdB stated in its comments that it had determined the beta values statistically, which means that it estimated them on the basis of a historical data sample. The BdB came to the initial conclusion that all the beta values for all the Landesbanks and periods considered were greater than one ([27]).

(71) Assuming a risk-free basic interest rate of 8,37 % (for the first instalment) and 6,57 % (for the second instalment) and a beta factor for BayernLB of 1,0803 (when the first instalment was made) and 1,0739 (when the second instalment was made), the BdB calculated the expected minimum remuneration for a hypothetical investment in the capital of BayernLB at the time when the building-loan claims were transferred to be 13,34 % per annum on 31 December 1994 and 12,87 % per annum on 31 December 1995.

3. *PREMIUMS AND DISCOUNTS ON ACCOUNT OF THE PARTICULARITIES OF THE TRANSACTIONS*

(72) The BdB also noted that the Commission's deduction, in its WestLB decision, from the minimum remuneration to allow for the lack of liquidity of the Wfa's assets was upheld by the Court of First Instance. It therefore saw no reason to depart from this method in the present case, with the result that a deduction for liquidity should also be made here. The amount of the discount for lack of liquidity would be calculated, using the WestLB method, on the basis of net refinancing costs (gross refinancing costs minus the applicable corporation tax).

(73) In the BdB's view, the premium added by the Commission in the WestLB case (1,5 %) and upheld as such by the Court of First Instance should also be applied in the BayernLB case. The three factors cited in the WestLB decision as increasing risk as compared with a 'normal share capital investment' also came into play here: the in part exceptionally high volume of assets transferred, the failure to issue new company shares and the associated absence of additional voting rights, and the lack of marketability of the investment, i.e. the impossibility of withdrawing the invested capital from the company again at any time

4. *CAPITAL BASIS AND ELEMENTS OF REMUNERATION*

(74) Lastly, the BdB argued that, in calculating the appropriate remuneration in BayernLB's case, the entire amount recognised as core capital should be taken into account, and not just the part which was actually used. It backed up this argument by stating that a market-economy investor would never agree to limit his remuneration to the portion of funds actually used. For a private investor bearing the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. What matters to the investor is that he himself can no longer invest that amount and obtain a corresponding return.

(75) Nor does the BdB regard the guarantee fee mentioned by Germany as forming an element of remuneration. This was in particular because the transfer was made at its cash value (DEM 1 197 million) and not at its nominal value (DEM 5 027 million). The fact that the cash value was used meant that account was already taken of the (default) risks connected with uncollectible loan claims and that there was no justification for any additional remuneration for the default guarantee.

(76) Applying the WestLB method, a guarantee commission of 0,3 % per annum should also be paid for the period between the transfer of the capital and its recognition as core capital, since the injected capital had at least a guarantee function up to that point. This applied up to 8 May 1996 for the full amount of DEM 1 197 million and between 8 May and 23 December 1996 for the amount of DEM 542 million.

([26]) To offset the effects of inflation, the rate of return on a long-term government bond should be determined for each transfer period, initially disregarding the inflation expectations. Then, to estimate the long-term risk-free base rate, the estimated figure for average long-term inflation expectations (3,60 %) is added to the 'real base rate' at the time in question.

([27]) For the purposes of comparison, the BdB also gives the theoretical beta values calculated using the Capital Asset Pricing Model (CAPM), which, as it indicates, differ very little from the empirically determined values.

VI. GERMANY'S RESPONSE TO THE BDB'S COMMENTS

(77) In its reply to the above-mentioned comments from the BdB, Germany pointed out that an investment in the share capital of a public limited company does not guarantee either dividends or an increase in equity price or value and that an investor naturally bears the risk of his return expectations not actually being fulfilled. Setting a fixed remuneration, as in the case of BayernLB, removed forecasting risks and the return was therefore generally lower. This shows that it would not have been normal market practice if BayernLB had, at the time of the injection of the special-purpose assets, guaranteed the *Land* of Bavaria a return that was merely expected, thereby placing the investor in special assets on a better footing than an investor in shares. The BdB's method was also problematic in that an investor in shares could realise the increase in value only by selling his shares, without burdening the company. A private investor could never have persuaded a company in which he was investing to pay from its assets the equivalent of increases in value which an investor in share capital could have realised only by selling to a third party.

(78) The CAPM method was said to be unsuitable for determining the market return. In particular, the risk assumed in the CAPM to account for market fluctuations did not exist, as the Landesbanks were not quoted on the stock exchange. There were therefore no historical data series for beta factors.

(79) Germany also felt that the BdB committed errors in determining the individual components of the CAPM. It was incorrect to take account of long-term inflation expectations in setting the risk-free base rate. What mattered was only which rates could actually be obtained on the market. At the time of the transfers of the special-purpose assets to BayernLB, these were only 7,50 % and 6,10 % per annum respectively. Current inflation expectations were already factored in.

(80) The market risk premium of 4,6 % applied by the BdB was inappropriately high. Among other things Germany pointed out that the 1991 study of trends in returns on the German stock market, carried out by Stehle/Harmond and referred to by the BdB, said nothing about the market risk premium on the German capital market. Furthermore, there were different methods of determining the market risk premium, all producing different results. Using its own calculations, Germany demonstrated that in the last 30 years the market risk premium had never reached anything approaching 4,6 %.

(81) Also, in defining the beta value, Landesbanks should not be compared to 'commercial banks', which, moreover, had not been clearly defined by the BdB. At most, the calculation should be based on the clearly defined group of listed banks, the so-called CDAX banks. Taking a reference period of five years, a beta value of 0,85 at 31 December 1994 and 0,80 at 31 December 1995 was obtained for this group on a monthly basis, as could be seen from the attached calculations from the Datastream database, which correctly used only a five-year period for calculating beta factors. The period from 1974, which the BdB used to calculate the beta factor, was too long, as both the capital market environment and the banking sector changed significantly in the early 1990s.

(82) Germany therefore argued that all the factors required for the CAPM had been wrongly established and that the appropriate minimum market rates for the transactions in question had been overestimated.

VII. COMMENTS BY THE LAND OF NORTH RHINE-WESTPHALIA AND WESTLB

(83) On 30 October 2003 the Federal Government forwarded a response from the *Land* of North Rhine-Westphalia and WestLB to the Commission's decision of 13 November 2002 to initiate the investigation procedure in which they disputed the statement that the assets transferred to the Landesbanks could be compared to share capital. They argued that silent partnership contributions and 'perpetuals' had in fact been recognised as core capital in Germany since 1991. They added that remuneration for an investment depended not on how it was classified by the banking supervisory authorities, but on its risk profile. Since the assets were junior-ranking, the risk pattern had more in common with silent partnership contributions or 'perpetuals' than with share-capital investments.

(84) WestLB had no objections to the CAPM method for calculating the minimum remuneration for a share-capital investment, but it felt that the beta values determined by BdB — at well over 1 — were inappropriate. A beta factor of more than 1 meant that a company's shares represented a higher risk than the market as a whole. Yet the risk of investing in a Landesbank was well below the overall market risk because of the institutional liability (*Anstaltslast*) and guarantor liability (*Gewährträgerhaftung*) which it enjoyed and which were not challenged at the time.

(85) Moreover, they argued that, in the specific case of the Landesbanks, it was a mistake to use as a benchmark the return expected at the time that the assets were transferred to the banks. Although this was generally a sensible approach to adopt in relation to the private-investor test, it here meant using as a basis the returns expected in 1991. But for an investor to receive in 2003 the return expected

in 1991, which was much higher than the returns actually achieved, flew in the face of all economic realities. Permanently and systematically applying a rate of return of around 12 % placed the Landesbanks at an unjustifiable disadvantage compared with private competitors.

(86) As regards the discount for the lack of liquidity of the transferred assets, WestLB and the *Land* of North Rhine-Westphalia considered that the rate for risk-free government bonds should be deducted in full from the basic return. They argued that the Landesbanks had received no liquidity as a result of the asset transfers. It was not defensible in economic terms to reduce this rate by the tax savings since the pricing of capital market instruments was independent of the tax situation. Otherwise the price of a capital market instrument would have to differ according to tax considerations.

(87) Finally, the fact that the assets' lack of liquidity did not pose a risk to the liquidity position should be seen as reducing the risk — and hence the remuneration — and should be taken into account by applying a corresponding deduction. Likewise, a discount should be granted on account of the 'owner effect', since an investor who already owned shares in a company took a different view of an additional investment from that of a new investor.

VIII. UNDERSTANDING BETWEEN THE BDB, THE LAND OF BAVARIA AND BAYERNLB

(88) On 24 September 2004 the BdB, the *Land* of Bavaria and the BayernLB submitted to the Commission an understanding on the BayernLB case. Irrespective of their basic interpretations of the legal situation, which remained unchanged, the parties to the understanding agreed on what they themselves regarded as suitable parameters for determining an appropriate remuneration for a hypothetical share-capital investment in BayernLB. The parties asked the Commission to take account of this understanding in its decision.

(89) Applying the CAPM, the parties first determined the minimum expected remuneration for a hypothetical share-capital investment in BayernLB. On this basis, the appropriate minimum renumeration for the first instalment of the special-purpose assets should amount to 9,87 % per annum and for the second instalment to 8,0 %.

(90) To arrive at this figure, the parties used the long-term risk-free interest rates calculated on the basis of the REX10 Performance Index of Deutsche Börse AG and beta factors estimated on the basis of a study by […] of 26 May 2004 commissioned by the Landesbanks. In practical terms, this resulted for BayernLB in a risk-free basic interest rate of 7,5 % on 31 December 1994 and 6,1 % on 31 December 1995 (the dates when the transfers took place). On the basis of the study by […], the beta factor was calculated at 0,593 on 31 December 1994 and 0,475 on 31 December 1995. A market-risk premium of 4 % was determined for all the Landesbanks.

(91) The initial interest rate of 9,87 % (31 December 1994) was calculated as follows: risk-free interest rate of 7,5 % + (general market-risk premium of 4,0 % × beta factor of 0,593).

(92) The initial interest rate of 8,00 % (31 December 1995) was calculated as follows: risk-free interest rate of 6,1 % + (general market-risk premium of 4,0 % × beta factor of 0,475).

(93) A deduction was then made to take account of the lack of liquidity of the special-purpose assets. For this the risk-free interest rates of 7,5 % and 6,1 % were applied generally as gross refinancing costs. To determine the key net refinancing costs, the overall tax rate for BayernLB was fixed at 50 %, leading to deductions for lack of liquidity of 3,75 % (31 December 1994) and 3,05 % (31 December 1995).

(94) Lastly, a premium of 0,3 % was added because no new voting rights were granted.

(95) Altogether this produced an appropriate remuneration for the special-purpose assets of 6,42 % (first instalment) and 5,25 % (second instalment) after tax, which is payable on the full amount recognised by BAKred as core capital, from the end of the month in which recognition was granted (i.e. from 31 May 1996 onwards for the amount of DEM 655 million and from 31 December 1996 onwards for the total amount of DEM 1 197 million). For 1998 and 1999, when fluctuations actually pushed the cash value below the amount recognised by BAKred, only the lower cash value is used as a basis for the calculation.

(96) According to the understanding, the aid element, which BayernLB must pay back, resides in the difference between the 0,6 % per annum remuneration actually paid by BayernLB on the part of the special-purpose assets used to cover risk-bearing assets and the remuneration determined as appropriate — 6,42 % for the first instalment and 5,25 % for the second instalment.

(97) The parties were unable to agree on whether the 0,05 % commission paid by BayernLB for a guarantee by the *Land* of Bavaria on the nominal value of the special-purpose assets constituted an additional element of remuneration that had to be deducted.

(98) The understanding itself made no mention of any guarantee commission payable for the period between the transfer of the capital into the Bank and its recognition by BAKred as

core capital. However, in a table calculating the aid element and attached to the understanding, the parties took as a basis a guarantee commission for that period of 0,15 % per annum after tax for both instalments.

IX. ASSESSMENT OF THE MEASURES

1. *STATE AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE EC TREATY*

(99) Article 87(1) of the EC Treaty states that, save as otherwise provided in the Treaty, any aid granted by a Member State or through State resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, insofar as trade between Member States is affected.

1.1. STATE RESOURCES

(100) With the transfer of assets described above, the *Land* of Bavaria opted for a form of capital increase based on the concept of transferring public building-loan claims to BayernLB in order to strengthen its equity-capital base ([28]) . In spite of the fact that the returns from these claims were still available for housing construction and hence served a public-benefit purpose, the assets were recognised by the supervisory authority and could therefore be used to provide cover for the liabilities of BayernLB, which was in competition with other credit institutions. Also, under a law adopted by the Bavarian Parliament, the *Land* of Bavaria was empowered to conclude an agreement transferring to BayernLB the public loans used to promote housing construction. Thus state resources were transferred to BayernLB.

1.2. FAVOURING OF A PARTICULAR UNDERTAKING

(101) In order to verify whether the transfer of state resources to a publicly-owned undertaking 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'. The European Court of Justice and Court of First Instance have accepted and developed this principle in a number of cases, most recently in the judgment of the Court of First Instance of 6 March 2003 in the WestLB case ([29]).

a) ***Market-economy investor principle***

(102) According to this principle, no state aid is involved where 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' ([30]) . In contrast, the undertaking is being favoured within the meaning of Article 87(1) of the EC Treaty if the agreed remuneration and/or the financial position of the undertaking are such that a normal return on investment cannot be expected within a reasonable period of time ([31]).

(103) The market-economy investor principle applies to all public undertakings, regardless of whether they are profitable or not. This view of the Commission has been confirmed by the Court of First Instance in *WestLB* ([32]).

(104) It is also clear that the Commission must base its assessment of a case on the information that was available to the investor when he decided on the financial measure in question. The transfer of the special-purpose assets was decided in 1994 and 1995 by the relevant public bodies. The Commission must therefore assess the transaction on the basis of the information available and the economic and market circumstances obtaining at the time. The figures provided in this decision that refer to subsequent years are used only to illustrate the effects of the transfer on BayernLB's situation and not to justify or question the transaction after the event.

(105) As explained above, application of the 'market-economy investor principle' entails an assessment of whether the expected and/or agreed remuneration for the transferred resources is lower than the remuneration paid on the market for comparable investments. The fact that the *Land* of Bavaria already owned half of the credit institution's shares does not stand in the way of such an assessment. In this regard Germany argues that the *Land*'s investment here is not comparable to that of any third party which is interested only in achieving the best possible return on its capital. According to Germany, the main concern of the *Land*, as owner of half of the shares, was to maintain the long-term competitiveness of its affiliated state bank and, by injecting new funds, to ensure that 'its' bank could carry on serving its existing customers in future. Lastly, the investment was also said to be guided by considerations relating to brand image. Given the bank's position at that time, Germany argues, even a private shareholder such as a private holding company or group of companies would

([28]) Bavarian *Land* Parliament, 12th session, document 12/15851 of 7 June 1994.

([29]) See footnote 4.

([30]) 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; see paragraph 11. Although this communication deals expressly with manufacturing, the principle doubtless applies likewise to all other sectors of the economy. As regards financial services, this approach was confirmed by a number of Commission decisions, e.g. in *Crédit Lyonnais* (OJ L 221, 8.8.1998, p. 28) and *GAN* (OJ L 78, 16.3.1998, p. 1).

([31]) Public authorities' holdings in company capital — Commission position (Bull.-EC 9-1984, pp.93-95).

([32]) See footnote 4 and paragraphs 206 *et seq* of the judgment.

have injected capital, and achieving an optimum return would not have been the only major consideration.

(106) However, the Commission cannot accept Germany's arguments. Even if a market-economy investor already holds shares in an undertaking, he will investigate other investment options outside that undertaking. As a rule he will then choose to invest further resources in the public undertaking only if he can expect a reasonable return on the investment of the fresh capital contributions. So, in determining whether a capital injection constitutes state aid, one must in principle disregard the shareholder's prospects of long-term profitability or even the simple concern to maintain a brand image. Whatever the motives behind it, a capital injection by a shareholder should be measured instead according to whether the investor can expect a normal return on the additional resources within a reasonable period.

(107) The European Court has raised no objections to this interpretation of the market-economy investor principle, which the Commission has already applied in its decision on WestLB (paragraphs 161 *et seq*.). The Court also adopted as a guiding principle that even a private investor who already owns share capital in an undertaking is not normally content with the fact that an investment does not cause him a loss or yields only limited profits. On the contrary, he will always seek to achieve a reasonable return on his investment according to the particular circumstances and the satisfaction of his short-, medium- or long-term interests ([33]).

(108) According to the market-economy investor principle, the key question in examining this case is, therefore, whether a market-economy investor would have transferred under the same conditions capital that had the same characteristics as the promotion-related assets of the *Land* of Bavaria, especially in view of the expected return of the investment.

b) ***Article 295 of the Treaty***

(109) Article 295 lays down that the system of property ownership in the various Member States must not be affected. This does not, however, justify any infringement of the competition rules of the Treaty.

(110) In connection with the Landesbank cases, Germany has stated that the resources transferred could not have been used in any other profitable manner than by being injected into a similar public institution. Consequently, the transfer represented the commercially most sensible use of those assets. So any remuneration for the transfer, i.e. any additional return on the assets transferred, would be sufficient to justify the transfer in the light of the market-economy investor principle.

(111) This line of argument cannot be accepted. It may be that the transfer of the promotion-related assets to BayernLB and the resulting opportunity for the bank to use the capital for solvency purposes was the economically most sensible use to which it could be put. However, as soon as public monies and other assets are used for commercial, competition-oriented activities, the normal market rules must be applied. This means that the State, once it decides to use certain assets (also) commercially for public purposes, must demand a remuneration in line with the normal market remuneration.

c) ***No change in ownership structure***

(112) One way of ensuring an adequate return on the capital provided would have been to increase the *Land*'s participation in BayernLB accordingly, provided that the bank's overall profitability corresponded to the normal rate of return that a market-economy investor would expect from his investment. However, this course was not adopted by the *Land*.

(113) Germany argues here that, given the circumstances, not even a private investor could have pushed through a change in ownership structure. As owner of the other half of the shares, the Sparkassenverband would not have agreed to a change in ownership structure, since, at the time when the special-purpose reserve was transferred, BayernLB needed no extra core capital whatsoever in order to maintain its credit volume and, under Section 2 of the transfer agreement, the Sparkassenverband would have borne half of the cost of any depletion of the special-purpose reserve. Moreover, when the first instalment was transferred, the Bavarian savings banks had already contributed a total of around DEM 900 million — by the time of the second instalment it was already EUR 1 100 million — in the form of silent partnerships, without this being matched by a comparable contribution by the *Land* of Bavaria.

(114) However, if a redistribution of shares were not feasible, a market-economy investor would, in the Commission's view, have embarked on the investment only if agreement had at least been reached on an appropriate direct remuneration. Normally a private investor is not content to avoid losses or to obtain a limited return on his investment, but attempts to maximise the return on his assets according to the circumstances in question and his interests ([34]). So a private investor who already holds shares in the beneficiary undertaking will usually insist on either a change in ownership structure or an appropriate fixed remuneration. Otherwise he would forgo part of the additional returns achieved as a result of the capital injection, as the other shareholders would also profit from higher dividends and an increase in the undertaking's value without having made a corresponding contribution.

([33]) See footnote 4 and paragraphs 241, 314 of the judgment.

([34]) See footnote 4 and paragraphs 320 and 335 of the judgment.

(115) Nor is there is any call here to adopt another view based on the fact that, at the time of the second transfer in 1995, the Bavarian savings banks had already contributed a total of around DEM 1 100 million to BayernLB in the form of silent partnerships. The question can remain open as to whether a private investor would forgo a shift in share structure only if the other shareholders carried out a similar, corresponding capital injection, at the same time as and directly linked to his own capital injection, and if their transfers were just as likely to increase the returns. In the Commission's view, there is no vital direct link here between the silent partnership contributions and the transfer of the housing-promotion assets. When the special-purpose reserve was transferred, the silent partnership contributions, only some of which were for an unlimited period, had already been transferred to BayernLB in a series of small instalments between 1991 and 1995. They were therefore unconnected with the transfer of the housing-promotion assets both in timing and in material terms. And, as far as can be ascertained, no such link can be established later either, at the time the assets were transferred. For example, there was no agreement to the effect that the savings banks must always maintain the total volume of their investment at a constant level ([35]) . Nor is it otherwise apparent that the *Land* took the savings banks' contribution into account in determining the remuneration for its capital injection.

(116) Furthermore, the contributions are not objectively comparable. According to Germany, the sole compensation for the silent partnership contributions was a fixed remuneration at the market rate, whereas the capital contribution of the *Land* of Bavaria was remunerated partly by a fixed remuneration and — Germany argues — partly by the expected value increases. There was therefore no symmetry between the two capital contributions in respect of the components of the remuneration, which consisted of a direct remuneration on the one hand and a value increase on the other. The capital contribution by the *Land* of Bavaria therefore differed fundamentally from the silent partnerships of the savings banks.

(117) Germany also refers here to the decision by the Court of First Instance in *Alitalia* ([36]). However, that decision concerned investments by a private investor, whereas the Sparkassenverband and the savings banks are not private, but public-law bodies. Moreover, as shown above, the capital contributions were not comparable to the transfer of the housing-promotion assets either in timing or in content.

(118) In conclusion, there is nothing to indicate that a private investor would have forgone an appropriate direct remuneration in a situation comparable to the transfer of promotion loans to BayernLB.

([35]) Nor can this be inferred from the law or the by-laws, which merely state that the 'share capital' is to be supplied by the two shareholders or — in the case of the Sparkassenverband — by the savings banks themselves.

([36]) Judgment given on 12 December 2000 in Case T-296/97 [2000] ECR II 3871.

Owner effect

(119) Germany also submits that, as owner of half of the shares, the *Land* could assume — at least at the time when the housing-promotion assets were transferred to BayernLB — that it would have the benefit of very advantageous capital returns in comparison with other credit institutions, as is clearly borne out by the capital returns achieved at that time. So, in making its investment, the *Land* of Bavaria was not content with a limited return or no return at all, but had in mind an undertaking with above-average profitability. Germany maintains that the 'owner effect', i.e. the fact that the investor already holds shares in the undertaking in which he is investing, must be taken into account at least where an undertaking has above-average profitability, the Court of First Instance having acknowledged as much in its judgment in WestLB.

(120) The Commission cannot accept Germany's argument. At the time of the investment, the *Land* of Bavaria owned only half of the shares. It would therefore benefit from only half of the increase in the undertaking's value and dividends which might be expected as a result of the investment, although it alone had made that investment. No market-economy investor would agree, as joint owner, to bear the entire cost of an investment if it were then to realise only part of the gains from it. Contrary to Germany's claims, the Court has specifically confirmed this view in its judgment in *WestLB* ([37]). The Court found that it is not consistent with the conduct of a market-economy investor if an increase in capital generates profits for the other shareholders of an undertaking without their contributing in any way to them.

(121) Even in the case of an undertaking with above-average profitability, as BayernLB is described by Germany, the key point is not by how much its profitability lies above the average and whether the investor may nevertheless continue to achieve a satisfactory return in overall terms at the time of the investment. Even where the undertaking is far more profitable than average, the private investor would take care to realise all the additional gains made possible by his investment. Where the investment is made by only one joint owner and there is no proportional increase in shares at the expense of the other (inactive) joint owners or the other joint owners fail to make a corresponding and proportional parallel contribution, this can be achieved only by opting for an advance remuneration at the expense of all joint owners, paid direct to the

([37]) See footnote 4 and paragraph 316.

investor, independently of his owner status and for his sole benefit, before the regular dividends.

d) ***Capital basis for the remuneration and elements of the remuneration***

i) **Capital basis**

(122) As in the WestLB case, the Commission has determined the appropriate remuneration for the transferred housing–promotion assets in the light of their commercial usefulness for BayernLB, while drawing a distinction in the present case between the 'business-expansion function' and the (mere) 'guarantee function' of the assets made available as equity capital for the bank's business activities.

(123) The 'business-expansion function' of capital refers to the expansion of business potential by means of risk-bearing assets following the recognition for supervisory purposes of a bank's additional equity capital. In this regard the starting point for determining the normal market remuneration is the remuneration that would be demanded by a private investor providing a bank with equity capital. Where the capital provided is shown in the balance sheet as equity but is not recognised as such for supervisory purposes or is intended to underpin promotion activities, it is not available for expanding business. However, equity is also important for reasons other than banking supervision. Its availability to the bank's creditors at least for the purposes of covering liabilities ('guarantee function') means that its economic function can still be compared to that of a surety or guarantee. The amount of equity shown in the balance sheet is 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. The normal market remuneration of the 'guarantee function' of capital is calculated according to the return which a private guarantor would have demanded from a credit institution comparable to BayernLB in size and risk strategy.

(124) The *Land* of Bavaria transferred to BayernLB interest-free and low-interest loans with a residual value of around DEM 3 798 million on 31 December 1994 and loans with a residual value of around DEM 1 219 million on 31 December 1995. An expert evaluation put the cash value of these housing-promotion assets at DEM 655,7 million for the first instalment and DEM 542,1 million for the second instalment. This constituted a special-purpose reserve totalling DEM 1 197 million, which was shown in BayernLB's balance sheet as own funds.

(125) BAKred had recognised as original own funds for supervisory purposes the cash value of the two instalments — DEM 1 197 million in total — as determined at the time of each transfer and shown as own funds in the balance sheet ([38]). Germany submits that all of BayernLB's housing-promotion assets concentrated in the special-purpose reserve were also available to underpin its competitive business ([39]). Unlike in the WestLB case, there were no plans to use part of the special-purpose reserve for the additional purpose of underpinning the bank's promotion business. So the question does not arise here as to whether part of the special-purpose reserve shown in the balance sheet as own funds might only have served a guarantee function for BayernLB. The value of the special-purpose reserve recognised for supervisory purposes therefore forms the basis for determining the appropriate remuneration for the business-expansion function of the capital provided.

(126) The Commission acknowledges here that, in 1998 and 1999, the cash value of the special-purpose reserve fell below the amount recognised by BAKred (DEM 1 197 million) and hence during those years the full amount of the special-purpose reserve recognised by BAKred was not available for underpinning competitive business. Although the *Land*'s default guarantee for loans from the special-purpose assets secured at least the return flow from the loan claims concentrated in the special-purpose reserve, the cash value could still fall below the reference amount, for example when the returned funds were granted afresh to promote housing construction, whereby the *Land* held sole decision-making power pursuant to the transfer agreement. No agreement was concluded whereby the *Land* guaranteed that the transferred assets would not fall below a certain cash value. Consequently, for 1998 and 1999, when fluctuations pushed the cash value below the amount recognised by BAKred, only the lower cash value should be used as a basis for calculation. The parties to the understanding submitted on 24 September 2004 also agreed on this point ([40]).

(127) The Commission would point out once again that the extent to which the capital provided was actually used cannot be a factor in determining the appropriate remuneration. All that matters is the *possibility* of using the capital to expand business. Even a private investor

([38]) Contrast this with the WestLB case, in which only part of the established cash value of the housing-promotion assets shown in the balance sheet as own funds was recognised as equity capital for supervisory purposes.

([39]) Moreover, where the cash value of the special-purpose reserve exceeded the value recognised for supervisory purposes, the difference was entered as a provision under liabilities so that none of BayernLB's equity capital was entered on the liabilities side either in terms of commercial law or for supervisory purposes.

([40]) In the course of the procedure, Germany even felt that a further flat-rate reduction of 25 % should be made to the cash value recognised by BAKred. In addition to the reasons already mentioned that could lead to fluctuations in the cash value, it argued that the *Land* could have switched its promotion policy from lending to outright grants for example, thereby reducing the cash value further. In that case the bank could not have taken up the full amount for its competitive business, for safety's sake. After examining this argument, the Commission concluded that a drastic reduction in the cash value was unlikely, given the close cooperation between the *Land* and the bank. Against this background it seems justified to take account only of the actual shortfalls below the recognised cash value.

would not be happy with a remuneration dependent on the capital being used. In this regard the Commission agrees with the BdB's observation that, for the market-economy investor who runs the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. As the BdB rightly points out, all that matters to the market-economy investor is that he himself can no longer use the amount transferred to engage in economic activity and hence achieve corresponding returns. So the fact that BayernLB used the injected capital only once in 1996 and even then only to a limited extent to cover risk-bearing assets is also irrelevant to the question of the capital basis being examined here. The parties themselves acknowledge this point in the understanding submitted to the Commission on 24 September 2004.

(128) Moreover, for the purposes of determining the remuneration for the business-expansion function of the capital, the most important point in time is when the special-purpose reserve was recognised by BAKred as core capital. According to Germany, BayernLB and the complainant, it was only from that time on that the capital could be used to cover risk-bearing assets.

(129) However, insofar as the capital had already been shown in the balance sheet as own funds, it also had at least a guarantee function, as explained above in more detail. This must also be taken into account in determining the appropriate remuneration ([41]).

ii) **Remuneration actually paid (elements of remuneration)**

(130) In addition to the 0,6 % per annum remuneration paid for capital actually used to cover risk-bearing assets, the Commission also acknowledges — contrary to the provisional view it expressed in its decision to initiate proceedings — the 0,05 % per annum guarantee fee which BayernLB had to pay for assuming the *Land*'s default guarantee.

(131) With reference to expert reports by the auditors […] dated 5 October 1994 and 30 April 1996, which have been supplied to the Commission, Germany was able to prove that, without the default guarantee, the cash value of the transferred loan claims would have had to have been set at a lower level, as the fixed capitalisation interest rate of 7,5 % would have been supplemented by a risk premium. This was also confirmed in a statement by BAFin dated 2 September 2004 which Germany submitted to the Commission. In the Commission's view, it has therefore been proven that the guarantee fee is also directly linked to the business-expansion function of the liable equity capital, for which remuneration was due, and must therefore be recognised as a element of remuneration.

([41]) In relation to the guarantee function, what matters is not the date when the balance sheet was established (31 December of the relevant business year), but the date when the actual transfer was made. It can be assumed that a bank would have informed its creditors of a capital injection, at least in the case of a large transaction. The Commission therefore considers that the guarantee function comes into play as soon as the balance sheet takes effect.

(132) Since the Commission's decision to initiate proceedings, Germany has conceded that the other elements mentioned in that decision, i.e. (1) interest payments by borrowers, also accruing to the *Land*, (2) interest on intermediate investments abroad and (3) proportional contributions to administrative costs, should not be regarded as elements of remuneration. The Commission therefore sees no reason to depart from the views expressed in its decision to initiate proceedings:

(133) *Interest payments by borrowers*: The arrangement laid down in Section 2(1) of the transfer agreement, whereby future and current interest on claims forming part of the transferred special-purpose reserve accrue to the *Land*, results from the fact that the special-purpose reserve is to be kept separate from the bank's other assets (see Section 2(3) of the transfer agreement). Future and current interest on claims forming part of the special-purpose reserve cannot therefore be regarded as remuneration for the reserve's business-expansion function as equity capital. This Section 2(1) arrangement is more a consequence of the requirement of Article 1(2) of the Special-purpose Assets Act that the transferred housing-promotion assets be used for social purposes. Under Article 1(2) of that Act, steps must be taken to ensure that the transferred assets are used to the same extent as hitherto for the purposes of social-housing construction. Consequently, future and current interest on claims forming part of the special-purpose reserve must be used solely for social-housing construction. The fact that this interest accrues to the *Land* is thus merely an expression of the mandatory social purpose of the assets and cannot subsequently be reinterpreted as remuneration payable by BayernLB.

(134) *Interest on intermediate investments*: The interest payments on intermediate investments laid down in the fourth and fifth sentences of Section 2(1) of the transfer agreement cannot be regarded as remuneration for the business-expansion function of liable equity capital either. This is because any returns which accrue to the special-purpose reserve on the basis of their continuing social purpose are ploughed back as low-interest loans specifically for social-housing construction in accordance with the *Land* guidelines and requirements ([42]) . As Germany itself states, BayernLB is in any case entitled only to the capital element of the loan rights (the securing function of equity capital), while the utilisation and earnings function of the equity capital will, by dint of its mandatory social purpose, remain entirely with the *Land* ([43]) . Since these proceedings are concerned with determining whether an appropriate remuneration has been paid for the securing function of the equity capital, any remuneration to be paid for actually using the funds cannot be counted as part of the remuneration for the securing function.

([42]) Letter from the Federal Government of 3 July 2001, p. 9.

([43]) Letter from the Federal Government of 3 July 2001, p. 10.

(135) *Proportional contributions to administrative costs*: The contributions to the administrative costs of the transfer payable to the *Land* are also nothing more than a further expression of the principle laid down in Section 2(3) of the transfer agreement of the separation between the contributed funds and the bank's other assets. The fact that a portion of the contributions from borrowers continues to accrue to the *Land* is thus an expression of the continued mandatory special purpose of the contributed funds and their associated separation from the bank's other assets. This cannot be reinterpreted subsequently as remuneration payable by BayernLB.

e) ***Comparison with other equity instruments***

(136) As explained above, the starting point for determining the normal market remuneration in this case is the remuneration that would be demanded by a market-economy investor providing a bank with equity capital.

(137) It is beyond dispute here that the housing-promotion assets transferred to BayernLB cannot be compared directly to other transactions. 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. Consequently, as in the WestLB case, the appropriate remuneration can be determined only by comparing the asset transfer with various equity instruments normally found on the markets, in order to determine by analogy which instrument is most similar to it und is therefore the benchmark for determining the remuneration.

(138) Germany, BayernLB and the complainant all agree that the housing-promotion assets concentrated in the special-purpose reserve can be compared only to either share capital or silent partnership contributions. The special-purpose reserve was recognised by BAKred as core capital ('tier I capital') and can therefore be compared only with equity instruments that were recognised as core capital in Germany in the year of the transfer. Germany states that, in 1994 and 1995, this meant only the share capital of banks or reserves and silent partnership contributions that met the special requirements laid down in Article 10(4) of the German Banking Act (KWG).

(139) The Commission agrees with the parties on this point. It already made clear in its WestLB decision of 1999 that a comparison between the Wfa's assets, which were also recognised as core capital, and hybrid equity instruments that were recognised only as additional capital, such as profit participation certificates and non-voting preference shares, cannot serve as a basis for determining the appropriate remuneration for the transferred capital (Decision 2000/392/EC, paragraph 199). Core capital is of much greater use to an undertaking 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. For the capital provided to be recognised as original own funds, there must be greater exposure to risk, which as a general rule is also reflected in a higher market remuneration for such instruments. Any point of comparison with 'additional funds' that offer only limited scope for use in business expansion can therefore be ruled out from the outset.

(140) The Commission also considers that the comparison made by Germany and BayernLB with silent partnerships within the meaning of Article 10(4) of the Banking Act, i.e. the silent partnerships of the Bavarian savings banks and other institutional investors which the bank has obtained since the beginning of 1991, is not a suitable basis for determining the appropriate remuneration for the special-purpose reserve. Instead the transfer of the special-purpose assets is comparable to a share-capital injection into BayernLB.

(141) The Commission feels it is significant here that the housing-promotion assets were transferred not in the form of a silent partnership contribution but by establishing an ordinary reserve, even though, at the time both tranches were transferred, BayernLB had already obtained significant volumes of silent partnerships and was familiar with that method of building up equity capital. As evidenced by the decisions supplied to the Commission, BAKred too considered the special-purpose reserve not as a silent partnership within the meaning of Article 10(4) of the Banking Act, but as a reserve ('Rücklage') within the meaning of point 5 of the first sentence of Article 10(2) and the second sentence of Article 10(3) of that Act. These two factors already suggest that the capital provided was similar to share capital rather than to a silent partnership.

(142) Although it is also true that the special-purpose assets of BayernLB have certain features that are somewhat typical of silent partnerships ([44]) , the Commission considers that the risk that the transferred capital would be used, at least in part, as cover in the event of insolvency or liquidation was generally no less than would be the case for a share-capital investment.

(143) The Commission cannot accept Germany's argument that the risk of loss was lower than that for a share-capital investment because BayernLB already had substantial own funds at its disposal before the special-purpose reserve was transferred and was therefore not at all dependent on that capital. Admittedly, the special-purpose reserve was actually used only once to cover risk-bearing assets and then only for a short time. However, the situation must be viewed as it appeared at the time and it was impossible to tell beforehand that the bank would not use the capital. On the contrary, the need to boost Bayerische Landesbank's national and international competitiveness by building up its equity capital in order to ensure that it could carry on its

([44]) For example the agreement on an 'additional payment claim' if the guarantee commission were not paid in a particular business year, as this would lead to a net loss (see Section 3 of the transfer agreement).

successful business activities was cited as a reason for the capital injection in the grounds of the draft Special-purpose Assets Act, which was eventually adopted by the Bavarian Parliament. It was also stated in preliminary drafts and in internal memos of the Bavarian Ministry that the declared aim of the transfer was to pave the way for an expansion of business. Moreover, Germany itself has admitted that, when the first and second instalments were transferred in 1994 and 1995, the definite intention was to use the special-purpose reserve to cover risk-bearing assets ([45]) . A market-economy investor providing capital under these circumstances would accordingly have insisted on a full remuneration since he, in the first place, bore the full risk of loss and, second, the bank was free to use the entire capital, like any other capital, in its competitive business, according to its own economic calculations and discretion.

(144) According to Germany and BayernLB, there was an understanding that BayernLB would cover the capital requirements for expanding its commercial activities largely by accepting silent partnership contributions from institutional investors. It must be said that this intention was not specifically expressed either in the relevant clauses of the transfer agreement or in the Act relating to the transfer. Consequently, a private investor would not have been confident that his capital would not be used. The fact that there was also an understanding that BayernLB would draw on the special-purpose reserve to cover risk-bearing assets only after using the other equity capital available does not stand in the way of the present risk analysis either, if it is assumed that the intention to use the funds to cover risk-bearing assets did exist. In the Commission's view, neither of these two factors prove that the risk of loss in insolvency or liquidation was qualitatively lower than for share capital.

(145) Germany points out that, pursuant to Section 2 of the agreement between the *Land* of Bavaria and the Bavarian Sparkassenverband of 15 December 1994, the Sparkassenverband was required, as second shareholder, to bear half of any loss suffered by BayernLB in the event of the special-purpose reserve being depleted or used by BayernLB's creditors to cover losses. However, this did not eliminate the risk that at least part of the special-purpose reserve might be lost in the event of insolvency or liquidation, as it meant that the reserve was to be replenished only proportionally. Moreover, the arrangement between the shareholders did not reduce the use which BayernLB could make of the capital, so that this circumstance cannot diminish the overall remuneration payable by BayernLB. It was inconceivable that BayernLB would have paid no more at all if the Bavarian Sparkassenverband had, for example, committed itself vis-à-vis the *Land* of Bavaria to bear the entire loss. At most the arrangement could have led to the *Land* compensating the Sparkassenverband internally for assuming this additional risk. However, no such agreement was concluded and the matter is irrelevant for the purposes of this proceeding.

([45]) Letter from Germany of 3 July 2001, p. 11.

(146) Nor is the Commission convinced by the argument that in this case the special-purpose reserve made up around 8 % of total capital at the time of the transfer and that the risk of loss was therefore considerably smaller than in the WestLB case, where Wfa's assets accounted for nearly 50 % of the bank's equity capital. In the WestLB case the large volume of capital injected was an indication of its similarity with share capital but not the only decisive factor in adopting that comparison. After taking a comprehensive view of the case, the Commission also came to the conclusion in its WestLB decision that the similarity of the transaction in question to a share-capital investment outweighed other considerations

(147) Given the above views, notably regarding an analysis of the risk incurred by an investor in carrying out the transaction at issue, the Commission concludes that the starting point for calculating the appropriate remuneration for the transfer of the housing-promotion assets is the remuneration for the share capital made available to BayernLB. In the understanding submitted to the Commission on 24 September 2004, the parties also adopted the share-capital approach as a basis for the proposed remuneration.

f) ***Liquidity costs***

(148) The arguments of Germany and BayernLB 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), 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 ([46]) . Since the housing-promotion assets do not provide BayernLB with initial liquidity because they and all the income from them remain earmarked by law for housing promotion, BayernLB faced additional funding costs equal to the amount of the capital if it was 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) ([47]) . 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.

([46]) 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.

([47]) 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).

(149) However, the Commission does not believe that the entire refinancing interest rate has 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 BayernLB because of the special nature of the capital transferred. The Commission therefore accepts that BayernLB incurs additional 'liquidity costs' to the extent of 'refinancing costs minus tax.' ([48])

(150) The Commission likewise cannot accept Germany's argument that a private investor would have been unable to deduct net refinancing costs alone because the capital transferred to BayernLB accounted for only 8 % of own resources, and not almost 50 % as in the WestLB case. This argument is not convincing. The only decisive factor is the fact that BayernLB could have offset the refinancing costs as operating expenses against tax and thus obtained an advantage which, from the point of view of the EU state aid rules, has to be taken into consideration irrespective of the volume of the capital made available.

g) *Appropriate remuneration for the amount of DEM 1 197 million*

(151) There are no doubt different ways of calculating the appropriate remuneration for the amount of DEM 1 197 million. However, as will be shown, all the methods for calculating the remuneration for capital made available follow the same basic principles. Taking these basic principles, the Commission here does the calculation in two steps: first, it determines the minimum remuneration that an investor would expect for a (hypothetical) investment in the capital of BayernLB. It then examines whether, in view of the particularities of the transaction at issue, the market would have agreed on a premium or a discount, and if so, whether it can produce a sufficiently robust quantification of that amount.

i) **Determination of a likely minimum remuneration for an investment in the capital of BayernLB**

(152) The expected return on an investment and the investment risk are key determinants in the decision of a market-economy investor to invest. In order to determine their level, the investor incorporates all available firm-related and market-related information into his calculation. He bases himself on historical average rates, which, generally speaking, are also a point of reference for a firm's future efficiency, and *inter alia* on an analysis of the company's business model for the investment period in question, the strategy and quality of management or the relative prospects for the sector in question..

(153) A market-economy investor will undertake an investment only if it produces a higher return or a lower risk than the next-best alternative use of his capital. Similarly, he will not invest in a company whose expected return is lower than the average return expected for other companies with a similar risk profile. It can be assumed in the present case that there are sufficient alternatives to the assumed investment project that promise a higher expected return with the same risk.

(154) Various methods exist for determining the minimum appropriate remuneration. They range from differing variants of the financing approach to the CAPM method. In describing the various approaches, it makes sense to distinguish between two components, viz. a risk-free return and a project-specific risk premium:

minimum appropriate return on a risky investment

=

risk-free base rate + risk premium for the risky investment.

Consequently, the minimum appropriate remuneration for a risky investment can be described as the sum of the risk-free rate of return and the additional risk premium for assuming the investment-specific risk.

(155) The basis for any determination of return is thus the existence of a default-risk-free form of investment with an assumed risk-free return. The expected return on fixed-interest government securities is normally used in determining the risk-free basic rate (or, as the case may be, an index based on such securities), but these represent forms of investment with a comparably low risk. The various methods differ, however, when it comes to determining the risk premium:

([48]) As confirmed by the European Court of First Instance in *WestLB*, paragraphs 321-331 (see footnote 4).

— *Financing approach*: an investor's expected return on capital represents, from the point of view of the bank using the capital, future financing costs. Under this approach, the historic capital costs incurred by comparable banks are first of all determined. The arithmetic average of the historic capital costs is then compared with the future expected equity capital costs and hence with the investor's expected return requirement.

— *Financing approach with Compound Annual Growth Rate*: at the heart of this approach stands the use of the geometric rather than the arithmetic mean value (Compound Annual Growth Rate).

— *Capital Asset Pricing Model (CAPM)*: the CAPM is the best-known and most frequently tested model of modern financial economics, by which the return expected by an investor can be determined using the following equation:

minimum return on capital

=

risk-free base rate + (market risk premium × beta)

The risk premium for the equity investment is obtained by multiplying the risk premium of the market by the beta factor (market risk premium × beta). The beta factor is used to quantify the risk of a company relative to the overall risk of all companies.

(156) The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since BayernLB is not a listed company, it is not possible directly to infer its beta value. The CAPM can be used only on the basis of an estimate of the beta factor.

(157) In its comments of 29 July 2003, the BdB, using the CAPM, concluded that the minimum remuneration to be expected for an investment in the share capital of BayernLB at the time when the building-loan claims were transferred was 13,34 % per annum at 31 December 1994 and 12,87 % per annum at 31 December 1995. Germany raised objections in principle to the use of the CAPM. It also argued that the BdB started from a high beta value and was incorrect in its calculation of the risk-free base rate, and that the market-risk premium of 4,6 % was too high. Had the BdB applied the CAPM correctly, it would have arrived at a much lower minimum remuneration for a hypothetical investment in the share capital of BayernLB. In their understanding on the normal market remuneration, the *Land* of Bavaria, BayernLB and the BdB concluded that the appropriate minimum remuneration was 9,87 % for the first instalment and 8,00 % for the second instalment.

(158) In their calculations, the parties based themselves on the CAPM and applied risk-free basic interest rates of 7,50 % (31 December 1994) and 6,10 % (31 December 1995). Determination of these interest rates was based on the assumption that BayernLB's special-purpose assets were to be made available on a permanent basis. The parties thus decided not to use a risk-free rate obtaining on the market at the time of the capital injection for a fixed investment period (e.g. 10-year return on government bonds), since such an approach would disregard the reinvestment risk, i. e. the risk that it would not be possible to invest again at the level of the risk-free interest rate once the investment period had expired. In the view of the parties, a total return index was the best way of taking the investment risk into account. They opted, therefore, for the REX10 Performance Index of Deutsche Börse AG, which tracks the performance of an investment in Federal loans over a period of exactly ten years. The index series used in the present case contains the relevant end-of-year results of the REX10 Performance Index since 1970. The parties thus calculated the return per annum that reflects the trend as tracked by the REX10 Performance Index in the period 1970-94/1970-95 and, in this way, arrived at the risk-free basic interest rates of 7,50 % and 6,10 % referred to above.

(159) Since BayernLB's capital injection was made available on a permanent basis, the method of determining the risk-free basic interest rates appears appropriate in this specific case. Moreover, the REX10 Performance Index is a generally recognised source of data. The risk-free basic interest rates calculated thus appear appropriate here.

(160) The beta factors of 0,593 (at 31 December 1994) and 0,475 (at 31 December 1995) were estimated on the basis of a report by […] on adjusted beta factors for all listed credit institutions in Germany. In the light of the report — which is available to the Commission — and of BayernLB's business profile, these beta factors are to be regarded as appropriate

(161) The Commission also regards the market-risk premium of 4,0 % as acceptable. Already in the WestLB case, the so-called general long-term market-risk premium, i.e. the difference between the long-term average return on a normal share portfolio and that on government bonds, was applied on several occasions. In the corresponding reports relating to the procedure, a range of some 3 % to 5 % was applied, depending on the method, the period under examination and the basic relevant data. A report prepared for BdB calculated figures of 3,16 % and 5 %. Another report on WestLB drawn up in the first procedure produced figures of 4,5 % and 5 %, while Lehman Brothers, also for WestLB, calculated a figure of 4 %. Against this background, the Commission has no reason to depart from the market-risk premium used in the understanding. On the basis of

the CAPM, the Commission considers there to be no doubt that the minimum remuneration determined by the parties can be regarded as appropriate

(162) The Commission has no reason to believe that the minimum remuneration determined by the parties for a hypothetical share-capital investment cannot pass a market test. Accordingly, it sets as the appropriate minimum remuneration (after corporation tax and before investor tax) a figure of 9,87 % per annum for the first instalment and 8,00 % per annum for the second instalment.

ii) **Return discount for lack of liquidity**

(163) Germany stated that BayernLB's actual refinancing costs came to 7,71 % in the second half of 1994, when the first instalment was transferred, and 6,78 % in the second half of 1995, when the second instalment was transferred. In the understanding the parties used a long-term risk-free base rate of 7,50 % at 31 December 1994 and 6,10 % at 31 December 1995 as minimum gross refinancing costs. They also agreed to assume a flat 50 % tax rate ([49]) . On this basis, they arrived at a net refinancing rate of 3,75 % for the first instalment and 3,05 % for the second instalment and hence a corresponding deduction for liquidity.

(164) In view of that understanding and the fact that the amounts in question still fall below the range previously cited by Germany, the Commission sees no reason to regard them as inappropriate and consequently uses these amounts as a basis for determining the aid element.

iii) **Return premium on account of the particularities of the transfer**

(165) In practice, when remuneration is determined, atypical circumstances which depart from a normal investment in the share capital of the company concerned generally give rise to discounts or premiums. It must therefore be examined whether the particularities, and especially the specific risk profile of the transfer of capital, constitute grounds for adjusting the above-determined minimum remuneration of 9,87 per annum (first instalment) and 8,00 % per annum (second instalment) which a private investor would expect for a (hypothetical) investment in the capital of BayernLB and whether the Commission can produce a methodically robust quantification of that adjustment. In this connection, three aspects should be considered: first, the failure to issue new shares in the company with associated voting rights; second, the exceptional volume of the asset transfer; and third, the non-marketability of the assets.

(166) The transfer did not provide the *Land* with any additional voting rights. Nor was this disadvantage offset by a comparable investment by the other shareholder. By forgoing voting rights, an investor renounces a say in decisions taken by the bank's board. To compensate for this acceptance of a higher risk of loss without a corresponding increase in influence over the company, a market-economy investor would demand a higher remuneration (even if the potential risk were cushioned by internal agreements with the other shareholders). On the basis of the higher remuneration for preference shares compared with ordinary shares, the Commission considers a premium of at least 0,3 % per annum (after corporation tax) to be appropriate. The parties to the understanding also regard a premium of 0,3 % as appropriate to take account of the failure to issue new voting rights.

(167) The Commission does not consider that a premium should be applied in this case on account of the volume of assets transferred and its effect on BayernLB from the point of view of the Solvency Directive. As a result of the transfer of special-purpose assets, BayernLB's core capital increased by only 8 %, whereas in some of the other Landesbank cases mentioned, the core capital doubled. Furthermore, in the light of the exceptional capital requirements of credit institutions in the EU laid down by the Solvency Directive, a capital injection of some DEM 1 197 million in one of the largest German all-purpose banks must not be regarded as completely alien to any normal business decision. The Commission deems it unlikely that a market-economy investor would have demanded a special premium for an injection of capital as large in relative and absolute terms as in this case. Consequently, it is not imposing a premium linked to the volume of the asset transfer, something which works in BayernLB's favour. The understanding between the parties also assumes that no premium should be applied on account of the high volume of assets transferred.

(168) Lastly, attention must be drawn to the non-marketability of the assets, i.e. the impossibility of withdrawing the invested capital at any time from the company. Normally, an investor can sell an equity instrument on the market to third parties, thereby terminating his investment. A normal transfer of capital takes place as follows: the investor brings in assets (either in cash or in kind), which are entered on the assets side of the balance sheet. As a rule, these are matched on the liabilities side by a tradable interest registered in the name of the investor, taking the form, in the case of a limited company for example, of shares. The investor can sell these shares to a third party. He cannot withdraw the assets he originally brought in, as these now

([49]) According to documents submitted by the German Government, the corporation tax rate was 42 % in 1995 and 1996. To this must be added the solidarity surcharge of 7,5 % (making 49,5 % in total). The overall tax rate came down to 47,5 % in 1998. Only as of 2001 did it fall to 30,5 %.

form part of the company's liable equity capital and are no longer at his disposal. But by selling the shares — at the prevailing exchange price — he can realise their economic counter value. His assets have thereby become marketable. Because of the special circumstances surrounding the transfer of special-purpose assets, this option was not available to the *Land*. However, the Commission does not see any reason for a further premium. Although the *Land* was unable to realise the economic counter value by trading freely in the investment, it was and is able at any time to withdraw the special-purpose assets from BayernLB by law and achieve possibly higher returns by reinvesting them in other institutions. Here too the understanding between the BdB, the *Land* and BayernLB assumes that no premium should be applied on account of the lack of marketability.

(169) Overall, the Commission therefore considers a premium of 0,3 % per annum (after corporation tax and before investor tax) to be appropriate for forgoing additional voting rights.

iv) **No reduction in remuneration on account of the agreement on a fixed amount**

(170) 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 (e.g. expressed by share price increases). 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 BayernLB'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 in the future. If the performance declines, a fixed rate benefits the investor, but if it improves it places him at a disadvantage. However, actual developments cannot subsequently be used to assess the investment decision. The fixed nature of the rate accordingly does not benefit the investor in a way that he would have agreed to a lowering of the remuneration. In aggregate, the Commission believes that the rate of remuneration should not be reduced for this reason.

v) **Total remuneration**

(171) On the basis of all these considerations and in agreement with the complainant BdB, the *Land* of Bavaria and BayernLB, the Commission concludes that an appropriate remuneration for the first instalment of the capital in question would be 6,42 % per annum (after corporation tax and before investor tax), namely a 9,87 % normal return on the investment, plus a premium of 0,3 % for the particularities of the transaction and minus 3,75 % on account of the financing costs resulting from the transferred assets' lack of liquidity for BayernLB. For the second instalment, the Commission concludes that an appropriate remuneration would be 5,25 % per annum (after corporation tax and before investor tax), namely a 8 % normal return plus a premium of 0,3 % and minus 3,05 % on account of the transferred assets' lack of liquidity for BayernLB.

vi) **Determination of the minimum remuneration for the capital of DEM 1 197 million up to the time when it was recognised by BAKred**

(172) As already mentioned, the special-purpose reserve of DEM 1 197 million was already of material value to BayernLB before it was recognised by BAKred as core capital within the meaning of the Banking Act (KWG), since the two instalments were recorded as equity capital in the balance sheet as from their transfer. Its economic function may in this respect be compared to that of a guarantee. A market-economy investor would demand an appropriate remuneration in return for exposing himself to a risk of this sort.

(173) Germany considers that 0,3 % per annum before tax is an appropriate starting-point for remuneration for the guarantee function in BayernLB's favour, in line with the Commission's approach in the WestLB case ([50]) . However, it argues that the grounds given in the WestLB decision for increasing the initial rate do not apply in the present case. In that decision, the (pre-tax) rate of 0,3 % per annum was increased by a premium of a further 0,3 % % per annum because (a) bank guarantees are normally associated with certain transactions and limited in time (which was not the case with WestLB), and (b) the amount of DEM 3 400 million made available to WestLB exceeded what is normally covered by such bank guarantees.

(174) On account of the fundamental comparability of WestLB and BayernLB and for want of other points of reference, the Commission assumes that this rate corresponds to the market remuneration which also BayernLB would have had to pay in the mid 1990s for a bank guarantee in its favour. Moreover, the Commission agrees with Germany that the amount of capital transferred to BayernLB was significantly less than in the WestLB case and that, accordingly, the second reason stated in the WestLB decision does not apply here. Admittedly, the guarantee function was not limited in time or tied to a specific transaction in BayernLB's case either. On the other hand, there was a *de facto* time limitation since the total amount could be used for business expansion once BAKred had recognised it as core capital. As a result, a separate guarantee commission no longer needed to be paid. The remuneration for the guarantee

([50]) Decision 2000/392/EC.

function was part of the remuneration for the business-expansion function. The fact of the sole guarantee function was, therefore, restricted from the outset, and this distinguishes the BayernLB case from the WestLB case.

Accordingly, the Commission considers that, in the case of BayernLB as opposed to WestLB, a premium is not justified and so sets a rate of 0,3 % per annum (before tax) as an appropriate remuneration for the guarantee function of the capital from the time of its inclusion in the balance sheet on 31 December 1994 and 31 December 1995 until its recognition by BAKred ([51]) . Assuming a corporation tax rate of some 50 % at that time ([52]) , an after-tax assessment gives a rate of 0,15 % per annum. This after-tax rate of 0,15 % was applied by the parties in calculating the aid element in the table attached to the understanding.

h) ***Amendment of the articles of association on 5 March 2004***

(175) Germany argued that an amendment had been made to Bayerische Landesbank's articles of association with effect from 5 March 2004 and that, under the new Section 2a, the special-purpose assets transferred to the bank on 31 December 1994 and 31 December 1995 no longer serve to underpin its competitive business, notwithstanding their function as liable equity capital.

(176) Since the entry into force of this provision, the bank has been prohibited from using the special-purpose capital to underpin risk assets from its competitive business. Consequently, the special-purpose assets may not be used to expand business, and the capital now serves only as a guarantee.

(177) According to the information provided by Germany and the agreement between the *Land* of Bavaria and BayernLB submitted to the Commission, the guarantee function is paid for by a guarantee commission (*Haftungsprovision*) of 0,3 % per annum after tax. Germany argues, with reference to the remuneration for a comparable transaction, that this is a normal market remuneration which BayernLB would have had to pay on the market for a bank guarantee in its favour. Germany has stated that in the BayernLB case the remuneration for the special-purpose assets was treated for tax purposes as use of profits and could therefore not be deducted as operating expenditure. As a result, the remuneration is payable after tax.

(178) The Commission agrees with Germany that a fee of 0,3 % per annum after tax can be regarded as a reasonable rate. It also takes 0,3 % per annum before tax as an appropriate initial rate for the transaction at hand, since that rate was used as a basis for the WestLB decision and in the present case for the appropriate remuneration for the injected capital up to its recognition by BAKred as core capital, and the Commission sees no reason why it should have changed in the intervening years. Nor has Germany put forward any information to the contrary. Moreover, applying the WestLB method, a premium of at least 0,15 % per annum before tax is justified, if only because the capital is at BayernLB's disposal for guarantee purposes for an unlimited period ([53]) . However, account must also be taken of the fact that corporate tax rates in 2004 are much lower than in the 1990s ([54]) . In the light of tax considerations, the Commission concludes that the agreed remuneration of 0,3 % after tax is appropriate.

(179) In the Commission's view, it has thus been demonstrated that, with the introduction of new rules on the special-purpose assets remaining in the bank, the state aid under investigation ended on 5 March 2004, the date on which the amended articles of association entered into force, and that, consequently, the remuneration it regards as appropriate — 6,42 % per annum after tax (first instalment) and 5,25 % after tax (second instalment) — need be paid only up to that date.

i) **Aid element**

(180) On the basis of the above calculations, the Commission concludes that the remuneration payable by BayernLB for the special-purpose assets, the cash value of which was recognised by BAKred as core capital, was 6,42 % per annum for the first instalment (31 December 1994) and 5,25 % per annum for the second instalment (31 December 1995), due from the end of the month in which the amounts were recognised by BAKred (for the amount of DEM 655 million from 31 May 1996 onwards and for the full amount of DEM 1 197 million from 31 December 1996). For 1998 and 1999, when the cash value actually fell below the amount recognised by BAKred because of fluctuations, only the lower cash value is used as basis for the calculation.

([51]) As already explained above, the key point in time for the guarantee function is not when the balance sheet was established (31 December of the business year concerned), but the date of the transfer (see footnote 41).

([52]) See footnote 49.

([53]) The Commission is aware that the amount of the capital available for guarantee purposes, which was cited in the WestLB decision as further grounds for an increase, is lower in the BayernLB case and hence of less importance here.

([54]) According to documents submitted by the German Government, the corporation tax rate was 42 % in 1995 and 1996. To this must be added the solidarity surcharge of 7,5 % (making 49,5 % in total). The overall tax rate came down to 47,5 % in 1998. As of 2001 it fell to only 30,5 %.

(181) This payment should have been made from the time of recognition by BAKred until the end of the state aid on 5 March 2004.

(182) In addition, the Commission regards as a normal market remuneration the figure of 0,15 % per annum after tax for the amount of the special-purpose reserve which was already shown as equity capital in the balance sheet but had not yet been accepted by BAKred as original own funds, i.e. over DEM 655 million up to recognition of the first instalment on 8 May 1996 and over DEM 542 million up to recognition of the second instalment on 20 December 1996.

(183) BayernLB currently pays a remuneration of 0,6 % per annum (after tax) — and this only on the amount actually used to cover risk-bearing assets. This remuneration was paid in 1996 in a single instalment of DEM 7 000. The Commission also accepts the guarantee fee (*Bürgschaftsgebühr*) paid by BayernLB as additional remuneration for the *Land* (see paragraph 131 above).

(184) The aid element can be calculated as the difference between the actual payments and the payments which would correspond to market conditions. The aid was at the beneficiary's disposal from the date on which the remuneration payable would have been due. In accordance with the transfer agreements, that corresponds to the date when the balance sheet was established for the relevant business year.

(185) Figure 2: Calculation of the aid element

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
	1st instalment										
1	Available for guarantee purposes (from-to):	01.01.-31.12.	01.01.-31.05.								
2	Available for guarantee purposes (DEM):	655 000 000	655 000 000								
3	Available for business-expansion purposes (from-to):		01.06.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-05.03.
4	Available for business-expansion purposes (DEM):		655 000 000	655 000 000	[...]	[...]	655 000 000	655 000 000	655 000 000	655 000 000	655 000 000
	2nd instalment										
5	Available for guarantee purposes (from-to):		01.01.-31.12.								
6	Available for guarantee purposes (DEM):		542 000 000								
7	Available for business-expansion purposes (from-to):			01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-31.12.	01.01.-05.03.
8	Available for business-expansion purposes (DEM):			542 000 000	[...]	[...]	542 000 000	542 000 000	542 000 000	542 000 000	542 000 000
	Calculation of the aid element										
9	Remuneration of 0,15 % after taxes for 2. (DEM)	982 500	408 033								
10	Remuneration of 6,42 % after taxes for 4. (DEM)		24 587 197	42 051 000	[...]	[...]	42 051 000	42 051 000	42 051 000	42 051 000	7 468 074
	Subtotal: remuneration for 1st instalment (DEM)	*982 500*	*24 995 230*	*42 051 000*	[...]	[...]	*42 051 000*	*42 051 000*	*42 051 000*	*42 051 000*	*7 468 074*
11	Remuneration of 0,15 % after taxes for 6. (DEM)		813 000								

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
12	Remuneration of 5,25 % after taxes for 8. (DEM)			28 455 000	[...]	[...]	28 455 000	28 455 000	28 455 000	28 455 000	5 053 484
	Subtotal: remuneration for 2nd instalment (DEM)	*0*	*813 000*	*28 455 000*	[...]	[...]	*28 455 000*	*28 455 000*	*28 455 000*	*28 455 000*	*5 053 484*
13	Total remuneration (DEM)	982 500	25 808 230	70 506 000	[...]	[...]	70 506 000	70 506 000	70 506 000	70 506 000	12 521 557
14	Remuneration already paid (DEM)	1 722 080	2 249 846	2 217 376	[...]	[...]	[...]	[...]	[...]	[…]	
	of which: *Bürgschaftsgebühr* (guarantee fee) * (after taxes) in DEM	1 722 080	2 242 846	2 217 376	[...]	[...]	[...]	[...]	[...]	[...]	
	of which: *Haftungsprovision* (guarantee commission)(after taxes) in DEM		7 000								
15	Aid element (13 — 14) — DEM	- 739 580	23 558 383	68 288 624	[...]	[...]	[...]	[...]	[...]	[...]	[...]
16	Total aid elements — DEM										**509 453 993**
	Total aid elements — equivalent in EUR										**260 479 690**

Since 1 January 1999, marks have been converted into euros at a rate of EUR1 = DEM 1,95583. The figures in DEM must be converted accordingly.

The fall in cash value in 1998 and 1999 was taken into account in both instalments by applying a flat rate amount in proportion to the cash value.

1.3. DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATES

(186) 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.

(187) The beneficiary, BayernLB, carries on regional and international banking business. It regards itself as a universal commercial bank, a central bank for savings banks and the bank of the *Land* and its municipalities. Despite its name, tradition and legally stipulated tasks, BayernLB is much more than a mere local or regional bank.

(188) These facts clearly show that BayernLB 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.

(189) It should also be pointed out that there is a very close relationship between a credit institution's equity capital and its banking activities. It is only when it has sufficient recognised equity capital that a bank can do business and expand its commercial activities. Since BayernLB was provided with such capital for solvency purposes as a result of the state measure, this had a direct impact on the bank's business opportunities.

(190) It is clear, therefore, that aid given to BayernLB distorts competition and affects trade between Member States.

1.4. RESULT

(191) 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. The difference between the agreed remuneration of 0,6 % per annum and the guarantee fee of 0,05 % per annum on the one hand and, on the other, the appropriate remuneration of 6,42 % per annum (first instalment) and 5,25 % per annum (second instalment) (in both cases after corporation tax and before investor tax) for the transferred capital that could be used by BayernLB up to 5 March 2004 to underpin its commercial business, plus 0,15 % per annum (after corporation tax and before investor tax) for the part of the capital that was similar to a guarantee constitutes state aid within the meaning of Article 87(1) of the EC Treaty.

2. *COMPATIBILITY WITH THE COMMON MARKET*

(192) An assessment must also be made as to whether that aid can be considered compatible with the common market. None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(193) 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 aspects, is applicable. Nor does the aid promote the execution of an important project of common European interest. It is not aimed either at promoting culture or heritage conservation.

(194) Since the economic survival of BayernLB 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 BayernLB 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.

(195) 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. BayernLB was not an undertaking in difficulty whose viability had to be restored with the support of state aid.

(196) 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 ([55]) . However, the formal conditions are not met in this case: the tasks which BayernLB carries out in providing services of general economic interest are not specified, and nor are the costs generated by such tasks. It is therefore clear that the transfer was effected in order to enable BayernLB to comply with the new own funds requirements and with no regard to any services of general economic interest. Accordingly, this exemption clause does not apply either in the case at hand.

(197) 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.

([55]) 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.

3. *NO EXISTING AID*

(198) Contrary to what was argued by Germany, the capital injection cannot be regarded as being covered by the existing state aid scheme for 'institutional responsibility' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*), but must be regarded instead as new aid.

(199) *Gewährträgerhaftung* is a default guarantee offered to creditors in the event that the bank's assets are no longer sufficient to satisfy their claims, and this is not the case here from the outset. The capital injection is not intended to satisfy the Landesbank's creditors and the bank's assets have not been exhausted.

(200) Nor does *Anstaltslast* apply. *Anstaltslast* requires the guarantor, the *Land* of Bavaria, to provide BayernLB with the resources it needs to function properly for as long as the *Land* decides to maintain it in existence. However, at the time of the capital injection, BayernLB was far from being in a situation where it was no longer able to operate properly for lack of sufficient resources. The capital injection was not needed in order to keep the Landesbank in operation. Indeed, according to the legislation, the injection was made to enable the Landesbank 'to continue its successful business activities' in the light of the tighter rules on core capital and equity ratios introduced on 30 June 1993. This conscious economic calculation by the *Land* as (joint) owner also enabled the Landesbank to seize future market opportunities in its competitive business. The 'emergency provision' of institutional liability is not applicable to such a normal economic decision by the *Land*. Since no other existing aid scheme under Articles 87(1) and 88(1) of the EC Treaty is applicable, the capital injection ranks as new aid within the meaning of Article 88(3) of the EC Treaty and must be investigated accordingly.

X. **CONCLUSION**

(201) The Commission finds that the Federal Republic of Germany has unlawfully implemented the aid in question contrary to Article 88(3) of the Treaty.

(202) The aid cannot be regarded as 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 Bayerische Landesbank — Girozentrale, amounting to EUR 260 479 690 in the period from 31 December 1994 to 5 March 2004 is incompatible with the common market.

Article 2

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 it.

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision.

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 in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 ([56]).

Article 4

Germany shall inform the Commission, within two months of notification of this Decision, of the measures which were taken and which it intends to take in order to meet the commitments described in this Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

([56]) OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION

1. Calculation of the amount to be recovered

1.1. Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient; if the measure consists of several instalments and reimbursements, use separate rows.

(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2. Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. Recovery measures planned or already taken

2.1. Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain which alternative measures are available in national legislation to bring about recovery of the aid. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2. By what date will the recovery of the aid be completed?

3. Recovery already effected

3.1. Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2. Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

implemented by Germany for Hamburgische Landesbank — Girozentrale, now HSH Nordbank AG

(notified under document number C(2004) 3928)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/740/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 the Member State and other interested parties to submit their comments pursuant to the provisions cited above [1] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) The procedure concerns the transfer of shares in Hamburgische Wohnungsbaukreditanstalt ('WK') to Hamburgische Landesbank — Girozentrale ('HLB') by the *Land* of Hamburg ('FHH'). There are a further six cases in which proceedings have been initiated against Germany in connection with transfers of assets to Landesbanks, and in particular to Westdeutsche Landesbank — Girozentrale ('WestLB').

(2) By letter of 12 January 1993, the Commission asked Germany for information concerning the circumstances of, and reasons for, a capital increase in WestLB resulting from the incorporation of *Wohnungsbauförderanstalt* ('WfA') and similar increases in the own funds of the Landesbanks of other *Länder*. Germany replied in March and September 1993 and, in response to further Commission requests dated 10 November and 13 December 1993, provided additional information in March 1994. In addition to information concerning WfA's transfer to WestLB, the German replies referred to similar transfers in Lower Saxony, Berlin and Schleswig-Holstein.

(3) By letters of 31 May and 21 December 1994, the *Bundesverband deutscher Banken e.V.* ('BdB'), an association representing private banks established in Germany, informed the Commission among other things that, with effect from 1 January 1986 and 1 January 1993, FHH had transferred shares in WK to HLB directly or indirectly. This increased the own funds at HLB's disposal and, in the BdB's view, distorted competition in its favour since the parties had not agreed remuneration consistent with the market-economy investor principle.

(4) In its second letter, the BdB accordingly lodged a formal complaint and requested the Commission to initiate proceedings under Article 93(2) of the EC Treaty (now Article 88(2)) against Germany. The complaint also related to similar transfers of assets to Westdeutsche Landesbank in North Rhine-Westphalia, Norddeutsche Landesbank in Lower Saxony, Landesbank Schleswig-Holstein ('LSH') in Schleswig-Holstein, Landesbank Berlin in Berlin and Bayerische Landesbank in Bavaria. In February and March 1995 and December 1996 several banks associated themselves individually with the complaint lodged by their association.

(5) The Commission investigated first the transfer of shares to WestLB. By Decision 2000/392/EC, [2] it finally found that the difference between the remuneration paid and the normal market return constituted state aid incompatible with the common market and ordered recovery of the aid. This decision was annulled by the Court of First Instance of the European Communities on 6 March 2003 as insufficient reasons had been given for two of the factors used to calculate the appropriate remuneration, but it was confirmed in all other respects. [3] Alongside the present Decision, the Commission is adopting a new decision on WestLB which takes account of the Court's criticisms.

(6) On 1 September 1999 the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks, including HLB. By letter of 8 December 1999, Germany submitted information on the transfer of WK to HLB which it supplemented by letter of 22 January 2001.

[1] OJ C 81, 4.4.2003, p. 24.

[2] OJ L 150, 23.6.2000, p. 1.

[3] Joined Cases T-228/99 and T-233/99 [2003] ECR II-435.

(7) By letter of 13 November 2002, the Commission informed Germany of its decision to initiate on account of the aid the procedure laid down in Article 88(2) of the EC Treaty.

(8) After requesting, and being granted, extensions of the deadline, Germany submitted its comments and provided additional information by letters of 14 April and 15 May 2003. Further questions were discussed at meetings with representatives of the German authorities on 26 June 2003. Following a renewed Commission request, Germany provided additional information on 29 August 2003.

(9) The Commission decision to initiate the procedure was published on 4 April 2003 in the *Official Journal of the European Union* [4] .The Commission called on interested parties to submit comments. It received comments from the BdB, which it forwarded to Germany for its opinion. Germany replied by letter of 30 October 2003.

(10) By letter of 7 April 2004, the Commission requested further information from Germany on all the Landesbank transfers, receiving replies on 1, 2 and 28 June 2004. On 1 October 2004 Germany provided updated figures and additional information.

(11) Following the merger between HLB and Landesbank Schleswig-Holstein-Girozentrale ('LSH') creating HSH Nordbank AG ('HSH') on 2 June 2003, the WK shares received by HLB were transferred back to FHH.

(12) On 19 July 2004 the complainant BdB, the *Land* of North Rhine-Westphalia and WestLB notified a provisional understanding concerning the appropriate remuneration for the transferred assets. In their view, this remuneration should form the basis of the Commission Decision. The definitive version of the understanding reached the Commission on 13 October 2004. On 29 September 2004 BdB, FHH and HSH Nordbank, which resulted from the merger of HLB and Landesbank Schleswig-Holstein in 2003, also reached a provisional understanding on the appropriate remuneration for the special-purpose assets transferred. Several letters were subsequently sent to the Commission by these interested parties and by Germany. The definitive version of the understanding on the transfer of the special-purpose assets to HLB reached the Commission on 14 October 2004.

II. DETAILED DESCRIPTION OF THE MEASURES

HAMBURGISCHE LANDESBANK — GIROZENTRALE ('HLB')

(13) At the time of the transfer, HLB was a public-law institution that had been set up by decree in 1938. This decree was replaced in 1993 by the Hamburgische Landesbank — Girozentrale Act, which was amended in 1997 in connection with the partial sale to 'LSH'. [5] Up to that point, FHH had been the sole shareholder in HLB as well as its sponsor and guarantor. In 1997 LSH, alongside FHH, became a shareholder in HLB. Each had a 49,5 % shareholding in HLB. In addition, HLB-Beteiligungsgesellschaft mbH ('HLB-BG'), which is controlled by FHH and the holding company Hamburger Gesellschaft für Beteiligungsverwaltung mbH ('HGV'), owns a de facto share of 1 % via an atypical silent partnership.

(14) On 2 June 2003 (for tax and balance-sheet purposes, 1 January 2003) HLB and LSH merged to form HSH. The owners are FHH with over 35 %, the *Land* of Schleswig-Holstein with just under 20 %, WestLB with just under 27 % and the Sparkassen- und Giroverband Schleswig-Holstein with over 18 %. With a balance-sheet total of some EUR 180 billion and some 4 500 employees in all, HSH is today one of the larger credit institutions in Germany.

(15) When the two transfers took place, HLB had a balance-sheet total of DEM 36,5 billion (1986) and just under DEM 60 billion (1992). In 2002, the year preceding the merger creating HSH, HLB had a group balance-sheet total of just under EUR 93 billion and an own-funds ratio of 11 %. That same year it had 2 700 employees at group level.

(16) As a state-owned bank, HLB took charge of FHH's banking business and that of its public and private legal persons. As a commercial bank, HLB was active especially in the areas of shipping and real estate finance, corporate and private customer business and international capital market business. In the field of shipping finance, HSH describes itself as the world leader.

TRANSFER OF WK SHARES TO HLB

(17) Under Article 1 of the Act amending the sponsorship of the Hamburgische Wohnungsbaukreditanstalt of 1 July 1986, FHH transferred 24 % of WK's equity and special capital to HLB with effect from 1 January 1986. According to the relevant contract of 10 July 1986 concluded between FHH and HLB, this was done as a means of increasing the latter's capital.

(18) In accordance with the Act increasing the capital of Hamburgische Landesbank — Girozentrale of 22 December 1992, FHH transferred with effect from 1 January 1993 a

[4] See footnote 1.

[5] LSH is an independent public-law institution. In 1998 it had a balance-sheet total of €100 billion and some 2 000 employees. Since 1994 it has been owned by WestLB (39,9 %), the *Land* of Schleswig-Holstein (25,05 %), the Sparkassen- und Giroverband für Schleswig-Holstein (25,05 %) and Landesbank Baden-Württemberg (10 %).

further 38 % of its shares in WK to HGV and the remaining shares (a further 38 %) directly to HLB. The FHH holding HGV in turn acquired an interest in HLB in the form of a typical silent partnership contribution with 19,86 % of the shares transferred to it. Consequently, according to the information supplied by Germany, FHH transferred 81,86% of its shares in WK to HLB, some directly, some indirectly.

(19) The transfer contract of 22 December 1992 also provided for a call option whereby FHH could at any time demand that the Landesbank transfer the WK shares transferred directly to it either to FHH itself or to a third-party designated by it. This option also included the right to receive back the shares transferred in 1986 (cf. a so-called ‘side letter’ of 22 December 1992). In the event of such a reassignment, payment would be based on the value of the WK shares as determined by an expert valuation for the financial year prior to the reassignment. In an addendum adopted on 21 April 1997 to the contract of 22 December 1992, it was laid down that, in the event of a reassignment, any increase in undisclosed reserves brought about by a readjustment of the WK aid scheme would accrue not to HLB but to FHH.

CAPITAL REQUIREMENTS UNDER THE OWN FUNDS AND SOLVENCY DIRECTIVES

(20) The German Banking Act (*Kreditwesengesetz* — KWG) has been amended in line with Council Directive 89/647/EEC on a solvency ratio for credit institutions [6] (the ‘Solvency Directive’) and Council Directive 89/299/EEC on the own funds of credit institutions [7] (the ‘Own Funds Directive’), which require banks to have own funds equivalent to 8 % of their risk-adjusted assets. At least 4 percentage points of this amount must consist of what is termed core capital, or ‘tier I’ capital, meaning items of capital which are at the credit institution’s disposal without restriction and immediately to cover risks or losses as soon as they arise. In determining the total own funds available to a bank for supervisory purposes, the core capital is of decisive importance because additional capital, or ‘tier II’ capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital.

(21) German banks had to adapt their own funds to the new requirements of the Solvency Directive and the Own Funds Directive by 30 June 1993 [8]. Even before the Solvency Directive was transposed into German law, many Landesbanks had relatively weak own-funds positions. They now had to strengthen their own-funds base as a matter of urgency in order to avoid restrictions on their business expansion and indeed to maintain their current level of activities. However, because the budgetary situation was tight, public shareholders were unable to provide any fresh capital, but neither were they prepared to privatise and to raise additional capital on the capital markets. The public banks thus decided to undertake asset and capital transfers: in the case of WestLB, the assets of the WfA and, in the case of HLB, the aforementioned WK shares, which were transferred to HLB’s capital reserves and silent partnership reserve.

EFFECTS OF THE TRANSFER ON LBB’S CAPITAL BASE

(22) The reason for the transfers was indicated as being capital requirements and/or a need to improve capital resources for the purpose of expanding HLB’s business. The transfer of WK shares presented the advantage of allowing this to happen without the need for an additional capital contribution from FHH’s budget.

(23) Back in the 1980s, business expansion had given rise to a steadily growing need for capital. According to the available information, the bank therefore regularly transferred part of its balance-sheet profit to its interest-bearing share capital. However, since this was clearly insufficient, FHH decided as early as 1986 to contribute 24 % of its WK shares (DEM 212,16 million) to HLB. At the beginning of the 1990s, a further increase in HLB’s equity capital was urgently required in view of the fourth amendment to the German Banking Act (‘KWG’) since HLB would have otherwise failed to comply with the new capital requirements laid down.

(24) Since FHH also did not have adequate liquid budgetary funds available at the time, it opted for a contribution of non-monetary capital and, on 1 January 1993, transferred the 57,68 % of WK shares (DEM 959,362 million) directly and via HGV to HLB.

(25) The total stated value of the transfers was DEM 1 171,552 million. Of this amount, DEM 212,16 million corresponded to the contribution to the open reserves in 1986 (24 % of the WK shares), DEM 659,362 million to the contribution to the open reserves in 1993 (38 % of the WK shares) and DEM 300 million to HGV’s silent partnership reserve of the same year. This calculation was based on WK valuation reports by two auditing firms in 1986 and 1993. The total amount of DEM 1 171,522 million was incorporated into the balance sheet for 1993 and subsequent financial years.

(6) OJ L 386, 30.12.1989, p. 14; replaced by European Parliament and Council Directive 2000/12/EC (OJ L 126, 26.5.2000, p. 1).

(7) OJ L 124, 5.5.1989, p. 16; replaced by Directive 2000/12/EC.

(8) Under the Solvency Directive, credit institutions must have own funds equivalent to at least 8 % of their risk-adjusted assets, whereas the previous German legislation required a ratio of 5,6 %; however, this ratio was based on a narrower definition of own funds than that which has applied since the entry into force of the Own Funds Directive.

(26) The Federal Banking Supervisory Authority (*Bundesaufsichtsamt für das Kreditwesen* or 'BAKred') recognised the capital amount of DEM 212,16million for 1986. With regard to the overall capital valuation after the further transfers in 1993, BAKred did not initially approve the relevant application from HLB because it took the view that, for WK to be recognised as a valuable holding, HLB would have to be entitled to sell it off. After a amendment to the WK Act in 1997 under which a decision on dissolution could be taken by shareholders at the request of a single shareholder (including HLB), the problem was settled and the full value was recognised as HLB's liable capital.

(27) According to Germany, HLB expanded its business significantly following the two transfers; in the period 1986-99 its balance-sheet total rose from DEM 36,5 billion to over DEM 145 billion.

REMUNERATION FOR THE OWN FUNDS TRANSFERRED

(28) According to the available information, FHH received no remuneration for the shares transferred on 1 January 1986 (24 % or DEM 212,16 million). Likewise, no remuneration was agreed for the shares transferred directly to HLB on 1 January 1993 (38 % or DEM 659,362 million); however, HGV received DEM [...] (*) million each year from HLB for the contribution.

(29) It was agreed that, in return for its contribution, HGV would receive [...] of profits, subject to a ceiling of 10 % each year. According to the information supplied, a sum of DEM [...] million had been paid by HLB since this understanding of 23 December 1992 (effective as of 1 January 1993).

(30) No further remuneration was agreed. Germany has nevertheless stated that, up to 1997, FHH, as HLB's sole shareholder, received the maximum annual dividend of 6 % laid down in the latter's statutes. ([9]) In addition, HLB has regularly converted reserves which it had generated itself into interest-bearing share capital (according to Germany, comparable to the issue of free shares), and this, according to the data submitted, resulted in an effective after-tax return of more than [...] % (and a corresponding inflow) on the capital actually paid in by the shareholder; HLB is thus the Landesbank with the highest effective yield.

III. GROUNDS FOR INITIATING THE PROCEDURE

(31) In its decision of 13 November 2002 to initiate the procedure, the Commission explained that the provision of resources by FHH to HLB had to be investigated in the light of the market-economy investor principle. According to this principle, no aid elements are present even in the case of resources provided by a state investor where such funds are provided on terms on which a private investor operating under normal market economy conditions would be willing to provide funds to a private company ([10]).

(32) For a credit institution, the economic benefit of a broader capital base created by the transfers of WK shares in question resides in the resulting greater capacity to lend and the opportunity to expand business. If this broader capital base is provided by the public investor on terms that are more advantageous than normal market conditions, the company concerned is favoured by state resources.

(33) As a result, the Commission conducted a preliminary assessment as to whether FHH had provided the funds in question on normal market conditions. Under normal market conditions, a remuneration corresponding to its value, its function and the risk incurred is expected for the contribution of capital.

(34) On the basis of the information available to it at the time, the Commission doubted whether the remuneration received by FHH and its holding company HGV, which amounted to DEM [...] million [...], or some [less than 3 %] of the total funds transferred, had been paid under normal market conditions. Since, at the time of the two transfers, even the return on outstanding ten-year Federal securities, i. e. risk-free assets, ranged from over 6 % to 7 %, the provision of capital can hardly be regarded as having taken place under normal market conditions. Even if the special features of the transaction, such as the transferred resources' lack of liquidity, were taken into consideration, the remuneration received by FHH and HGV can hardly be regarded as a normal market remuneration.

(35) Germany, it is true, had stated that, at the time of the transfer, HLB was an economically sound company whose value as a going concern had increased year on year. Proceeds were either distributed to FHH in the form of dividends or channelled into HLB's capital stock as revenue reserves, which, it is claimed, increased their value and benefited FHH as the only shareholder at the time. On the basis of a report drawn up at the time of the sale of shares (49 %) to LSH, an earning capacity value of DEM [...] million had been calculated for HLB as at [...]. According to internal calculations, this had still amounted to DEM [...] million as at 31 December 1985 and at DEM [...] million as at

(*) Confidential information: indicated below by [...] or by a range in [].

([9]) The redrafted HLB Act, applicable since 1997, no longer provides for a maximum dividend; according to the data provided, distributed dividends have more than doubled since, amounting to some 21 % in 1999.

([10]) OJ C 307, 13.11.1993, p. 3, point 11.

31 December 1992, representing an annual average rise in value of [...] % between 1986 and 1992 and of [...] % between 1993 and 1996 which FHH, the only shareholder until 1997, had been able to use entirely for its own benefit and which had been able to be realised on a pro rata basis on the occasion of the sale to LSH. Since, however, no other information or calculations, e.g. relating to the increases in dividends and value attributable to the contribution of WK shares, were available, the Commission was unable to carry out an assessment.

(36) On the basis of the available information, the Commission thus had serious misgivings as to whether the conditions on which FHH had transferred the funds that were apparently available to HLB in full as liable capital were normal market conditions. It therefore concluded that HLB was probably favoured by state resources.

(37) As regards the calculation of remuneration, the Commission stated that, as things stood and given the special circumstances of the present case, it intended to apply the method used in the WestLB Decision of 8 July 1999.

(38) Since HLB is active at the regional, national and international level and since there is strong competition between financial institutions of different Member States as a result of the growing integration in the financial services sector in the Community, it was assumed that the existence of state aid was distorting this competition and affecting trade between Member States. Accordingly, the Commission came to the provisional conclusion that the measures in question probably constituted aid within the meaning of Article 87(1) of the EC Treaty, giving rise to misgivings regarding their compatibility with the common market since none of the exemption clauses in Article 87(2) and (3) or in Article 86(2) of the EC Treaty appear to be applicable in the present situation.

(39) As part of its provisional assessment and in accordance with Article 1(b) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [11], the Commission also assumed that, if there were aid, the measure constituted new aid and not existing aid and referred here to Article 15(2) of that Regulation. In its view, the decision to initiate the procedure was a further Commission measure that interrupted the limitation period within the meaning of Article 15(2) and, as such, confirmed previous measures, including the Commission's requests for information dated 12 January, 10 November and 13 December 1993 and 1 September 1999 as well as the decisions to initiate the procedure in the WestLB case [12] and in the case of Landesbank Berlin [13].

IV. COMMENTS FROM GERMANY

(40) In its comments, Germany repeated first of all the view that the transfer on 1 January 1986 of 24 % of WK's capital (value transferred to the reserves: DEM 212,16 million) to HLB could not be recovered as unlawful aid in accordance with Article 15(2) of Regulation (EC) No 659/1999 since the ten-year period applicable to the transfer had expired on 1 January 1996.

(41) This transfer ('1986 transfer') was to be seen as a legally and economically independent process separate from the 1993 transfers. In so far as Germany had previously spoken of a 'single intention to invest', as the Commission had noted in its decision to initiate the procedure, this applied solely to the 1993 transfers. The 'side letter' of 22 December 1992, which was referred to in Germany's letter of December 1999, also referred to — and was only concerned with — the 1986 transfer solely to the extent that the reassignment right to reassign the shares given to FHH in 1986 and 1993 was concerned. In addition, Germany's statement that the direct remuneration of DEM [...] million each year corresponded to around [less than 3 %] of the total amount of all the transfers, was intended merely as an illustration. However, in its view, this in no way altered the fact that *de facto* and *de jure* the 1986 transfer was a quite separate process.

(42) If, however, the 1986 transfer was to be viewed separately from the 1993 transfers, action by the Commission within the meaning of Article 15(2) of Regulation (EC) No 659/1999 could interrupt the limitation period only if it were taken before 1 January 1996. However, the Commission's requests for information that preceded the one dated 1 September 1999 were of a general nature, had not even mentioned HLB and so did not meet the conditions for them to be regarded materially as action interrupting the limitation period within the meaning of Article 15(2). Germany also mentioned in this respect the judgment by the Court of First Instance of 10 April 2003 in Case T-369/00 *Département du Loiret* v *Commission* [14] (hereinafter '*Scott*'). The Court ruled that a Commission letter requesting information regarding a possible aid element was a measure interrupting the limitation period within the meaning of Article 15(2) of Regulation (EC) No 659/1999. However, the letter in question had been a request for information that was concerned expressly and materially with a plot of land that the firm Scott S.A. had sold on preferential conditions. In that letter the Commission had referred expressly to the fact that the lawfulness of the aid in question was being examined and that the aid might have to be repaid. According to Germany, the Court had thus laid down the minimum requirements that a request for information must meet in order to be regarded as action interrupting the limitation period.

[11] OJ L 83, 27.3.1999, p. 1, as amended by the 2003 Acts of Accession.
[12] OJ C 140, 5.5.1998, p. 9.
[13] OJ C 239, 4.10.2002, p. 12.
[14] [2003] ECR II-1789.

(43) In the present case, the Commission, with its requests for information of 12 January, 10 November and 13 December 1993, which were mentioned by it in the decision to initiate the procedure and were addressed to Germany, fell far short of these requirements. These letters had referred simply to Westdeutsche Landesbank and to a general request regarding possible similar transfers to other Landesbanks. HLB and FHH had not been mentioned in any of those letters. According to Germany, the triggering of the limitation period prevented further examination of the 1986 transfer.

(44) As for the economic assessment of the capital transfer, Germany confirmed first of all that the total value of the WK shares transferred in 1986 and 1993 (DEM 1 171,522 million) had been made available to HLB as equity capital. At no time had the transferred capital been assigned to a special purpose or made subject to any other restriction as to its use.

(45) It should be borne in mind here that the capital transferred in 1986 was recognised from then on by BAKred as liable capital. However, the total amount, i.e. including the 1993 transfer of around DEM 959 million (of which 38 % was directly transferred WK shares which were assigned to HLB's open reserves with a value of DEM 659,362 million, and 19,86 % was WK shares transferred indirectly via HGV, which were transferred to HLB as a silent partnership contribution amounting to DEM 300 million), was recognised by BAKred as liable capital only in 1997. This was because the WK Act was amended only on 25 June 1997 and because HLB as shareholder was granted the right to dissolve or liquidate WK.

(46) Germany stated that the transferred funds had, therefore, been made available to HLB in full as liability cover only retrospectively on 1 January 1997. Even so, as Germany later explained, HLB had before that date used part of the capital reserve as liability cover, viz. DEM 183 million in 1993, more than DEM 436 million in 1994, DEM 255 million in 1995 and DEM 208 million in 1996 (figures rounded; see also the table in paragraph 183). The remaining amount of the capital reserve had not been used and had not been recognised as liable core capital. It was only after 1 January 1997 and until the divestment of WK at the time of the merger with LSH to form HSH on 2 June 2003 that the amount of DEM 659,4 million had been available. The silent partnership contribution of DEM 300 million had also been available in full as liable core capital until that date. Prior to 1997 these funds had not been used and had not been recognised as core capital.

(47) As regards the remuneration, the maximum fixed amount of DEM [...] million [...], corresponding to [not more than 10 %], was paid throughout on the silent partnership contribution. No remuneration was paid on the capital reserve of some DEM 659 million.

(48) Germany nevertheless repeated the view that it was not only the agreed, direct remuneration for the silent partnership contribution that should be taken into account as a remuneration component. For one thing, the dividend payments to the sole shareholder FHH had to be taken into consideration since the profits earned by HLB were necessarily also attributable to the funds transferred by FHH. And so, as the sole shareholder until 1997, FHH had received the highest dividend of 6 % laid down in the statutes and from 1997 onwards had received varying, but increasing dividends on its share of the share capital. These dividend payments rose from EUR [...] million in 1985 to EUR [...] million in 1996, when FHH had still been the only shareholder. As they were then payable only on 50,5 % of FHH's shares, they amounted to EUR [...] million in 1997 and to EUR [...] million in 2001.

(49) Moreover, the reserves that HLB had itself built up were regularly converted into equity capital, which rose from EUR 228,3 million in 1985 to EUR 250,9 million in 1997 and has remained unchanged since. The revenue reserves had also risen steadily, from EUR 93,1 million in 1985 to EUR 321,8 million in 2001. All of these facts indicated a substantial increase in revenue.

(50) Account must also be taken of the increases in value that has been produced by the transferred capital and were attributable solely to FHH. There was an increase in value of between some [...] % and [...] % that was attributable solely to the transfer of WK shares. Germany provided more detailed calculations based on the capitalised value method. Between 1985 and 1992 the value of HLB had risen by DEM [...] million, or just under DEM [...] million a year, giving a return of [...] % in terms of the WK shares transferred in 1986. Between 1992 and 1995 the company's value had risen by DEM [...] million a year, giving an annual yield of [...] % in terms of the WK shares transferred on 1 January 1993. This again demonstrated that, all factors being taken into consideration, FHH had received appropriate returns.

(51) Lastly, FHH could have expected appropriate returns at the time of the two investments. At the end of 1985 and at the end of 1992 HLB had been a profitable company with equity returns (before tax), given here as examples, of over 19 % in 1985, 8 %-9 % in 1989 and 1990 and over 12 % in 1992. For purposes of comparison, Germany communicated capital returns it had itself calculated for five private German banks which showed that in the years 1980-92 HLB had not or had in only a few years lagged behind the relevant annual average of the other five institutions by some 1 %-6 % (before tax) and 1 %-4 % (after tax). In other words, HLB 'does not lag behind' the other private banks.

(52) For the rest, Germany took the view that the transfers were to be compared to a non-monetary capital contribution because of the lack of liquidity of the funds made available. For a calculation of return, what mattered therefore was the difference between a non-monetary contribution and a cash contribution, which consisted in the refinancing costs for the lending to promote business expansion or in the disadvantage represented by the fact that the cash value of the deposit cannot be invested directly. According to the calculations provided, the interest-rate difference relative to a cash contribution in the case of the non-monetary capital transferred in 1986 was some 6,8 % in respect of lending and some 6,8 % in respect of income-producing, risk-free investments. For the contribution made on 1 January 1993, the difference was around 8,3 % for lending and 7,36 % for risk-free investments. In terms of the gross return, this represented a difference of some 6 % (1996) and 6,6 % (1993) between capital assumed to be provided in cash and the illiquid capital actually provided. A market-economy investor too must take this disadvantage into account when assessing whether his remuneration is appropriate.

V. COMMENTS FROM THE BDB

(53) The BdB considers the remuneration that was actually paid to be insufficient. No remuneration at all had been agreed for the WK shares transferred on 1 January 1986 while, for the shares transferred in 1993, only the interest payable on the silent partnership contribution had been agreed. In terms of the total capital transferred, this corresponded to less than 3 % per annum and could not in any way be regarded as normal for the market. FHH's claim to an appropriate remuneration was not undermined, for instance, by the fact that it had been HLB's sole shareholder. What mattered was the expectation at least of an average return that private banks too regularly associate with the provision of equity capital to their subsidiaries.

(54) Admittedly, it is true that this anticipated return did not figure in the understanding on a fixed interest rate since the return to the parent company could be in the form not only of dividend payments but also of the increase in the revenue and associated value of the subsidiary. Even so, the expected normal market return corresponded to the setting of a fixed interest rate.

(55) As a market-economy investor, FHH should, therefore, have expected a normal market return from HLB. However, it had by no means been able to count on this.

(56) Even for the transfer on 1 January 1986, it appears that, according to the Land Government notice of 17 December 1985, a below-average return of between DEM 0,3 million and DEM 0,5 million (according to the BdB, corresponding to between 0,1 % and 0,2 %) was expected. Since dividends were to be paid only after business had actually expanded, there had clearly been no remuneration at all for FHH in the early years. Even the dividends actually paid out subsequently to FHH were not to be taken into account since, under the circumstances obtaining, a private investor would have demanded a fixed annual remuneration. Similarly, the reserves and revenue converted into share capital could not be taken into consideration.

(57) Possible increases in value could not have been expected here either since the shares in HLB had not been negotiable. In addition, therefore, the shares had not been subject to any ongoing assessment of their value. The transfer in 1997 of 49,5 % of the shares to LSH had not removed the aid element. The sale had taken place after the time of the investment and had, therefore, been quite immaterial as regards the remuneration expectation. For the state aid investigation it was a matter of whether a transaction had taken place under normal economic conditions.

(58) It transpired from all this that, under these circumstances, a private investor would have undertaken the investment only if revenue or cash flows could have been generated promptly, either in the form of fixed dividends or alternatively in the form of variable cash flows. In such a situation, however, a private investor would presumably prefer fixed interest payments. There is also the fact that FHH had not been entitled to reassign the WK shares without any consideration (compensatory payment at book value).

(59) In calculating a normal market return, BdB first assumed that the resources transferred needed to be remunerated in the same way as share capital because they constituted core capital recognised for banking supervisory purposes. It stated that an appropriate return on capital made available would invariably be based on a risk-free return and a risk premium. In other words, the basic principle of 'expected return on a risky investment = risk-free return + risk premium for the risky investment' would be applied.

(60) The BdB then calculated the minimum remuneration applying the so-called Capital Asset Pricing Model (CAPM), which determines the expected individual risk premium with the help of the so-called beta value (statistically measured deviation of the individual risk premium from the general long-term market risk premium).

(61) In determining the risk-free return, the BdB used the returns on long-term government bonds, fixed-rate securities issued by state bodies being the form of investment with the lowest risk or with no risk at all ([15]).

(62) For the purpose of deriving the risk premium, the BdB first determined the so-called general market risk premium, i.e. the difference between the long-term average return on the

([15]) To adjust for inflationary effects, the rate of return on a long-term government bond had first to be determined for each contribution period disregarding inflationary expectations. In estimating the long-term, risk-free basic interest rate, the estimation of the expected long-term average inflation rate of 3,60 % was then added to the 'real basic interest rate' at the relevant moment.

normal market share portfolio and the risk-free return (government bonds). In its comments of 25 June 2003, it assumed in the first place a long-term market risk premium of a uniform 4,6 %.

(63) The BdB stated that it estimated the beta values on the basis of a historical data sample for comparable banks. It concluded first that all beta values for all Landesbanks and for all the periods under consideration were greater then one. In other words, it considered that the risk premium for investments in Landesbanks was higher than the market risk premium.

(64) Assuming a risk-free basic interest rate of 8,05 % (December 1985, for the 1986 transfer) and of 5,90 % (December 1992, for the 1993 transfer) and a beta factor for HLB of 1,1660 (first date) and of 1,0836 (second date), the BdB arrived at an expected minimum remuneration of 13,41 % for the shares transferred on 1 January 1986 and of 10,88 % for the shares transferred on 1 January 1993.

(65) The BdB also noted that the Commission's deduction pursuant to Decision 2000/392/EC from the minimum remuneration to take account of the lack of liquidity of Wfa's assets had been upheld by the Court of First Instance. There was therefore no reason to depart from this method in the present case, with the result that a deduction for liquidity should also be made here. The amount of the deduction for lack of liquidity would be calculated, using the WestLB method, on the basis of net refinancing costs (gross refinancing costs less the applicable corporation tax).

(66) The BdB also took the view that the deduction made by the Commission pursuant to Decision 2000/392/EC (1,5 %) and upheld as such by the Court of First Instance, ought similarly to be made in the case of HLB. In its opinion, if there were circumstances in the other Landesbank cases that had the effect of increasing risk as compared with a 'normal share capital investment', such as the in part exceptionally large size of the asset transfer, the decision not to issue new company shares and the associated absence of additional voting rights as well as the lack of fungibility of the asset, a deduction would be justified here too.

(67) Instead of a normal market return calculated in this way, FHH had not agreed on or received any remuneration whatsoever for the 1986 transfer, and the remuneration for the 1993 transfer had been too small. For the 1993 transfer, which had been recognised as core capital for supervisory purposes only in 1997, HLB had, since 1993, paid out an annual share in profits consisting of a guaranteed remuneration of 7 % and a variable component (fixed interest rate of 0,5 % on the dividend payout from net profit for the year). The BdB did not know the actual amount. However, since it could be compared to share capital, the remuneration appeared to be too low. In addition, it had been paid to HGV, which, although it was a holding company of FHH, was, economically speaking, an independent unit, whereas nothing had accrued directly to FHH. No remuneration at all had been agreed for the transfer of the other shares to the capital reserve.

(68) The limitation period for the transfer of shares on 1 January 1993 had been interrupted by the Commission as a result of the information request dated 1 September 1999 and the decision of 13 November 2002 to initiate the procedure. With regard to the transfer on 1 January 1986, the BdB, in rejecting the time limitation, relied on the legal concept of a continuous series of acts, which also had its equivalent in the case law relating to traditional competition legislation. The conditions for such related acts were met here because all the transfers had been in response to a uniform concept of capital strengthening and business expansion and had followed the same pattern. Accordingly, the transfer of 1 January 1993 could not be viewed separately either on account of the new solvency rules. The transfers in 1986 and 1993 were, therefore, to be regarded as a single capital measure, and the aid was not granted in full until 1 January 1993.

(69) Accordingly, it was also immaterial whether the Commission's requests for information in 1993 could have interrupted the limitation period. However, the BdB maintains here that this period could have been interrupted as regards the aid granted to HLB only if those requests had also related to this aid measure. Since the BdB did not know the exact content of those letters, it could not take a definitive position on the matter.

VI. GERMANY'S RESPONSE TO THE BDB'S COMMENTS

(70) Germany stated first that the BdB had misinterpreted the judgment of 6 March 2003 by the Court of First Instance in the WestLB case (hereinafter 'WestLB judgment'). The BdB apparently felt that the judgment had made it clear that the increase in value attributable to the capital contribution was not a normal market return. However, the Court had not commented in any material way on the decision. The Court's ruling that a private investor would not normally be content with minimum losses or a limited return even where he already held share capital in the company said nothing about the assessment from the viewpoint of state aid legislation of a return that consisted not in a fixed interest rate but, for example, in an increase in the company's value.

(71) The BdB clearly acknowledged this when, in discussing capital contributions by private banks to subsidiaries, it stated that the expected return was not expressed in the setting of a fixed interest rate but in the form of dividends as well as revenue increases and associated increases in value. It should be pointed out in this connection that the BdB was not aware of the facts regarding the possibility — which it itself doubted — of an increase in the value of HLB as, contrary to what BdB believed, 49,5 % of the shares were not negotiable since they were sold to LSH in 1997.

(72) The minimum returns of 13,41 % (1986 transfer) and 10,88 % (aggregate 1993 transfer), which had been calculated on the basis of the CAPM method, were incorrect. On the one hand, fundamental misgivings were expressed regarding the use of the CAPM method and specific misgivings regarding its use by the BdB. Among other things, the BdB had restricted the market portfolio to the German shares making up the CDAX, had estimated the parameters solely on the basis of what were in part past data without checking their validity for the relevant date of the investment, had derived the market risk premium from a study that dealt solely with the average return on German shares in the period 1954-88 and, in calculating the beta factors, had regarded the CDAX banks as companies with the same business and risk profile. As a result, virtually all the factors needed for the CAPM were wrongly estimated and the normal minimum market returns for the transactions in question were overstated.

(73) In addition, the BdB had maintained that a premium charged to take account of the special features of the transactions was simply the result of applying the criteria specified in Decision 2000/392/EC, without however carrying out a quantitative assessment such as that criticised in that decision. Moreover, on account of the lack of liquidity, the full refinancing rate had been deducted since it was not at all admissible to set off the tax-reducing effect claimed by the BdB as a liquidity deduction against the appropriate return. This was based on a fundamental misconception. Expected returns for investors had nothing to do with the tax effects on the balance sheet for companies.

(74) In line with its interpretation of the law, Germany calculated an alternative normal market return to that calculated by BdB. It did so only for the 1993 transaction since the 1986 transfer had been time-barred.

(75) Germany took the view here that a risk profile analysis should be carried out first for the two non-monetary contributions. The silent partnership contribution should be compared with such other contributions with a similarly long period to maturity (16 years). As regards the capital reserve, the comparison should preferably be made with a silent partnership contribution of unlimited duration in view of the risk profile, e.g. the guarantee, if any, afforded by institutional liability in the event of insolvency, the irrelevance of voting rights given that FHH was the sole owner, the participation in losses, the ranking of the dividend claim and the period to maturity. On this basis, Germany, in its reply to the BdB's comments, combined the two instruments when calculating the remuneration but weighted their shares of the overall contribution according to whether they were of limited or unlimited duration. By deducting refinancing costs in full, it arrived at an appropriate remuneration of 1,48 % for the total contribution.

(76) In line with its interpretation of the law, however, Germany also calculated in its reply the return on the capital reserve according to the CAPM. Assuming a market risk premium of 3 % and a beta value for HLB of 0,7861, this gave a hypothetical minimum return on cash deposits of 9,74 % in respect of the increase in the capital reserve although the full refinancing costs had to be deducted on account of the lack of liquidity, with the result that the actual minimum normal market return worked out at 2,36 %. For the silent partnership contribution, because these instruments were not traded on the secondary market, Germany did not use the CAPM but the comparison with similar financing instruments. After deducting again the full refinancing costs, this produced a premium of 1,29 % for silent partnership contributions of unlimited duration similar to HLB's contribution. In weighted terms, this gave an aggregate remuneration of 2,08 %.

(77) As regards the time-bar, which, according to the BdB, had not been triggered because of the linkage between the two transactions, Germany repeated the objections it had raised previously and stated once again that the 1986 transfer had been a transaction that was *de facto* and *de jure* separate from the 1993 transfer as the documents produced at the outset and subsequently proved. For the rest, the legal concept of a continuous series of acts, cited by the BdB, had in the meantime been called into question by criminal court judges at the Federal Constitutional Court. The concept of continuing relationship in European cartel legislation, which had been explicitly dealt with in a regulation on prosecution and enforcement prescription, could not be applied to the state aid legislation relating to other facts, especially as Regulation (EC) No 659/1999 did not recognise that concept.

VII. UNDERSTANDING BETWEEN THE BDB, FHH AND HSH

(78) On 8 October 2004 the Commission was informed of the outcome of an understanding reached between the complainant BdB, FHH and HSH, which resulted from the merger of LSH and HLB in 2003. Irrespective of their basic interpretations of the legal situation, which remained unchanged, the parties to the understanding agreed on the basic method of calculating a return as a comparative

direct, fixed remuneration. In the light of the 1993 transfer of 38 % of WK shares to the capital reserve amounting to some DEM959,4 million, they agreed on the amount of appropriate remuneration. As regards the indirect contribution to a silent partnership reserve that also took place on 1 January 1993 of 19,86 % of WK shares amounting to DEM 300 million, although agreement could be reached on the basic approach of a fixed remuneration criterion, no agreement was reached on the exact calculation method, especially regarding the deduction for lack of liquidity (see paragraphs 81 to 203). The parties asked the Commission to take account of the outcome of the understanding in its decision. The understanding did not concern the 1986 transfer; the parties declared that they would not object to a definitive Commission decision on the limitation period for this transfer.

(79) Applying the CAPM, the parties first determined a minimum normal market remuneration for the contribution to the capital reserve (some DEM 959 million). Assuming a risk-free interest rate of 7,23 %, a general market risk premium of 4 % and a beta value of 0,74, the appropriate minimum remuneration for the shares transferred to the capital reserve should, under this understanding, amount to 10,19 %. Since FHH was the sole owner, no other premium, e.g. for the lack of voting rights, was agreed. Lastly, a deduction of 3,62 % was determined for the capital's lack of liquidity (on the basis of the risk-free interest rate as gross refinancing costs, of which some 50 % company taxes plus solidarity surcharge to determine net refinancing costs). This gives an appropriate remuneration of 6,57 %.

(80) HSH and FHH calculated a remuneration margin of 129 basis points for the DEM 300 million transfer to the silent partnership reserve since the gross refinancing costs had to be deducted. The BdB also preferred a calculation based on the CAPM and, applying a lower beta factor (0,32) for this special transaction, which took place at the same time, and the after-tax liquidity deduction of 3,62 % and deducting solely the (net refinancing costs), arrived at an appropriate remuneration of 4,89 %.

VIII. ASSESSMENT OF THE MEASURES

1. ON THE GENERAL QUESTION OF THE LIMITATION PERIOD

(81) Germany has taken the view that the ten-year limitation period provided for in Article 15 of Regulation (EC) No 659/1999 has elapsed as regards the transfer on 1 January 1986 of 24 % of the shares, which increased HLB's capital by DM 212 160 000, in so far as it constituted state aid. The Commission requests for information dated 12 January, 10 November and 13 December 1993, i.e. those prior to 1 January 1996, were general in nature and so were not measures under Article 15(2) of the Regulation that could have interrupted the limitation period.

(82) After examining the facts of the case closely, the Commission agrees with this view and will not subject the transfer of 1 January 1986 to a further state aid investigation.

(83) It is to be noted that Article 15(1) of the Regulation (entry into force on 16 April 1999), which sets a deadline for the recovery of unlawful aid, applies to any definitive action ordering recovery of aid taken after the date on which the Regulation entered into force, including aid granted before that date ([16]) . The beginning of the ten-year period, within which the Commission may recover unlawful aid, is the day on which the aid was granted, even if the Regulation was not applicable at that time ([17]).

(84) The transfer on 1 January 1986 was a one-off, non-recurrent state measure. It thus differs from state regulations that provide for recurrent measures such as annual grants or tax reliefs. Moreover, it has no *de facto* or *de jure* relationship with the 1993 transfer. The side letter of 22 December 1992, which is mentioned by Germany in a letter dated December 1999 and was subsequently handed over, does not, as originally claimed, speak of a uniform investment objective for both transfers. It refers solely to the 1993 transfer and, for this purpose, takes over a specific rule governing the 1986 transfer and applies it to the 1 January 1993 transfer of additional shares, namely the right of FHH to require the transfer of WK's shares.

(85) The transfer of FHH on 1 January 1986 is to be taken as the time at which the unlawful aid, if any, was granted. As a result of the legally valid injection of resources under the conditions described above, the possible economic advantage at issue here accrued to HLB. The resources were available to HLB with effect from 1 January 1986; they were recognised by BAKred for 1986. Accordingly, the ten-year period ended on 1 January 1996.

(86) In accordance with Article 15(2) of Regulation (EC) No 659/1999, the ten-year period is interrupted by any action taken by the Commission or by a Member State, acting at the request of the Commission, with regard to the unlawful aid. In *Scott* the Court of First Instance ruled that, although a request made by the Commission prior to the entry into force of the Regulation for information concerning a clearly defined possible aid measure could not possibly interrupt the ten-year period at that time, such an effect could be attributed to it if the Commission exercises its powers to recover the aid in question following the entry into force of the Regulation. ([18])

([16]) [2003] ECR II-1789 ('Scott').

([17]) Ibid.

([18]) Ibid, paragraph 57.

(87) In the present case the Commission requests for information prior to 1 January 1996 do not satisfy the requirements for action interrupting the ten-year period as they do not constitute action *with regard to the unlawful aid*, as provided for in Article 15(2).

(88) Prior to the request for information dated 1 September 1999, the Commission did not, in any letter to Germany, ask about the transfers in Hamburg and did not mentioned either FHH or HLB. The three letters from 1993 refer exclusively to the transfer of WfA to WestLB; what is more, they simply contain general requests relating to other possible transfers to Landesbanks of other *Länder*. In addition to questions concerning WestLB, the request for information dated 10 November 1993 mentions only the Länder of Berlin, Schleswig-Holstein and Lower Saxony. In its two letters of 1994 and its letter of 3 January 1995, the BdB did, it is true, draw attention to the transfers of FHH to HLB. However, the Commission reacted for the first time in its letter dated 1 September 1999 and requested information on the transfers in Hamburg.

(89) Before the end of the ten-year recovery period on 1 January 1996, there was therefore no evidence of a Commission investigation into the transfers to HLB. The correspondence relating to WestLB and the general enquiries regarding possible transfers in other *Länder* cannot replace requests for information with regard to a specific possible aid. Otherwise, general Commission notices sent out every ten years would interrupt the period and would undermine the purpose of any limitation period.

(90) In the Commission's view, Germany and HLB can, under the special circumstances of the 1986 transfer, rely on legal certainty and confidentiality even though the contribution was not notified in accordance with Article 88 of the EC Treaty. It should be borne in mind here that state aid legislation and monitoring was not at that time as developed in all details as it has been since the 1990s. This is particularly true as regards capital injections by public-sector owners and, for example, the market-economy investor principle, which was developed only after the first transfer to HLB and has been examined in practice. To this extent, the German authorities and HLB, which in 1986 undertook share transfers between two companies wholly owned by it, could not assume the existence of possible state aid and hence the need for a notification.

(91) Accordingly, the Commission regards the ten-year period under Article 15(1) of Regulation (EC) No 659/1999 as having expired. Any aid associated with the contribution of 24 % of WK's shares to HLB on 1 January 1986 is to be regarded as existing aid within the meaning of Article 15(3) of the Regulation. The observations below refer exclusively to the transfers carried out on 1 January 1993.

2. STATE AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE EC TREATY

(92) Article 87(1) of the EC Treaty states that, save as otherwise provided in the Treaty, any aid granted by a Member State or through state resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, in so far as it affects trade between Member States.

2.1 *State resources and favouring of a particular undertaking*

(93) As stated above, a total of just under 58 % of FHH's shares in WK was transferred directly and indirectly (silent partnership contribution through HGV) to HLB on 1 January 1993. This ranks as state resources within the meaning of Article 87(1) of the EC Treaty.

(94) The economic benefit of a broader capital base resides in a greater lending capacity and the associated possibility of expanding business. If additional capital is made available to the undertaking on conditions better than normal market conditions, this ranks as favouring within the meaning of Article 87(1) of the EC Treaty. In examining this matter, the Commission applies the 'market-economy investor' principle. The Court of Justice and the Court of First Instance have accepted and developed this principle in a number of cases, in particular in the ruling by the Court of First Instance of 6 March 2003 ([19]), which is of relevance to the present case.

(a) Market-economy investor principle

(95) According to this principle, no state aid is involved where 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

([19]) See footnote 3.

under normal market-economy conditions' ([20]). In contrast, a financial measure is deemed unacceptable for a market-economy investor if, and this has to be examined, the expected or agreed remuneration for the transferred resources is lower than the remuneration paid on the market for comparable investments.

(96) The market-economy investor principle is likewise applicable to all public undertakings, irrespective of whether they are profit- or loss-making. This position of the Commission has been confirmed by the Court of First Instance in *WestLB* ([21]).

(97) The Commission must base its assessment of a case on the information that was available to the investor when he decided on the financial measure in question. The transfer at issue here was decided by the competent authorities at the end of 1992 and became effective on 1 January 1993. The Commission must, therefore, assess the transaction on the basis of the information available and the economic and market circumstances obtaining at the time. Information in this decision that refers to subsequent years is used only for purposes of illustration.

(98) If a public shareholder decides that a capital injection for the bank is appropriate for meeting capital requirements, the question arises whether the specific circumstances under which the capital is provided would be acceptable to a market-economy investor. If a capital measure is necessary to meet solvency requirements, a market-economy investor might be prepared to undertake such a measure in order to safeguard the value of the existing investment. He would, however, insist on an appropriate return for the new capital injection that took account of the risk profile.

(99) Even if a market-economy investor already holds shares in an undertaking, he will look into other investment options outside that undertaking. As a rule, he will then choose to invest further in the public undertaking only if he can expect a reasonable return on the additional resources. Basically, no account is taken of the mere avoidance of losses or of a better use than previously of the resources in question in deciding whether a capital contribution constitutes state aid. Whatever the motives behind it, a capital injection by a shareholder should be measured instead according to whether the investor can expect a normal return on the additional resources within a reasonable period.

(100) The Court has raised no objections to this interpretation of the market-economy investor principle, which the Commission has already applied in its Decision 2000/392/EC ([22]). It has also adopted as a guiding principle that even a private investor who already owns share capital in an undertaking is not normally content with the fact that an investment does not cause him a loss or produces only limited profits. Instead he will always seek to obtain an appropriate return on his investment according to the particular circumstances and the satisfaction of his short-, medium- or long-term interests ([23]).

(101) According to the market-economy investor principle, the key question in examining this case is, therefore, whether a market-economy investor would have transferred under the same conditions capital that had the same characteristics as the promotion-related assets of FHH, especially in view of the expected return on the investment.

(b) **Article 295 of the EC Treaty**

(102) Article 295 lays down that the system of property ownership in the various Member States must not be affected. This does not, however, justify any infringement of the competition rules of the Treaty.

(103) Germany has stated that the resources transferred could not have been used in any other profitable manner than by being injected into a similar public institution. Consequently, the transfer represented the commercially most sensible use of those assets. So any remuneration for the transfer, i.e. any additional return on the assets transferred, would be sufficient to justify the transfer in the light of the market-economy investor principle.

(104) This line of argument cannot be accepted. It may be that the contribution of the shares to HLB and the resulting opportunity for the bank to use the capital for solvency purposes was the economically most sensible use to which it could be put. However, as soon as public monies and other assets are used for commercial, competition-oriented activities, the normal market rules must be applied. This means that the State, once it decides to use certain assets (also) commercially for public purposes, must demand a remuneration in line with the normal market remuneration.

(c) **Ownership structure**

(105) The key question, as formulated by the Court of First Instance in *WestLB* with reference to the previous case law, is whether, in similar circumstances, a private investor operating in normal conditions of a market economy and of a comparable size to that of the bodies operating in the public interest could have been prompted to make the capital contribution in question ([24]). Lastly, as the Court also points out with reference to other case law, 'the comparison between the conduct of public and private investors must be made by reference to the attitude which a private investor would have had at the time of the transaction in question having regard to the available information and foreseeable developments at the time' ([25]).

([20]) 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; see paragraph 11. Although this communication deals expressly with manufacturing, the principle doubtless applies likewise to all other sectors of the economy. As regards financial services, this approach was confirmed by a number of Commission decisions, e.g. in *Crédit Lyonnais* (OJ L 221, 8.8.1998, p. 28) and *GAN* (OJ L 78, 16.3.1998, p. 1).

([21]) See footnote 3 and paragraph 206 *et seq*.

([22]) See footnote 2 and paragraph 161 *et seq*.

([23]) See footnote 3 and paragraphs 241 and 314.

([24]) *WestLB*, paragraph 245.

([25]) *WestLB*, paragraph 246.

This makes it clear that the assessment must focus on the time of the investment and on the expectations which an investor might reasonably, i.e. on the basis of available information, have had at that time. These expectations essentially relate to the likely return.

(106) FHH was the sole owner of HLB. Even if this fact were to make it possible not to focus simply on an agreed remuneration (here DEM [...] million [...], corresponding to [at most 10 %] on the silent partnership contribution), ownership of FHH cannot be relied on in the present case to justify the low level of direct remuneration.

(107) Reference to FHH's ownership of HLB would necessitate the existence of a business plan, expert report or valuation of the expected return on the investment in question.

(108) This was not the case here. At the time of the investment, there was no business plan, expert report or valuation of the expected return on the investment in question. Except for the agreed direct remuneration, the Commission therefore has no reliable and quantifiable evidence for the return expected by FHH at the time.

(109) Germany stated that not only the reserves built up by HLB itself and regularly converted into capital but also the dividend payments to FHH as the sole owner ought to have been considered since the profits generated by HLB were inevitably also attributable to the resources transferred by FHH. In addition, account must be taken of the increases in value that were produced by the capital contributed and were also achieved in 1997 with the sale of the shares to LSH.

(110) According to the principle of the market-economy investor, who, on the basis of the information available to him at the time of the investment, can either expect or agree on an appropriate return, dividend payments or increases in value occurring *after* the investment are not relevant. Consequently, dividend payments or increases in value that could not be calculated beforehand cannot be determining factors. Nor can the question as to whether or not an increase in value following a sale generates revenue. In addition, dividends are paid on capital and not on reserves, even if these contribute to an increase in earnings per share.

(111) The Commission thus takes the view that, in the present case, an appropriate remuneration should be determined in the light of the direct return that a market-economy investor would have demanded.

(d) **Remuneration and elements of remuneration for the contribution of DEM 659,4 million to HLB's capital reserve**

Capital base for calculating the remuneration

(112) As in the WestLB case and as has been confirmed by the Court, remuneration is basically payable in respect of the entire value of the assets transferred. It may differ for parts of the resources transferred. In setting an appropriate remuneration, a distinction should be made between the different parts of the capital reserve according to their benefit for HLB.

(113) The value of the shares transferred and shown on the balance sheet remained constant after 1 January 1993 at DEM 659,4 million. However, that amount could not be used in full as capital prior to its recognition by BAKred. Until it was recognised as capital on 1 January 1997, its use was tolerated by BAKred only in so far as this was necessary to meet the relevant solvency rules. For instance, from 1993 to 1996 HLB covered parts of the reserve (DEM 182,5 million in 1993, over DEM435,6 million in 1994, DEM 255,1 million in 1995 and DEM 451,1 million in 1996). After 1997, because of the prudential requirement to cover the reserve with capital of DEM [...] million at all times, only DEM [...] million could be utilised in full up to May 2003. The table in paragraph 183 gives the relevant basis for calculating the appropriate return on liable capital.

(114) Although they were not, and could not, be used to expand its competitive business, the parts of the reserve that were not covered up to 1997 and could not subsequently be covered (see the table in paragraph 183) were still of benefit to HLB since the amount of capital shown on the balance sheet provides the bank's lenders with an indication of its soundness and thus affects the conditions on which it can borrow capital. Creditors and ratings agencies take the bank's overall economic and financial situation into account. Since these amounts could not be used each year for business expansion but improved the bank's standing in the eyes of creditors, the economic function of the capital can in this respect at least be compared to a guarantee.

(115) A market-economy investor would also have required a remuneration for these resources on account of the economic benefit they conferred.

Appropriate remuneration for liable capital

(116) Financial assets of differing economic quality demand differing returns. Determining whether an asset is acceptable for an investor operating under normal market conditions must, therefore, be based on the specific economic nature of the capital measure in question and on the value to HLB of the capital made available.

Similarity of the investment to share capital

(117) The Commission takes the view that, apart from its lack of liquidity, the contribution to the capital reserve, which, at least from 1997 onwards, has been regarded as core capital by BAKred, most closely resembles an investment in share capital.

(118) The complainant shares this view. Germany had, on account of the risk profile, compared the capital reserve to a silent partnership contribution. In their understanding, the parties took the similarity to share capital as the basis for calculating an appropriate remuneration.

(119) The special-purpose reserve has been recognised by BAKred as core capital ('tier 1 capital') and can therefore be compared only with equity instruments that were recognised as core capital in Germany in the year of the transfer. According to the information available to the Commission, these were in 1992 simply the equity or share capital of a bank as well as the reserves and silent partnership contributions that satisfied the special requirements laid down in Section 10(4) KWG.

(120) The Commission has already made clear in its Decision 2000/392/EC that a comparison between WfA's assets, which were also recognised as core capital, and hybrid equity instruments that were regarded only as additional capital, such as profit participation certificates and non-voting preference shares, cannot serve as a basis for determining the appropriate remuneration for the transferred capital ([26]). Core capital is of greater benefit to an undertaking because it can be used to raise additional own funds (e.g. profit participation certificates) up to the same amount in order to increase its own funds base. For the capital provided to be recognised as original own funds, there must be greater exposure to risk, which, as a general rule, is also reflected in a higher market remuneration for such instruments. Any point of comparison with 'additional funds' that offer only limited scope for business expansion can therefore be ruled out at the outset.

(121) The Commission considers that the comparison with silent partnership contributions made by Germany and HLB is not suitable as a basis for determining the appropriate remuneration for the capital reserve. Instead, the transfer of the shares is comparable to an investment of share capital in HLB.

(122) An essential point for the Commission is that the transfer of the promotion-related assets was precisely not in the legal form of a silent partnership contribution but consisted in the creation of a reserve. Although it is also true that a capital reserve has a number of characteristics that are typical, if anything, of silent partnership contributions, the Commission considers that the risk that the transferred capital would be used at least in part for cover purposes in the event of insolvency or liquidation was generally no less than that associated with a share capital investment.

(123) Given the above views, notably regarding an analysis of the risk incurred by an investor in carrying out the transaction at issue, the Commission concludes that the starting point for calculating the appropriate remuneration for the transfer to HLB's capital reserve is the amount of share capital made available.

Liquidity costs

(124) Germany takes the view that, on account of the lack of liquidity and the resulting refinancing costs, the transfer of WK's shares can best be compared to a real capital contribution. As it stated in its original position, this meant, in terms of the gross return, a difference of some 6,6 % compared with capital contributed in cash. A market-economy investor must take this cost into account when considering the appropriateness of his remuneration.

(125) The Commission is also of the opinion that the lack of liquidity should be taken into account. 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 extend its business. 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 %), 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 ([27]).

(126) Since its capital did not provide any liquidity at first, HLB incurred additional financing costs to the extent of the amount of capital if it borrowed on the financial markets the funds necessary to exploit fully the business opportunities opened up by the additional own capital, i.e. to expand the risk-weighted assets by a factor of 12,5 (or to maintain existing assets at this level) ([28]). Because of these extra costs, which do not arise in the case of equity capital provided in liquid form, 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.

([26]) See footnote 2 and paragraph 199.

([27]) 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.

([28]) 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).

(127) The Commission is here of the opinion that the overall refinancing interest rate must 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 cooperation tax. Only the net costs should be taken into account as an additional burden on HLB because of the special nature of the capital transferred. Overall, therefore, the Commission recognises that HLB incurred additional 'liquidity costs' to the amount of 'refinancing costs less company taxes'.

(128) In their understanding, the parties similarly base their calculation on the net refinancing costs. They applied a long-term, risk-free interest rate of 7,23 % for the total refinancing costs ([29]). They also agreed to accept a flat-rate level of tax of 50 % ([30]).

Determination of a likely minimum remuneration for an investment in the share capital of HLB

(129) The expected return on an investment and the investment risk are key determinants in the decision of a market-economy investor to invest. In order to determine their level, the investor incorporates all available firm-related and market-related information into his calculation. He bases himself on historical average rates, which, generally speaking, are also a point of reference for a firm's future efficiency, and *inter alia* on an analysis of the company's business model for the investment period in question, the strategy and quality of management or the relative prospects for the sector in question.

(130) A market-economy investor will undertake an investment only if it produces a higher return or a lower risk than the next-best alternative use of his capital. Similarly, he will not invest in a company whose expected return is lower than the average return expected for other companies with a similar risk profile. It can be assumed in the present case that there are sufficient alternatives to the assumed investment project that promise a higher expected return with the same risk.

(131) Various methods exist for determining the minimum appropriate remuneration. They range from differing variants of the financing approach to the CAPM method. In describing the various approaches, it makes sense to distinguish between two components, viz. a risk-free return and a project-specific risk premium: minimum appropriate return on a risky investment = risk-free basic rate + risk premium for the risky investment. Consequently, the minimum appropriate remuneration for a risky investment can be described as the sum of the risk-free rate of return and the additional risk premium for assuming the investment-specific risk.

(132) The basis for any determination of return is thus the existence of a default-risk-free form of investment with an assumed risk-free return. The expected return on fixed-interest government securities is normally used in determining the risk-free basic rate (or, as the case may be, an index based on such securities), but these represent forms of investment with a comparably low risk. The various methods differ, however, when it comes to determining the risk premium:

— *Financing approach*: An investor's expected return on capital represents, from the point of view of the bank using the capital, future financing costs. Under this approach, the historical capital costs incurred by comparable banks are first of all determined. Their arithmetic average is then compared with the future expected equity capital costs and hence with the investor's expected return requirement.

— *Financing approach with compound annual growth rate*: At the heart of this approach stands the use of the geometric rather than the arithmetic mean.

— *CAPM*: The CAPM is the best-known and most frequently tested model of modern finance with which the return expected by an investor can be determined applying the following equation: expected return = risk-free interest rate + market-risk premium x beta. The beta factor is used to quantify the risk of a company relative to the overall risk of all companies. The risk premium for the specific investment is determined by multiplying the market's risk premium by the beta factor.

(133) The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since HLB is not a listed company, it is not possible directly to infer its beta value. The CAPM can, therefore, be used only on the basis of an estimate of the beta factor. Germany is thus critical of the use of the CAPM for, among other things, a transfer to a Landesbank.

(134) In their calculations, the parties based themselves on the CAPM and applied a risk-free basic interest rate of 7,23 % for NordLB. Determination of this interest rate was based on the assumption that the LTS special-purpose assets were to be made available on a permanent basis. The parties thus

([29]) The REX10 Performance Index of Deutsche Börse AG was used as a generally recognised source in determining the risk-free basic interest rate.

([30]) According to documents provided by the German Government, the corporation tax rate was 46 % in 1992, to which has to be added the solidarity surcharge of 3,75 % (i.e. 49,75 % in total). The overall tax rate fell to 46 % in 1993 before rising to 49,5 % in the period 1994-2000. It has been 30 % since 2001.

decided not to use a risk-free rate obtaining on the market at the time of the capital injection for a fixed investment period (e.g. 10-year return on government bonds) since such an approach would disregard the reinvestment risk, i. e. the risk that it would not be possible to invest again at the level of the risk-free interest rate once the investment period had expired. In the view of the parties, a total return index was the best way of taking the investment risk into account. They opted, therefore, for the REX10 Performance Index of Deutsche Börse AG, which tracks the performance of an investment in Federal loans over a period of ten years. The index series used in the present case contains the relevant end-of-year results of the REX10 Performance Index after 1970. The parties then determined the rate per annum, which reflects the trend tracked by the REXIO Performance Index in the period 1970-91 and, in this way, arrived at the risk-free basic interest rate of 7,23 % referred to above.

(135) Since HLB's capital injection was made available on a permanent basis, the method of determining the risk-free basic interest rate appears appropriate in this specific case. Moreover, the REX10 Performance Index is a generally recognised source of data. The risk-free basic interest rate calculated thus appears appropriate here.

(136) The beta factor of 0,74 was estimated on the basis of a KPMG report on adjusted beta factors for all listed credit institutions in Germany that is available to the Commission. In the light of the report and of HLB's business profile, this beta factor is to be regarded as appropriate.

(137) The Commission also regards the market-risk premium of 4,0 % as acceptable. Previously in the procedure, the so-called general long-term market-risk premium, i.e. the difference between the long-term average return on a normal share portfolio and that on government bonds, was applied on several occasions. In the corresponding report on the procedure, a range of some 3 % to 5 % was applied, depending on the method, the period under examination and the basic relevant data. A report prepared for BdB calculated figures of 3,16 % and 5 %. Another report on WestLB drawn up in the first procedure produced figures of 4,5 % and 5 %, while Lehman Brothers, also for WestLB, calculated a figure of 4 %. Against this background, the Commission has no reason to depart from the market-risk premium used in the understanding. On the basis of the CAPM, the Commission considers there to be no doubt that the minimum remuneration determined by the parties can be regarded as appropriate.

(138) The Commission has no reason to believe that the minimum remuneration determined by the parties for a hypothetical share capital investment cannot pass a market test. Accordingly, it sets as the appropriate minimum remuneration a figure of 10,19 % per annum (after corporation tax and before investor tax).

Abolition of the return premium on account of sole ownership

(139) It has to be ascertained whether there are reasons for adjusting the minimum remuneration. In line with the practice in the other Landesbank procedures, the following three characteristics, which are peculiar to the transaction, justify such a premium: (i) the decision not to issue any new company shares and the associated voting rights, (ii) the unusually large transfer of assets; and (iii) the investment's lack of fungibility.

(140) As in the other procedures, the Commission takes the view that premiums in connection with the last two aspects mentioned above are not justified. No premium is possible either for the decision not to issue any new company shares and the associated voting rights since FHH already owns all the voting shares.

No reduction in remuneration for agreement on a flat-rate remuneration

(141) In the case of shares, the remuneration depends directly on the company's results and consists primarily of dividends and a share in the increase in the company's value (e.g. expressed through share price rises). FHH receives a flat-rate remuneration which should reflect these two aspects of the remuneration for a 'normal' capital injection. It could be argued that the fixed remuneration which FHH receives instead of a remuneration linked directly to HLB's results constitutes a benefit that justifies a reduction in the level of remuneration. Whether such a fixed remuneration is actually more favourable than a variable, profit-related remuneration depends on the company's future results. If these deteriorate, the flat-rate remuneration is beneficial for the investor but, if they improve, the opposite is true. The actual trend cannot though be taken into account subsequently when it comes to assessing the investment decision. Accordingly, the Commission takes the view that the rate of remuneration need not be reduced.

Total remuneration

(142) In view of the foregoing and in agreement with the complainant BdB, FHH and HLB, the Commission comes to the conclusion that an appropriate remuneration for the amounts that were transferred to the capital reserve and that were used until 1997 and could be used subsequently as cover would be 6,57 % (after company taxes), i.e. normal return of 10,19 % on the investment less 3,62 % for the financing costs which HLB incurred on account of the lack of liquidity of the assets transferred.

Appropriate remuneration for the uncovered and uncoverable part of the capital reserve

(143) As stated above, the capital share that was not used up to 1997 and could not be used subsequently is of material value to HLB and its economic function can be compared to that of a guarantee or liability. A market-economy investor would demand an appropriate remuneration in return for exposing himself to a risk of this sort. The understanding between BdB, FHH and HSH Nordbank is silent on this matter.

(144) In Decision 2000/392/EC ([31]), Germany regarded a remuneration of 0,3 % per annum before tax as an appropriate initial rate. The grounds given in that decision for increasing the initial rate do not apply to the present case. In that decision a premium of a further 0,3 % per annum was added to the rate of 0,3 % per annum (before tax) because guarantees are normally tied to certain transactions and of limited duration (which was not the case in WestLB) and because the amount of DEM 3 400 million made available to WestLB was higher than that normally covered by such bank guarantees.

(145) On account of the fundamental comparability between WestLB and HLB and for want of other points of reference, the Commission assumes that a rate of 0,3 % corresponds to the remuneration that HLB would also have had to pay on the market in the early 1990s for a guarantee in its favour. It also notes that the amount of the capital in question is much smaller in the case of HLB than in the case of WestLB and that, for this reason, the second reason given in the WestLB decision does not hold. Admittedly, in the case of HLB, the guarantee function was not of limited duration or tied to a particular transaction. On the other hand, there was a *de facto* time limitation since the total amount could be used for business expansion once BAKred had recognised it as core capital. As a result, a separate guarantee commission no longer needed to be paid. The remuneration for the guarantee function was part of the remuneration for the business-expansion function. The fact of the sole guarantee function was, therefore, restricted from the outset, and this distinguishes the HLB case from the WestLB case.

(146) Accordingly, the Commission considers that, in the case of HLB as opposed to WestLB, a premium is not justified and so sets a rate of 0,3 % per annum (before tax) as an appropriate remuneration for the guarantee function of the capital from the time of its inclusion in the balance sheet on 1 January 1993 until its recognition by BAKred. Assuming a corporation tax rate of some 50 % at that time, an after-tax assessment gives a rate of 0,15 %. This after-tax rate of 0,15 % was applied by the parties in calculating the aid element in the table attached to the understanding.

(147) A guarantee premium constitutes an operating expense for HLB and thus reduces the taxable profit. The remuneration payable to FHH comes out of after-tax profits. Consequently, the rate of 0,3 % has basically to be adjusted for the tax rate. As with the refinancing costs, the Commission assumes a single overall tax rate of 50 %. Consequently, it sets a rate of 0,15 % per annum after tax.

(e) **Remuneration for the silent partnership contribution**

(148) A remuneration of DEM [...] million, i.e. [at most 10 %] on an amount of DEM 300 million per year, was paid throughout for the silent partnership contribution. In the Commission's view, it is of no relevance to the assessment that this compensation was paid to HGV since the latter was a wholly owned holding of FHH and since the indirect way was chosen only for tax reasons. Whether an investor selects a holding to receive the remuneration or books the remuneration direct cannot be of any importance for the state aid investigation in the present case.

(149) The silent partnership contribution had a 16-year maturity, i.e. it could not be called earlier. And so, in spite of this long period, it has to be regarded as a silent partnership contribution of limited duration.

(150) Germany has stated that a remuneration of 1,29 % would have been appropriate for the silent partnership contribution given the comparison with similar instruments and the lack of liquidity. The BdB considers that, although, compared with the capital reserve, a deduction should be made, there was basically a similarity to share capital so that, as stated above, a higher remuneration should be assumed.

Capital base

(151) From 1 January 1993 onwards, the value of the silent partnership contribution remained unchanged at DEM 300 million. However, as stated earlier, the amount was not used as liable capital before its recognition by BAKred. After 1 January 1997 the DEM 300 million could be used in full until May 2003. The table in paragraph 183 provides details on the calculation basis of relevance to the appropriate return on liable capital.

(152) Although the silent partnership contribution that was not covered prior to 1997 was not, and could not, be used to expand competitive business, it was of benefit to HLB since the amount of equity shown on the balance sheet provides the bank's lenders with some indication of its soundness and thus affects the conditions on which the bank can borrow outside capital. Creditors and ratings agencies take the bank's overall economic and financial situation into consideration. Since this amount cannot be used each year for business expansion but improves the bank's standing in the eyes of creditors, its economic function can in this respect be compared at least to a guarantee.

([31]) See footnote 2 and paragraph 221.

(153) A market-economy investor would also have demanded a remuneration for these resources on account of the economic benefit they conferred. However, as with the capital reserve, the amount of this remuneration is lower than that for the part of the equity that can be used by HLB for its competitive business.

Legal and economic classification of the transferred capital

(154) As with its approach in Decision 2000/392/EC, the Commission will determine the appropriate remuneration for the promotion-related assets transferred on the basis of their commercial benefit to HLB. As explained above, the starting point for determining the normal market remuneration in this case is the remuneration that would be demanded by a market-economy investor providing a bank with equity capital.

(155) The BdB is of the opinion that this constitutes an investment similar to share capital. However, the comparability with share capital is undermined by the fact that the investment is callable, albeit only after a long time. Even so, in the event of losses, the silent partnership contribution would have equal ranking with the share capital. Lastly, the callability of the investment serves to reduce risk, with the result that the silent partnership contribution should be remunerated with a small discount compared with share capital. However, Germany disputes this similarity to share capital. In its view, the capital is instead a silent partnership contribution, with this being reflected in the level of the remuneration.

(156) Germany, the BdB and the Commission agree that the silent partnership contribution constitutes core capital. Since 1997 at any rate, the silent partnership contribution has been recognised by BAKred as core capital ('Tier 1 capital') and can, therefore, be compared only with such equity capital instruments that were recognised in Germany as core capital at the time of the transfer.

(157) The Commission agrees with the parties on this point. It already made clear in its Decision 2000/392/EC that a comparison between WfA's assets, which were also recognised as core capital, and equity instruments that were recognised only as additional capital, such as profit participation certificates and non-voting preference shares, cannot serve as a basis for determining the appropriate remuneration for the transferred capital ([32]). Core capital is of greater benefit to an undertaking 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. For the capital provided to be regarded as original own funds, there must be greater exposure to risk, which, as a general rule, is also reflected in a higher market remuneration for such instruments. Any point of comparison with 'additional funds', which offer only limited scope in business expansion, can therefore be ruled out at the outset.

(158) The Commission considers that, viewed from a risk analysis angle, the silent partnership contribution is, typologically speaking, a 'normal' silent partnership contribution, and not share capital. To this extent, it agrees with Germany. In the event of insolvency, both the silent partnership contribution in question and other silent partnership contributions of limited duration raised on the capital market would be repaid before the share capital and the investor would receive the relevant percentage in bankruptcy whereas, in the case of a share capital investment, he would come out with nothing. As long as the undertaking does not make any losses, FHH receives the total remuneration agreed, whereas an investor in share capital qualifies simply for the payment of a profit-related, i.e. much smaller, dividend.

Determining an appropriate remuneration for the silent partnership contribution of limited duration to HLB

(159) As explained, the Commission regards the capital measure at issue as a silent partnership contribution. A determining factor in assessing the market appropriateness of the agreed remuneration is whether it can be regarded as normal compared with remunerations agreed on the market for economically and legally comparable transactions involving silent partnership contributions. Starting from the methodology employed by FHH and HLB, the remuneration for the silent partnership contribution in question should be determined on the basis of silent partnership contributions that are of limited duration and otherwise comparable.

(160) Germany has stated that, during the 1990s, silent partnership contributions were used increasingly by the Landesbanks to expand their capital base. The silent partnership contribution resulting from the transfer of WK's assets to HLB was, therefore, one of the first such transactions of appreciable size in the banking sector in Germany.

(161) As a risk profile analysis of various equity capital instruments had shown, silent partnership contributions, given a comparable share of liability and in view of their fungibility as a contribution of limited duration with a fixed remuneration, strongly resembled profit participation certificates. In addition, there were tax advantages for the accepting bank since the interest payable does not involve the use of profits but usually, as in the present case, represented a (tax-reducing) operating expense.

(162) The silent partnership contribution to HLB on 1 January 1993 was the first and — for almost five years — the only transaction of this kind for the bank and HLB knew nothing about simultaneous reference transactions by other Landesbanks. It was not possible, therefore, to determine the appropriate risk premium for the silent partnership contribution directly on the basis of other agreed silent partnership contributions. However, the available data on

([32]) See footnote 2 and paragraph 199.

silent partnership contributions of limited and unlimited duration that were agreed with third parties in 1997 and 1998 permitted an indirect calculation in cases where the extent to which the appropriate risk premium for HLB instruments similar to equity capital instruments had changed between the end of 1992 and the end of 1997. Changes in the risk premium for long-term HLB profit participation certificates could serve as a benchmark. As a general overview that was submitted showed, the risk premium on HLB profit participation certificates demanded by investors increased appreciably overall during this period ([33]). If, therefore, the market conditions at the end of 1997 are transposed to 31 December 1992, the appropriate risk premium at the end of 1992 is at least not understated ([34]). Accordingly, the risk premium appropriate for the end of 1992 for a silent partnership contribution with a duration i can be determined by applying the following equation: risk premium on silent partnership contributions, i, 1992 = swap spread on Federal loans, i, 1992 + swap spread on silent partnership contributions, i, 1997.

(163) The market data collected for December 1997 and February 1998 and the interest rates on agreed silent partnership contributions would give for such contributions with a duration of 16 years a premium of some 1,25 % over swaps. Taking the market data as at 31 December 1992 (swap spread for Federal loans of 0,04 %), an appropriate risk premium for 16-year silent partnership contributions would be 0,04 % + 1,25 % = 1,29 %.

(164) Alternatively, the fair risk premium could also be derived from the conditions for other financial instruments with a similar risk profile, this being normal practice. Silent partnership contributions of limited duration rank between profit participation certificates and silent partnership contributions of unlimited duration as regards their risk profile. As a result, their risk premium must basically be higher than that for profit participation certificates but lower than that for silent partnership contributions of unlimited duration. Whereas reference values for silent partnership contributions of unlimited duration were available only from October 1999, market data for profit participation certificates were available as early as the beginning of the 1990s since the latter had already been in existence for quite some time and were dealt in daily on the stock exchange. In addition, the report drawn up by Lehman Brothers for WestLB gave risk premiums for profit participation certificates issued by German banks as at mid-December 1991 ([35]).

(165) In order to derive from HLB's conditions for profit participation certificates at the end of 1992 the appropriate risk premium for silent partnership contributions of limited duration to HLB, an assessment is needed of the fair return premium as between the two instruments. Here too, because of the incomplete data, reference can be had only to the market conditions at the end of 1997/beginning of 1998 and the resulting risk assessment by investors for HLB can be assumed to be adequate for the end of 1992. The appropriate risk premium for silent participation contributions at the end of 1992 can then be determined by applying the following equation: risk premium for silent partnership contributions, i, 1992 = risk premium for profit participation certificates, i, 1992 + spread for silent participation contributions/profit participation certificates, i, 1997.

(166) Market data as at December 1997 and February 1998 give a premium of 0,35 %-0,40 % over 10-year HLB profit participation certifications for 16-year silent participation contributions as at the end of 1997. Taking the market data as at 31 December 1992 (risk premium on 8-year HLB profit participation certificates of 0,91 %) gives an appropriate risk premium for 16-year silent participation contributions of between 1,26 % and 1,31 %. Applying the risk premium for 10-year profit participation certificates of 0,90 % used in the Lehman Brothers report for the end of 1991 yields virtually identical values ([36]).

(167) Using both methods, the information provided by Germany yields a margin of some 1,26 %-1,31 %. The basic data concerning issues of profit participation certificates and contributions made were sent to the Commission. The Commission also has access to surveys of the risk-free interest rates prevailing in the years under consideration for Federal loans and the Federal swap spreads valid for silent partnership contributions and other relevant spreads. It concludes, therefore, that the margin of 1,29 % communicated by Germany is altogether reasonable.

(168) In the Commission's view, there is no need for a further market investigation in connection with the state aid assessment of the market-like nature of the silent partnership contribution at issue. It is sufficient that the Commission should ensure, on the basis of trend forecasts, that the agreed remuneration falls within the normal market range.

1.1.1. Liquidity costs

(169) The — to this extent concurrent — arguments put forward by Germany and the BdB regarding the liquidity costs can be accepted where a 'normal' capital contribution to a bank provides it with both liquidity and an equity capital base that is necessary for supervisory reasons in order to expand business. As stated above, a bank that wishes to use the capital to its full extent, i.e. to expand its 100 % risk-adjusted assets by a factor of 12,5 (i.e. 100 divided by the solvency ratio of 8 %) must refinance itself on the financial

([33]) The determining factor here in each case is the return premium not on Federal loans but on swaps since the spread of swaps in the case of Federal loans ('swap spread') is determined basically by supply and demand on the swap market and not by considerations of creditworthiness.

([34]) In view of several upheavals on financial markets (e.g. the emerging markets crisis in mid-1997) and the implications of the Commission's state aid investigation into WestLB, the risk premium that an investor would have demanded for a silent partnership contribution of limited duration to HLB at the end of 1992 ought actually to have been lower than the market conditions at the end of 1997 suggest.

([35]) Cf. Lehman Brothers, *Analyse der Kapitalzuführung aus der Einbringung der Wohnungsbauförderungsanstalt des Landes Nordrhein-Westfalen* of 8 July 1997, p. 4, and Annex II, p. 27. This basically lists the issues floated by the leading German private commercial banks (Deutsche Bank, Dresdner Bank, etc.), which at the time had a higher business risk than HLB.

([36]) Cf. Lehman Brothers, *Analyse der Kapitalzuführung aus der Einbringung der Wohnungsbauförderungsanstalt des Landes Nordrhein-Westfalen* of 8 July 1997, p. 4.

markets 11,5 times over. Put simply, the difference between 12,5 times the interest received and 11,5 times the interest paid on this capital minus other costs of the bank (e.g. administration) gives the profit on the equity ([37]). Since the silent partnership contribution to HLB in question did not provide any liquidity initially, HLB incurred additional financing costs up to the amount of the capital when it borrowed on the financial markets the resources needed to exploit the business opportunities to the full. On account of these additional costs, a corresponding deduction must be made in order to determine the appropriate remuneration. A market-economy investor could not expect to be remunerated in the same way as for a cash injection.

(170) Unlike the BdB, however, the Commission considers that the gross refinancing interest is deductible. Refinancing costs constitute operating expenses and therefore reduce taxable income. The same, however, is true of the remuneration for a silent partnership contribution made in liquid form at the outset. Compared with the latter, which, as shown above, provides the appropriate market test, there is, therefore, no further tax benefit. In both cases, therefore, the bank's net profit is reduced by the amount of the interest paid for the liquidity. As a result, the total refinancing costs are deductible.

(171) This situation is similar to that in the Landesbank Hessen-Thüringen case but differs from the other Landesbanks that were also the subject of an investigation, including WestLB, since the promotion-related assets in the latter case are shown as reserves in the balance sheet and the total remuneration is to be regarded as a use of profits but not as an operating expense and thus has to be met out of taxed profits. The other Landesbanks thus enjoy a tax benefit where the costs for the liquidity that once more has to be found are tax-deductible as an operating expense, whereas this would not be the case for an investment that was in cash at the outset but otherwise identical, such investment providing the relevant benchmark.

(172) Since there is no (other) tax benefit, HLB has therefore to pay only the remuneration for the risk to which FHH is exposed by virtue of its promotion-related assets in the form of the silent participation contribution, i.e. the guarantee remuneration that is expressed in basis points and exceeds the relevant reference interest rate.

Appropriate remuneration for the uncovered part of the silent partnership contribution

(173) As stated above, the silent partnership contribution was not recognised as liable core capital for supervisory purposes in the period 1993-96.

(174) In Decision 2000/392/EC, the Commission assumed a basic rate of 0,3 % before tax for the amount shown in the balance sheet but which could not be used to underpin its competitive business. A premium corresponding to a further 0,3 % was charged on account of the amount in question and the absence of any limitation over time (see paragraph 144).

(175) In addition, unlike in the WestLB case, the Commission does not regard as justified a premium on account of the much larger amount for HLB. Since they are otherwise comparable cases, it also applies here a rate of 0,3 % per annum (before tax) as the appropriate remuneration for the guarantee function of the capital at the time of its inclusion in the balance sheet on 1 January 1993 until its recognition by BAKred (see paragraph 145). Since the remuneration for the entire silent participation contribution is tax-deductible as an operating expense and also differs in this respect from the tax treatment of the remuneration in Decision 2000/392/EC, this premium has to be understood as a before-tax rate that can be claimed in full as an operating expense.

(176) It transpires that the remuneration on the silent partnership contribution, DEM [...] million [...], corresponding to [at most 10 %] was altogether excessive.

(f) **Date as of which aid no longer present**

(177) Germany has shown that after the merger on 2 June 2003 between HLB and LSH to form HSH Nordbank, the WK shares received by HLB were transferred back to FHH.

(178) After 2 June 2003 HSH was, therefore, no longer able to underpin risk assets resulting from HLB's competitive business with special-purpose assets or to use the latter as a guarantee.

(179) In the Commission's view, it has thus been demonstrated that, with the hiving-off of the special-purpose assets, the aid under investigation ceased to be present on 2 June 2003.

(g) **Aid element**

(180) The calculation methods, remuneration components and remunerations described for the various forms of transferred capital give the amounts that are shown in the Table 1 in paragraph 183 and would have been payable as appropriate remuneration for the individual components and years.

(181) The amounts agreed as remuneration components at the time of the investment need to be deducted. In the Commission's view, only the remuneration of DEM [...] million [...] for the silent participation contribution is concerned. Other components such as the dividends paid and set by Germany cannot, however, be calculated. As stated above (see paragraph 110), according to the market-economy investor principle, dividend payments and/or increases in value occurring *after* the investment are not relevant.

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

(182) The Commission takes the view, however, that, in spite of the differences between the two capital instruments attributable to the fact that the 1993 transfer by FHH was designed as an overall package, the agreed, excessive remuneration for the silent partnership contribution can be set off as the remuneration paid for this entire investment project. The overpayment can therefore be set against the capital reserve as remuneration. It must though be converted into an after-tax value, something which the parties left open in their understanding.

(183) Accordingly, the aid element is made up of the following ([38]):

Table 1

Calculation of the aid element — HLB (in DEM m)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	(5 months) 2003
Amount of silent partnership contribution available to HLB	300,0	300,0	300,0	300,0	300,0	300,0	300,0	300,0	300,0	300,0	300,0
Remuneration payable (1,29 %)					3,9	3,9	3,9	3,9	3,9	3,9	1,6
Guarantee commission payable (0,3 %)	0,9	0,9	0,9	0,9							
Paid	30,0	30,0	30,0	30,0	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Overpaid (= imputable against capital reserve)	29,1	29,1	29,1	29,1	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Company taxes	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %	50,00 %
Less tax	- 14,6	- 14,6	- 14,6	- 14,6	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Recoverable overpayment after tax	14,6	14,6	14,6	14,6	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Amount of capital reserve from WK 1993 available to HLB	659,4	659,4	659,4	659,4	659,4	659,4	659,4	659,4	659,4	659,4	659,4
Finally recognised by BAKred	0,0	0,0	0,0	0,0	659,4	659,4	659,4	659,4	659,4	659,4	659,4
of which not usable as liable capital	0,0	0,0	0,0	0,0	[...]	[...]	[...]	[...]	[...]	[...]	[...]
of which used/usable as liable capital (*GS I-Anrechnung*) (as of 1997)	182,9	435,6	255,1	208,3	[...]	[...]	[...]	[...]	[...]	[...]	[...]
of which not used/not usable as liable capital (as of 1997)	476,5	223,7	404,2	451,1	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Remuneration payable (6,57 %)	12,0	28,6	16,8	13,7	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Guarantee commission payable (0,15 %)	0,7	0,3	0,6	0,7	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Total remuneration payable	12,7	29,0	17,4	14,4	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Recoverable overpayment from silent partnership contribution	14,6	14,6	14,6	14,6	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Aid element											
	- 1,9	14,4	2,8	- 0,2	[...]	[...]	[...]	[...]	[...]	[...]	[...]

([38]) On 1 January 1999 the German mark was replaced by the euro at a rate of EUR 1 = DEM 1,95583. The annual data on the aid element given in the table must be adjusted accordingly in order to calculate the total amount of aid to be recovered.

(184) An aid element of DEM 177,5 million (EUR 90,75 million) results from the difference between actual payments and the payments that would correspond to market conditions.

2.2 *Distortion of competition and effect on trade between Member States*

(185) 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.

(186) The beneficiary HLB carried on both regional and international banking business. It regarded itself as a universal commercial bank that was engaged above all in shipping finance and now operates under the name of HSH Nordbank. Despite its name, tradition and statutory tasks, HLB was much more than a mere local or regional bank until 2003.

(187) These facts clearly show that HLB offered its banking services in competition with other European banks outside Germany and, since banks from other European countries are active in Germany, inside Germany.

(188) It should also be pointed out that there is a very close relationship between a credit institution's equity capital and its banking activities. It is only when it has sufficient recognised equity capital that a bank can do business and expand its commercial activities. Since HLB was provided with such capital for solvency purposes as a result of the state measure, this had a direct impact on the bank's business opportunities.

(189) It is clear, therefore, that aid given to HLB distorts competition and affects trade between Member States.

2.3 *Finding*

(190) 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 that therefore the transfer of the special-purpose assets involves state aid within the meaning of that Article.

3. COMPATIBILITY WITH THE COMMON MARKET

(191) None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(192) 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 aspects, is applicable. Nor does the aid promote the execution of an important project of common European interest. It is not aimed either at promoting culture or heritage conservation.

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

(194) 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, apply also to restructuring aid in the banking sector. However, in the case at hand, the conditions for applying this exemption clause are not met. HLB was not an undertaking in difficulty whose viability had to be restored with the support of state aid.

(195) Article 86(2) of the EC Treaty, which allows exemptions from the Treaty's state aid rules under certain conditions, is also applicable, in principle, to the financial services sector. This was confirmed by the Commission in its report on services of general economic interest in the banking sector ([39]). The formal conditions for this are not met in the present case and were not referred to by Germany.

(196) 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. The contribution of WK's shares to HLB on 1 January 1993 is not existing aid.

(197) The transfer on 1 January 1993 cannot be regarded either as being covered by institutional liability and guarantor liability.

(198) On the one hand, the test of guarantor liability as a default liability vis-à-vis creditors in the event that the bank's assets are not sufficient to satisfy them is not met from the outset. The capital injection was not designed to satisfy HLB's creditors, and HLB's assets were not exhausted.

([39]) 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.

(199) On the other, the test of institutional liability does not apply either. Under institutional liability, the institution concerned is required to provide HLB with the resources necessary to safeguard its orderly functioning in so far as it decides to ensure HLB's continued existence. At the time of the capital injection, however, HLB was in no way unable to continue orderly operations. The capital injection was not, therefore, necessary to maintain the orderly functioning of LBB, which could therefore, on the basis of a conscious economic calculation by the Land as part-owner, also see future market opportunities under conditions of competition. The 'emergency provision' of institutional liability is not applicable to such a normal economic decision by the Land. Since no other existing aid scheme under Articles 87 (1) and 88(1) of the EC Treaty is applicable, the capital injection ranks as new aid within the meaning of Article 88 (3) of the EC Treaty.

IX. **CONCLUSION**

(200) Since the period specified in Article 15(1) of Council Regulation (EC) No 659/1999 has expired, the aid that might result from the transfer of WK's shares on 1 January 1986 can no longer be recovered and is to be regarded as existing aid under Article 15(3) of that Regulation.

(201) The aid resulting from the transfer of WK's shares on 1 January 1993 cannot be regarded as being compatible with the common market either under Article 87(2) and (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 unlawfully put into effect must be recovered by the German Government,

HAS ADOPTED THIS DECISION:

Article 1

The state aid which Germany has implemented for Hamburgische Landesbank — Girozentrale, now HSH Nordbank AG, amounting to EUR 90,75 million in the period from 1 January 1993 to 1 June 2003 is incompatible with the common market.

Article 2

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 it.

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision.

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 in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 [40].

Article 4

Germany shall inform the Commission, within two months of notification of this Decision, of the measures which were taken and which it intends to take in order to meet the commitments described in this Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

[40] OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION

1. **Calculation of the amount to be recovered**

1.1. Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient; if the measure consists of several instalments and reimbursements, use separate rows.
(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2. Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. **Recovery measures planned or already taken**

2.1. Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain which alternative measures are available in national legislation to bring about recovery of the aid. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2. By what date will the recovery of the aid be completed?

3. **Recovery already effected**

3.1. Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2. Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

on State Aid implemented by Germany for Landesbank Schleswig-Holstein — Girozentrale, now HSH Nordbank AG

(notified under document number C(2004) 3930)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/741/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 the Member State and other interested parties to submit their comments pursuant to the provisions cited above [1] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) The subject of these proceedings is the transfer of Wohnungsbaukreditanstalt des Landes Schleswig-Holstein ('WKA'), Wirtschaftsaufbaukasse Schleswig-Holstein AG ('WAK') and the special-purpose real-estate reserve by the Land of Schleswig-Holstein to Landesbank Schleswig-Holstein — Girozentrale ('LSH'). There are a further six cases in which proceedings have been initiated against Germany in connection with transfers of assets to Landesbanks, and in particular to Westdeutsche Landesbank Girozentrale ('WestLB').

(2) By letter of 12 January 1993, the Commission asked Germany for information on a DEM 4 billion capital increase for WestLB resulting from the incorporation of the housing organisation Wohnungsbauförderanstalt ('WfA') and on similar increases in the own funds of the Landesbanks of other Länder. It asked which Landesbanks had benefited from a transfer of public enterprises and for information on the reasons for those transactions.

(3) Germany replied by letters dated 16 March and 17 September 1993. The Commission requested further information by letters of 10 November and 13 December 1993, to which Germany replied by letter of 8 March 1994.

(4) By letters of 31 May and 21 December 1994, the Bundesverband deutscher Banken e.V. ('BdB'), an association representing private banks established in Germany, informed the Commission that, among other things, WKA and WAK, together with their entire assets, had been transferred to LSH with effect from 1 January 1991. At the same time, WKA's and WAK's tasks had been transferred to the recently set-up Investitionsbank Schleswig-Holstein ('IB'). IB operated as a special division of LSH. This increased the own funds at LSH's disposal and, in the BdB's view, distorted competition in its favour since the parties had not agreed remuneration consistent with the market-economy investor principle. In its second letter, the BdB accordingly lodged a formal complaint and called on the Commission to initiate proceedings against Germany under Article 93(2) of the EC Treaty (now Article 88(2)).

(5) The complaint also related to similar transfers of assets to Landesbank Berlin, Westdeutsche Landesbank, Norddeutsche Landesbank, Hamburger Landesbank and Bayerische Landesbank. In February and March 1995 and December 1996 several banks associated themselves individually with the complaint lodged by their association.

(6) By letters of 6 August 1997 and 30 July 1998, the BdB informed the Commission of two further transfers of assets, to Landesbank Schleswig-Holstein in Schleswig-Holstein and Landesbank Hessen-Thüringen in Hessen. According to the BdB, the Land of Schleswig-Holstein intended to transfer the real estate it owned to IB as a special-purpose reserve forming part of LSH's equity capital. The BdB referred in this context to Section 20 of a bill amending the Schleswig-Holstein Investment Bank Act (version as at 26 June 1997), which stipulates that the real-estate assets, after deduction of liabilities, should be considered to constitute a special-purpose reserve forming part of LSH's equity capital. The BdB also referred to the comments on Section 20 contained in the explanatory memorandum to this bill, which state that the special-purpose real-estate reserve constitutes part of the bank's liable equity capital according to the principles of the Banking Act (Kreditwesengesetz). The stated objective of 'mobilising Land assets in order to create liquidity without loss of disposal or

[1] OJ C 76, 28.3.2003, p. 2.

decision-making authority on the Land's part' would not be achieved if LSH were actually to pay the market price for the real estate transferred to it.

(7) The Commission first examined the transfer of assets to WestLB but announced that it would review the transfers to the other banks in the light of the findings in that case ([2]). By Decision 2000/392/EC ([3]), it finally declared in 1999 that the aid measure (the difference between the remuneration paid and the normal market remuneration) was incompatible with the common market and ordered that the aid should be recovered. This decision was annulled by the Court of First Instance of the European Communities on 6 March 2003 ([4]) as insufficient reasons had been given for two of the factors used to calculate the appropriate remuneration, but it was confirmed in all other respects.

(8) On 1 September 1999 the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks. By letter of 8 December 1999, Germany supplied information on the transfer of WKA and WAK to LSH, supplementing that information in a letter of 22 January 2001. Germany replied to a further request for information dated 22 February 2001 by letter of 3 May 2001.

(9) By letter of 13 November 2002, the Commission informed Germany of its decision to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the transfer of WKA, WAK and the special-purpose real-estate reserve of the Land of Schleswig-Holstein to LSH. At the same time, it launched the investigation procedure in respect of similar transfers of assets to Norddeutsche Landesbank — Girozentrale, Bayerische Landesbank Girozentrale, Hamburgische Landesbank — Girozentrale and Landesbank Hessen-Thüringen. It had already opened an investigation into the transfer of Wohnungsbaukreditanstalt to Landesbank Berlin back in July 2002.

(10) The decisions initiating the procedure were published in the Official Journal of the European Union ([5]). The Commission called on interested parties to submit comments.

(11) By letter of 11 April 2003, LSH submitted its comments on the initiation of the procedure in the LSH case.

(12) By letter of 14 April 2003, Germany commented on the decision to initiate the procedure.

(13) By letter of 29 July 2003, the BdB submitted comments on all the decisions taken on 13 November 2002 to initiate the investigation procedure.

(14) The Commission asked for further information on 11 September 2003, and Germany replied on 29 October and 6 November 2003, commenting also on BdB's comments on LSH. On 30 October 2003, Germany forwarded comments by the Land Government of North Rhine-Westphalia and by WestLB on the BdB's statement concerning the five Landesbank cases opened in November 2002.

(15) The Commission sent further requests for information on 7 and 30 April, 19 May and 12 August 2004, to which Germany replied on 1 and 28 June, 27 May, 23 June, 27 August and 30 September 2004.

(16) On 19 July 2004 the complainant (BdB), the Land of North Rhine-Westphalia and WestLB AG submitted a provisional agreement on the appropriate remuneration for the transferred assets. In their view, this remuneration should form the basis of the Commission Decision. The Commission received the final version of this understanding on 13.10.04. On 29 September 2004, the BdB, the Land of Schleswig-Holstein and HSH Nordbank — which was formed from LSH and Hamburgische Landesbank in 2003 — submitted a provisional understanding on the appropriate remuneration for the transferred assets. These parties and Germany subsequently addressed several letters to the Commission. The definitive version of the understanding on the transfer of the special-purpose assets to LSH reached the Commission on 14.10.04. Similar understandings reached in the other cases involving transfers of assets to Landesbanks — except Landesbank Hessen-Thüringen — were also submitted to the Commission.

II. DETAILED DESCRIPTION OF THE MEASURES

1. *LANDESBANK SCHLESWIG-HOLSTEIN — GIROZENTRALE*

(17) Landesbank Schleswig-Holstein — Girozentrale (LB Kiel), with its head office in Kiel, had a group balance-sheet total of EUR 145 500 million (as at 31 December 2002), making it one of Germany's 15 largest banks. Founded in 1917 as the bank of the Province of Schleswig-Holstein, it was a publicly owned credit institution operating in the form of a public institution (Anstalt des öffentlichen Rechts).

(18) From 1994 LSH was owned by the WestLB group (39,9 %), the Land of Schleswig-Holstein (25,05 %), the Sparkassen- und Giroverband für Schleswig-Holstein (25,05 %) and Landesbank Baden-Württemberg (10 %). This ownership

([2]) OJ C 140, 5.5.1998, p. 9.

([3]) OJ L 150, 23.6.2000, p. 1; actions challenging that decision have been brought by Germany (Case C-376/99), by North Rhine-Westphalia (Case T-233/99) and by WestLB (Case T-228/99). The Commission has also brought proceedings for infringement of the Treaty (Case C-209/00).

([4]) [2003] ECR I-435.

([5]) Norddeutsche Landesbank: OJ C 81, 4.4.2003, p. 2; Bayerische Landesbank: OJ C 81, 4.4.2003, p. 13; Hamburgische Landesbank: OJ C 81, 4.4.2003, p. 24; Landesbank Hessen-Thüringen: OJ C 73, 26.3.2003, p. 3.

structure resulted from a transfer of capital holdings from the Land of Schleswig-Holstein and the Sparkassen- und Giroverbands für Schleswig-Holstein to WestLB and Landesbank Baden-Württemberg on 1 January 1994. Prior to this transfer, the Land and the Sparkassen- und Giroverband each held 50 % of the shares.

(19) On 2 June 2003, LSH and Hamburgische Landesbank merged to form HSH Nordbank AG, a public limited company (Aktiengesellschaft). For tax and balance-sheet purposes, the merger had a retroactive effect as of 1 January 2003.

(20) According to its annual report for 2002, LSH's core capital ratio was 6,5 % and its equity ratio 10,3 %. Its income-to-equity ratio stood at 10,4 % in 2002.

(21) Under Section 42 of the Schleswig-Holstein Savings Bank Act (Sparkassengesetz für das Land Schleswig-Holstein), LSH was required to perform the tasks of a government-owned bank, a central savings bank and a commercial bank. It had to manage the Land's banking operations, support the savings banks in carrying out their tasks and issue municipal loans. As a government-owned bank, it granted credit to public authorities and participated — sometimes in a consortium with private banks — in the placement of Land loans and note loans. It also operated as an all-purpose commercial bank.

(22) Employing over 2 500 staff, LSH had a regional base and an international focus, viewing the north of northern Germany and the Baltic Sea area as its core banking region. It had its own branches, representative offices and holdings and was an international product and sector specialist in transport, shipping and real-estate finance, bank finance and — increasingly — in syndication and as a player on the international capital markets.

2. *TRANSFER TO LSH OF WKA'S AND WAK'S ASSETS AND THE SPECIAL-PURPOSE REAL-ESTATE RESERVE*

2.1. SETTING-UP AND DEVELOPMENT OF INVESTITIONSBANK SCHLESWIG-HOLSTEIN

(23) Under the Schleswig-Holstein Investment Bank Act (Investitionsbankgesetz: 'IBG') of 11 December 1990, IB was set up with effect from 1 January 1991 as a public institution with organisational and economic independence. It is therefore refinanced on behalf of and with the involvement of LSH.

(24) IB is the central development institution providing economic and structural policy back-up in Schleswig-Holstein. Its product range covers economic and housing assistance, support for environmental and energy projects, municipal and agricultural assistance, and project management for the Land and municipal authorities ([6]). It also assists infrastructure projects in the Baltic area.

(25) By the Act of 7 May 2003, which came into force on 1 June 2003, IB was split off from LSH's assets, with legal effect from 1 June 2003 and with retroactive effect on the balance sheet as of 1 January 2003, and set up as an independent public-law institution (Anstalt des öffentlichen Rechts) under the name 'Investitionsbank Schleswig-Holstein' with its head office in Kiel. The assets assigned to Investitionsbank Schleswig-Holstein, including all asset and liability items, were transferred to the hived-off Investitionsbank Schleswig-Holstein by means of universal succession. Despite the retroactive effect on the balance sheet as of 1 January 2003, LSH was able to continue to use IB's capital to underpin its competitive business in the same manner until 1 June 2003.

(26) The real-estate administration body Liegenschaftsverwaltung Schleswig-Holstein ('LVSH') was also set up as an independent public-law institution, with its head office in Kiel, with legal effect from 1 June 2003 and with retroactive effect on the balance sheet as of 1 January 2003. The special-purpose real-estate reserve was therefore hived off to LVSH on 1 June 2003. At the same time, all assets and liabilities were transferred to Investitionsbank Schleswig-Holstein by means of universal succession. Despite the retroactive effect on the balance sheet as of 1 January 2003, LSH was able to continue to use the special-purpose real-estate reserve to underpin its competitive business in the same manner until 1 June 2003.

2.2. TRANSFER OF WKA TO LSH

(27) By the Act of 31 March 1950, WKA was set up as a public institution under the name 'Landestreuhandstelle für Wohnungs- und Kleinsiedlungswesen in Schleswig-Holstein'. Its purpose was to support the Land, particularly by financing public and low-tax residential construction and in providing the public with suitable housing. Its assets were made up of so-called special assets and own funds. By law, the special assets had to be used for the specific purpose of financing social-housing operations. WAK's own funds were not subject to this requirement. WKA used its own funds to grant building loans at particularly low interest rates ([7]).

(28) Under Section 2(1) of the IBG, WKA and its entire assets were transferred, minus the costs of the liquidation, to LSH with effect from 1 January 1991. Section 2(1) of the IBG thus provided for the merger of WKA and LSH. Under Section 14(1) of the IBG, all of the tasks and responsibilities of WKA referred to in Annex 1 to the IBG were transferred to IB with effect from 1 January.

([6]) See its annual report for 1998, p. 1.

([7]) Communication from Germany, 8.12.99, p. 84.

2.3. TRANSFER OF WAK TO LSH

(29) WAK was a special credit institution set up by the Land as a public limited company (Aktiengesellschaft) with the task of providing financial assistance to the projects of commercial businesses and other measures designed to strengthen the economic and communications structure.

(30) Section 3 of the IBG authorises the Minister for Finance to take over all of WAK's assets, including all of its rights and obligations. This was necessary because, as a public limited company, WAK could not be merged with LSH in the same way that WKA was. WAK's assets were therefore initially transferred to the Land by means of universal succession under Section 359 of the Public Limited Company Act (Aktiengesetz) so that they could subsequently be transferred to LSH. In financial terms, this was the same as WAK being incorporated into LSH.

(31) The Ministry of Finance made use of this authorisation and accepted the offer made by WAK's executive board on 19 November 1990 to transfer the assets on 2 January 1991. An 'incorporation agreement' of 2 January 1991 between the Land and LSH regulated the transfer of WAK's assets, including all rights and obligations, with effect from 1 January 1991 ([8]).

(32) Under Section 14(1) of the IBG, IB continued to perform all of WAK's tasks, which are listed in Annex 2 to the IBG.

2.4. TRANSFER OF THE SPECIAL-PURPOSE REAL-ESTATE RESERVE TO LSH

(33) Under Section 17(2) of the IBG, the Schleswig-Holstein Ministry of Finance and Energy was authorised to transfer real estate to IB. This involved IB becoming the legal and economic owner of the real estate in question. According to Germany, IB may not, however, freely dispose of the real estate transferred to it. Instead, the real-estate assets as a whole, including any gains made on them, had to be used for a specific purpose.

(34) Under Section 20(1) of the IBG, the transferred real-estate assets were accordingly designated as a special-purpose real-estate reserve. Under Section 20(2), proceeds from these assets had to be used to maintain, acquire and construct real estate. However, they could also be used — subject to a decision by the Land Government — for the tasks of the Investitionsbank or be returned to the Land.

(35) The Land of Schleswig-Holstein has sold a total of […] (*) properties to IB in several lots. The purchase price for each property was based on the market value, as determined beforehand by an expert evaluation.

(36) In each case the Land of Schleswig-Holstein transferred part of the price it received to LSH via the 'special-purpose real-estate reserve'. The effect of these transfers on LSH's own funds as shown in the balance sheet was as follows: the purchase of the first lot of properties by IB increased LSH's own funds as shown in the balance sheet at 31 December 1999 by DEM […] million. On 31 December 2000 the special-purpose real-estate reserve had increased to a total of DEM […] million following the purchase of a second lot of properties. Following the purchase of the third lot, it reached a total of DEM […] million on 31 December 2001 and remained at the same level on 31 December 2002 ([9]).

(37) Germany submits that the special-purpose real-estate reserve did not perform either a financing or a business-expansion function for LSH. It could not be used for business activities as it had not been recognised by the Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen — 'BAKred') ([10]) as core capital for supervisory purposes.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS AND SOLVENCY DIRECTIVES*

(38) Pursuant to Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions ([11]) (the 'Solvency Directive') and Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions ([12]) (the 'Own Funds Directive'), which amended the German Banking Act (Kreditwesengesetz, or KWG), banks must have a level of own funds equal to 8 % of their risk-adjusted assets. At least 4 percentage points of this amount must consist of what is termed core capital, or 'tier 1' capital, meaning items of capital which are at the credit institution's disposal without restriction and immediately to cover risks or losses as soon as they arise. In determining the total own funds available to a bank for supervisory purposes, the core capital is of decisive importance because additional capital, or 'tier 2' capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital.

(39) By 30 June 1993 ([13]) German banks had to adapt ([14]) their own funds to the new requirements of the Solvency Directive and the Own Funds Directive. Even before the Solvency Directive was transposed into German law, many

([8]) Communication from Germany, 8.12.99, p. 89.

(*) Confidential information.

([9]) Communication from Germany, 30 September 2004.

([10]) Now the Federal Agency for the Supervision of Financial Services (Bundesanstalt für Finanzdienstleistungsaufsicht — 'BaFin').

([11]) OJ L 386, 30.12.1989, p. 14; replaced by Directive 2001/12/EC of the European Parliament and of the Council (OJ L 126, 26.5.2000, p. 1).

([12]) OJ L 124, 5.5.1989, p. 16; replaced by Directive 2000/12/EC.

([13]) In fact, the new own funds requirements should have entered into force on 1 January 1993; they were introduced late in Germany.

([14]) Under the Solvency Directive, credit insitutions must have own funds equivalent to at least 8 % of their risk-adjusted assets, whereas the previous German legislation required a ratio of 5,6 %; however, this ratio was based on a narrower definition of own funds than that which has applied since the entry into force of the Own Funds Directive.

Landesbanks had relatively weak own-funds positions. They now had to strengthen their own-funds base as a matter of urgency in order to avoid restrictions on their business expansion and indeed to maintain their current level of activities. However, because the budgetary situation was tight, public shareholders were unable to provide any fresh capital but neither were they prepared to contemplate privatisation and to raise additional capital on the capital markets. It was therefore decided to undertake transfers of assets and capital: in WestLB's case, for example, there was a transfer of the assets of the housing organisation Wohnungsbauförderungsanstalt des Landes Nordrhein-Westfalen ('WfA'), and in LSH's case there was a transfer of the assets of WKA and WAK, followed later by the real estate.

4. *EFFECTS OF THE TRANSFERS ON LSH*

4.1. TRANSFER OF WKA'S AND WAK'S ASSETS TO LSH

(40) According to Germany, WKA's own assets and WAK's assets were placed in IB's special-purpose reserve. This took IB's capital up to a total of DEM 1 306,05 million (IB special-purpose reserve of DEM […] million made up of WKA's capital (DEM […] million) and WAK's capital (DEM […] million), plus the special housing reserve of DEM […] million) [15]. The provisional opening balance sheet at 1 January 1991 showed total equity capital of DEM 1 558 million. The final audit at 1 January 1991 corrected this amount to DEM 1 306,05 million [16].

(41) BAKred had acknowledged by letter of 15 August 1991 that LSH's liable equity capital had increased by DEM 1 559,44 million as a result of IB's capital reserve. Germany pointed out that the final audit indicated that the recognised equity capital was only DEM 1 306,05 million and that, from 15 August 1991, LSH had only that amount of additional liable capital at its disposal [17].

(42) Because the special-purpose reserve was earmarked for promotion-related tasks, even though it constituted own funds, it was not, however, at LSH's unrestricted disposal. Of the IB special-purpose reserve of DEM 1 306 million, DEM 288 million was assigned in 1991 to IB's promotion-related tasks. Germany states that, for the period 1991-2003, the following amounts were available to LSH for use in competitive business or were actually used by LSH as a liability basis.

Figure 1:

Transferred IB capital and capital amounts available for and actually used in competitive business (annual average values)

DEM million

	1991 (4 months)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 (5 months
Total IB capital	**1 306,0**	**1 312,2**	**1 337,9**	**1 387,0**	**1 472,0**	**1 563,0**	**1 665,9**	**1 763,0**	**1 814,0**	**1 817,0**	**1 849,2**	**1 923,9**	**1 967,6**
Recognised for supervisory purposes	1 306,0	1 312,2	1 337,9	1 387,0	1 472,0	1 563,0	1 665,9	1 763,0	1 814,0	1 817,0	1 849,2	1 923,9	1 967,6
Used by IB	288,0	299,0	383,9	363,0	380,0	391,0	401,9	417,0	[…]	[…]	[…]	[…]	[…]
Amount available to LSH	1 018,0	1 013,1	954,0	1 024,0	1 092,0	1 172,0	1 264,0	1 346,0	[…]	[…]	[…]	[…]	[…]
Actually used by LSH	0	0	347,0	326,0	161,0	508,0	815,0	1 104,0	[…]	[…]	[…]	[…]	[…]

(43) Germany states that, at 31 December 1990, LSH had core capital of DEM 581 million and additional capital of DEM 100 million. The promotion-related assets of DEM 1 306 million therefore increased the total equity capital base of DEM 681 million by around 190 %.

(44) Assuming that DEM 1 013 million was available for LSH's competitive business in 1992, its 100 % risk-lending capacity, based on the then applicable solvency ratio of 5,6 % laid down in the Banking Act, was enhanced by at least DEM 18 000 million.

(45) Assuming also that, since the Community solvency ratio of 8 % has been applicable, between DEM 1 024 million (1994) and DEM […] million (2002) has been available for LSH's competitive business, its 100 % risk-lending capacity has been enhanced by DEM 12 800 million (1994) and by over DEM […] million (2002) respectively. In 1999 it had

(15) Communication from Germany, 8.12.99, p. 90.

(16) Communication from Germany, 8.12.99, p. 91.

(17) Communication from Germany, 8.12.99, p. 94.

as much as DEM […] million available, representing an increase in capacity of at least DEM […] million.

(46) In reality, the permissible credit volume could have been expanded even more because the risk-adjusted assets of a bank are not normally deemed to bear a 100 % risk ([18]). This is also true for LSH since inter alia it conducts its refinancing business with savings banks and its lending business with municipalities. On the basis of a realistic risk adjustment, which in LSH's case is probably below 50 %, it should be possible to double the above-mentioned business expansion to over DEM 30 000 million.

4.2. TRANSFER OF LAND-OWNED REAL ESTATE TO LSH

(47) According to Germany, BAKred refused, by letter of 25 May 1999, to recognise the special-purpose real-estate reserve as core capital for supervisory purposes, deeming it to constitute a capital reserve but not equity capital. In its view, the transferred property and the special-purpose reserve formed immediately after its acquisition by LSH were 'deductible' at any time ([19]).

(48) Following this refusal, LSH did not, according to Germany, again seek BAKred's recognition of this reserve as core capital, not even in view of the current proceedings concerning the amount of remuneration. The consequence of this is, in Germany's view, that the special-purpose real-estate reserve cannot be used by LSH for its commercial business or by IB in its own business ([20]).

5. *REMUNERATION FOR THE OWN FUNDS TRANSFERRED*

5.1. REMUNERATION FOR WKA'S AND WAK'S ASSETS

(49) LSH paid remuneration for the transferred IB capital, but only to the extent of the liable amount actually used. According to available information, a flat-rate remuneration of DEM 900 000 was agreed for 1993. For 1994 and 1995 a so-called 'profits advance' (Gewinnvorab) of 0,5 % was charged on those portions of the special-purpose reserve used for competitive business, in addition to a flat-rate remuneration of DEM 750 000 (1994) and DEM 200 000 (1995). For 1997 to 2002, the profits advance was set at […] % of the portion of IB's capital used for competitive business ([21]). No remuneration was paid for 1991 or 1992.

(50) LSH has paid the following remuneration ([22]):

Figure 2:

Remuneration paid on transferred IB capital (after tax)

DEM million

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Remuneration paid (after tax)	0	0	0,9	2,4	1,0	2,5	5,0	6,6	[…]	[…]	[…]	[…]	[…]

(51) According to Germany, however, the new Solvency Directive was not the only reason for the transfer of WKA's and WAK's assets. The purpose of transferring the special-purpose residential property assets without allowing them to be used as liquid capital was to enable the assets to be used as efficiently as possible by, on the one hand, broadening the capital base or further promotion-related activities and, on the other, putting the assets to a commercial use. The Land felt that merging WKA and WAK with LSH was the appropriate financial solution, even compared with the option of setting up a legally independent promotion institution ([23]). It also enabled LSH's financial strength to be enhanced in the event of a sale of its shares. At the same time, the merger secured LSH's long-term equity-capital base in the face of more stringent Community requirements ([24]). The prospect of increasing its liable equity capital was, according to Germany, a major factor in the decision to transfer WKA's and WAK's assets to LSH.

([18]) See footnote 3; paragraph 64 of the Decision.

([19]) Letter from BAKred, 25.5.99.

([20]) Communication from Germany, 3.5.01, p. 2.

([21]) Communications from Germany of 8 December 1999, p. 96, and 29 October 2003, p. 18.

([22]) Communications from Germany, 14 April 2003 (Annex 1) and 30 September 2004.

([23]) Communication from Germany, 8.12.99, p. 86.

([24]) Communication from Germany, 8.12.99, p. 88.

5.2. REMUNERATION FOR THE REAL ESTATE

(52) Germany states that LSH paid no remuneration to the Land of Schleswig-Holstein for the assets transferred in the form of the special-purpose real-estate reserve ([25]).

III. GROUNDS FOR INITIATING THE PROCEDURE

(53) In its decision of 13 November 2002 initiating the procedure, the Commission concluded that the transfer of WKA and WAK and the placing of EUR […] million in a special-purpose real-estate reserve of the Land of Schleswig-Holstein probably constituted state aid to LSH within the meaning of Article 87(1) of the EC Treaty.

(54) The starting point for its investigation was the principle of the market-economy investor. According to this principle, it is not the fact that undertakings are publicly owned and receive funding from the public authorities which constitutes state aid. The provision of public money confers an advantage only if funds are made available to such a public undertaking on terms which it would not have obtained under normal market conditions.

(55) In the present case, the Commission regarded the economic advantage conferred on LSH by the injection of own funds as consisting in particular in the increase in its commercial, competitive lending capacity (by dint of the business-expansion function of equity capital). Under normal market conditions, the capital contribution would be remunerated in line with the value of the contributed capital, taking account of its function and the risk incurred. One method of determining the normal market remuneration for the contributed capital was thus to take the long-term risk-free rate (for 10-year Federal bonds) and apply to it a risk premium corresponding to the higher risk of equity capital. As Germany had already indicated that the rate of remuneration for a long-term, risk-free investment of assets stood at around 9 % per annum ([26]) at the end of 1990, when the transfer of assets took place, the Commission had serious doubts as to whether the flat-rate remuneration paid and/or an extra 0,5 % or […] % per annum for the equity capital actually used could be deemed normal for the market, irrespective of any necessary risk premium.

(56) The Commission also doubted whether a market-economy investor would have agreed to limit remuneration to the portion of the funds actually used.

(57) However, the Commission had already acknowledged in its decision to initiate the procedure that the contributed capital's lack of liquidity should not be disregarded when determining the normal market remuneration. Although the bank's non-liquid equity capital permitted an increase in the volume of its lending, it had to be borne in mind that LSH could achieve the full extent possible of any increase in its business volume only if it refinanced the additional lending in full on the capital market. The Land could not therefore expect the same return as a provider of liquid capital, and the appropriate remuneration had to be reduced accordingly.

(58) The Commission could not see that the Land of Schleswig-Holstein, when transferring WKA's and WAK's assets, had ensured that it was going to participate to an appropriate extent in the distribution of the bank's profits and the increase in its value. In particular, the Land did not insist on a change in the ownership structure in its favour, which it would have had to do in order to ensure that dividend payments and increases in value were consistent with the level of invested capital. Moreover, since 1 January 1994 the Land had not increased but reduced its share of this increase in value.

(59) The Commission therefore concluded in its decision to initiate the procedure that the measures in favour of LSH, which conducts business mainly at regional level but also operates nationally and internationally, constituted state aid within the meaning of Article 87(1) of the EC Treaty. As none of the exemptions provided for in Article 87(2) and (3) or Article 86(2) of the EC Treaty applied in the present case, the state aid appeared not to be compatible with the common market.

IV. COMMENTS BY GERMANY AND LSH

(60) It was submitted that IB's capital had been of only limited use to LSH since, unlike ordinary core capital, it failed to perform — or performed only to a limited extent — three important functions: (a) the financing function, which would have been at LSH's disposal only if WAK and WKA had been transferred in full; (b) the guarantee function, which was severely restricted as IB's capital was subordinate in liability to LSH's other equity capital (moreover, a replenishment commitment ensured that IB's capital would not be used even in the event of LSH becoming insolvent); (c) IB's capital was also of only limited use for generating business because, first, part of it had to be deducted for use as cover for the Land's real estate transferred to IB and, second, the portion of IB's capital available to LSH had shrunk in recent years because of IB's own expansion of business.

(61) The conclusion reached was that the transfer of IB's capital should not be regarded as a normal capital investment and that the special circumstances of the case reduced the remuneration which the Land was entitled to expect as appropriate.

([25]) Communication from Germany, 29.10.03, p. 2.

([26]) In LSH's annual report for 1990, values of between 8,8 % and over 9 % are mentioned (p. 28). In the annual report for 1991, values for that year of between 8,4 % and 9,17 % are mentioned (page 27). Since the transfer of WAK's and WKA's assets occurred on 1 January 1991, any agreement on a normal market remuneration would have been tailored to the normal returns for 1990.

(62) It was also submitted that there is no state aid within the meaning of Article 87(1) of the EC Treaty in the present case. First, at the time when IB's capital was transferred, the relationship between the Landesbank and its guarantors was still determined primarily by the special guarantee arrangements enjoyed by publicly owned banks in Germany (i.e. Anstaltslast (institutional liability) and Gewährträgerhaftung (guarantor liability)). Anstaltslast should be taken to mean an obligation on the part of the guarantors to furnish the institution with the financial resources it needs to perform its tasks and hence ensure that it is capable of functioning for the duration of its existence. That was precisely the purpose of the transfer of IB's capital. To reduce Anstaltslast to a mere obligation on the guarantor to keep the institution out of bankruptcy would be inconsistent with the historical understanding of this established guarantee arrangement. Second, LSH argues that it provides services of general economic interest. Third, the average return requirement is said to be at variance with Article 87(1) EC, read in conjunction with Article 295 EC, since imposing such a special requirement on the public investor infringes the principle of equal treatment of private and public undertakings arising from Article 295 EC.

Appropriate remuneration according to the principle of the market-economy investor

(63) Three different economic approaches were discussed which could be used to calculate the normal market remuneration for a capital injection: the insurance premium approach, the risk profile approach and the share capital approach.

(64) The starting-point for the insurance premium approach is the fact that the transfer of WAK's and WKA's assets to LSH was subject to restrictions and that, because of their special purpose, the liquidity remained entirely with the Land. As a result, remuneration is said to be payable only for the risk to the Land that IB's capital might be used in the event of the Landesbank becoming insolvent.

(65) Under the risk profile approach, the point of reference for determining the appropriate market remuneration is the risk underlying an investment in a bank's liable equity capital. In this respect, the transfer of assets such as IB's capital is compared with capital market instruments that are similar to the Land's investment in terms of economic profile, and the normal market remuneration is determined as a result.

(66) The share capital approach is much more complex and prone to errors but, if applied properly, it should yield the same result as the other two approaches. The following comments were made on the basic interest rate used and the individual premiums and discounts applied:

(67) Minimum return after tax: Given current earnings in the banking sector, and especially public banks, the 12 % rate applied is said to be too high. The basic rate should be 11 % at most. Reference is made here to various expert reports submitted in the WestLB case.

(68) Risk premium: It is argued that the 1,5 % risk premium in Decision 2000/392/EC is unwarranted and should be dropped altogether. The capital injection in LSH totalled only DEM 1 600 million, compared with DEM 5 900 million in the WestLB case (a substantial financial investment). Moreover, from the investor's standpoint, what matters is not the size of the investment, but the risk structure. The failure to increase voting rights is not pertinent in the LSH case as additional rights would not have secured any greater influence. The third argument raised, namely the lack of fungibility of IB's capital, is also dismissed as inaccurate since IB's capital was transferred to LSH for an unlimited period, but not irrevocably.

(69) Discount for lack of liquidity: The liquidity cost is said to reside in the fact that, because of the restrictions on the transfer, LSH received IB's capital only as subordinated capital but had to obtain the corresponding liquidity on the capital market, since the liquidity of IB's capital remained with the Land. The additional interest on the outside funds — up to the amount of the risk-free interest rate — should therefore be deducted in full from the return demanded by the Land as an investor. In the WestLB case, the Commission applied a deduction of around half as much, citing as justification the reduction in the bank's taxable income and the resulting lower level of corporation tax liability. This approach is said to be incorrect. In material terms, the corporation tax payable on a standard investment is an advance payment on the investor's income or corporation tax. Accordingly, under German corporation tax law, it is not levied on the undertaking.

(70) Corporation tax credit procedure: LSH argues that, if the Commission wishes to abide by its share capital approach, it must either subtract the tax credit balance from the return of a comparable private investor or add a corresponding fictional tax credit balance to the Land's return.

(71) Owner effect, coupon effect, discount for fixed remuneration: LSH mentions other economic effects that lead to a reduction in what can be regarded as an 'appropriate' remuneration for IB's capital.

(72) It was also argued that it was irrelevant for the purposes of state aid legislation how the Land of Schleswig-Holstein arranged a remuneration from LSH for the transfer of IB's capital. In assessing the remuneration paid to the Land, account must be taken of the synergy gains achieved through the transfer. The transfer of IB's capital enabled the Land to obtain a higher price than would have otherwise been possible for holdings in LSH acquired by WestLB and Landesbank Baden-Württemberg.

(73) It was also claimed that the special-purpose real-estate reserve did not perform either a financing or a business-generating function for LSH since it was not recognised by BAKred as core capital for supervisory purposes. No remuneration need therefore be paid for the assets transferred to LSH as a special-purpose real-estate reserve since the transfer conferred no economic advantage on LSH for which a market-economy investor would have demanded a remuneration.

(74) To sum up, the transfer of the housing-promotion assets of the Land of Schleswig-Holstein to LSH was said not to constitute state aid. A hypothetical private investor would have undertaken a similar transfer. The Land received for the transfer to LSH an appropriate remuneration in line with market conditions.

V. COMMENTS BY THE BDB

(75) The BdB submits that LSH did not pay an appropriate remuneration for the transferred core capital and was therefore in receipt of state aid.

(76) In its comments of 29 July 2003 on the procedures initiated in respect of the Landesbanks on 13 November 2002, the BdB states that the question of whether the remuneration was appropriate should be determined using the method employed by the Commission in Decision 2000/392/EC.

(77) The first step is therefore to compare the capital provided with other equity instruments. The second step is to determine the minimum remuneration which an investor would expect for a real equity-capital investment in the Landesbank. Finally, a calculation must be made of any premiums and discounts applied by virtue of the particularities of the transfer.

Comparison with other equity instruments

(78) In its comments the BdB came to the conclusion that the transfer of housing-construction and promotion-related assets in all five of the above Landesbank cases, i.e. also in the case of LSH, can be compared to an injection of share capital.

(79) Nearly all the Landesbanks are said to have required fresh core capital from 1992 onwards in order to meet the stricter requirements arising from the Solvency Directive. Without these increases in capital, the Landesbanks would have had to scale down their business. It can therefore be concluded, the BdB argues, that the capital injected can be compared only with equity instruments that were recognised as core capital ('tier 1 capital') and available in Germany in the year of the transfer. This immediately excluded from any comparison non-voting preference shares, profit participation rights and perpetual preferred shares. In Germany these three equity instruments are recognised not as core capital but as additional capital ('tier 2 capital'). Moreover, perpetual preferred shares did not exist in Germany at the beginning of the 1990s.

(80) At the time of the respective transfers, only share capital and silent partnership reserves were recognised as core capital in Germany. Any comparison with silent partnership contributions could be ruled out across the board. First, unlike share capital, silent partnership contributions were valid for a limited period only or could be terminated and had to be paid back to the investor on maturity. An investor could not therefore expect to receive the same remuneration for a silent partnership contribution as for equity instruments recognised for supervisory purposes for an unlimited period.

(81) Second, although in some cases it was asserted that the transferred capital was subordinate in liability to share capital pursuant to agreements between the Landesbanks' owners, this did not necessarily mean a lower risk for the investor. In all cases the transferred capital made up a significant proportion of the total core capital, sometimes even more than 50 %. This made it extremely likely that the injected capital could be drawn on — at least in part — in the event of losses ([27]).

(82) Third, the BdB submits that the difference in quality between silent partnership contributions and share capital is confirmed by the definition of core capital for supervisory purposes adopted by the Basle Committee for Banking Supervision. According to this definition, silent partnership contributions must be recognised for supervisory purposes as no more than lower tier 1 capital, which may account for no more than 15 % of the requisite core-capital ratio. In other words, where the core-capital ratio is 4 %, 3,4 % must be made up of nominal capital and open reserves (e.g. the special-purpose reserves transferred to the Landesbanks). Furthermore, banks only ever took up subordinate equity instruments such as preference shares or profit participation rights in small volumes. Under pressure from the rating agencies, such instruments hardly ever accounted for more than 10 % of a bank's total core capital — a very different situation from that in the cases under examination. Against this background, silent partnership contributions could not be used for large volumes invested by a single investor.

([27]) Moreover, a risk or liability premium was paid primarily because of the risk of loss in the event of insolvency. If this were to happen, the capital would be irretrievably lost. In the event of ongoing (partial) losses, i.e. outside insolvency, there was always a chance that the equity capital might be replenished through profits.

Minimum remuneration for a share-capital investment in a Landesbank

(83) The BdB argues that all methods of determining an appropriate remuneration (return) for the provision of share capital start from a risk-free return and add a risk premium.

They can be traced back to the following basic principle:

Expected return on a high-risk investment

= risk-free return + risk premium for the risky investment

(84) To determine the risk-free return, the BdB used the returns on long-term government bonds, fixed-rate securities issued by state bodies being the form of investment with the least or no risk ([28]).

(85) To derive the risk premium, the BdB first worked out the 'market risk premium', i.e. the difference between the long-term average return on shares and that on government bonds. In its comments of 29 July 2003, it assumed in the first place a long-term market risk premium of a uniform 4,6 %.

(86) It then determined the beta value for the Landesbanks, i.e. the individual risk premium for the banks by which the general market-risk premium was to be adjusted. The BdB stated that it had determined the beta values statistically, which means that it estimated them on the basis of a historical data sample. The BdB initially concluded that all the beta values for all the Landesbanks and periods considered were greater than one ([29]).

(87) On the basis of a risk-free basic interest rate of 9,74 % and a beta factor for LSH of 1,1105, the BdB calculated the expected minimum remuneration for an investment in the share capital of LSH to be 14,85 % per annum at the time when IB's capital was transferred on 31 December 1990.

Premiums and discounts on account of the particularities of the transactions

(88) The BdB also noted that the Commission's deduction pursuant to Decision 2000/392/EC from the minimum remuneration to take account of the lack of liquidity of Wfa's assets had been upheld by the Court of First Instance. It therefore saw no reason to depart from this method in the present case, with the result that a deduction for liquidity should also be made here. The amount of the discount for lack of liquidity would be calculated, using the WestLB method, on the basis of net refinancing costs (gross refinancing costs minus the applicable corporation tax).

(89) In the BdB's view, three aspects of the transfer increased its risk compared with a 'normal share capital investment': the in part exceptionally high volume of assets transferred, the failure to issue new shares in the company and the related forgoing of additional voting rights, and the lack of fungibility of the investment, i.e. the impossibility of withdrawing the invested capital from the company again at any time.

Capital basis and elements of remuneration

(90) Lastly, the BdB argued that, in calculating the appropriate remuneration in LSH's case, the entire amount recognised as core capital should be taken into account, and not just the part which was actually used. It backs up this argument by stating that a market-economy investor would never agree to limit his remuneration to the portion of funds actually used. For a private investor bearing the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. What matters to the investor is that he himself can no longer invest that amount and obtain a corresponding return.

(91) The BdB also argued that a remuneration of 0,3 % should have been paid for the special-purpose real-estate reserve, which has not yet been recognised by BAKred as own funds for supervisory purposes. Although this amount was not recognised as core capital, it too was available to the Landesbank's creditors to cover losses, and both investors and rating agencies take as a reference not only a bank's core capital, but also the economic equity capital shown on the balance sheet. The 0,3 % per annum guarantee commission (Haftungsprovision) applied by the Commission in its WestLB decision, which it calculated by comparing the amount of capital with a guarantee, is equally appropriate in this case.

VI. GERMANY'S RESPONSE TO THE BDB'S COMMENTS AND FURTHER COMMENTS BY GERMANY

(92) In its response of 29 October 2003 to the BdB's comments, Germany rejected the argument that remuneration should also be paid for the IB capital that is recognised for

([28]) To offset the effects of inflation, the rate of return on a long-term government bond should be determined for each transfer period, initially disregarding the inflation expectations. In estimating the long-term, risk-free basic interest rate, the estimation of the expected long-term average inflation rate of 3,60 % was then added to the 'real basic interest rate' at the relevant moment.

([29]) For the purposes of comparison, the BdB also gives the theoretical beta values calculated using the Capital Asset Pricing Model (CAPM), which, as it indicates, differ very little from the empirically determined values.

supervisory purposes but not used. It contended that this part of IB's capital conferred no economic advantage on LSH and therefore required no remuneration. Not all of a bank's additional liable capital recognised for supervisory purposes was automatically of economic use or conferred an economic advantage. Moreover, the capital transferred to LSH was not liquid share capital but non-liquid assets which performed an — at most — limited guarantee function and so could not be used by LSH for investment or lending purposes.

(93) Germany also contested the argument that remuneration should be paid for the portion of transferred capital not recognised for supervisory purposes (in LSH's case, the special-purpose real-estate reserve). It argued that, since that capital is assigned to a specific long-term purpose, it forms part of a circular financial circuit and has not conferred any advantage on LSH by increasing its solvency. Germany added that the rating agencies concentrate exclusively on capital recognised for supervisory purposes as liable core capital. Accordingly, it did not see why the banking supervisory authorities and creditors should regard the special-purpose real-estate reserve as a lasting reservoir of value.

(94) Germany submitted that IB's capital is closest in nature to perpetual preferred shares, profit participation certificates and silent partnership contributions.

(95) Germany argued that in 1994 LSH's guarantors agreed on a proportionate replenishment commitment which would ensure that, in the (unlikely) event of LSH becoming insolvent, IB's capital would not be called on. Accordingly, an investor in a Landesbank faced a risk which might require remuneration in that the transferred capital might be lost as a result of ongoing losses. However, an investor was protected from that risk by the existence of the subordination agreement.

(96) The BdB's calculation of the minimum remuneration was said to be wrong for a number of reasons: incorrectly defined factors in the CAPM calculation, the unrealistic assumption of the guaranteed fixed remuneration and incomprehensible discounts and premiums.

(97) Germany also took a critical view of the CAPM used by the BdB to determine the minimum return for share-capital investments in the Landesbanks. It criticised not only the suitability of the CAPM for determining the expected return on an investment which should yield a fixed remuneration, but also the factors employed (risk-free interest rate, market-risk premium and beta value).

(98) It objects to the BdB's method of determining the risk-free interest rate, i.e. using a real interest rate based on a reference date, arguing instead for the use of an average value over the longest possible period. Germany applied an arithmetic mean of the annual total returns of the REX10 between February 1970 and December 1990, which yielded a result of 6,91 %.

(99) Germany rejected the figure of 4,6 % used by the BDB for the market-risk premium, proposing 3,0 % instead.

(100) The banks listed in the CDAX used by the BdB to determine the beta value for LSH are said to give rise to distortions: first, the five largest commercial banks together account for a very high proportion of the CDAX banks (76 %); second, there are differences in business profile. Instead, the correct beta value for LSH should be determined by taking a comparable group, namely IKB, BHF Bank and Vereins- und Westbank, resulting in a beta value of 0,7894.

(101) Germany therefore concluded that the minimum remuneration for an investment in the share capital of LSH at 31 December 1990 (taking account of the beta factor of 0,7894, the market-risk premium of 3 % and the base rate of 6,91 %) was 9,28 %.

VII. COMMENTS BY THE LAND OF NORTH RHINE-WESTPHALIA AND WESTLB

(102) On 30 October 2003 Germany forwarded a response from the Land of North Rhine-Westphalia and WestLB to the decision to initiate the investigation procedure in which they disputed the statement that the assets transferred to the Landesbanks, including LSH, could be compared to share capital. They argued that silent partnership reserves and 'perpetuals' had in fact been recognised as core capital in Germany since 1991. They added that remuneration for an investment depended not on how it was classified by the banking supervisory authorities, but on its risk profile. Since the assets were junior-ranking, the risk pattern had more in common with silent partnership contributions or 'perpetuals' than with share-capital investments.

(103) WestLB had no objections to the CAPM method for calculating the minimum remuneration for a share-capital investment, WestLB had no objections to the CAPM method for calculating the minimum remuneration for a share-capital investment but felt that the beta values determined by the BdB — at well over 1 — were inappropriate. A beta factor of more than 1 meant that a company's shares represented a higher risk than the market as a whole. Yet the risk of investing in a Landesbank was well below the overall market risk because of the institutional liability (Anstaltslast) and guarantor liability (Gewährträgerhaftung) which it enjoyed and which were not challenged at the time.

(104) Moreover, they argued that, in the specific case of the Landesbanks, it was a mistake to use as a benchmark the return expected at the time that the assets were transferred to the banks. Although this was generally a sensible approach to adopt in relation to the private-investor test, Although this was generally a sensible approach to adopt in relation to the private-investor test, it here meant using as a basis the returns expected in 1991. But for an investor to receive in 2003 the return expected in 1991, which was much higher than the returns actually achieved, flew in the face of all economic realities. Permanently and systematically applying a rate of return of around 12 % placed the Landesbanks at an unjustifiable disadvantage compared with private competitors.

(105) As regards the discount for the lack of liquidity of the transferred assets, WestLB and the Land of North Rhine-Westphalia considered that the rate for risk-free government bonds should be deducted in full from the basic return. They argued that the Landesbanks had received no liquidity as a result of the asset transfers. It was not defensible in economic terms to reduce this rate by the tax savings since the pricing of capital market instruments was independent of the tax situation. Otherwise the price of a capital market instrument would have to differ according to tax considerations.

(106) Finally, the fact that the assets' lack of liquidity did not pose a risk to the liquidity position should be seen as reducing the risk — and hence the remuneration — and should be taken into account by applying a corresponding deduction. Likewise, a discount should be granted on account of the 'owner effect' since an investor who already owned shares in a company took a different view of an additional investment from that of a new investor.

VIII. UNDERSTANDING BETWEEN THE BDB, THE LAND OF SCHLESWIG-HOLSTEIN AND HSH NORDBANK

(107) On 8 October 2004, the Commission was informed of the outcome of an understanding between the complainant (the BdB), the Land of Schleswig-Holstein and HSH Nordbank, which was formed from LSH and Hamburgische Landesbank in 2003. Although their basic legal positions remained unchanged, the parties to that understanding concurred on what they themselves regarded as suitable parameters for determining an appropriate remuneration. The parties asked the Commission to take account of this understanding in its decision.

(108) First, the parties determined a minimum remuneration for a hypothetical investment in the share capital of LSH on the basis of the CAPM, which produced an appropriate remuneration for the special-purpose reserve of around 9,29 % per annum. To arrive at this figure, the parties used the long-term risk-free interest rate calculated on the basis of the REX10 Performance Index of Deutsche Börse AG and the beta factor estimated on the basis of a study by KPMG of 26 May 2004 commissioned by the Landesbank. In concrete terms this yielded a risk-free basic interest rate for LSH of 6,61 % at the time of the transfer (31 December 1990). A beta factor of 0,670 was applied on the basis of KPMG's study. A uniform market-risk premium of 4 % was set for all the Landesbanks.

(109) A deduction was then determined for the capital's lack of liquidity on the basis of the risk-free interest rate of 6,61 % as gross refinancing costs. To determine the net refinancing costs, the standard tax burden on LSH at the time of the transfer was set at a flat rate of 50 %, producing a liquidity discount of 3,31 %.

(110) Lastly, a premium of 0,3 % was added to allow for the failure to issue voting rights.

(111) Altogether this produced an appropriate remuneration for the special-purpose reserve of 6,28 % per annum after taxes for the portion of the promotion-related assets available for use in LSH's competitive business. This remuneration was payable as of the end of the month when the assets were recognised as core capital (31 August 1991).

(112) According to the understanding, the aid element, which HSH Nordbank must pay back, resides in the difference between the actual remuneration paid by LSH and the remuneration determined as appropriate (6,28 %).

(113) The parties also agreed on a guarantee commission of 0,3 %, payable not only on the liable capital used by IB itself, but also on the special-purpose real-estate reserve. Furthermore, HSH Nordbank raised no objection to the suggestion that, for the period of the transfer up to the end of the month when the assets were recognised as core capital by BAKred (1 January 1991 — 30 August 1991), a guarantee commission of 0,3 % is also payable on the sum of DEM 1 306,05 million shown on the balance sheet.

(114) During negotiations on the understanding, it was argued for the first time that, in addition to the remuneration for IB's capital already mentioned, a further remuneration element consisted of IB's annual surplus, which was paid to the Land of Schleswig-Holstein as a dividend on the basis of Section 17(2) IBG (1990 version) or Section 19(2) IBG (1998 version). In accordance with these legal provisions, the annual surplus from the IB's special-purpose reserve was paid out to the Land (in each case on the basis of a corresponding decision by the Landesbank's bodies). Under a rule laid down in the respective budgetary law of the Land of Schleswig-Holstein, these payments were intended for the purposes of the IB, i.e. for the Land's promotion-related tasks, and transferred back to IB accordingly. This arrangement served to respect the budgetary sovereignty of the Land Parliament, as it should be the parliament, not the executive arm that had decision-making power over these funds. In economic terms, this was a 'pay out and

claw back' arrangement which did not prevent the amounts being counted as dividend payments.

(115) Moreover, the cycle was broken by the suspension of the special purpose by a number of individual laws accompanying the budget, each relating to the annual surplus. In these cases the dividends paid out were not reinvested in IB. As the special purpose was suspended, the surplus in those years was paid entirely to the Land of Schleswig-Holstein to finance expenditure from the Land budget. It should be borne in mind here that the lion's share of the dividend payments discussed here concerns amounts that, for that reason, were not transferred back to IB but remained entirely with the Land.

(116) The table below shows the IB dividend payments to the Land:

Figure 3:

IB dividend payments to the Land of Schleswig-Holstein (DEM million)

DEM million

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
IB dividend payments to the Land	0,0	0,0	1,1	2,6	1,5	2,5	3,5	47,5	[…]	[…]	[…]	[…]	[…]

(117) Accordingly, these dividend payments from the annual surplus must be taken into account in calculating the aid element and were indeed included by the parties to the understanding in their calculations.

IX. ASSESSMENT OF THE MEASURES

1. *STATE AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE EC TREATY*

(118) Article 87(1) of the EC Treaty states that, save as otherwise provided in the Treaty, any aid granted by a Member State or through state resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, insofar as trade between Member States is affected.

1.1. STATE RESOURCES

(119) With the transfer of assets described above, the Land of Schleswig-Holstein opted for a form of capital increase based on the concept of transferring the assets and real estate of WKA and WAK to LSH in order to strengthen its equity-capital base. Although the resources transferred were not at LSH's unrestricted disposal, as the special-purpose reserve was earmarked for promotion-related tasks, the assets were recognised by the supervisory authority and could therefore be used to provide cover for the liabilities of LSH, which was in competition with other credit institutions. There can therefore be no doubt that state resources were transferred to LSH.

1.2. FAVOURING OF A PARTICULAR UNDERTAKING

(120) In order to verify whether the transfer of state resources to a publicly-owned undertaking 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'. The European Court of Justice and Court of First Instance have accepted and developed this principle in a number of cases, most recently in the judgment of the Court of First Instance of 6 March 2003 in the WestLB case, which is of relevance to the present case ([30]).

(a) ***Market-economy investor principle***

(121) According to the market-economy investor principle, no state aid is involved where 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' ([31]). In contrast, the undertaking is being favoured within the meaning of Article 87(1) of the EC Treaty if the agreed remuneration and/or the financial position of the undertaking are such that a normal return on investment cannot be expected within a reasonable period of time.

(122) The market-economy investor principle applies here even though LSH was a profitable company at the time the promotion-related assets were transferred. Although the principle has previously been applied mainly to under-

([30]) See footnote 4.

([31]) Commission communication to the Member States on the 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). Although this communication deals expressly with manufacturing, the principle doubtless applies likewise to all other sectors of the economy. As regards financial services, this has been confirmed by a number of Commission decisions, e.g. Crédit Lyonnais (OJ L 221, 8.8.1998, p. 28) and GAN (OJ L 78, 16.3.1998, p. 1).

takings in difficulties, this does not mean that its application is restricted to that category of undertakings.

(123) 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 cannot 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. The Commission's position in this respect was confirmed by the European Court of First Instance in its judgment in WestLB ([32]).

(124) It follows that the key question in examining this case is whether a market-economy investor would have transferred capital that had the same characteristics as the Land of Schleswig-Holstein's promotion-related assets and real estate and under the same conditions, especially in view of the expected return on the investment.

(125) According to Germany, the chief considerations here were to draw together all the Land's promotion-related activities and continue them in a more economic and more efficient manner, to optimise deliberation on and completion of promotion-related tasks and to create the conditions for the flexible use of funds. This reorganisation was combined with an increase in LSH's capital base, which helped secure its long-term capacity for expansion, given the foreseeable changes in solvency requirements. Furthermore, the Land intended to make a fundamental change in its business orientation by managing its own real estate and the real estate used by the various Land departments and institutions with the aim of reducing inefficiency.

(126) Even if a market-economy investor already holds shares in an undertaking, he will look into other investment options outside that undertaking. As a rule he will then choose to invest further resources in the public undertaking only if he can expect a reasonable return on the investment of the fresh capital contributions. So, in determining whether a capital injection constitutes state aid, one must in principle disregard the shareholder's prospects of long-term profitability or efficiency and synergy aspects. Whatever the motives behind it, a capital injection by a shareholder should be measured instead according to whether the investor can expect a normal return within a reasonable period.

(127) The Court of First Instance has raised no objections to this interpretation of the market-economy investor principle, which the Commission has already applied in Decision 2000/392/EG ([33]). It has also adopted as a guiding principle that even a private investor who already owns share capital in an undertaking is not normally content with the fact that an investment does not cause him a loss or produces only limited profits. Instead he will always seek to obtain an appropriate return on his investment according to the particular circumstances and the satisfaction of his short-, medium- or long-term interests ([34]).

(128) In the light of the market-economy investor principle, the key question in examining this case is whether a market-economy investor would have transferred capital that had the same characteristics as the Land of Schleswig-Holstein's promotion-related assets and under the same conditions, especially in view of the expected return on the investment

(b) ***Article 295 of the Treaty***

(129) Article 295 lays down that the system of property ownership in the various Member States must not be affected. But this cannot justify any infringement of the Treaty's competition rules.

(130) In connection with the Landesbank proceedings, Germany has argued that the resources transferred could not have been used in any other profitable manner than by transferring them to a similar public institution. Consequently, the transfer represented the commercially most sensible use of those assets. It is therefore argued that any remuneration for the transfer, i.e. any additional return on the assets transferred, would be sufficient to justify the transfer in the light of the market-economy investor principle.

(131) This line of argument cannot be accepted. It may be true that the transfer of the promotion-related assets to LSH, which subsequently allowed LSH to use the capital for solvency purposes, was the most commercially sensible use. 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 the State, once it decides to use certain assets (also) commercially for public purposes, must demand a remuneration in line with the normal market remuneration.

(c) ***No change in ownership structure***

(132) One way for a market-economy investor in a bank to secure a normal market remuneration is to have an appropriate share in the bank's profits and increases in its value. This can be achieved by means of a change in the structure of ownership in line with the capital injection, giving the investor an appropriate share in the dividends and in a possible increase in value as a result of enhanced

([32]) See footnote 4; paragraphs 206 et seq. of the decision.

([33]) See footnote 3; paragraphs 161 et seq. of the decision

([34]) See footnote 4; paragraphs 241 and 314 of the decision.

earning capacities. Therefore, one way of ensuring an adequate return on the capital provided would have been to increase the Land's participation in LSH 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 agreed rate of remuneration on that part of the funds actually used to underpin competitive business is appropriate. However, this course was not adopted by the Land.

(133) In this regard Germany argues that, for the purposes of state aid law, it is irrelevant how the Land of Schleswig-Holstein arranged a remuneration from LSH for the transfer of IB's capital, as the capital injection was not necessarily linked to acquisition of a share in profits and voting rights. It also points out that the transfer of IB's capital to LSH enabled the Land to obtain a higher price than would have otherwise been possible for holdings in LSH acquired by WestLB and Landesbank Baden-Württemberg.

(134) However, if a redistribution of shares were not feasible, a market-economy investor would, in the Commission's view, have embarked on the investment only if agreement had at least been reached on an appropriate direct remuneration. Normally a market-economy investor is not content to avoid losses or to obtain a limited return on his investment, but attempts to maximise the return on his assets according to the circumstances in question and his interests ([35]). So a private investor who already holds shares in the beneficiary undertaking will usually insist on either a change in ownership structure or an appropriate fixed remuneration. Otherwise he would forgo part of the additional returns achieved as a result of the capital injection, as the other shareholders would also profit from higher dividends and an increase in the undertaking's value without having made a corresponding contribution.

(135) There is therefore nothing to indicate that a market-economy investor would have forgone an appropriate direct remuneration in a situation comparable to the transfer of promotion-related assets to LSH, where no shift in share structure was achievable and the owner of the other half of the shares did not make a corresponding capital contribution directly connected with the capital injection.

(d) ***Capital basis for the remuneration***

(136) As with its approach in the WestLB case, the Commission will determine the appropriate remuneration for the promotion-related assets transferred and the special purpose real-estate reserve on the basis of their commercial benefit to LSH, while drawing a distinction in the present case between the 'business-expansion function' and the (mere) 'guarantee function' of the promotion assets made available as equity capital for the bank's business activities.

(137) The 'business-expansion function' of capital refers to the expansion of business potential by means of risk-bearing assets following the recognition for supervisory purposes of a bank's additional equity capital. In this regard the starting point for determining the normal market remuneration is the remuneration that would be demanded by a private investor providing a bank with core capital. Where the capital provided is shown in the balance sheet as equity but is not recognised as core capital for supervisory purposes or is intended to underpin promotion-related activities, it is not available for expanding business. However, equity is also important for reasons other than banking supervision. Its availability to the bank's creditors at least for the purposes of covering liabilities ('guarantee function') means that its economic function can still be compared to that of a surety or guarantee. The amount of equity shown in the balance sheet is 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. The normal market remuneration of the 'guarantee function' of capital is calculated according to the return which a private guarantor would have demanded from a credit institution comparable to LSH in size and risk strategy.

(138) On 1 January 1991, the Land of Schleswig-Holstein transferred to LSH the capital of IB, which, according to the final audit, came to DEM 1 306 million. The capital transferred increased in value year on year, amounting to DEM 1 967,6 million in 2003.

(139) On the balance-sheet date of 31 December 1999 the Land also transferred the special-purpose real-estate reserve to LSH, thereby increasing the equity capital shown on the balance sheet by DEM […] million. After two further transfers, this special-purpose reserve totalled DEM […] million at 31 December 2002.

(140) Each year the full amount of the capital transferred from IB was recognised as additional core capital by BAKred ([36]). However, it was not entirely at LSH's disposal for underpinning its competitive business. As in the WestLB case, part of the special-purpose reserve was also used for promotion-related tasks by IB itself. Accordingly, this part of the special-purpose reserve was not at LSH's disposal for expanding competitive areas of its business, although it did have a guarantee function. The same applied to the special-purpose real-estate reserve, which was not recognised as core capital by BAKred, but served as a guarantee for the bank.

(141) The Commission believes that the extent to which the capital provided was actually used cannot be a factor in determining the appropriate remuneration. All that matters is the possibility of using the capital to expand business. Even a private investor would not be happy with a

([35]) See footnote 4; paragraphs 320 and 335 of the decision.

([36]) Contrast this with the WestLB case, in which only part of the established cash value of the housing-promotion assets shown in the balance sheet as own funds was recognised as equity capital for supervisory purposes.

remuneration dependent on the capital being used. In this regard the Commission agrees with the BdB's observation that, for the market-economy investor who runs the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. As the BdB rightly points out, all that matters to the market-economy investor is that he himself can no longer use the amount transferred to engage in economic activity and hence achieve corresponding returns. So the fact that LSH used the injected capital in full between 1999 and 2003 is irrelevant to the question of the capital basis being examined.

(142) Moreover, for the purposes of determining the remuneration for the business-expansion function of the capital, the most important point in time is when the special-purpose reserve was recognised by BAKred as core capital. According to Germany, it was only from that time on that the capital could be used to cover risk-bearing assets.

(143) However, insofar as the capital had already been shown in the balance sheet as own funds, it also had at least a guarantee function, as explained above in more detail. The same applies to the amount used by the IB itself and to the special-purpose real-estate reserve. These points must also be taken into account in determining the appropriate remuneration.

(e) ***Comparison with other equity instruments***

(144) As explained above, the starting point for determining the normal market remuneration in this case is the remuneration that would be demanded by a market-economy investor providing a bank with equity capital.

(145) It is beyond dispute that the promotion-related assets transferred to LSH cannot be compared directly to other transactions. 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. Consequently, as in the WestLB case ([37]), the appropriate remuneration can be determined only by comparing the asset transfer with various equity instruments normally found on the markets, in order to determine by analogy which instrument is most similar to it and is therefore the benchmark for determining the remuneration.

(146) The complainant submits that the promotion-related assets concentrated in the special-purpose reserve can be compared only to share capital. The special-purpose reserve was recognised by BAKred as core capital ('tier 1' capital) and can therefore be compared only with equity instruments that were recognised as core capital in Germany in the year of the transfer. However, Germany considers that the only purpose of comparison with various equity instruments is to determine which risk profile (and hence which range of remuneration) is closest to that of the investment from an investor's point of view. IB's capital is therefore said to be closest in nature to perpetual preferred shares, profit participation certificates and silent partnership reserves.

(147) It should be borne in mind that the instruments used by Germany for the comparison 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, the promotion-related assets transferred to LSH virtually tripled its own funds for solvency purposes. Even if one takes account only of the increase in the amount usable by LSH to underpin its commercial business, this still represents an increase of over 50 %. As the BdB points out, the other instruments referred to were usually issued up to a much lower level. It would not have been possible to increase LSH's capital in the same way, and on a permanent basis, by one of the instruments compared.

(148) In this connection, it should also be stressed that the relatively wide range of innovative 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 IB's capital was transferred or in 1993, when LSH had to comply with new, stricter capital requirements. Some of these instruments have been 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 IB's capital to such innovative instruments, most of which have developed in the meantime and some of which were available only in other countries.

(149) As to the two instruments which, as the closest benchmarks, play the central role in Germany's 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 as such in Germany. Profit participation certificates constitute only additional own funds, whereas IB's capital qualifies as original own funds. The latter is therefore of much greater use to LSH because it can be used to raise additional own funds (such as profit participation certificates) up to the

([37]) See footnote 3; paragraph 19 of the decision.

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 IB's capital. In addition, IB's capital is available to LSH 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 IB's capital is rather large, it will be used relatively quickly when major losses occur.

(150) For all these reasons, the Commission believes that, because of the peculiarities of IB's capital, the comparison with innovative equity instruments submitted by Germany is not a suitable way to determine the appropriate remuneration to be paid for IB's capital. Moreover, in the understanding of 8 October 2004, the parties assumed that the transaction was akin to a share capital injection.

(151) Furthermore, the Commission agrees with the BdB that the risk to the investor is not reduced by the subordination agreement in the covering agreement between LSH's shareholders whereby IB's capital is to be used only after other equity capital of LSH. The injected capital makes up a significant proportion of the total core capital, making it extremely likely that it will be drawn on — at least in part — in the event of losses.

(f) ***Liquidity costs***

(152) LSH's argument 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), 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 ([38]). Since the promotion assets did not provide LSH with initial liquidity because they and all the income from them remained earmarked by law for business and housing promotion, LSH faced additional funding costs equal to the amount of the capital if it was 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) ([39]). Because of these extra costs, which do not arise in the case of equity capital provided in liquid form, 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.

(153) However, in the Commission's view, 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 LSH because of the special nature of the capital transferred. The Commission therefore accepts that LSH incurs additional 'liquidity costs' to the extent of 'refinancing costs minus corporation tax' ([40]).

(g) ***Appropriate remuneration***

Appropriate remuneration for the amount available for competitive business

(154) There are no doubt different ways of calculating the appropriate remuneration for the amount available for competitive business. All the methods for calculating the remuneration for capital made available follow the same basic principles, however. Taking these basic principles, the Commission here does the calculation in two steps: first, it determines the minimum remuneration that an investor would expect for a (hypothetical) investment in the share capital of LSH. It then examines whether, in view of the particularities of the transaction at issue, the market would have agreed on a premium or a discount, and if so, whether it can produce a sufficiently robust quantification of that amount.

Determination of a likely minimum remuneration for an investment in the share capital of LSH

(155) The return expected on an investment and the risk involved are important determining factors in the investment decision of a market-economy investor. In order to determine their level, the investor incorporates all available firm-related and market-related information into his calculation. He bases himself on historical average rates, which, generally speaking, are also a point of reference for a firm's future efficiency, and inter alia on an analysis of the

([38]) 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.

([39]) 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).

([40]) As confirmed by the Court of First Instance, see footnote 4; paragraphs 321 to 331 of the decision.

company's business model for the investment period in question, the strategy and quality of management or the relative prospects for the sector in question.

(156) A market-economy investor will make an investment only if it offers him a higher return or a lower risk than the next best alternative use of his capital. Accordingly, he will not invest in a company whose expected returns are lower than the average of other companies with a comparable risk profile. In this case it can be assumed that there are sufficient alternatives to the investment that promise a higher expected return for the same risk.

(157) There are various methods of determining an appropriate minimum return. They range from differing variants of the financing approach to the CAPM method. In describing these various approaches, it makes sense to draw a distinction between two components, namely a risk-free return and a project-specific risk premium:

Appropriate minimum return on a high risk investment

=

risk-free base rate + risk premium for the risky investment.

The appropriate minimum return on a high-risk investment can therefore be described as the sum of the risk-free rate of return and the additional risk premium for assuming the specific investment risk.

(158) The basis for any determination of return is thus the existence of a default-risk-free form of investment with an assumed risk-free return. Normally the risk-free base rate is determined using the expected return on fixed-rate securities issued by state issuers (or an index based on such securities), as they represent forms of investment with comparably low risks. However, the difference between the various methods lies in the method of determining the risk premium: -

— Financing approach: An investor's expected return on capital represents, from the point of view of the bank using the capital, future financing costs. Under this approach, the historical capital costs incurred by comparable banks are determined first. The arithmetic average of the historical capital costs is then compared with the future expected equity capital costs and hence with the investor's expected-return requirement.

— Financing approach with Compound Annual Growth Rate: at the heart of this approach stands the use of the geometric rather than the arithmetic mean value.

— *CAPM*: the CAPM is the best-known and most frequently tested model of modern finance, by which the return expected by an investor can be determined using the following equation:

Minimum return on capital =

risk-free base rate + (market-risk premium × beta)

The risk premium for the equity investment is obtained by multiplying the risk premium on the market by the beta factor (market-risk premium × beta). The beta factor is used to quantify the risk of a company relative to the overall risk of all companies.

The CAPM is the predominant method of calculating investment returns in the case of large listed companies. However, since LSH is not a listed company, it is not possible directly to infer its beta value. The CAPM can be used only on the basis of an estimate of the beta factor.

(159) In its comments of 29 July 2003, the BdB, using the CAPM, concluded that the minimum remuneration to be expected for an investment in the capital of LSH at 31 December 1990, when the transfer took place, was 14,85 % per annum. Germany raised objections in principle to the use of the CAPM. It also argued that the BdB started from a high beta value and was incorrect in its calculation of the risk-free base rate, and that the market-risk premium of 4,6 % was too high. Had the BdB applied the CAPM correctly, it would have arrived at a much lower minimum remuneration for a hypothetical investment in the share capital of LSH. In their understanding on the normal market remuneration, the Land of Schleswig-Holstein, HSH Nordbank and the BdB concluded that a minimum remuneration of 9,29 % was appropriate.

(160) In their calculations, the parties based themselves on the CAPM and applied a risk-free basic interest rate of 6,61 %. Determination of this interest rate was based on the assumption that special-purpose assets were to be made available to LSH on a permanent basis. The parties thus decided not to use a risk-free rate obtaining on the market at the time of the capital injection for a fixed investment period (e.g. 10-year return on government bonds), since such an approach would disregard the reinvestment risk, i. e. the risk that it would not be possible to invest again at the level of the risk-free interest rate once the investment period had expired. In the view of the parties, a total return index was the best way of taking the investment risk into account. They opted, therefore, for the REX10 Performance Index of Deutsche Börse AG, which tracks the performance of an investment in Federal loans over a period of ten years. The index series used in the present case contains the relevant end-of-year results of the REX10 Performance

Index since 1970. The parties then calculated the rate of return per annum, which reflects the trend tracked by the REX10 Performance Index in the period 1970 to 1990 and, in this way, arrived at the risk-free base rate of 6,61 %.

(161) Since LSH's capital injection was made available on a permanent basis, the method of determining the risk-free basic interest rate appears appropriate in this specific case. Moreover, the REX10 Performance Index is a generally recognised source of data. The risk-free basic interest rate calculated thus appears appropriate here.

(162) The beta factor of 0,670 was estimated on the basis of a KPMG report on adjusted beta factors for all listed credit institutions in Germany that is available to the Commission. In the light of the report and of LSH's business profile, this beta factor may be regarded as appropriate.

(163) The Commission also regards the market-risk premium of 4,0 % as acceptable. The so-called general long-term market-risk premium, i.e. the difference between the long-term average return on a normal share portfolio and the return on government bonds, has already been applied on several occasions in the WestLB case, which resulted in Decision 2000/392/EC. In the corresponding report on the procedure, a range of some 3 % to 5 % was applied, depending on the method, the period under examination and the basic relevant data. A report prepared for BdB calculated figures of 3,16 % and 5 %. Another report on WestLB drawn up in the first procedure produced figures of 4,5 % and 5 %, while Lehman Brothers, also for WestLB, calculated a figure of 4 %. Against this background, the Commission here sees no reason to depart from the market-risk premium used in the understanding. On the basis of the CAPM, the Commission considers there to be no doubt that the minimum remuneration determined by the parties can be regarded as appropriate

(164) The Commission has no reason to believe that, in the case under consideration, the minimum remuneration determined by the parties for a hypothetical share-capital investment cannot stand up to a market test. Accordingly, it sets the minimum remuneration for the special-purpose reserve at 9,29 % per annum (after corporation tax and before investor tax).

Return discount for lack of liquidity

(165) The long-term risk-free rate (10-year German Federal government bonds) at the end of 1990 was 8,98 %. LSH claimed that its actual refinancing costs on the basis of its financial structure at the time of the transfer were 9,2 %. In their understanding the parties apply a long-term risk-free rate of 6,61 % ([41]). They also agree to adopt a flat 50 % tax rate. On this basis, they arrive at a net refinancing rate of 3,31 % and a corresponding deduction for liquidity.

(166) In view of that understanding and the fact that the amount in question falls below the range previously cited by Germany, the Commission sees no reason to regard this amount as inappropriate and consequently uses it as a basis for determining the aid element.

Return premium on account of the particularities of the transfer

(167) In practice, when remuneration is determined, atypical circumstances which depart from a normal investment in the share capital of the company concerned generally give rise to discounts or premiums. It must therefore be examined whether the particularities, and especially the specific risk profile of the transfer of IB's capital, constitute grounds for adjusting the minimum remuneration determined of 9,29 % which a private investor would expect for a (hypothetical) investment in the capital of LSH and whether the Commission can produce a methodically robust quantification of that adjustment. In this connection, three aspects should be considered: first, the non-issuance of new shares in the company with the associated voting rights; second, the exceptional volume of the asset transfer; and third, the non-marketability of the assets.

(168) The transfer did not provide the Land with any additional voting rights. By forgoing voting rights, an investor renounces a say in decisions taken by the bank's board. If the Land's voting rights had been increased, it would have possessed more than 50 % of those rights, thereby becoming the majority shareholder. To compensate for this acceptance of a higher risk of loss without a corresponding increase in influence over the company, a market-economy investor would demand a higher remuneration (even if the potential risk were cushioned by internal agreements with the other shareholders). On the basis of the higher remuneration for preference shares compared with ordinary shares and in agreement with the complainant, BdB, the Land of Schleswig-Holstein and LSH, who, as a result of their meetings in August and September 2004, regard a rate of 0,3 % per annum (after tax) as reasonable, the Commission considers a premium of at least 0,3 % per annum (after corporation tax) to be appropriate. The parties to the understanding also regard a 0,3 % premium as appropriate to take account of the failure to issue voting rights.

(169) The size of the amount transferred and its effect on LSH from the point of view of the Solvency Directive has already been mentioned. Through the transfer of IB's capital, LSH's core capital was increased substantially without any acquisition or administration costs. A market-economy investor would probably have demanded a premium for an injection of capital as large in relative and absolute terms as the IB assets. On the other hand, in the light of the exceptional capital requirements of credit institutions in the EU laid down by the Solvency Directive,

([41]) The parties use as a basis the risk-free interest rate calculated according to the REX10 Performance Index of Deutsche Börse AG.

a capital injection of some DEM 1 300 million in one of the largest German all-purpose banks must not be regarded as completely alien to any normal business decision. Moreover, where an investment involves a large volume of assets, this suggests a similarity with share capital. When the transfer took place at the end of 1990, large silent partnership contributions were atypical on the market. So if the volume of assets transferred is used to justify a further premium in the case of an investment that is similar to share capital, this means that the volume is being unduly taken into account twice over. The Commission therefore feels that it cannot be proved with sufficient certainty that a market-economy investor would have required a particular premium for an injection of capital as large in relative and absolute terms as in this case. Accordingly, it is not imposing a premium linked to the volume of the asset transfer, something which works in LSH's favour. Similarly, the understanding between the parties assumes that no premium should be applied on account of the high volume of assets transferred.

(170) Lastly, attention must be drawn to the non-marketability of the assets, i.e. the impossibility of withdrawing the invested capital at any time from the company. Normally, an investor can sell an equity instrument on the market to third parties, thereby terminating his investment. A normal transfer of capital takes place as follows: the investor brings in assets (either in cash or in kind), which are entered on the assets side of the balance sheet. As a rule, these are matched on the liabilities side by a tradable interest registered in the name of the investor, taking the form, in the case of a limited company for example, of shares. The investor can sell these shares to a third party. He cannot withdraw the assets he originally brought in since these now form part of the company's liable equity capital and are no longer at his disposal. But by selling the shares — at the prevailing exchange price — he can realise their economic countervalue. His assets have thereby become fungible. Because of the special circumstances surrounding the transfer of IB's assets, this option was not available to the Land. However, the Commission does not see any reason for a further premium. Although the Land was unable to realise the economic countervalue by trading freely in the investment, it could at any time have withdrawn the special-purpose reserve from LSH by law and achieved possibly higher returns by reinvesting it in other institutions. Here too the understanding between the BdB, the Land of Schleswig-Holstein and HSH Nordbank assumes that no premium should be applied on account of the lack of fungibility.

(171) Overall, the Commission therefore considers a premium of 0,3 % per annum (after corporation tax and before investor tax) to be appropriate for forgoing additional voting rights.

Overall remuneration

(172) In view of all of the above observations and in agreement with the complainant (BdB), the Land of Schleswig-Holstein and LSH, the Commission comes to the conclusion that an appropriate remuneration would be 6,28 % (after corporation taxes), i.e. a 9,29 % normal return on the investment in question, plus 0,3 % for the particularities of the transaction and minus 3,31 % for the financing costs which LSH incurred on account of the lack of liquidity of the assets transferred.

Appropriate remuneration for IB's capital up to the time when it was recognised by BAKred, for the amount used by IB and for the special-purpose real-estate reserve

(173) As stated above, IB's capital was already of material value to LSH before it was recognised by BAKred as core capital within the meaning of the Banking Act (KWG), as it appeared on the balance sheet as equity right from the time of the transfer. The same applies to the amount used by IB and to the special-purpose real-estate reserve. Its economic function can be compared to that of a guarantee or liability. A market-economy investor would demand an appropriate remuneration in return for incurring a risk of this sort. Germany initially regarded as inappropriate the basic rate of 0,3 % per annum recognised by the Commission in Decision 2000/392/EC ([42]) for the guarantee function enjoyed by LSH. In Decision 2000/392/EC, a premium of a further 0,3 % per annum was added on top of that rate because, firstly, guarantees are normally tied to certain transactions and limited in time (which was not the case in WestLB) and, secondly, the amount of over DEM 3 400 million made available to WestLB was higher than that normally covered by such bank guarantees.

(174) Since WestLB and LSH are fundamentally comparable and for want of any other points of reference, the Commission assumes that this rate corresponds to the remuneration that LSH would also have to have paid on the market for a guarantee in its favour.

(175) Here too the understanding between the BdB, the Land of Schleswig-Holstein and LSH assumes that a premium of 0,3 % is justified. The Commission therefore considers that a premium is justified in the case of LSH and lays down a rate of 0,3 % per annum as appropriate remuneration for the guarantee function of the capital from the time when the transferred amount appeared on the balance sheet (1 January 1991) up to its recognition by BAKred. The parties used a rate of 0,3 % per annum after tax as a basis in the table calculating the aid element annexed to the text of their understanding.

No account to be taken of IB dividend payments

(176) Germany argued that the IB dividends paid to the Land from 1993 to 2002, amounting to DEM 99,9 million, should be deducted from the remuneration payable.

([42]) See footnote 3; paragraph 221 of the decision.

However, payments made or increases in value achieved after the investment cannot be taken into account when applying the principle of the market-economy investor, who, on the basis of the information available to him at the time of the investment, either expects an appropriate return or agrees a direct remuneration. Dividends or increases in value which cannot be calculated in advance are not relevant.

(177) The Commission therefore considers that the IB dividend payments should not be deducted from the remuneration to be paid in this case.

(h) ***SYNERGY EFFECTS***

(178) LSH considers that an assessment of the remuneration paid to the Land must take account of the synergy gains achieved through the transfer. However, it is clear that the actual purpose of the transfer was to provide LSH with the equity base needed to comply with the new solvency rules. Synergy gains were seen as a positive side-effect but were certainly not the main driving force behind the transaction at the time.

(179) Furthermore, if such synergies and cost savings accrue to IB, this will help the WKA and WAK (and hence the Land) by reducing costs, but cannot be regarded as consideration paid by LSH for the provision of the original own funds. Since these synergies neither reduce the usability of the transferred capital for LSH nor increase LSH'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 (IB's capital).

(180) Moreover, following a merger operation, synergy effects normally arise in both merged entities. It is difficult to understand why LSH should not profit at all from such advantages.

(i) ***Legislative amendment on 1 June 2003***

(181) Germany stated that IB was split off from the assets of LSH with legal effect as of 1 June 2003. The special-purpose real-estate reserve was split off from LSH with legal effect as of 1 June 2003.

(182) After 1 June 2003 LSH was, therefore, no longer able to underpin risk assets resulting from its competitive business with special-purpose assets or to use the latter as a guarantee.

(183) The Commission therefore accepts that the favourable treatment was brought to an end with the hive-off of the special-purpose assets on 1 June 2003.

(j) ***Aid element***

(184) As calculated above, the Commission comes to the conclusion that LSH should have paid a remuneration of 6,28 % per annum after tax for the special-purpose reserve that was recognised by BAKred as core capital, and 0,3 % after tax for the difference between this part and the amount shown as equity on LSH's balance sheet, as well as for the special-purpose real-estate reserve.

(185) This remuneration should have been paid from 1 January 1991 until the favourable treatment was brought to an end on 31 May 2003.

(186) LSH paid a remuneration only on the amount it could use to underpin its commercial business.

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

(188) The following table shows the calculation of the aid element:

Figure 4:

Calculation of the aid element (DEM million)

DEM million

	1991 (*)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 (5 months)
Total IB capital	1 306,0	1 312,2	1 337,9	1 387,0	1 472,0	1 563,0	1 665,9	1 763,0	1 814,0	1 817,0	1 849,2	1 923,9	1 967,6
1. Amount available to LSH	1 018,0	1 013,1	954,0	1 024,0	1 092,0	1 172,0	1 264,0	1 346,0	[…]	[…]	[…]	[…]	[…]
2. Amount used by IB	288,0	299,0	383,9	363,0	380,0	391,0	401,9	417,0	[…]	[…]	[…]	[…]	[…]
3. Amount between 1.1.1991 and 30.8.1991	870,7	—	—	—	—	—	—	—	—	—	—	—	—
4. Special-purpose real-estate reserve	—	—	—	—	—	—	—	—	—	[…]	[…]	[…]	[…]

DEM million

	1991 (*)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 (5 months)
Remuneration of 6,28 % (after tax) on point 1	21,3	63,6	59,9	64,3	68,6	73,6	79,4	84,5	[…]	[…]	[…]	[…]	[…]
Remuneration of 0,3 % (after tax) on point 2	0,3	0,9	1,2	1,1	1,1	1,2	1,2	1,3	[…]	[…]	[…]	[…]	[…]
Remuneration of 0,3 % (after tax) on point 3	2,6	—	—	—	—	—	—	—	—	—	—	—	—
Remuneration of 0,3 % (after tax) on point 4	—	—	—	—	—	—	—	—	—	[…]	[…]	[…]	[…]
Total remuneration in line with market conditions	24,2	64,5	61,1	65,4	69,7	74,8	80,6	85,8	[…]	[…]	[…]	[…]	[…]
Actual remuneration (after tax)	0	0	0,9	2,4	1,0	2,5	5,0	6,6	[…]	[…]	[…]	[…]	[…]
Aid element	**24,2**	**64,5**	**60,2**	**63,0**	**68,7**	**72,3**	**75,6**	**79,2**	[…]	[…]	[…]	[…]	[…]

(*) For balance-sheet purposes IB's capital was transferred as of 1 January 1991. It was available to LSH as a guarantee function for the first eight months of 1991. After recognition by BAKred, i.e. for the last four months of 1991, it was also available for use to underpin competitive business.
Since 1 January 1999, marks have been converted into euros at a rate of EUR1 = DEM 1,95583. The figures in DEM must be converted accordingly.

(189) Accordingly, the aid element for the period from the granting of the aid up to and including 31 May 2003 comes to DEM 845,6 million, which must be converted to EUR 432,3 million.

1.3. DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATES

(190) 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.

(191) LSH had a regional base and also carried on international banking business. It defined itself as an all-purpose commercial bank, central bank for the savings banks and the bank of the Land and its municipalities. Despite its name, tradition and legally stipulated tasks, LSH was much more than a mere local or regional bank.

(192) These facts clearly show that LSH offered its banking services in competition with other European banks outside Germany and, since banks from other European countries are active in Germany, inside Germany.

(193) It should also be pointed out that there is a very close relationship between a credit institution's equity capital and its banking activities. It is only when it has sufficient recognised equity capital that a bank can do business and expand its commercial activities. As the state measure provided LSH with such equity capital for solvency purposes, it directly influenced the bank's business possibilities.

(194) It is clear, therefore, that aid given to LSH distorts competition and affects trade between Member States.

1.4. CONCLUSION

(195) On the basis of all these considerations, it can be stated that all the criteria of Article 87(1) of the EC Treaty are met and hence that the transfer of the special-purpose reserve involves state aid within the meaning of that Article.

2. *COMPATIBILITY WITH THE COMMON MARKET*

(196) An assessment must also be made as to whether that aid can be considered compatible with the common market. It should be noted in this respect that LSH invoked only the exemption laid down in Article 86(2) of the EC Treaty in relation to any aid elements present in the transfer of IB's capital and of the real estate.

(197) None of the exemption clauses of Article 87(2) of the EC Treaty is applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(198) 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 aspects, is applicable. Nor does the aid promote the execution of an important project of common European interest. It is not aimed either at promoting culture or heritage conservation.

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

(200) 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. LSH is not described as an undertaking in difficulty whose viability must be restored with the support of state aid.

(201) Article 86(2) of the EC Treaty, which allows exemptions from the Treaty's state aid provisions under certain conditions, is in principle also applicable to the financial services sector. This was confirmed by the Commission in its report on services of general economic interest in the banking sector ([43]). LSH argued that it provided services of general economic interest and that to the extent that any sums contributed by the Land of Schleswig-Holstein were used for purposes of its public-service tasks or services of general interest, such sums did not constitute unlawful state aid. However, LSH does not meet the necessary formal conditions: no precise indication is given of the specific tasks which it carries out in providing services of general economic interest, and in particular of the specific costs generated by such tasks. It is therefore clear that the transfer was effected in order to enable LSH to comply with the new own funds requirements and with no regard to any services of general economic interest. Accordingly, this exemption clause does not apply either in the case at hand.

(202) 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.

3. *NO EXISTING AID*

(203) Contrary to what was argued by Germany and LSH, the capital injection cannot be regarded as being covered by the existing state aid scheme for Anstaltslast and Gewährträgerhaftung.

(204) Gewährträgerhaftung is a default guarantee offered to creditors in the event that the bank's assets are no longer sufficient to satisfy their claims, and this is not the case here from the outset. The capital injection is not intended to satisfy the Landesbank's creditors and the bank's assets have not been exhausted.

(205) Nor does Anstaltslast apply. Anstaltslast requires the guarantor, the Land of Schleswig-Holstein, to provide LSH with the resources it needs to function properly for as long as the Land decides to maintain it in existence. However, at the time of the capital injection, LSH was far from being in a situation where it was no longer able to operate properly for lack of sufficient resources. The capital injection was not needed in order to keep the Landesbank in operation. Rather, the capital injection was made in order to enable the Landesbank to increase its capital in the light of the tighter rules on core capital/own resources ratios introduced on 30 June 93 so as to avoid an otherwise necessary reduction in its business volume/risk assets and (in addition) to enable it to expand in future. This conscious economic calculation by the Land as joint owner also enabled LSH to seize future opportunities in its competitive business. The 'necessity requirement' for Anstaltslast does not apply to such a normal economic decision by the Land as joint owner of the bank. Since there is no other existing aid scheme under Articles 87(1) and 88 (1) of the EC Treaty, the capital injection ranks as new aid within the meaning of Article 88(3) of the EC Treaty and must be investigated accordingly.

X. **CONCLUSION**

(206) The Commission finds that the Federal Republic of Germany has unlawfully implemented the aid in question contrary to Article 88(3) of the Treaty. This aid is therefore illegal.

(207) The aid cannot be regarded as compatible either under Article 87(2) or (3) or under any other provision of the EC 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 of €432,3 million which Germany granted to Landesbank Schleswig-Holstein Girozentrale, now HSH Nordbank AG, from 1 January 1999 to 31 May 2003 is incompatible with the common market.

Article 2

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

([43]) 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 3

Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision.

The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient until the date of its recovery.

Interest shall be calculated in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 [44].

Article 4

Using the questionnaire set out in the Annex, Germany shall inform the Commission, within two months of notification of this Decision, of the measures taken to implement it.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Brussels, 20 October 2004.

For the Commission

Mario MONTI

Member of the Commission

[44] OJ L 140, 30.4.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF THE COMMISSION DECISION

1. **Calculation of the amount to be recovered**

1.1. Please provide the following details regarding the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of paymentº (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date or dates on which the aid or individual instalments of aid were put at the disposal of the recipient; if the measure consists of several instalments and reimbursements, use separate rows.
(*) Amount of aid put at the disposal of the recipient, in gross grant equivalent.

Comments:

1.2. Please explain in detail how the interest payable on the amount to be recovered will be calculated.

2. **Recovery measures planned or already taken**

2.1. Please describe in detail what measures have been taken and what measures are planned to bring about the immediate and effective recovery of the aid. Please also explain which alternative measures are available in national legislation to bring about recovery of the aid. Where relevant, please indicate the legal basis for the measures taken or planned.

2.2. By what date will the recovery of the aid be completed?

3. **Recovery already effected**

3.1. Please provide the following details of aid that has been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identity of recipient

(°) Date or dates on which the aid was repaid.

3.2. Please attach supporting documents for the repayments shown in the table at point 3.1.

COMMISSION DECISION

of 20 October 2004

on aid granted by Germany Landesbank Hessen-Thüringen — Girozentrale

(notified under document number C(2004) 3931)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/742/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:

I. PROCEDURE

(1) By letters dated 31 May and 21 December 1994, the *Bundesverband deutscher Banken e.V.* ('BdB'), an association representing private banks established in Germany, informed the Commission among other things that housing-promotion loans had been or would be transferred to the liable equity capital of the Landesbanks in North Rhine-Westphalia, Lower Saxony, Schleswig-Holstein, Bavaria, Hamburg and Berlin, i.e. the Westdeutsche Landesbank, the Norddeutsche Landesbank, the Landesbank Schleswig-Holstein, the Hamburger Landesbank and the Landesbank Berlin. The BdB considered the resulting increase in the equity capital of the relevant Landesbanks distorted competition in their favour, since the parties had not agreed remuneration consistent with the market-economy investor principle. In its second letter, the BdB accordingly lodged a formal complaint and called on the Commission to initiate proceedings under Article 93(2) of the EC Treaty (now Article 88(2)) against Germany. In February and March 1995 and December 1996, several banks associated themselves individually with the complaint lodged by their association.

(2) By letters dated 6 August 1997 and 30 July 1998, the BdB informed the Commission of two further transfers of assets, to Landesbank Schleswig-Holstein in Schleswig-Holstein and Landesbank Hessen-Thüringen in Hessen. As regards the latter transaction, the Commission wrote to Germany on 31 July 1998 requesting information. Germany answered by letter dated 2 October 1998 that this was currently still only at the planning stage and that the Commission had no cause for concern either now or at a later stage.

(3) The Commission first examined the transfer of assets to Westdeutsche Landesbank ('WestLB'), but announced that it would review the transfers to the other banks in the light of the findings in that case ([2]). It finally adopted a decision on the WestLB case in 1999, concluding that there was a state aid component equal to the difference between the remuneration paid and the normal market remuneration, which was incompatible with the common market and should be recovered ([3]). The decision was annulled by the Court of First Instance on 6 March 2003 for not setting out sufficient reasons as regards two of the factors used to calculate the appropriate remuneration, but it was confirmed in all other respects ([4]). On 20 October 2004, the Commission issued a new decision which took account of the Court's criticisms.

(4) On 1 September 1999, the Commission sent Germany a request for information on the transfers of assets to the other Landesbanks, including Helaba. By letter dated 8 December 1999, Germany submitted information on

([1]) OJ C 72, 26.3.2003, p. 3.

([2]) OJ C 140, 5.5.1998, p. 9 (Decision to initiate proceedings).

([3]) OJ L 150, 23.6.2000, p. 1; actions challenging that decision were brought by Germany (before the Court of Justice, Case-C 376/99), by North Rhine-Westphalia (before the Court of First Instance, Case T-233/99) and by WestLB (before the Court of First Instance, Case T-228/99); the Commission brought proceedings for an infringement of the Treaty (before the Court of Justice, C-209/00).

([4]) Joined Cases T-228/99 and T-233/99 Westdeutsche Landesbank Girozentraleand Land Nordrhein-Westfalen v Commission [2003] ECR II-435.

the transfer of the special assets of the *Land* to Helaba, which it supplemented, following a further request for information from the Commission sent on 31 October 2000, by letter dated 21 January 2001.

(5) By letter dated 13 November 2002, the Commission informed Germany that it had decided, with regard to the transfer of the special assets by the *Land* of Hessen as a silent partnership contribution to Helaba, to initiate formal proceedings under Article 88(2) of the EC Treaty. At the same time, the Commission also initiated proceedings in respect of similar transfers of assets to Norddeutsche Landesbank — Girozentrale ('NordLB'), Landesbank Schleswig-Holstein — Girozentrale ('LSH'), Hamburgische Landesbank — Girozentrale ('HLB') and Bayerische Landesbank-Girozentrale ('Bayern LB'). It had already initiated proceedings in respect of a further similar transfer of promotion-related assets by the *Land* of Berlin to Landesbank Berlin back in July 2002.

(6) The decisions initiating proceedings were published in the Official Journal of the European Union [5] . The Commission called on interested parties to submit comments.

(7) By letter dated 9 April 2003, Germany submitted comments on the initiation of proceedings in the Helaba case.

(8) By letter dated 29 July 2003, the BdB submitted comments on all the decisions taken on 13 November 2002 to initiate proceedings, and those comments were forwarded to Germany by letter dated 28 July 2003 for its opinion.

(9) By letters dated 10 October and 4 December 2003, Germany submitted comments on the BdB's remarks in the Helaba case. By letter dated 30 October 2003, Germany also forwarded comments by the Government of North Rhine-Westphalia and by WestLB on the BdB's remarks.

(10) By letter dated 7 April 2004, the Commission requested further information from Germany on all the Landesbank proceedings, and wrote specifically requesting information on the Helaba case by letters dated 19 May and 3 August 2004. Germany replied by letters dated 1 June, 23 June and 23 August 2004.

(11) In September and October 2004, talks took place between the BdB, the *Land* of Hessen and Helaba on the question of an appropriate remuneration for the capital provided. No understanding was reached. By letter dated 28 September 2004, the BdB sent comments on the proceedings. The Commission then asked Germany for further comments, which were submitted by letters dated 1 October and 6 October 2004.

II. DETAILED DESCRIPTION OF THE MEASURES

1. *HELABA*

(12) Landesbank Hessen-Thüringen Girozentrale (Helaba), with head offices in Frankfurt am Main and Erfurt, has a group balance-sheet total of EUR 140 billion (as at 31 December 2003), which makes it one of Germany's largest banks. The bank's balance-sheet total amounts to some EUR 130 billion, which is more than 90 % of the group balance-sheet total. It is a publicly owned credit institution operating in the form of a public institution (*Anstalt des öffentlichen Rechts*). The owners and guarantors of the bank have since 1 January 2001 been the *Sparkassen- und Giroverband Hessen-Thüringen* with an 85 % stake (at the time of the transfer at the end of 1998, it was the sole owner and guarantor), the *Land* of Hessen with a 10 % stake and the *Land* of Thuringia with a 5 % stake. According to its annual report for 2003, the group had equity capital of EUR 4,1 billion. As at 31 December 2003, the group's core capital ratio was 7,8 % and its equity ratio 11,3 %.

(13) Given its ownership structure, Helaba operates as the principal banker to the *Land* of Hessen and to the *Land* of Thuringia and as the central institution of the Hessen and Thuringia savings banks. Helaba also operates as a customer-orientated and market-orientated commercial bank with a particular emphasis on wholesale banking, and as a partner for public-sector customers, supporting the *Länder* and municipalities in financing and implementing investment plans. Via its holding in the *Landesförderinstitute*, Helaba supports economic and structural-policy objectives in Hessen and Thuringia.

(14) The Helaba group had some 3 500 employees as at 31 December 2003. It is present in major world financial centres. In addition to its two head offices in Frankfurt am Main and Erfurt, it is represented internationally in London, New York, Zurich, Dublin, Madrid, Paris and Luxembourg.

2. *THE TRANSFER OF THE SPECIAL 'HOUSING AND FUTURE INVESTMENT' FUND AS A SILENT PARTNERSHIP CONTRIBUTION TO HELABA*

(15) By the Law of 17 December 1998, the *Land* of Hessen established a special 'Housing and Future Investment' fund.

[5] NordLB: OJ C 81, 4.4.2003, p. 2; BayernLB: OJ C 81, 4.4.2003, p. 13; HLB: OJ C 81, 4.4.2003, p. 24; Helaba: OJ C 73, 26.3.2003, p. 3; LBKiel: OJ C 76, 28.3.2003, p. 2.

The Hessen Finance Ministry was empowered to transfer all or part of this fund to a credit institution as a silent partnership contribution or in any other form of equity holding recognised for supervisory purposes in return for a market remuneration that remained with the special fund.

(16) The special fund comprises *Land* claims from loans granted between 1948 and 1998 for the purpose of promoting social housing construction. As at 31 December 1998, the loan portfolio amounted to DEM 7,829 billion (*Land* portion: DEM 6,026 billion). Its cash value was determined by two independent experts at DEM 2,473 billion (EUR 1,264 billion). This special fund was transferred to Helaba as a silent partnership contribution under a contract between the *Land* of Hessen and Helaba signed in December 1998 and entering into force on 31 December 1998.

(17) A contractually agreed re-valuation by an expert on 31 December 2003 put the value of the promotion-related assets at EUR [...] (*) million. The increase in value is due to the fact that accruals had exceeded outflows from the promotion-related assets since 1999. However, pending final agreement with BAFin on the outcome of the expert valuation as at 31 December 2003, Helaba continues to have only the previous reference amount available.

(18) No injection of liquidity or inflow of revenue for the bank is associated with the transfer of the special fund as a silent partnership contribution. Income (interest and repayments) from the house-building loans does not accrue to the bank, but to the special fund and must be ploughed back into the promotion of housing construction.

(19) The transfer of the special fund to Helaba should be seen in the light of the *Land*'s efforts to tighten up its aid and structural-policy instruments and make them more efficient.

(20) According to information provided by Germany, the *Land* initially considered the possibility of inviting bids for the outstanding claims and selling them by auction (highest bidder) to private operators for cash and split up into tranches. Although splitting the special fund into tranches would have had the advantage of increasing the number of potential banking partners for the *Land* given that very few operators would have been interested in taking on a fund of some DEM 2,5 billion, the fund was nevertheless a revolving fund involving income from loans granted being ploughed back and thus constituted a single entity. It would, according to Germany, have been very expensive to carry out a periodic valuation of the tranches divided between individual institutions. The *Land* would, moreover, have lost the flexibility it had to shift the emphasis between the various aid objectives.

(21) The *Land* consequently decided to keep the house-building assets undivided, to continue to use the income for promotion purposes in house building and economic promotion, to organise the administration of the assets as effectively and cheaply as possible and, by using the claims in other ways, to generate additional income.

(22) In the light of these considerations, Helaba declared itself ready to take on and administer the entire fund of outstanding claims worth DEM 2,473 billion (EUR 1,264 billion). Another advantage of transferring it to Helaba was that the latter had, since 1953, already been administering the *Landestreuhandstellen* (LTH) as a legally independent business division and handling aid programmes in a trust capacity. Helaba is moreover required under the State Treaty and its own statutes to comply with general economic basic principles in pursuing its business policy. These three factors convinced the *Land* that Helaba would be best suited as a banking partner in realising the objectives of the Special Fund Law.

(23) Under [...] within the meaning of Section 10(4) of the German Banking Act of 30 December 1998, the *Land* transferred the special fund to the bank as a silent partnership contribution in the form of an internal partnership. This means that the *Land* co-founded a silent partnership with Helaba under Sections 230 *et seq*. of the German Commercial Code, i.e. a partnership whereby the silent partner has a capital holding in another business involving the transfer of a contribution to the assets of the active partner.

(24) According to the [...] the purpose of the contribution is 'to serve permanently as liable equity capital in the form of core capital within the meaning of Section 10(2), the first sentence of Section 10(2a) and Section (4) of the Banking Act, taking account of the requirements formulated by the Basle Committee on Banking Supervision (Bank for International Settlements) on 27 October 1998'.

(25) For a silent partnership contribution to count as the liable equity capital of a credit institution under Section 10(4) of the German Banking Act, it must in particular participate fully in losses and, in the event of the institution's bankruptcy or liquidation, be repayable only after all creditors' claims have been met. The fact that, as was agreed, the silent partnership contribution cannot be

(*) Confidential information, also indicated below by [...].

withdrawn by the *Land* of Hessen means that, according to the information provided by Germany, it does not count towards the 15 % limit for innovative financial instruments laid down by the Basle Committee, but is fully recognised by BAKred, as tier 1 liable equity capital (core capital).

(26) The alternative of transferring the housing construction fund not as a silent partnership contribution, but as share capital was, according to Germany, not pursued by the *Land* because it was not at the time willing to commit itself to being a direct shareholder and guarantor, and this was in any case not desired by the then sole shareholder, the *Sparkassen- und Giroverband Hessen-Thüringen*.

(27) The asset transfer to Helaba by the *Land* of Hessen in 1998 occurred later than the earlier transfers of promotion-related assets to Landesbanks in Germany, which are also the subject of the complaint by the BdB and of proceedings initiated by the Commission. However, according to Germany, the earlier transfers did to some extent serve as a model to the *Land* of Hessen even though, in the asset transfer to Helaba, account was taken of the developments which had in the meantime taken place on the capital market and in banking supervisory rules in the direction of increased use and recognition of hybrid or innovative equity capital instruments, which in the first half of the 1990s were not yet available in Germany in that form or to that extent and could not yet be taken into consideration for supervisory purposes.

3. *CAPITAL REQUIREMENTS UNDER THE OWN FUNDS AND SOLVENCY DIRECTIVES*

(28) The German Banking Act (*Kreditwesengesetz*) has been amended in line with Council Directive 89/647/EEC [6] (the 'Solvency Directive') and Council Directive 89/299/EEC [7] (the 'Own Funds Directive'), which require banks to have own funds of 8 % of their risk-adjusted assets. At least four percentage points must consist of what is termed core capital, or 'tier 1' capital, meaning capital items which are at the credit institution's disposal without restriction and immediately in order to cover risks or losses as soon as they arise. In determining the total own funds available to a bank for supervisory purposes, the core capital is of decisive importance, because additional capital, or 'tier 2' capital, is accepted as underpinning for risk-bearing transactions only up to the amount of the available core capital.

4. *EFFECTS OF THE TRANSFER ON HELABA'S EQUITY CAPITAL ENDOWMENT*

(29) The scale of a credit institution's business depends to a large extent on the amount of its equity capital. This was increased to a not inconsiderable extent by the transfer of the special fund to Helaba.

(30) Of the silent partnership contribution of DEM 2,473 billion (EUR 1,264 billion) as valued by an independent expert, entered in Helaba's balance sheet and recognised for supervisory purposes as core capital, an annually fluctuating amount of some DEM 2,3 billion (around EUR 1,2 billion), potentially usable to underpin its competitive business, is available to Helaba. The rest is, according to Germany, required as capital coverage for the claims making up the special fund. However, the *Land* of Hessen and Helaba agreed in the contract on a phased arrangement under which, in the period from 1999 to 2002, only an annually increasing partial amount of the usable core capital was to be actually used by Helaba to cover competitive business, and only this partial amount was to be remunerated accordingly. Only as from 2003 was the amount recognised by BaFin, in so far as not required for promotion-related business, to be usable in full to underpin competitive business. The precise amounts available to Helaba as core capital and usable or actually used for competitive business are shown in the following table:

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(6) OJ L 386, 30.12.1989, repealed and replaced by Directive 2000/12/EC, OJ L 126, 26.5.2000.

(7) OJ L 124, 5.5.1989, repealed and replaced by Directive 2000/12/EC.

Table:

Extent, recognition for supervisory purposes and use or usability of the silent partnership contribution (in EUR millions; end-of-year figures = annual average figures) [8]

	1999	2000	2001	2002	2003
Nominal value in the balance sheet	1 264,4	1 264,4	1 264,4	1 264,4	1 264,4
Core capital recognised for supervisory purposes for the underpinning of risk assets	1 264,4	1 264,4	1 264,4	1 264,4	1 264,4
Core capital used as cover for promotion-related business	[…]	[…]	[…]	[…]	[…]
Core capital usable as cover for competitive business, but not to be so used under the agreed phased arrangement	[…]	[…]	[…]	[…]	[…]
Core capital usable or actually used under the phased arrangement to cover competitive business	[…]	[…]	[…]	[…]	[…]

(31) Pending final agreement with BAFin on the outcome of the independent expert valuation of the promotion-related assets as at 31 December 2003, EUR [...] million continue to be available to Helaba as the reference amount (usable for competitive business).

(32) As a result of the capital transfer, according to the information provided by Germany, the core capital ratio (as defined by the Basle Capital Agreement) notified to BAKred, now BAFin, increased from 5,4 % (31 December 1997) to 9,3 % (31 December 1998), while the equity ratio rose from 9,6 % (31 December 1997) to 13,1 % (31 December 1998). The notified core capital and equity ratios thus rose by some 72 % and 36 % respectively.

(33) Through the injection of funds, Helaba's capacity to expand its business with risk-assets to be weighted at 100 %, assuming a multiplication factor of 12,5, which corresponds to the equity ratio of 8 %, was enhanced by some DEM 28 billion (EUR 14 billion). In reality, however, the permissible credit volume could have been expanded even more as a result of a DEM 2,3 billion increase in own funds, since a bank's assets are not usually deemed to bear an average risk of 100 %.

(34) Since this increase in its core capital enabled Helaba to take up further additional capital, its actual lending capacity indirectly increased still further.

(8) Letter from Germany of 23 June 2004, p. 2-7.

(35) Set out in tabular form, the absolute and relative changes in Helaba's core capital since 1997, including the silent partnership contribution of the *Land* of Hessen and other silent partnership contributions, are as shown in the chart, with a distinction being made between the situation in accordance with recognition for banking supervisory purposes and the situation in accordance with the contractually agreed phase arrangements.

Chart: End-of-year figures		1997	1998	1999	2000	2001	2002	2003
		EUR millions	EUR millions	EUR millions	EUR millions	EUR millions	EUR millions	EUR millions
Under supervisory rules	Silent partnership contribution *Land* Hessen	—	1 023	1 264	1 264	1 264	1 264	1 264
	Other silent partnership contributions	153	153	[…]	[…]	[…]	[…]	[…]
	Core capital	1 449	2 579	[…]	[…]	[…]	[…]	[…]
	Share silent partnership contribution *Land* Hessen in %	—	40 %	[…]	[…]	[…]	[…]	[…]
	Share other silent partnership contributions in %	11 %	6 %	[…]	[…]	[…]	[…]	[…]
Under agreed phased arrangements	Silent partnership contribution *Land* Hessen	—	—	[…]	[…]	[…]	[…]	[…]
	Other silent partnership contributions	153	153	[…]	[…]	[…]	[…]	[…]
	Core capital	1 449	1 556	[…]	[…]	[…]	[…]	[…]
	Share silent partnership contribution *Land* Hessen in %	—	—	[…]	[…]	[…]	[…]	[…]
	Share other silent partnership contributions in %	11 %	10 %	[…]	[…]	[…]	[…]	[…]

5. *REMUNERATION OF THE OWN FUNDS TRANSFERRED*

(36) According to the information provided by Germany, for the silent partnership contribution Helaba paid the *Land* a remuneration (the so-called liability commission) of 1,4 % a year, consisting of a remuneration for the liability function of 1,2 % a year and a premium of 0,2 % a year for the perpetuity of the contribution and the bank's unilateral right of notice, plus trade tax on the part of the special fund usable by the bank, i.e. a total of 1,66 %. It was agreed under the phased arrangement that this remuneration should not be payable in the first four years (1998 to 2002) on the full value of the fund, but on the agreed fixed tranches (reference amounts) rising in annual increments, which under the agreements reached in the transfer contract were to be used as cover for competitive business. According to the information provided by Germany, Helaba is liable to pay this remuneration on the basis of the phased arrangements irrespective of whether the silent partnership contribution is used to underpin competitive business or the business it pursues as part of its public task or whether the transferred capital is indeed used for solvency purposes at all.

6. *GROUNDS FOR INITIATING THE PROCEEDINGS*

(37) In its decision of 13 November 2002 to initiate proceedings, the Commission took the preliminary view that the transfer of the housing-promotion loans by the *Land* of Hessen to Helaba probably constituted new state aid within the meaning of Article 87(1) of the EC Treaty, which, since

the derogations provided for in Article 87(2) and (3) and in Article 86(2) of the EC Treaty were not met, appeared to be incompatible with the common market.

(38) The starting point for its investigation was the principle of the market-economy investor. According to that principle, favourable treatment exists through the provision of public money if state funds are made available to an undertaking on terms which it would not have obtained under normal market conditions.

(39) In view of the long-term risk-free rate (ten-year federal bonds) of around 4 % at the end of 1998, it appeared doubtful to the Commission whether the agreed remuneration could be regarded as appropriate, in particular allowing for a proper risk premium. On the other hand, the Commission conceded that, in determining the normal market remuneration, the lack of liquidity of the capital provided in this instance should not be ignored. The promotion-related loans transferred as a silent partnership contribution would have to be used for public promotion purposes in the same way as before the transfer. Consequently, Helaba could not use the transferred resources directly for its business. The broadening of the bank's equity capital base would, it is true, broaden Helaba's lending capacity (business-expansion function of equity capital). However, the bank could achieve the full potential scope of the increase in business volume only if it refinanced the additional credit volume to the full extent on the capital market. In the Commission's view, therefore, the *Land* could not expect exactly the same yield as a provider of liquid capital, and a corresponding reduction was therefore proper. However, whether this could justify the deduction of the entire gross refinancing costs from the usual market remuneration for a liquid silent partnership contribution was doubtful in view of the tax deductibility of the refinancing costs.

(40) The Commission doubted that the basic remuneration of 1,2 % a year agreed for the silent partnership contribution lay within the market corridor for comparable transactions, particularly as the absolute volume seemed to be above what was otherwise usual on the market. It also doubted whether the addition of 0,2 % a year for the long-term nature of the contribution was usual on the market and whether the trade tax of 0,26 % a year payable by Helaba here, but not payable by it if it took on a silent partnership contribution from commercial investors, could be regarded as a further constituent part of the remuneration and as relevant for the market comparison.

(41) The Commission further doubted whether a market-economy investor in a comparable situation would have agreed to limit the remuneration in the first few years to partial amounts. It had moreover to be examined in this context whether Helaba derived from the non-remunerated part of the silent partnership contribution further advantages that had to be remunerated, in particular an improvement in credit standing, since the silent partnership contribution was from the outset entered in full in the balance sheet and hence was available for liability purposes.

III. COMMENTS FROM GERMANY

(42) Germany stated that the *Land* of Hessen had in 1997/1998 sought ways of achieving additional income from its housing-promotion assets, while maintaining the specific earmarking of their use, by transferring them to a credit institution. It was intended that the assets should remain undivided. Only Helaba was prepared to accept this arrangement. The shareholders of Helaba would not have agreed to a share capital investment by the *Land*. Consequently, the only core capital instrument considered was a silent partnership contribution.

(43) According to Germany, none of the comments made by the Commission regarding the other Landesbanks applied to Helaba, particularly since it was profitable and not relatively under-endowed with liable capital and was not dependent on a transfer of promotion-related assets in order to maintain its existing business volume or to underpin its growth. Helaba was able to cover its capital requirements through its shareholder, the *Sparkassen- und Giroverband Hessen-Thüringen*, and on the capital market.

(44) After the Basle Committee on Banking Supervision had, on 21 October 1998, in the 'Sydney Declaration', formulated new guidelines on the supervisory recognition of core capital instruments for credit institutions that operated internationally, the *Land* and the bank decided that the funds raised would be of unlimited rather than limited duration, so as to comply with the new provisions regarding recognition as core capital above the 15 % limit. However, the *Land* had required a remuneration premium of 0,20 % a year in return for the perpetuity of the contribution and the bank's unilateral right of notice.

(45) According to Germany, in the wake of the Sydney Declaration by the Basle Committee on Banking Supervision, a fungible market for silent partnership contributions had developed which was characterised by broad diversification on the investor side, with investors ranging from private investors to large institutional investors.

(46) A silent partnership differed here fundamentally from a holding in the share capital. The silent partner did not have a holding in the undertaking and had only rudimentary rights of control. Whereas subscribed capital had to be remunerated through dividends after tax, the remuneration for a silent partnership contribution was a tax deductible operating expense. Under German banking supervision law, silent partnership contributions had been recognised even before 1998 as core capital without any limitation as to amount, and under international banking supervision law too, perpetual silent partnership contributions had been recognised as core capital since the 'Sydney Declaration' in October 1998. In 1998/99, credit institutions had made increasing use of silent partnership contributions. The amounts involved had ranged up to USD 1 billion or DEM 1,2 billion (around EUR 0,6 billion). Whereas they had not been very widespread at the beginning of the

1990s, silent partnership contributions were certainly no longer a marginal financing instrument in 1998/99.

(47) In working out the legal arrangements and in agreeing on the remuneration, the *Land* based itself on comparable transactions involving private credit institutions. According to Germany, in 1998 SGZ Bank, for example, had agreed a liability remuneration of 1,2 % a year above the reference rate and HypoVereinsbank Luxemburg one of 1,6% a year, while in 1999 Dresdner Capital LLC had agreed a liability remuneration of 1,65 % above the relevant reference rate, HypoVereinsbank Luxemburg one of 1,25 % a year and Deutsche Bank one of 1,15 % a year for a so-called 'perpetual'. The remuneration premiums for the funds taken up by private institutions were basically in a corridor between 0,80 % above twelve-month Libor ([9]) and 2,15 % above US federal bonds ([10]) . Furthermore, the savings banks in Hessen and Thuringia had granted Helaba a silent partnership contribution with effect from 5 December 1997, for which the remuneration was 1,2 % a year above the reference interest rate.

(48) Germany further stated that, in the case of variable interest rates, the reference interest rates related to money market instruments (Libor and Euribor), while in the case of fixed interest rates they related to bond market instruments (fixed-interest government bonds such as US treasuries and German federal bonds) or the interest rates on the swap market. On the euro money market, lendings were usually carried out on the inter-bank market without any further premiums on the basis of Libor or Euribor. In so far as these reference interest rates were chosen for silent partnership contributions, the premiums were identical to the liability remuneration for silent partnership contributions. On the bond market, the yields on government bonds were usually used as reference interest rates and, since the end of the 1990s, mid-swaps were increasingly used as the reference rate. Even for first-rank bank bonds, banks had, on credit standing and/or liquidity grounds, to pay a different premium, varying with the state of the market, compared with government bonds having the same term. This premium was described as the refinancing premium. In assessing the fixed-interest silent partnership contributions of credit institutions, therefore, these refinancing premiums had to be deducted from the remuneration premiums.

(49) These refinancing premiums for euro banks (senior bonds, JP Morgan-Index) compared with federal bonds had, according to Germany, ranged from just under 20 to over 40 basis points in the two-year period 1998-99. At the end of 1998, they amounted to just under 40 basis points ([11]). In so far as the swap rate (mid-swaps) was chosen as the reference figure, however, the interest rate premium of a silent partnership contribution corresponded largely to the specific liability remuneration of the silent partnership contribution, since the swap rate interest premium relative to federal bonds corresponded roughly in market terms to the interest premium of 'covered' bank bonds relative to federal bonds and could therefore also be converted into interest premiums compared with Euribor.

(50) The negotiations on the contribution and remuneration were carried out between the *Land* and the bank as between two independent parties. They had based themselves, in determining the finally agreed remuneration of 1,4 % a year (1,2 % plus a 0,2 % premium for the perpetuity of the contribution and the unilateral right of notice of the bank), on the above-mentioned corridor, with a whole series of data from the market as it then stood.

(51) With regard to the premium for the perpetuity of the contribution, Germany stated that the comparable transactions referred to had terms of ten or twelve years and also 32 years or were of unlimited duration. The premium of 0,2 % a year for the perpetuity of the contribution was in conformity with the market in view of Helaba's AAA/Aaa rating at the relevant time, a rating which none of the comparable institutions achieved. The transactions on the capital market referred to for comparison purposes did not moreover reveal any dependence of the level of the remuneration on the amount of the funds taken up, either from the point of view of the institutions (total amount of the issue) or from the point of view of the investors (amount of the subscribed tranche).

(52) In addition, Helaba had to pay trade tax, to which the *Land* of Hessen was not liable, on the remuneration of 1,4 %, so that the total charge was 1,66 % (before tax). According to Germany, therefore, in comparing the remunerations, the trade tax effect of 0,26 % a year in relation to Helaba's silent partnership contribution had to be taken into account. Commercial investors in Germany pay trade tax on profit shares from silent participations. However, the *Land* of Hessen is not subject to trade tax. In its place, Helaba had to pay the trade tax applicable to the remuneration of the silent partnership contribution. A market-economy institutional investor would therefore have required a higher remuneration than the *Land* in order to offset the charge he had to pay in the form of trade tax. Conversely, Helaba would have been immediately prepared to pay a remuneration premium to such an investor, since it made no difference to it whether it paid the premium as a remuneration to the investor or as trade tax to the tax office. Inclusive of the trade tax effect of 0,26 % a year, Helaba's charge resulting from the remuneration it had to pay of 1,40 % a year for the silent partnership contribution

([9]) See Germany's letter of 9 April 2003, p. 25: variable-interest-rate tranche of the silent partnership contribution of USD 700 million with a term of ten years taken up by Deutsche Bank in January 1998.

([10]) See Germany's letter of 9 April 2003, p. 25: tranche of the silent partnership contribution of USD 1 000 million with a term of 32 years taken up by Dresdner Bank in May 1999.

([11]) See chart in annex 15 of Germany's letter of 9 April 2003.

amounted in total to 1,66 % a year, which was clearly in the market corridor and represented the result of negotiations between Helaba and the *Land* of Hessen.

(53) According to Germany, the remuneration paid was tax deductible by Helaba as operating expenditure. Silent partnership contributions represented equity capital only in the calculation of solvability for banking supervisory purposes, whereas in company and tax law terms they were treated as outside capital.

(54) According to Germany, the bank needed only DEM [...] million in equity capital for its planned annual growth, whereas the value of the promotion-related assets as liable equity capital for banking supervisory purposes amounted to over DEM [...] billion. Helaba would, according to Germany, not have taken up a silent partnership contribution amounting to some DEM 2,5 billion in a single step, since this amount covered its equity capital requirements for several years; rather, it would have made repeated calls on the capital market. Despite these effects and the charges they imposed on Helaba, no deduction from the remuneration rate of 1,4 % was agreed. The *Land* and Helaba had instead agreed, as a transitional solution, on a gradual use and remuneration of the silent partnership contribution (the phased arrangement). The bank had endeavoured here to reach an arrangement under which it would remunerate the silent partnership contribution only in accordance with the growth targets agreed with its owner to the tune of its actual use to cover risk assets. However, this had been too unfavourable for the *Land* of Hessen and had therefore not been acceptable to it. Following negotiations to offset the conflicting interests, an arrangement had been agreed involving annually increasing remunerated tranches (DEM [...] million in 1999, DEM [...] billion in 2000, DEM [...] billion in 2001, DEM [...] billion in 2002, DEM [...] billion in 2003, i.e. the upper limit for usable core capital). These phased arrangements had provided for a significantly faster increase for the first few years than was necessary for the bank's planned growth. The managing board had then asked the board of directors to approve an additional special quota of DEM [...] million to cover liable equity capital, from whose yields the remuneration of the difference was to be financed so as to ensure that the contribution was used in a way that was neutral in terms of operating result. In Germany's view, this showed that the 'over-endowment' of the bank had not only not conferred any additional advantage, but that, without the special quota, it would rather have burdened the profit situation of the bank, because the remuneration for those parts of the gradually increasing assessment basis not covered by additional business would not have been matched by any income.

(55) This would have produced annually increasing payment obligations up to an amount of some DEM 33 million as from 2003. In addition to the remuneration of the silent partnership contribution, the bank had to bear the refinancing costs of lending.

(56) Germany also made comments on the market-economy investor principle. It followed from case law that an assessment must be made of the market nature of the transaction from the investor's point of view. It therefore had misgivings if the Commission, as made clear in the decision to initiate proceedings, set out to examine primarily from the recipient's point of view whether Helaba had received an economic concession which it would not receive under normal economic conditions.

(57) It could not therefore be right for the Commission, irrespective of whether a market-economy investor would have accepted a gradually increasing assessment basis for the remuneration, to set out to examine whether Helaba gained further advantages (improvement in general credit rating) from the non-remunerated part of the silent partnership contribution. In accordance with paragraph 327 of the WestLB judgment, reference could not be made only to the single undertaking benefiting from the investment. Any additional advantage to the recipient was irrelevant if, for whatever reason, a market-economy investor would not have required additional remuneration for such advantage. No institution would have been prepared to pay immediate remuneration on the total volume if it could use only slowly increasing partial amounts for business expansion purposes and also had no use whatsoever for the surplus amounts. However, the *Land* of Hessen wanted to invest its special housing fund, despite its size, *en bloc* with a single credit institution. A private investor would in such a situation not have insisted on immediate remuneration of the entire investment, unless it had found a credit institution which needed a capital injection on such a scale either because of explosive growth in its business activity or to offset massive losses. However, this had not been the case. Helaba had derived no advantage from those parts of the silent partnership contribution which in the first few years it could not use for banking supervisory reasons and was also not supposed to use because of the wishes of its owners.

(58) On the basis of the phased arrangements agreed with the *Land* of Hessen, Helaba made use for business expansion purposes only of tranches of some DEM [...] million a year plus the abovementioned special quota of some DEM [...] million. In economic terms, the phased arrangements corresponded to the taking up of several silent partnership contributions spread over time. The amounts taken up by private institutions were therefore at best to be compared with the amounts of individual tranches. It could therefore be said that the order of magnitude involved was in conformity with the market. The *Land* could not demand a remuneration premium for the taking up of the special fund *en bloc*, which only Helaba was prepared to do, but had rather, as a result of the negotiations, to accept that a remuneration would be paid only on gradually increasing partial amounts of the investment.

(59) The investment had quite properly not received any remuneration for its additional liability function through payment of a guarantee commission, since it had not been used by the bank in banking supervisory terms for business expansion. It would not have made sense in economic terms for a credit institution that was already accorded the top credit rating by all the rating agencies to pay a remuneration for the liability function of additional resources it had taken up. The terms and conditions under which the institution could take up outside capital would not have improved any further, so that no monetary advantage existed. The investor in whose interest the entire capital was transferred *en bloc* to the bank could therefore not have imposed any remuneration for the liability function.

(60) The Commission's doubts, referred to in the decision to initiate proceedings, regarding the non-liquidity of the capital were based partly on the methodology of the WestLB decision, which could not however be applied to the present case because of the major differences in the underlying facts. According to Germany, in the present case the gross and not just the net refinancing costs had to be deducted from the remuneration of otherwise comparable, but liquid silent partnership contributions. This was because, even in the case of private credit institutions, the remuneration for the liquidity function of the silent partnership contributions taken up by them was tax deductible. If, in the case of Helaba, only the net refinancing costs were deducted from the notional remuneration for a liquid silent partnership contribution, the same process would have to be applied in the case of private credit institutions as regards the remuneration actually paid by them for liquid silent partnership contributions. Otherwise the comparison would be distorted.

IV. **COMMENTS FROM INTERESTED PARTIES**

1. *COMMENTS FROM THE COMPLAINANT BDB*

(61) The BdB submits that Helaba did not pay an appropriate remuneration for the transferred core capital and was therefore in receipt of state aid.

(62) In its comments of 29 July 2003 on the proceedings initiated on 13 November 2002 in respect of the Landesbanks, the BdB states that the question of whether the remuneration was appropriate should be determined using the method employed by the Commission in its WestLB decision.

(63) The first step was therefore to compare the capital provided with other equity instruments. The second step was to determine the minimum remuneration which an investor would expect for a real equity-capital investment in the Landesbank. Finally, a calculation had to be made of any premiums and discounts applied by virtue of the peculiarities of the transfer.

1.1. COMPARISON WITH OTHER EQUITY INSTRUMENTS

(64) Nearly all the Landesbanks are said by the BdB to have required fresh core capital from 1992 onwards in order to meet the stricter requirements arising from the new Solvency Directive. Without these increases in capital, the Landesbanks would have had to scale down their business. It could therefore be concluded, the BdB argues, that the capital injected could be compared only with equity instruments that were recognised as core capital ('tier 1 capital') and available in Germany in the year of the transfer. This immediately excluded from any comparison non-voting preference shares, profit participation rights and perpetual preferred shares. In Germany, these three equity instruments were recognised not as core capital, but as additional capital ('tier 2 capital').

(65) At the time of the respective transfers, only share capital and silent partnership contributions were recognised as core capital in Germany. In the BdB's opinion, the only legal form properly available to Helaba for the investment was share capital. The BdB does not challenge the recognition by the relevant authorities that actually took place. It argues rather that such recognition should not have taken place, since the silent contribution by the *Land* of Hessen that was specifically agreed was economically and legally comparable not with 'normal' silent partnership contributions, but rather with share capital. Given then, that such recognition had actually taken place, the remuneration at least of the silent partnership contribution of the *Land* of Hessen had to be based on that of share capital, since a market-economy investor would have required such remuneration on the basis of its similarity to share capital and specific risk structure.

(66) The BdB gives an analysis here, based on a list of criteria, of why in its opinion the silent partnership contribution of the *Land* of Hessen was, in economic and legal terms, comparable with share capital and not with silent partnership contributions observed on the market.

(67) The BdB bases this view essentially on the fact that 'normal' silent partnership contributions are only of limited duration and can be withdrawn and, under the principles of the Basle Committee on Banking Supervision, cannot be used for volumes above 15 % of core capital, whereas the silent partnership contribution of the *Land* of Hessen, like share capital, was of unlimited duration and allowed the 15 % limit to be exceeded. Furthermore, it could not be deduced from an agreement on the junior-ranking nature of the assets that there was a lower risk for the investor, since the transferred capital represented an important part of the entire core capital, in some instances more than 50 %. This

meant a much higher probability that the transferred capital would be called upon in the event of a loss, for which consequently a higher risk premium should be paid. The BdB also stated that, for banking supervisory purposes, silent partnership contributions were to be recognised only as lower tier 1 capital and hence, under the 1998 'Sydney Declaration' of the Basle Committee on Banking Supervision, could make up only 15 % of the necessary core capital ratio. Large-volume silent partnership contributions above this limit could not therefore be used. Lastly, the Deutsche Bank *perpetuals* referred to by Germany could not be taken as a criterion for the appropriate remuneration, since they all lay below the 15 % limit and hence would not have been alternatives for Helaba at the end of 1998.

(68) Another factor was that the *Land* made its contribution available to Helaba without any possibility of withdrawal on its part, i.e. for unlimited duration. Although a shareholder could not 'withdraw' his share capital, he was nevertheless free to decide to sell his shares and invest elsewhere. Regardless of the details of the legal form, there was no such transferability in this instance if only because at all events there was virtually no market for a capital investment of this size and of unlimited duration. Private investors, by contrast, usually kept open the possibility of withdrawing their capital again in the event of persistently bad results and of investing again more profitability. A private investor would — if at all — accept the permanent tying of risk capital only in return for a correspondingly high yield.

(69) The form of capital transfer opted for here was therefore a normal share capital investment, for which a market-economy investor would expect a corresponding yield. In particular, it was not sufficient to take account of the unlimited term merely through a premium on the basic yield, determined for comparison purposes, on a silent partnership contribution of limited duration.

(70) The following two tables showed the essential differences between Helaba's 'silent partnership contribution' and other forms of equity capital available at the time of the investment:

	Helaba's 'silent partner-ship contribution'	Share capital	Silent partner-ship	Preference shares	Profit partici-pation rights	Preferred shares
Availability on the German market in 1998	Yes	Yes	Yes	Yes	Yes	Yes
Status for banking supervisory purposes	Core capital	Core capital	Core capital only under certain conditions and 15 % limit	Additional capital	Additional capital subject to special conditions	Additional capital or core capital with 15 % limit

	Share capital	Helaba's 'silent partnership contribution'	Silent partnership
Usability for large volumes	Yes	Yes	No
Unlimited duration	Yes	Yes	No
Investor has no right of withdrawal	Yes	Yes	Yes
Participation in current losses	Yes	Yes	Yes
Repayment in insolvency proceedings, by creditor	Yes	Yes No internal 'junior-ranking nature' compared with share capital	Yes Repayment before share capital

	Share capital	Helaba's 'silent partnership contribution'	Silent partnership
Profit-share remuneration	Yes	Yes	Yes
No subsequent payment in the event of absence of remuneration	Yes	Yes	No Cumulative subsequent payment possible

1.2. TAX DEDUCTIBILITY

(71) The BdB doubts that the profit share of the *Land* of Hessen is tax deductible as operating expenditure. In its view, it was to be assumed that the *Land* of Hessen was incurring a substantial business risk with the silent partnership contribution. This was evident not only from the size of the capital investment, but also from the fact that the participation was not withdrawable. This business risk justified the existence of a partnership (so-called atypical silent partnership), the ranking of the silent partnership contribution for tax purposes as partnership equity capital and the non-deductibility of the silent partner's profit share as operating expenditure on the part of Helaba.

1.3. MINIMUM REMUNERATION FOR A SHARE-CAPITAL INVESTMENT IN A LANDESBANK

(72) The BdB argues that all methods of determining an appropriate remuneration (return) for the provision of equity capital start from a risk-free return and add a risk premium. They can be traced back to the following basic principle:

Expected return on a high-risk investment

= risk-free return + risk premium for the high-risk investment

(73) To determine the risk-free return, the BdB uses the returns on long-term government bonds, fixed-rate securities issued by state bodies being the form of investment with the least or no risk ([12]).

(74) To derive the risk premium, the BdB first works out the 'market risk premium', i.e. the difference between the long-term average return on shares and that on government bonds. For the German share market, the BdB assumes, on the basis of a study by Stehle-Hartmond (1991), a uniform long-term market risk premium of 4,6 %.

(75) The BdB then determines the beta value for the Landesbanks, i.e. the individual risk premium for the banks, on the basis of which the general market risk premium was to be adjusted. The BdB stated that it had determined the beta values statistically, which means that it had estimated them on the basis of a historical data sample. The BdB concludes that all the beta values for all the Landesbanks and periods considered are greater than one ([13]).

(76) The BdB therefore calculates the expected minimum remuneration for an investment in the share capital of Helaba to be 11,66 % a year at the time when the promotion-related assets were transferred on 31 December 1998.

1.4. PREMIUMS AND DISCOUNTS ON ACCOUNT OF THE PARTICULARITIES OF THE TRANSACTIONS

(77) The BdB notes that the Commission's deduction in its decision on WestLB of 4,2 % from the minimum remuneration of 12 % to take account of the lack of liquidity of the Wfa assets was upheld by the Court of First Instance. It therefore sees no reason to depart from this method in the present case, with the result that a deduction for liquidity should also be made here. The amount of the discount for lack of liquidity would be calculated, using the WestLB method, on the basis of net refinancing costs (gross refinancing costs minus the applicable corporation tax).

(78) The liquidity deduction would be calculated for Helaba on the basis of a gross refinancing rate of 6,57 % a year (corresponding to the long-term risk-free base rate at the time of the transfer in 1998), to which the overall tax rate should be applied to obtain the net refinancing rate.

([12]) To offset the effects of inflation, the rate of return on a long-term government bond should be determined for each transfer period, initially disregarding the inflation expectations. Then, to estimate the long-term risk-free base rate, the estimated figure for average long-term inflation expectations (3,60 %) is added to the 'real base rate' at the time in question.

([13]) For the purposes of comparison, the BdB also gives the theoretical beta values calculated using the Capital Asset Pricing Model (CAPM), which, as it indicates, differ very little from the empirically determined values.

(79) In the BdB's view, three aspects of the transfer increase its risk compared with a 'normal share capital investment': the in part exceptionally high volume of assets transferred, the failure to issue new shares in the company and the related forgoing of additional voting rights, and the lack of fungibility of the investment, i.e. the impossibility of withdrawing the invested capital from the company again at any time. The BdB considers a premium of at least 1,5 % a year justified here in line with the WestLB methodology.

1.5. CAPITAL BASE AND ELEMENTS OF REMUNERATION

(80) The BdB stresses firstly that, in calculating the appropriate remuneration in the case of Helaba, the total amount which was recognised as core capital for underpinning competitive business should be taken as the basis and not solely the actually used or usable part. It backs up this argument by stating that a market-economy investor would never agree to limit his remuneration to the portion of funds actually used. For a private investor bearing the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. What matters to the investor is that he himself can no longer invest that amount and obtain a corresponding return.

(81) The calculation of the remuneration in the period 1998 to 2002 on the basis of tranches rising in annual steps had been justified not as a discount because of the fact that the transferred capital had not been 'split up' or by the fact that transfer '*en bloc*' to Helaba would have had the effect of imposing a burden on it. Even if the capital transfer was perhaps not necessary to meet solvability criteria, it had nevertheless considerably increased Helaba's equity capital base and had allowed a strong expansion in its competitive activity. A market-economy investor would therefore require a full remuneration on the entire amount on the basis of its recognition as liable equity capital.

(82) The 0,3 % a year guarantee commission (*Haftungsprovision)* applied by the Commission in its WestLB decision, which it calculated by comparing the amount of capital with a guarantee, had to be charged for the part of the transferred core capital that could not be used to underpin competitive business.

(83) Only the guarantee commission (*Haftungsprovision*) and the perpetuity premium (*Permanenzzuschlag)* could be taken into account as components of the remuneration. Trade tax, most of which went not to the *Land* at all, but to the municipality, was not a part of the remuneration. It was a charge imposed by law, stemming from tax-related circumstances that were independent of the intentions of the parties.

(84) Lastly, the return was paid not to the *Land* of Hessen, but — after deduction of capital yield tax — 'allocated as a net amount to the special fund'. Since Helaba was the (sole) owner of the special fund, it was in reality paying itself. A private investor would not have accepted this as a return for his investment.

2. *COMMENTS FROM THE LAND OF NORTH RHINE-WESTPHALIA AND WESTLB*

(85) On 30 October 2003, Germany forwarded a response from the *Land* of North Rhine-Westphalia and WestLB to the Commission's decision of 13 November 2002 to initiate proceedings in which they disputed the statement that the assets transferred to the Landesbanks could be compared to share capital. They argued that silent partnership contributions and 'perpetuals' had in fact been recognised as core capital in Germany since 1991. They added that remuneration for an investment depended not on how it was classified by the banking supervisory authorities, but on its risk profile. Since the assets were junior-ranking, the risk pattern had more in common with silent partnership contributions or 'perpetuals' than with share-capital investments.

(86) WestLB had no objections to the CAPM method for calculating the minimum remuneration for a share-capital investment, but it felt that the beta values determined by the BdB — at well over one — were inappropriate. A beta factor of more than one meant that a company's shares represented a higher risk than the market as a whole. Yet the risk of investing in a Landesbank was well below the overall market risk because of the institutional liability (*Anstaltslast)* and guarantor liability (*Gewährträgerhaftung*) which it enjoyed and which were not challenged at the time.

(87) Moreover, in the specific case of the Landesbanks, it was a mistake to use as a benchmark the return expected at the time that the assets were transferred to the banks. Although this was generally a sensible approach to adopt in relation to the private-investor test, it here meant using as a basis the returns expected in 1991. But for an investor to receive in 2003 the return expected in 1991, which was much higher than the returns actually achieved, flew in the face of all economic realities. Permanently and systematically applying a rate of return of around 12 % placed the Landesbanks at an unjustifiable disadvantage compared with private competitors.

(88) As regards the discount for the lack of liquidity of the transferred assets, WestLB and the *Land* of North Rhine - Westphalia considered that the rate for risk-free government bonds should be deducted in full from the basic return. They argued that the Landesbanks had received no liquidity as a result of the asset transfers. It was not defensible in economic terms to reduce this rate by the tax savings since the pricing of capital market instruments was

independent of the tax situation. Otherwise the price of a capital market instrument would have to differ according to tax considerations.

(89) Lastly, the fact that the assets' lack of liquidity did not pose a risk to the liquidity position should be seen as reducing the risk — and hence the remuneration. This should be taken into account by applying a corresponding deduction. Likewise, a discount should be granted on account of the 'owner effect' since an investor who already owned shares in a company took a different view of an additional investment from that of a new investor.

V. GERMANY'S RESPONSE TO THE BDB'S COMMENTS

(90) In Germany's view, the BdB was not successful in its attempt to reinterpret the silent partnership contribution as a share capital investment, nor was it able to raise doubts as to the appropriateness of the remuneration which was agreed and paid to the *Land* of Hessen. In Germany's view, therefore, there was no aid.

(91) In Germany's view, there was no justification, in calculating the remuneration, for taking the roundabout approach of calculating the remuneration on a fictitious share capital investment. The *Land* of Hessen had from the outset transferred its housing-promotion assets as a silent partnership contribution to the bank. What was involved was therefore a financing instrument which was defined in company, tax and banking supervision law and which differed fundamentally from a share capital investment, in which the *Land* was not interested and which the owners of the bank did not want.

(92) The BdB ignored important differences between share capital and silent partnership contributions and tried to identify non-existent differences between 'normal' silent partnership contributions and the silent partnership contribution of the *Land* of Hessen.

(93) The BdB essentially argued that silent partnerships were of only limited duration or could be withdrawn and consequently, in accordance with the principles of the Basle Committee on Banking Supervision, were recognised as core capital only up to 15 % of the entire core capital of a credit institution. Since the silent partnership contribution of the *Land* of Hessen had been made available to Helaba without any time limit and was not covered by the 15 % limit and therefore did not represent a 'normal' silent partnership contribution, but functionally represented share capital, the criterion in assessing the remuneration should not be other silent partnership contributions or other innovative capital instruments, but share capital investments.

(94) This core argument on which the BdB was relying was, for a number of reasons, erroneous. For example, limited duration or withdrawability were not a necessary and indispensable feature of silent partnerships either under company law or under banking supervision law. Conversely, share capital was not necessarily of unlimited duration and unwithdrawable. Under German company law, rather, all companies irrespective of their legal form could be set up for a limited period or it could be agreed that a contribution could be withdrawn subject to notice, which did not stand in the way of its recognition as core capital under German banking supervision law.

(95) The BdB was also wrong in arguing that the 15 % limit for recognition as core capital under international banking supervision law did not, under the 'Sydney declaration' of the Basle Committee on Banking Supervision and the practice of the Germany supervisory authority based on it, apply to permanent capital instruments, which could be withdrawn only on the initiative of the issuer (but not of the investor). Furthermore, the practice of the German supervisory authority was now based on the assumption that a contribution with a term of at least 30 years and the explicit exclusion of withdrawal was made available to the investor on a 'permanent' basis and consequently did not come under the 15 % limit. This too showed that the difference between contributions of limited and unlimited duration was by no means as great as the BdB was arguing. As far as the appropriate remuneration was concerned, there was no cause or justification on this account for reinterpreting silent partnership contributions as share capital.

(96) Only a few months after Helaba, the Deutsche Bank had taken up a 'permanent' contribution in the form of 'perpetuals', and had done so on the capital market. Contrary to what the BdB asserted, the 15 % limit did not, according to a newspaper report submitted on the subject, apply to this contribution, since no increase in the interest rate had been agreed if the bank did not exercise a right of withdrawal that had been accorded to it (no 'step-up' clause). The Deutsche Bank perpetuals were by no means exceptional in character, since in the subsequent period numerous other credit institutions had taken up 'permanent' contributions on the market, examples of which Germany provided. No single issue, whose volumes ranged from EUR 150 million to over EUR 2 billion, provided anything like the return of share capital; the remuneration lay in the range between 110 and 290 basis points above mid-swaps. Already in 1999, the market had, as regards remuneration, not attached any major importance either to the distinction between capital instruments of limited and unlimited duration or to the question of whether the issue proceeds fell under the 15 % limit or not.

(97) Nor did Germany accept the criteria selectively applied by the BdB, which were supposed on the one hand to demonstrate common features between share capital and the silent partnership contribution of the *Land* of Hessen

and, on the other, differences between this silent partnership contribution and a 'normal' silent partnership contribution. The BdB was overlooking on the one hand the extent to which the shaping of silent partnership contributions could be shaped by agreement between the parties and, on the other, features that were essential and indispensable to the distinction between share capital and a silent partnership.

(98) Share capital did not yield interest, but conferred a claim to payment of a dividend, which was not only dependent on profits, but above all in proportion to profits. The remuneration on a silent partnership contribution, by contrast, was only profit-dependent. Whether or not provision was made for retrospective payments in the case of a silent partnership contribution was a matter for agreement between the parties and was not in any case one of the constitutive features of a 'normal' silent partnership. However, under [...] pursuant to Section 10(4) of the German Banking Act, specific provision had been made, in the event of losses, for the junior-ranking retrospective payment requirement typical of silent partnership contributions. The prior-ranking requirement was to replenish the contribution again to the original amount from future profits ([14]).

(99) The assertion that for very large volumes only share capital and not 'normal' silent partnerships could be used was contradicted by the size of the silent partnership contributions which private credit institutions had taken up on the capital market in 1998/99 and were also currently taking up. These ranged up into the area of around EUR 1 billion. In relative terms, any silent partnership contribution even over the 15 % limit was recognised as core capital if it met the requirements of the Basle Committee on Banking Supervision and was in line with the practice of the German supervisory authorities which was based on them.

(100) Current evidence of the possibility of the 15 % limit being exceeded was provided by a capital measure taken on 2 December 2003 by a BdB member institution, the Deutsche Bank. This was the taking up of silent partnership contributions from private investors totalling EUR 300 million for an unlimited term (a so-called '*perpetual*') ([15]) . This illustrated once again how liquid and transparent the market for silent partnership contributions in respect of German banks was, even where large volumes were involved. With an agreed liability premium of 0,99 %, moreover, the measure provided further evidence that the liability remuneration that had been agreed for the silent partnership contribution of the *Land* of Hessen to Helaba had been calculated in a way that was market-related and market-adequate.

(101) In response to a request from the Commission, Germany submitted a table showing the trend of silent partnership contributions and other hybrid core capital instruments for selected large banks in the private sector from 1998 to 2003. Germany argued that this made it clear that the institutions listed had also taken up hybrid core capital beyond the 15 % limit set for banking supervisory purposes, and the extent to which they had done so, since the proportion of total core capital accounted by such instruments exceeded 15 % ([+]).

	[Bank A]			[Bank B]			[Bank C]		
	Hybrid core capital instruments(of which silent partnership contributions)	Core capital (€ millions)	Share of hybrid core capital (%)	Hybrid core capital instruments (€ millions)	Core capital (€ millions)	Share of hybrid core capital (%)	Hybrid core capital instruments (€ millions)	Core capital (€ millions)	Share of hybrid core capital (%) (*)
1998	612 (612)	15 978	4 %	—	10 623	—	614	13,0	5 %
1999	3 096 (713)	17 338	18 %	1 495	12 908	12 %	1 937	14,6	13 %
2000	3 275 (768)	21 575	15 %	1 574	12 046	13 %	2 014	21,3	9 %

([14]) [...] states: '[...]'

([15]) See *Börsenzeitung* of 7 November 2003 and *International Financial Review* of 22 November 2003.

([+]) The names of the listed banks in the private sector are confidential information and are referred to as Bank A, Bank B and Bank C.

	[Bank A]			[Bank B]			[Bank C]		
	Hybrid core capital instruments(of which silent partnership contributions)	Core capital (€ millions)	Share of hybrid core capital (%)	Hybrid core capital instruments (€ millions)	Core capital (€ millions)	Share of hybrid core capital (%)	Hybrid core capital instruments (€ millions)	Core capital (€ millions)	Share of hybrid core capital (%) (*)
2001	3 404 (811)	24 803	14 %	1 923	11 542	17 %	3 650	21,7	17 %
2002	2 973 (686)	22 742	13 %	1 732	8 572	20 %	4 164	19,1	22 %
2003	3 859 (**) (572)	21 618	18 %	1 561	7 339	21 %	4 076	14,4	28 %

(*) On the basis of full appropriation to core capital.

(**) Including cumulative preference shares after deconsolidation of trust companies.

(102) Contrary to what the BdB argued, both the silent partnership contribution of the *Land* of Hessen and silent partnership contributions taken up on the capital market would be paid back in the event of insolvency before the share capital, i.e. on a prior-ranking basis compared to the share capital. Contrary to what the BdB stated, the *Land* of Hessen like the investor of any other silent partnership contribution would in the event of insolvency receive the recovery percentage, whereas the owner would receive nothing, resulting in a reduced risk compared with share capital.

(103) A silent partnership differed significantly from share capital because the silent partner did not have a stake in the assets of the undertaking and also did not have any voting rights. The BdB had mistaken this in its analysis and thought that a premium should be paid for it. The market did not follow this line of thinking.

(104) The BdB's doubts as to the tax deductibility of the remuneration were unfounded. The *Land* of Hessen had taken on neither the entrepreneurial risk nor the entrepreneurial initiative necessary for the assumption of a partnership. The *Land* of Hessen, like any typical silent partner, participated, under the contract on the setting up of the silent partnership, only in Helaba's current profit and loss, but not in its undisclosed reserves, nor in the business value and increases in value in the operating assets. Upon termination of the silent partnership, it merely got back its contribution. The *Land* of Hessen had not been given any possibility of exercising company rights that corresponded to the voting, monitoring and contradictory rights of a limited partner or the monitoring rights of a shareholder in accordance with Article 716(1) of the Civil Code. Furthermore, the state contract between the *Länder* of Hessen and Thuringia on the formation of a joint savings bank organisation had authorised the bank to take up an atypical silent partner. In the absence of partnership, the financial authorities had accordingly also recognised the tax deductibility of the remuneration paid to the *Land* of Hessen.

(105) Balance sheet treatment was also different. Share capital was serviced from the balance sheet profit (surplus of asset items over liability items) by decision of the general meeting of shareholders. In the case of the silent partnership contribution of the *Land* of Hessen, by contrast, the remuneration reduced the bank's operating result by reducing net interest received (the remuneration was a component part of expenditure on interest) and did not constitute profit utilisation, and did not therefore require any decision by shareholders. This mandatory balance sheet treatment of the silent partnership contribution reduced the cost-income-ratio and the balance-sheet equity return.

(106) Contrary to what the BdB argued, a market-economy investor would have agreed to the assessment basis for calculating his remuneration being limited to the part actually used for business expansion and would, for the excess part, not have required a remuneration of 0,3 % in line with the Commission's WestLB decision. Because of Helaba's limited requirement, made known from the outset, any other investor would not have been able to achieve any better negotiating result than the *Land* of Hessen.

(107) As far as the level of the appropriate remuneration was concerned, the BdB's argument was mistaken in its very approach. The criterion could only be remunerations that

had been agreed during the relevant period on the market for comparable silent partnership contributions to credit institutions. Differences in the shaping of the various silent partnership contributions, but also in the quality of the credit institutions taking them up, should be taken into account in the comparison of the remunerations through deductions from or premiums on such remunerations and not on the remuneration for a hypothetical share capital investment.

(108) Quite apart from that, the determination of the yield on share capital investments by the BdB was erroneous. In determining the beta value, the Landesbanks should not be equated with credit banks with an above-average systematic risk. Rather, the proper criterion should be the clearly defined group of banks listed on the stock exchange, the so-called CDAX banks. A large proportion of Helaba's balance sheet total related to low-risk local authority, interbank and mortgage claims. As part of an objective business appraisal, an independent expert had, on 1 January 1999, determined for seven credit institutions with a comparable risk structure in terms of business risk, business activity, customer structure and size, an average beta factor of [...], i.e. well below 1. The expert had started from the assumption of a long-term market yield of 5,0 % and a long-term risk-free interest rate of 6,0 %. This gave, on 1 January 1999, an equity capital cost of [...] %. The BdB's assertion regarding the equity yield of 11,66 % on 31 December 1998 for Helaba was based on an excessive beta factor and, moreover, on historical data that were no longer current. The level of interest rates had changed significantly in recent decades, and the BdB's comments on inflation and inflation expectations were not comprehensible in this context.

(109) Furthermore, the agreed remuneration for the duration of the silent partnership contribution could be compared only with the changing level of the relevant share capital yield and not, for example, with the share capital yield of the undertaking at the time of the investment. No-one would have guaranteed an owner of the bank an equity yield at the level of the end of 1998 and thus afforded protection from the risk of yield fluctuations.

(110) The BdB's comments on the level of the deduction of refinancing costs did not stand up. Reference could be made to the net refinancing costs only if, from the comparative remunerations which private credit institutions pay for comparable silent partnership contributions taken up by them on the capital market, the theoretical or actual overall tax ratio of such institutions was deducted. For the contributions taken up on the capital market, however, it was usually not the overall remuneration, but only the remuneration premium that was given, which in the case of variable interest rate instruments and in the case of illiquid contributions, was identical with the liability remuneration. The comparison between the remuneration on the silent partnership contribution of the *Land* of Hessen and the remunerations paid on the market could, therefore, be made directly. The roundabout approach of taking a fictitious overall remuneration on a fictitious cash contribution from which the refinancing costs then had to be deducted was unnecessary and, moreover, increased the uncertainty of the quantitative assessment many times over, since estimates then had to be introduced at a number of stages.

(111) Contrary to what the BdB argued, there was no justification for any remuneration premiums. There was no empirical evidence that a premium was paid on the market for a particularly large contribution. Comparable capital-raising operations by private credit institutions did not reveal any connection between the amount and the remuneration. Rather, the *Land* had had to accept the agreed phased arrangements because Helaba had initially no use for the special fund *en bloc*. On the market, no investor would have been able to receive not only a remuneration immediately for the entire amount, but in addition a premium as well.

(112) Furthermore, the argument that, in the case of share capital investments, the waiving of a voting right must be compensated for by an additional remuneration could not be applied to a silent partnership. The silent partner had by law no voting right, and the market did not grant any remuneration for the silent partner's 'waiving' of the possibility of exercising influence.

(113) It was in principle true that, on the market, an investor accepted the lack of fungibility of his investment in return for a higher yield. Indeed, the lack of fungibility of the silent partnership contribution of the *Land* as compared with profit-sharing capital had been taken into account in the discussions leading up to the transaction. The parties had taken account of the perpetuity of the contribution in the form of the remuneration premium of 0,20 % a year. However, a private investor would have taken account of the fact that in this instance an investment was sought not for cash, but for a large, non-divisible special fund earmarked for a specific purpose that could be transferred only as an illiquid capital contribution. When the BdB argued that there was virtually no market for such an investment, this applied not only to reinvestment (fungibility), but also to the initial investment. It was not plausible that a private investor would in view of this have demanded or received an even higher premium than the 0,20 % a year agreed for the perpetuity aspect. Nor had the BdB provided any further explanation or justification on this point.

(114) In the market comparison, lastly, contrary to the view put forward by the BdB, the trade tax effect had to be taken into account. Silent partnership contributions to credit institutions were usually provided by institutional investors which had themselves to pay the trade tax on the remuneration received. The *Land*, by contrast, was not liable to trade tax and would therefore be satisfied with a correspondingly lower remuneration. The counter effect of the non-liability

of the *Land* was the liability of the bank, which accordingly had to pay the trade tax. Whether it was paid to the *Land* or the municipality was irrelevant, as was the fact that the trade tax was assessed on the taxable income (usually the taxable income of the recipient of the remuneration, but here the taxable income of the bank), so long as the bank did in fact achieve income. If, by contrast, it suffered losses, not only was there no payment of trade tax, but also no payment of the remuneration on the contribution.

(115) Contrary to what the BdB argued, Helaba did not pay the remuneration to itself either. In accordance with the decision of the *Land* of Hessen, the yield remaining after tax from the investment of the special fund did not accrue to the general budget, but was similarly tied to the earmarked purposes of the fund and was to be used to strengthen the promotion-related business. This was a question of the use of the resources paid by Helaba to the *Land*.

VI. ASSESSMENT OF THE MEASURE

1. *STATE AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE EC TREATY*

(116) Article 87(1) of the EC Treaty states that, save as otherwise provided in that Treaty, any aid granted by a Member State or through state resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market, insofar as it affects trade between Member States.

1.1. STATE RESOURCES

(117) With the transfer of silent partnership assets, the *Land* of Hessen opted for a form of contribution of resources based on the concept of transferring public aid resources to Helaba in order to strengthen its equity-capital base, but also of achieving additional income for the *Land* of Hessen. In spite of the fact that the returns from these claims were still available for promotion-related assets and hence served a public-benefit purpose, the assets were recognised by the supervisory authority and could therefore be used to provide cover for the liabilities of Helaba, which was in competition with other credit institutions. State resources therefore were transferred to Helaba.

1.2. FAVOURING OF A PARTICULAR UNDERTAKING

(118) In order to verify whether the transfer of state resources to a publicly-owned undertaking 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 was accepted and developed by the Court of Justice and the Court of First Instance in a number of cases, in particular by the *WestLB judgment*, in a context which is relevant to the present case ([16]).

a) ***Market-economy investor principle***

(119) According to this principle, no state aid is involved where 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' ([17]). In contrast, the undertaking is being favoured within the meaning of Article 87(1) of the EC Treaty if the proposed remuneration arrangement and/or the financial position of the undertaking is such that a normal return on investment cannot be expected within a reasonable period of time.

(120) The market-economy investor principle is applicable in the same way to all public enterprises, whether profitable or loss-making. The Commission's view here was upheld by the Court of First Instance in *WestLB* ([18]).

(121) It follows that the key question in examining this case is whether a market-economy investor would have transferred to Helaba capital that had the same characteristics as the *Land* of Hessen's promotion-related assets and under the same conditions, especially in view of the probable return on the investment.

b) ***Legal and economic classification of the capital contributed***

(122) The *Land* of Hessen contributed to Helaba up to 31 December 1998 as silent partnership reserves promotion-related assets with a nominal loan portfolio for the *Land* share of DEM 6,026 billion (EUR 3,081 billion) and a cash value assessed on the basis of an expert evaluation of DEM 2,473 billion (EUR 1,264 billion). BAKred recognised these, as stated above, in full as basic own funds for supervisory purposes. They were to only a small extent required, on the basis of an amount which varied from year to year, to underpin promotion operations. This part of the silent partnership reserves shown in the balance sheet served only a guarantee function for Helaba. Most of the remainder was available to Helaba to underpin and expand its competitive business.

(123) As in the *WestLB* case the Commission has determined the appropriate remuneration for the transferred promotion-related assets in the light of their commercial usefulness for

([16]) Judgment in Joined Cases T-228/99 and T-233/99.

([17]) Commission communication to the Member States on the 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. Crédit Lyonnais (OJ L 221, 8.8.1998, p. 28) and GAN (OJ L 78, 16.3.1998, p. 1).

([18]) WestLB judgment paragraph 206 *et seq*.

Helaba. As explained above, the starting point for determining the normal market remuneration is primarily the remuneration that would be demanded by a market-economy investor providing a bank with equity capital.

(124) The complainant argues that the capital made available to Helaba is, as in the case of the transfer of the WfA assets to WestLB, an investment similar to share capital. Germany disputes its similarity with share capital. It argues, rather, that the capital is a silent partnership, which affects the level of the remuneration.

(125) Germany, Helaba and the complainant agree that the promotion-related assets comprised in the silent partnership of the *Land* of Hessen constitute core capital. The special-purpose reserve was recognised by BAKred as core capital ('tier 1 capital') and could therefore only be compared with equity instruments that were recognised as core capital in Germany in the year of the transfer and that were available to Helaba at the time of contribution specifically for an investment of this order of magnitude, which made up significantly more than 15 % of the core capital.

(126) The Commission agrees with the parties on this point. It already made clear in its WestLB decision of 1999 that a comparison between the Wfa assets, which were also recognised as core capital, and equity instruments that were recognised only as additional capital, such as profit participation certificates and non-voting preference shares, cannot serve as a basis for determining the appropriate remuneration for the transferred capital (Decision 2000/392/EC, paragraph 199). Core capital is of much greater use to an undertaking 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. For the capital provided to be recognised as basic own funds, there must be greater exposure to risk, which as a general rule is also reflected in a higher market remuneration for such instruments. Any point of comparison with 'additional funds' that offer only limited scope for use in business expansion can therefore be ruled out from the outset.

(127) In the view of the BdB, however, the only legal form properly available to Helaba for this specific investment was that of share capital. In the view of Germany, another legal form available was that of a silent partnership contribution of unlimited duration (*perpetual*), which met the requirements of Section 10(4) of the German Banking Act (KWG) and at the same time the criteria of the 'Sydney Declaration' of the Committee on Banking Supervision of the Bank for International Settlements in Basle, which in turn guided the decisions taken by the German banking supervisory authority BAKred. The subject of the agreement between the *Land* of Hessen and Helaba was, therefore, the legal form of a silent partnership contribution of unlimited duration, which was recognised as such both by the competent banking supervisory authority BAKred and also by the competent tax authority.

(128) In the Commission's view, Germany has demonstrated sufficiently that the BdB's argument will not stand up. The BdB argues that the silent partnership of the *Land* of Hessen represented a formal abuse of a 'normal' silent partnership. In economic terms, the silent partnership contribution had so many points in common with share capital that an investor would have insisted on the payment of interest corresponding to the remuneration of share capital.

(129) The Commission notes firstly that the silent partnership contribution was expressly agreed as such between the *Land* of Hessen and Helaba and accepted as such by the competent German authorities. In order to be able to assume that there was an abuse of form, it would have to be beyond question that the competent German authority wrongly recognised the silent partnership of the *Land* of Hessen as such. However, there is no evidence of this. The Commission agrees here with Germany's view that the limited duration or withdrawability of a silent partnership contribution is, neither from the company law nor banking supervision points of view, a necessary characteristic feature for the recognition of a silent partnership as core capital pursuant to Section 10(4) of the German Banking Act. Furthermore, the Commission interprets the 'Sydney Declaration' of the Basel Committee on Banking Supervision of October 1998 as imposing a 15 % limit only for the recognition of certain innovative capital instruments, particularly those limited in time, as core capital. However, the converse conclusion may not be drawn that permanent innovative capital instruments may not at all be recognised as core capital or are also covered by this limit. Moreover, the usefulness of permanent innovative capital instruments as core capital above the 15 % limit is testified to by the practice of private banks as well in recent years, as was amply demonstrated by Germany.

(130) Nor does the Commission regard the selective criteria adduced by the BdB as sufficiently convincing. From the risk analysis point of view, the silent partnership of the *Land* of Hessen is more similar in type to a 'normal' silent partnership than to share capital. The Commission agrees with Germany's comments here too.

(131) For the Commission, it is crucial in this context that both the silent partnership of the *Land* of Hessen and other 'normal', i.e. time-limited silent partnerships taken up on the capital market must in insolvency proceedings be paid back before share capital and that the investor thus gets the recovery percentage, whereas in the case of a share capital investment he gets nothing. Germany submitted a legal opinion demonstrating that, under the contractual provisions, the silent partnership contribution of the *Land* of Hessen will, in the event of solvency or liquidation, in so far as it has not been reduced or used up by losses, be met on a prior-ranking basis before share capital from any remaining assets.

(132) Furthermore, so long as the undertaking is not making a loss, both the *Land* of Hessen and the investor of a time-

limited silent partnership get the entire agreed remuneration, whereas the investor in share capital can claim only payment of a dividend that is in proportion to profits. In this respect too, the silent partnership contribution of the *Land* of Hessen is a typical silent partnership contribution within the meaning of Section 10(4) of the German Banking Act.

(133) Nor is the BdB's objection convincing that the silent partnership was equivalent to share capital because in the long term it had resulted in an increase of almost 50 % in Helaba's core capital. Account should be taken here firstly of the phased arrangement which the *Land* of Hessen and Helaba had agreed and under which, in the period from 1999 to 2002, in line with its actual capital requirement, Helaba could use only an annual increasing partial amount of the usable core capital to actually cover core business. Furthermore, the Commission would in this context draw explicit attention to the fact that, in the WestLB case too, the large volume of the capital injection is merely an indicator, but not on its own decisive in assuming similarity to share capital. In the WestLB decision, the Commission concluded, on the basis of an overall assessment, that the similarity of the transaction being examined to a share capital investment was predominant. An essential consideration in this respect was, for example, the fact that the WfA assets had, like share capital, been exposed to the full risk of loss in the event of solvency or liquidation. Furthermore, in the WestLB case, the Commission also took account of the fact that, at the time of the transfer of the WfA assets in 1991 — in contrast to the time of the transfer of the silent partnership contribution of the *Land* of Hessen to Helaba in 1998 — there was not yet a developed market for hybrid core capital instruments in Germany and a credit institution such as WestLB could have taken up a comparable core capital volume on the market only in the form of share capital. In the current case, Helaba could also easily have covered its estimated capital requirement in the period from 1998 to 2002 on the market by taking up, at intervals, several smaller silent partnership contributions from a number of different institutional investors.

(134) The BdB also points out that, with the silent partnership contribution of the *Land* of Hessen, Helaba's share capital buffer was only 50 %, whereas, in the case of private credit institutions, the share of hybrid instruments in core capital is below 20 % and hence the share capital buffer amounts to more than 80 %. An institutional investor would, according to the BdB, against the background of this high share in Helaba's overall core capital, not have agreed to a comparable contribution. Germany confirmed that the proportion of core capital accounted for by the silent partnership contribution in 2003, i.e. after the last stage of the phased arrangement had been reached, was [...] % and that the proportion accounted for by all the silent partnership contributions (i.e. not only the silent partnership contribution of the *Land* of Hessen) in 2003 amounted to [...] %. Nevertheless, in the Commission's view, it cannot necessarily be deduced from this that an institutional investor would not have made a comparable silent partnership contribution because of the high proportion of total equity capital it represented. Germany pointed out that Landesbanks generally make greater use of silent partnership contributions beyond the 15 % limit as instruments of core capital procurement, and do so predominantly from amongst their guarantors, but also from third-party investors. For example, according to the information provided by Germany, the share of silent partnership contributions of in 2003 was 72 % in the case of [...] [i], 39 % in the case of [...] [ii] , 33 % in the case of [...] [iii] 39 %, in the case of [...] [iv] and 42 % in the case of [...] [v] [19]. The reasons for this high share of hybrid instruments have to do with the fact that, because of their public-law structure, the Landesbanks are not allowed to raise capital on the stock markets. It also seems that investors in Landesbanks are more prepared to accept a smaller share capital buffer, since, because of the different business orientation and the accompanying reduced risk structure of the institutions, the capital is exposed to a generally smaller risk. At least in the case of Helaba, which, even within the group of the above-mentioned Landesbanks, must be regarded as a comparatively low-risk credit institution, the Commission cannot therefore exclude the possibility that, despite a share capital buffer of (only) some 50 %, an institutional investor would have made a comparable investment in the form of a silent partnership contribution to Helaba.

(135) The Commission also examined in detail to what extent the perpetuity of the contribution, i.e. the fact that it is of unlimited duration and not withdrawable subject to notice by the *Land* of Hessen, affects the risk analysis to be carried out here.

(136) The BdB argues here that no hybrid instruments of unlimited duration exist on the capital market. Institutional investors were in principle prepared to acquire only hybrid equity instruments of fixed duration or instruments for which repayment could be assumed, because the payout rate was higher (so-called step-up) or the instrument was transformed into another form of investment at a given point in time. Step-up clauses gave the debtor (issuer) a strong economic incentive to repay the silent partnership contribution. A step-up clause thus made a *perpetual* in actual fact into an instrument with a fixed term. Furthermore, innovative core capital instruments were typically placed only by private investors.

(137) Germany and Helaba argue in response to this that, even in the case of *perpetuals*, investors have to reckon with step-up, that, contrary to possible expectations, at the time when the step-up clauses become effective, there is no 'on-schedule'

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[i] Confidential information, designated here as bank I.

[ii] Confidential information, designated here as bank II.

[iii] Confidential information, designated here as bank III.

[iv] Confidential information, designated here as bank IV.

[v] Confidential information, designated here as bank V.

[19] Communication from the Federal Government of 1 October 2004, p. 16.

repayment and that thus the perpetuity risk exists. This was due, firstly, to the fact that the right of withdrawal lay solely with the debtor (issuer); secondly, the economic situation of the issuer at the time the step-up clause became effective was crucial for on-schedule repayment; thirdly, the supervisory authority had to approve the withdrawal, and it gave its approval only if the debtor had, at the time of the withdrawal, a comfortable equity capital base or carried out a replacement transaction on the market. Furthermore, examples showed that even institutional investors placed hybrid instruments with unlimited duration and without step-up, one instance cited by Germany being a junior-ranking Air Canada loan of unlimited duration from 1987 which, as the Commission ascertained, did indeed not have any step-up arrangement. Germany also argued that, although the existence of withdrawal rights was taken into account in the prices, the remuneration corridor was not wide.

(138) For the Commission, the key point in the situation to be assessed here is the fact that the perpetuity of the contribution in this instance involves primarily the risk for the investor of not being able to profit from interest rate increases on the market, since, on the one hand, he has no possibility of withdrawal and, on the other, cannot rely on a step-up. The perpetuity aspect does not, however, involve the risk of loss in the event of insolvency or liquidation. Against this background and taking account of the market description provided by Germany, the Commission therefore takes the view that the unlimited duration of the contribution does not in this instance justify changing the reference to the product from 'silent partnership contribution' to 'share capital'. However, the Commission will later examine whether the perpetuity aspect justifies a premium on the usual market remuneration for the silent partnership contribution.

(139) The conclusion must be, therefore, that in the case of Helaba the transfer was undoubtedly made in the legal form of a silent partnership that has much more in common with other silent partnerships than with share capital. There is, therefore, in the Commission's view, not sufficient evidence of an abuse of the legal form of a silent partnership for a contribution of capital that in actual economic terms constituted share capital. The basis for the remuneration of the relevant capital instrument is, therefore, 'normal', i.e. time-limited silent partnership assets typical in size of those observable on the market, on whose remuneration a premium may possibly have to be charged. The comments of the BdB on the appropriate remuneration of share capital are therefore not relevant.

c) ***Determination of the capital base to be used in determining the remuneration***

Capital base standard

(140) In determining the capital base to be remunerated, the Commission distinguishes firstly between the 'business-expansion function' and the (mere) 'guarantee function' of the promotion-related assets made available as equity capital for the business activity of the credit institution.

(141) The 'business-expansion function' of capital refers to the expansion of business potential by means of risk-bearing assets following the recognition for supervisory purposes of a bank's additional equity capital. In this regard the starting point for determining the normal market remuneration is the remuneration that would be demanded in the specific situation by a private investor providing a bank with equity capital. In so far as capital made available is shown in the balance sheet as equity capital but is not recognised for supervisory purposes as equity capital or is used to underpin promotion activities or for other reasons cannot be used to underpin competitive business, it is not available for business expansion. However, capital is also important for reasons other than banking supervision. Its availability to the bank's creditors at least for the purposes of covering liabilities ('liability function') means that its economic function can still be compared to that of a surety or guarantee. The amount of equity shown in the balance sheet gives the bank's lenders an indication of its soundness and may thus influence the conditions under which the bank is able to raise outside funds. The normal market remuneration of the 'liability function' of capital is calculated according to the return which a private guarantor would have demanded in this specific situation from a credit institution comparable to Helaba in size and risk strategy.

(142) Consequently, in calculating the remuneration, the silent partnership recognised in full as core capital must be divided into two separate capital bases. The capital base which was available to underpin Heleba's competitive business must be remunerated in the same way as a market-economy investor would have reasonably required for a silent partnership with the same characteristics in this specific situation. The capital base that was not available for Heleba's competitive business must be remunerated in such a way as a market-economy investor would have reasonably required in this specific situation.

Capital base that was available to underpin Helaba's competitive business

(143) The Commission takes the fundamental view that the extent to which the capital provided was actually used cannot be a factor in determining the appropriate remuneration. All that matters is the possibility of using the capital to expand business. Even a private investor would not be happy with a remuneration dependent on the capital being used. In this regard, the Commission agrees in principle with the BdB's observation that, for the market-economy investor who runs the risk of losing his investment, it is irrelevant whether the credit institution actually uses the injected capital to expand its business. As the BdB rightly points out in principle, all that matters to the market-economy investor is that he himself can no longer use the amount transferred to engage in economic activity and hence achieve corresponding returns. To illustrate the point one might take the example of a rented

house: a landlord will insist on rent being paid even if, for whatever reason, the tenant no longer lives in the house, as by renting to the tenant, the landlord is forgoing the possibility of renting to someone else, and, in any event, he has no control over where the tenant resides. It is therefore the usability of the house that is the subject of the contract.

(144) The Commission notes firstly that the capital base to be remunerated as agreed which was available to Helaba to underpin competitive business is not dependent on actual use, but focuses only on usability to underpin competitive business. The arrangement accordingly is in line with the Commission's criteria outlined above.

(145) The *Land* of Hessen and Helaba agreed on the 'phased model' described above. Under that model, although the cash value of the entire promotion-related assets was entered in the balance sheet on 31 December 1998 so as not to have to divide up the promotion-related assets, most of the promotion-related assets, i.e. with the exception of the part required to underpin the promotion-related business, were de facto usable to underpin the competitive business. However, Heleba made it clear from the outset to the *Land* that, in line with its business plan, it required the assets only in stages, i.e. according to the agreed phased instalments, to underpin its competitive business. Within the stages, however, the key criterion was the usability of the capital, i.e. the remuneration was not dependent on actual use. On the basis of this clear plan of use, the capital base to be remunerated was clearly predictable for the *Land* of Hessen. The *Land* of Hessen therefore did not leave use to the business discretion of the bank, but accepted the arrangement on the basis of Heleba's clear wish.

(146) The Commission considers this approach compatible with the conduct of a market-economy investor who, in the situation of the *Land* of Hessen, would not realistically have been able to achieve any faster increase in the capital base to be remunerated, since, in view of its business plan, Heleba would not have agreed to it. Consequently, in the Commission's view, from 1999 to 2002 only the stages provided for and, only from 2003, the full amount of the silent participation usable to underpin competitive business are to be remunerated in such a way as a market-economy investor would have required for a silent participation having the same characteristics in this specific situation.

Capital base entered in the balance sheet, but not available to Helaba for competitive business

(147) As stated above, the amount of the silent participation that could not be used to underpin competitive business was also entered in Heleba's balance sheet on 31 December 1998. It was in full a component part of the liable equity capital and was thus from the outset available as security to the bank's creditors. Potentially at least, this represents an advantage for the bank, since the level of the equity capital shown in the balance sheet gives the bank's investors an indication of its soundness and may thus influence the conditions under which the bank is able to raise outside funds.

(148) Germany argues that the fact that Helaba entered the full amount of the silent partnership contribution of EUR 1 264.4 million in the balance sheet directly after receiving it cannot be interpreted as having had any effect in improving the bank's credit standing. Since the mid-1980s Helaba has been ranked in the top category AAA/Aaa in the long-term credit standing rating which is relevant for creditors of the bank, with the key criteria being the existing liability arrangements such as 'institutional responsibility' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*) and hence the creditworthiness of the guarantors. Showing the silent partnership contribution in the balance sheet could not have improved this outstanding top-rank credit standing any further. ([20])

(149) Germany also argues in response to further enquiry from the Commission that even if the Moody's Investors Service financial strength rating for Helaba and Fitch's individual rating during the relevant period are taken into account, the silent partnership could have had no perceptible influence on the ranking of Helaba's financial strength. The two ratings mentioned were based, notwithstanding the existing state liabilities in the form of *Anstaltslast* and *Gewährträgerhaftung* and ownership structures, solely and directly on the profitability of the relevant institution, the quality of its management, the market position and also equity capital endowment. ([21]) The two ratings remained unchanged from 1997 to 2000, i.e. despite the contribution of the silent partnership at the end of 1998 (Moody's financial strength rating remained at C+ and the Fitch individual rating at B/C) and deteriorated as from 2001 (Moody's financial strength rating fell to C+ (neg.) and C(neg.) and the Fitch individual rating to C). In Germany's view, this showed that the silent partnership had had no influence on Helaba's credit standing even leaving aside the existing state liabilities. ([22])

([20]) Germany's reply of 23 June 2004, p. 12.

([21]) Germany's reply of 23 June 2004, p. 12, Annex 29/2004, Fitch Ratings: Bank Rating Methodology: May 2004, p. 12: '*Principal considerations are profitability, balance sheet integrity (including capitalisation), franchise, management, operating environment, consistency, as well as size (in terms of a bank's equity capital)*'.

([22]) Germany states that the reason for this, as already mentioned, was the fact that the minimum supervisory standards for capital ratios (core capital ratio of 4,0 %, overall ratio or equity ratio of 8,0 %) were more than met during the relevant period, which was a significant difference compared to the situation with WestLB. In 1997, for example, i.e. before the contribution, in accordance with Principle I to Section 10a of the German Banking Act, the core capital ratio was 4,8 % for the Helaba group and 5,0 % for the Helaba institution on its own. In accordance with the principles of the Bank for International Settlements, the core capital ratio (tier 1) was 5,4 % in 1997. The overall ratio and equity ratio in 1997 were 8,9 % and 9,6 % for the group and 9,2 % for the institution on its own. Even against the background of the business growth planned by Helaba for the following financial years, there was no direct need for the taking-up of core capital amounting to EUR 1 264.4 million.

(150) The Commission cannot agree with Germany's argument. Germany's comments on the financial strength rating and individual rating show rather than a financial institution's endowment with equity capital is an important factor for the quality of a rating and hence also for financial standing. From an ex ante perspective, i.e. at the time of the agreement on the silent partnership between the *Land* of Hessen and Helaba, the two parties had to start from the assumption that the entering of core capital amounting to some EUR 1,2 billion was such as to further improve the bank's financial standing. The financial strength ratings given by Moody's and Fitch and cited by Germany show that a further improvement was entirely possible, since the ratings had by no means reached the highest level. The fact that ex post no change in the financial strength rating was discernible does not necessarily mean that there was no positive influence on the financial strength rating. The positive influence of the significant increase in the core capital base could have helped to ensure that the financial strength rating did not fall for other reasons or did not fall faster than it in fact did, i.e. only as from 2001.

(151) In assessing the potential influence (to be assessed ex ante) of a measure on the financial standing of a bank and/or on future financing conditions, the Commission sees the financial strength rating of a Landesbank as being important in its own right alongside the long-term rating based on the existing state liabilities in the form of *Anstaltslast* and *Gewahrträgerhaftung*.

(152) As far as the (from the point of view of 1998) future borrowing of outside capital is concerned, Helaba obtained in 1998 and the following years the top rating of AAA/Aaa on the basis of *Anstaltslast* und *Gewährträgerhaftung*. As far as the Commission is aware and as Germany itself points out, the actual refinancing costs of a bank vary or fluctuate, in comparison with other similarly rated banks, within a corridor for a given rating category. In other words, specific refinancing costs cannot be deduced precisely and unchangingly for all similarly rated banks and over time from a specific long-term rating, in this instance AAA/Aaa. It follows from this empirical observation that other influences and factors play a role, such as the financial strength of Helaba in relation to other Landesbanks with the same long-term rating on the basis of *Anstaltslast* and *Gewährträgerhaftung*. The better Helaba's financial strength is, the better are its prospects, within the AAA/Aaa rating category, in specific negotiations on refinancing conditions, of finding itself at the favourable edge of the corridor of the refinancing conditions observable on the market for AAA/Aaa. Furthermore, its dependence on the rating of the guarantors is reduced, i.e. in the event of a possible deterioration in their rating, which cannot be excluded ex ante, Helaba could use its individual financial strength as an argument in defence of its favourable refinancing conditions.

(153) As far as the (from the point of view of 1998) future borrowing of further outside funds is concerned, which in fact took place in 2001 in the form of further silent partnership assets, a large capital buffer entered in the balance sheet reduces the probability of the new capital being lost in the event of bankruptcy provided that old and new capital are liable on a *pari passu* basis. Germany stated that such *pari passu* liability is the rule with silent partnerships. From the perspective of 1998, therefore, it could not be ruled out that new investors might insist on it.

(154) Germany also argued, in response to an enquiry by the Commission, that silent partnerships within the meaning of Section 10(4) of the German Banking Act do not fall within the protected area of *Anstaltslast* and *Gewährträgerhaftung*. This was the direct consequence of the contractually arranged participation in losses as a precondition for the recognition of the silent partnership reserves as liable own funds. Consequently, the investor was not to be regarded as a creditor of the bank and was not covered by *Gewährträgerhaftung*. Similarly, he was not covered by *Anstaltslast*, since that provided only for the obligation of providing the institution with an economic basis and of making available the contributions required for maintaining normal business operation. This in no way excluded third-party participation in losses. Losses were in principle possible up to the point where the liable own funds had been used up. Consequently, the silent partner is not protected in his asset interests by the intervention of the guarantor on the basis of *Anstaltslast*. In view of the fact that equity investors do not fall within the protective scope of '*Anstaltslast*' and '*Gewährträgerhaftung*', the individual financial strength of Helaba, which was enhanced or kept constant, had, from the viewpoint of 1998, in the Commission's view a positive influence on the future terms and conditions on which Helaba was able to take up further equity such as silent partnerships.

(155) The Commission concludes that the substantial improvement in the core-capital ratio for supervisory purposes which was achieved through the immediate entry of the silent partnership in the balance sheet in 1998 represented, at least from an ex ante point of view, a potentially decisive factor in the assessment of the individual financial strength and future financing conditions of the bank and hence an advantage for Helaba, regardless of whether the amount was used to underpin competitive business. A market-economy investor who, as a result of the immediate entry of the entire invested capital in the balance sheet, exposed it in full to the risk of loss in the event of bankruptcy would have required an appropriate remuneration reflecting this loss risk. For its part Helaba, on the basis of the at least potential advantage to it, whose actual achievement depended on future developments which were not fully foreseeable in 1998, would have agreed to a remuneration. The Commission therefore agrees on this point in principle and on the basis of a factual analysis with the comments of the complainant BdB.

d) ***Appropriate remuneration for the capital contributed and comparison with remuneration actually paid***

(1) *Assessment of whether the remuneration that was agreed for the capital to be used to underpin competitive business was the normal market remuneration*

(aa) Preliminary remark

(156) As explained, the Commission considers the capital measure agreed between the *Land* of Hessen and Helaba to be a silent partnership. Consequently, in examining whether the remuneration specifically agreed was appropriate to the market, it is important to determine whether such remuneration can be regarded as lying within the corridor of remunerations agreed on the market in economically and legally comparable transactions involving silent partnerships.

(157) According to information provided by Germany, however, in making the market comparison of the silent partnership of the *Land* of Hessen, the trade tax effect of (in relation to Helaba's silent partnership) 0,26 % a year must be taken into account. Helaba had to pay on the remuneration of 1,4 % trade tax to which the *Land* of Hessen was not subject, so that there was a total charge of 1,66 % (before tax). Commercial investors operating in Germany pay trade tax on dividends from silent partnership assets. However, the *Land* of Hessen is not subject to trade tax. Instead, Helaba had to pay the trade tax applicable to the remuneration of the silent partnership. A market-economy institutional investor would therefore have required a higher remuneration than the *Land* in order to offset the charge he had to pay in the form of trade tax. Conversely, Helaba would have been immediately prepared to pay a remuneration premium to such an investor, since it makes no difference to it whether it pays the premium as a remuneration to the investor or as trade tax to the tax office.

(158) When the BdB argues that the trade tax, most of which does not go to the *Land* at all, but to the local authority, is not a component part of the remuneration, but a charge imposed by law, stemming from tax-related circumstances that are independent of the intentions of the parties, this is in itself, in the Commission's view, correct. However, the BdB fails to recognise that in making the market comparison the question is not ultimately whether the trade tax does or does not represent a part of the remuneration. The point is rather to take account of Helaba's special situation in taking up the silent partnership of the *Land* of Hessen and, in particular, of the particular charge involved here, which would not have arisen in taking up silent partnerships from commercial investors, in the market comparison to be carried out here.

(159) The Commission therefore shares Germany's view that, in the market comparison, the trade tax of 0,26 % a year to be paid by Helaba must be added to the remuneration of 1,40 % a year, giving a total charge of 1,66 % a year. According to information provided by Germany, the trade tax may be divided proportionally between the two remuneration components, with 0,23 % a year apportioned to the agreed initial remuneration of 1,2 % a year and 0,03 % apportioned to the agreed perpetuity premium of 0,2 %. For the purposes of the market comparison, therefore, the rate of 1,43 % a year is to be applied for the initial remuneration and the rate of 0,23 % a year for the perpetuity premium.

(bb) Customary market nature of the agreed initial remuneration of 1,2 % a year (rate of 1,43 % a year for the purposes of the market comparison taking account of the trade tax)

(160) The initial remuneration of the relevant silent partnership is to be determined, using the method applied by the *Land* of Hessen and Helaba, on the basis of time-limited, but otherwise comparable, silent partnerships. The question of the appropriate remuneration for the unlimited nature of the period covered by the silent partnership of the *Land* of Hessen must be examined separately under point bb) with a view to a premium on this initial remuneration.

(161) Germany presented comprehensive data on remunerations of time-limited silent partnerships round about the time of the contribution at the end of 1998 and thereafter.

(162) According to the information provided by Germany, in comparing premiums for silent partnerships, a distinction should be drawn on the basis of the reference interest rate. If, in the case of a variable overall remuneration, the remuneration premium relates to the (variable) money market interest rate on the interbank market (Libor or Euribor), i.e. the refinancing rate for first-class banks, this corresponds to the liability remuneration for the silent partnership without any need for further adjustment. However, if, in the case of a fixed overall remuneration, the remuneration premium relates to the (fixed-interest) bond market rate (generally the yield on public bonds with a ten-year maturity), the remuneration premium consists of the (general) refinancing premium of the bank vis-à-vis the State for the procurement of liquidity and the specific liability remuneration for the silent partnership. For the purposes of comparing the liability remuneration with money-market-related liability remunerations, therefore, the refinancing premium must in this case be deducted from the remuneration premium. With illiquid capital contributions, as in the case of the silent partnership contribution of the *Land* of Hessen, the remuneration premium is, however, as with variable-interest money-market-related instruments, usually identical to the liability remuneration.

(163) It follows from this that the remuneration for the silent partnership contribution of the *Land* of Hessen, as an

illiquid capital contribution, can be compared directly with money-market-related remuneration premiums (i.e. variable-interest overall remunerations), since these correspond to the liability remunerations. In the comparison with bond-market-related overall remunerations, however, the refinancing premium (from in principle around 20 to 40 basis points, leaving aside further short-term upward or downward deviations, in the relevant periods according to the information provided by Germany [23]) must be deducted from these in order to determine the specific liability remuneration for the silent partnership contribution.

(164) On the basis of the information provided by Germany, the Commission has carried out the market comparison on the basis of the comparative transactions which are listed in the following table and which were known to the *Land* of Hessen and Helaba either at the time of the transaction at the end of 1998 or, where they took place some months later, through their direct chronological proximity, allow conclusions to be drawn as to the market conditions prevailing at the time of the transaction at the end of 1998:

Relevant comparative transactions [24]						
Description of the transaction	Volume	Term	Financial strength/ product ratings	Remuneration premium p.a. (in basis points)	Reference interest rate and any adjustment [25] of the remuneration premium by deduction of the refinancing premium	Liability remuneration of relevance for comparison
Silent partnership contribution to Helaba made in December 1997 by the Hessen and Thuringia savings banks	DEM 300 million	10 years	FSR: Aaa/AAA (because of state liabilities) PR: ?	1,2 %	10-year federal loan (adjustment through deduction of 20-40 bp)	80-100 bp
Fixed-interest USD tranche of the silent partnership contribution to Deutsche Bank, January 1998	First tranche of USD 700 million	10 years	FSR: AAA/Aa1 PR: AA-	80 bp	12-month Libor (no adjustment)	80 bp
Variable-interest USD tranche of the silent partnership contribution to Deutsche Bank, January 1998	Second tranche of USD 700 million	10 years	FSR: AAA/Aa1 PR: AA-	140 bp	10-year US treasuries (adjustment through deduction of 65 bp [26])	75 bp
Variable-interest silent partnership contribution to SGZ-Bank, October 1998	DEM 50 million	10 years	FSR: A1/A+ PR: ?	120 bp	12-month Libor (no adjustment)	120 bp

[23] See Germany's reply of 9 April 2003, Annex 15-16. The figures relate to the refinancing premium for euro banks as opposed to federal loans and the refinancing premium on bank bonds (10-year mortgage bonds) as opposed to federal loans. In the absence of figures for the corresponding refinancing premium as compared with US treasuries and on the basis of their fundamental economic comparability, the Commission is using the above-mentioned corridor for refinancing premiums for US treasuries as well, since it is not precise figures, but the order of magnitude that matters in determining the corridor for the relevant liability remuneration..

Relevant comparative transactions [24]

Description of the transaction	Volume	Term	Financial strength/ product ratings	Remuneration premium p.a. (in basis points)	Reference interest rate and any adjustment [25] of the remuneration premium by deduction of the refinancing premium	Liability remuneration of relevance for comparison
Silent partnership contribution to HypoVereinsbank, December 1998	First tranche of DEM 1,2 billion [27]	10 years	FSR: Aa2, Aa3/ AA- PR: A2	160 bp	DEM Libor (no adjustment)	160 bp
Euro tranche of the silent partnership contribution to Dresdner Bank, May 1999	EUR 500 million	12 years	FSR: Aa1/AA PR: Aa2; A+	165 bp	10-year German federal loan (adjustment through deduction of 20-40 bp)	125-145 bp
USD tranche of the silent partnership contribution to Dresdner Bank, May 1999	USD 1 billion	32 years	FSR: Aa1/AA PR: Aa2; A+	215 bp	30-year US treasuries (adjustment through deduction of 65 bp [28])	150 bp
Silent partnership contribution to HypoVereinsbank, May 1999	EUR 500 million	12 years	FSR: Aa2, Aa3/ AA- PR: ?	125 bp	12-month Euribor (no adjustment)	125 bp
Euro tranche of the perpetual for Deutsche Bank, July 1999	EUR 500 million	No limit	FSR: Aa3/AA PR: A1	Overall 6,6 % (corresponds to 115 bp)	Corresponds to 30-year federal loan (adjustment through deduction of 20-40 bp)	75-95 bp
USD tranche of the perpetual for Deutsche Bank, July 1999	USD 200 million	No limit	FSR: Aa3/AA PR: A1	Overall 7,75 % (corresponds to 160 bp)	Corresponds to 30-year US treasuries (adjustment through deduction of 65 bp)	95 bp

([24]) See in particular Germany's reply of 9 April 2003, Annexes 2-4, 8-12, 17-18.
([25]) Downward adjustment carried out by the Commission on the basis of the data provided by Germany.
([26]) Refinancing premium as compared with US treasuries having the same term, see letter from Germany of 9 April 2003, p. 27.
([27]) Second tranche fixed-interest, but equivalent terms.
([28]) Refinancing premium as compared with US treasuries having the same term, see letter from Germany of 9 April 2003, p. 27.

(165) The above table gives a corridor for the market comparison of relevant liability remunerations of 0,75 % to 1,6 % a year. In support of this, Germany also presented a survey from the investment bank [...] which shows the trend of liability remunerations on euro-denominated, hybrid capital instruments that can be treated as core capital from December 2001 to July 2004 ([29]). This shows that, during this period, the average liability remuneration in relation to all rating classes (as a premium above Libor) moved within a corridor between 2,25 % a year (briefly around the end of 2002 and beginning of 2003) as an upper limit and around 0,8 % a year (in 2004) as a lower limit, with a rate of just under 1,5 % a year being the average for the period. The figure for credit institutions rated at A or better is, according to the survey, some 10 to 20 basis points lower and the figure for credit institutions rated BAA some 10 to, during the brief peak in the spring of 2003, around 250 basis points higher.

(166) The Commission is aware that the market remunerations contained in the table can in methodological terms give only a very rough indication. For example, the transactions differ in many respects, in particular as regards the rating of the issuing financial institutions, the volume and the underlying reference interest rate. These factors all have a significant influence on price formation and a further market survey would have to be carried out to quantify their respective influence on price formation in methodologically correct terms.

(167) For the purposes of the competition assessment of the market nature of the silent partnership contribution by the *Land* of Hessen, however, any such further market survey can in the Commission's view be dispensed with. It is sufficient if, on the basis of trends, the Commission checks that the agreed remuneration lies within the market corridor.

(168) It is apparent that the comparative transactions shown are, in terms of volume, in an area of under DEM 50 million (some EUR 25 million) to some USD 1 billion (taking account of evolving exchange rates, around EUR 1 billion). The volume of the silent partnership contribution of the *Land* of Hessen, at some EUR 1,2 billion, is somewhat above this area. However, the Commission agrees with Germany that the silent partnership contribution of the *Land* of Hessen can, on the basis of the above-mentioned phased model, be compared with a series of four smaller silent partnership contributions each amounting to around EUR 150 million and EUR 300 million. Helaba was not dependent on the immediate injection of such a large amount, but would have been able, in accordance with its business plan, to take up silent partnership contributions of this size gradually on the market. The Commission notes that it was primarily in Germany's interest that the silent partnership contribution could from the outset be provided to Helaba in one whole so as not to have to divide up the promotion-related assets.

(169) On the other hand, as a result of the silent partnership contribution of the *Land* of Hessen, even if it is understood as a series of several silent partnership contributions, the proportion of Helaba's core capital accounted for by silent partnerships rose to some [...] %. According to Germany, this is significantly higher than is usually the case with hybrid core capital instruments in the case of private banks. ([30]) The Commission considers that the higher the proportion of hybrid core capital compared with share capital, the higher the remuneration would tend to be which a private investor would require, since there would then be a greater probability of silent partnership contributions being claimed rather than share capital if the bank got into difficulties. Germany disputes this, arguing that silent partnership contributions usually have equal liability ranking and that silent partnership contributions taken up later are not prior-ranking. However, regardless of the liability relationship of silent partnership contributions amongst themselves, the Commission also sees an increased risk in the fact that, with silent partnership contributions making up a larger proportion of the core capital, the bank's risk assets are necessarily based more on silent partnership contributions and hence the buffer effect of the core capital decreases, with the result that the probability of their being utilised in the event of a loss is greater and the speed with which they are replenished in the event of improved profitability is slower. Germany also points out that it cannot be deduced from market data that investors contributing silent partnerships in undertakings with an already high proportion of silent partnership contributions also require higher liability remuneration. The Commission notes this point and considers that it is not feasible to carry out a methodologically sound quantification of any such premium for the purposes of this Decision. Nevertheless, the Commission sees this as evidence that a market-economy investor would at least not have accepted a remuneration in the lower part of the market corridor.

(170) Contrary to the view taken by Germany, the Commission does not regard Helaba's top rating of AAA/Aaa at the end of 1998 on the basis of the state liabilities in the form of *Anstaltslast* and *Gewährträgerhaftung* as significant in examining the remuneration on the silent partnership contribution. As explained above, the silent partnership investor is not protected by intervention by the guarantor on the basis of *Anstaltslast* in the interests of his assets.

([29]) Germany's reply of 23 August 2004, Annex 6.

([30]) Germany's reply of 23 August 2004, pp. 11-12. In the case of the [...] private banks in Germany listed there, [...], [...] and [...], the relevant proportion rose from some 5 % in 1998 to around 20-30 % in 2003. According to the information provided by Germany, the relevant proportion in the case of Helaba lies within the 33 % to 72 % range typical of Landesbanks.

(171) The Commission concludes here too that the rating based on *Anstaltslast* and *Gewährträgerhaftung* cannot be taken as an indicator of the risk the investor is running. In the Commission's view, the long-term rating without state liabilities is more significant. Germany argues in this context that this type of rating could not be determined for the period at the end of 1998, since a corresponding rating methodology for Landesbanks as a whole was developed only after the agreements on the abolition of the state guarantees, i.e. after 2001 and 2002. For the purposes of this Decision, therefore, the Commission assumes that a market-economy investor in Helaba would have started from the assumption of a somewhat similar risk of loss as in the case of an investment in one of the large private banks included in the market comparison whose rating was consistently in the A category, and not of a reduced risk corresponding to the top rating of AAA. Consequently, a reduction in the appropriate remuneration premium as compared with the market comparison data does not appear apposite; rather, the market comparison data can be applied directly.

(172) For the reasons set out above, the Commission would regard any remuneration of the silent partnership contribution of the *Land* of Hessen in the lower part of the market corridor as not being in line with the market. However, given the market corridor of 0,75 % to 1,6 % determined for the liability remuneration for silent partnership contributions, the relevant comparative figure for the silent partnership contribution of the *Land* of Hessen at 1,43 % (taking account of the trade tax effect) is in the middle to upper range of the corridor. In view of this, therefore, the Commission does not, in respect of the initial remuneration, see any evidence of favourable treatment of Helaba and hence of state aid.

(cc) Market nature of the agreed perpetuity premium of 0,2 % a year (market comparison rate of 0,23 % a year taking account of trade tax)

(173) The silent partnership contribution of the *Land* of Hessen is of unlimited duration and is what is known internationally as a *perpetual*. This distinguishes it from most of the other transactions cited by Germany for comparison purposes and typical during the 1990s, which generally have a term of ten or twelve years.

(174) Looking at the market in abstract terms, unlimited duration means that an investor is faced with a higher risk of non-payment and a higher interest rate fluctuation risk, which a premium is supposed to offset, although in the present instance, because liquidity was not provided, the interest rate fluctuation risk is not relevant. Furthermore, the *Land* restricted its freedom in the use of the silent partnership contribution more than would normally have been the case with limited duration. [31] The unlimited duration of the silent partnership contribution does, on the other hand, give Helaba the added economic benefit that it can be recognised above the 15 % limit as core capital and was in fact so recognised. This was provided for by the above-mentioned 'Sydney Declaration' of the Basle Committee for Banking Supervision in October 1998.

(175) For these reasons, the *Land* of Hessen and Helaba agreed to a further premium on the initial remuneration, the so-called perpetuity premium, of 0,2 % a year. Taking account of the above-mentioned trade tax effect, the rate applicable for the market comparison rises to 0,23 % a year.

(176) In assessing whether this rate of0,23 % a year is in line with the market-economy investor principle, the Commission cannot, or can to only a very limited extent, rely on market data from the time of the transaction. According to the information provided by Germany, Helaba and the *Land* of Hessen were to some extent market pioneers in arranging the transaction in such a way that, in coordination with the relevant banking supervisory and financial authorities, recognition in full as core capital above the 15 % limit was achieved. According to Germany, the transaction was evidently the first of this kind. Comparative data on the market nature of the perpetuity premium were not available to the parties at the end of 1998, since, in the period between the 'Sydney Declaration' of 28 October 1998 and 1 December 1998, it was not possible for a transparent market for permanent silent partnerships to develop.

(177) The Commission notes firstly that a public investor or a public bank cannot be prevented from acting as a market pioneer. On the contrary, a market pioneer must actually be allowed greater leeway in setting terms and conditions than is the case with established benchmarks that determine the relevant market corridor on the basis of which the market test is to be carried out. The Commission can therefore at most examine whether the determination of the perpetuity premium was wrong in economic terms, i.e. was based for example on false premises.

(178) In carrying out this examination, therefore, reference must be made to market data from a later period. In the Commission's view, there is no reason to believe that a premium for the perpetuity of a silent partnership varies

[31] This does not automatically mean that the *Land* has committed itself to Helaba 'forever' or can never again have at its disposal the funds comprised in the silent partnership. The *Land* can assign its rights from the silent partnership (at least with Helaba's agreement) to a third party against payment. The fungibility of the silent partnership is not thus necessarily reduced to zero.

much over time. However, no specific data on the level of the perpetuity premium can be deduced from the market. *Perpetuals*, including the silent partnership contribution of unlimited duration, have established themselves on the market since the Sydney Declaration of October 1998, but more particularly since 1999.

(179) Germany did not therefore present separate data on the level of the appropriate perpetuity premium for carrying out the market comparison, but rather presented data on overall pricing of *perpetuals* and silent partnerships of unlimited duration observable on the market since 1999 (contributions with a term of thirty years or more are also regarded as being of unlimited duration on the market). The data are summarised in the following table, with the *perpetuals* from 1999 listed in the above table being listed here once again for the sake of completeness:

Relevant comparative transactions [32]

Description of the transaction	Volume	Term	Financial strength/product ratings	Remuneration premium p.a. (in bp)	Reference interest rate and any adjustment [33] of the remuneration premium by deduction of the refinancing premium	Liability remuneration of relevance for comparison
USD tranche of the silent partnership contribution to Dresdner Bank, May 1999	USD 1 billion	32 years	FSR: Aa1/AA PR: Aa2; A+	215 bp	30-year US treasuries (adjustment through deduction of 65 bp [34])	150 bp
Euro tranche of the perpetual for Deutsche Bank, July 1999	EUR 500 million	no limit	FSR: Aa3/AA PR: A1	Fixed 6,6 % (corresponds to 115 bp)	Corresponds to 30-year federal loan (adjustment through deduction of 20-40 bp)	75-95 bp
USD tranche of the perpetual for Deutsche Bank, July 1999	USD 200 million	no limit	FSR: Aa3/AA PR: A1	Fixed 7,75 % (corresponds to 160 bp)	Corresponds to 30-year US treasuries (adjustment through deduction of 65 bp)	95 bp
Deutsche Bank, December 2003	EUR 300 million	no limit	PR: A2/A	Fixed 6,15 % (corresponds to 99 bp over mid-swaps)	Corresponds to mid-swaps (no adjustment)	99 bp

[32] See in particular Germany's reply of 9 April 2003, Annexes 2-4, 8-12, 17-18.

[33] Downward adjustment carried out by the Commission on the basis of the data provided by Germany.

[34] Refinancing premium as compared with US treasuries having the same term, see letter from Germany of 9 April 2003, p. 27.

(180) The few specified comparative data for *perpetuals* do not produce any change here in the market comparison corridor as compared with silent partnership contributions of limited duration. However, economic theory dictates that a market-economy investor naturally requires a premium for perpetuity as compared with an otherwise similar silent partnership contribution of limited duration, so as to offset in particular the additional risk of non-payment resulting from the stronger and longer tie. However, it is evident from the data presented that, on the market for *perpetuals,* it is not necessarily the case that a significantly higher liability remuneration is required than for silent partnership contributions of limited duration. This finding, though it certain cannot be described as statistically robust, given the lack of a sufficient number of comparative transactions, also lends further plausibility to Germany's argument that the perpetuity aspect does not change the silent partnership contribution into a capital instrument of a different type, as argued by the BdB, for example.

(181) Germany presented a comparative calculation of the perpetuity premium for the Deutsche Bank's euro transaction (*perpetual*) of July 1999, which was of unlimited duration, as compared with the Dresdner Bank's transaction of May 1999, which was of limited duration ([35]) . It stated that the Deutsche Bank *perpetual* of July 1999 showed an overall remuneration of 6.6 % a year (see above table). In 1 July 1999, the current yield for ten-year federal loans was 4,66 % a year, which meant that the remuneration premium in relation to them amounted to 1,94 % a year ([36]) . By contrast, the euro tranche of the twelve-year silent partnership contribution to Dresdner Bank of May 1999 was remunerated at 1,65 above ten-year federal loans. This gave a difference of 0,29 % a year. This, it was argued, was only slightly above the premium agreed here of 0,20 % a year (0,23 % a year with the trade tax effect). Another reason for the difference was that the Deutsche Bank *perpetuals* were rated lower by Moody's at A1 than the Dresdner Bank silent partnership contribution, rated Aa2, and consequently had a higher remuneration.

(182) The Commission believes this comparative calculation is plausible, bearing in mind the limited data available in the period 1998/1999, which is not the fault of the *Land* of Hessen and Helaba. The figure of 0,29 % resulting from the comparative calculation is only slightly above the perpetuity premium agreed between the *Land* of Hessen and Helaba, i.e. 0,23 %. In addition, at least part of the difference is attributable to differences in product rating, which would probably be smaller if one were to compare silent partnership contributions to Helaba of limited and unlimited duration, since the issuer is identical.

(183) Consequently, the Commission has no evidence that the comparative rate of 0,23 % a year for the perpetuity premium lies below the market corridor and that there was therefore any favouring of Helaba, i.e. state aid.

(dd) Taking appropriate account of liquidity costs

(184) The arguments of Germany, Helaba and the BdB regarding liquidity costs, which are in agreement in this respect, can be accepted, in so far as 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), 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. ([37]) Since the silent partnership contribution of the *Land* of Hessen did not provide Helaba with initial liquidity because the assets transferred and all the income from them remained earmarked by law for housing promotion, Helaba faced additional funding costs equal to the amount of the capital if it was to raise the necessary funds on the financial markets to take full advantage of the business potential 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). ([38]) Because of these extra costs, which do not arise in the case of liquid 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.

(185) Unlike the BdB, but like Germany and Helaba, however, the Commission takes the view that the gross refinancing interest rate is deductible. Refinancing costs are operating expenses and thus reduce taxable income. However, the same applies to the remuneration on a silent partnership

([35]) Letter from Germany of 9 April 2004, p. 28.

([36]) The remuneration premium of the Deutsche Bank *perpetual* (agreed fixed-interest remuneration of 6,60 %) is put here at 1,94 % a year in relation to 10-year federal loans in order to make it more comparable with the 12-year silent partnership contribution to Dresdner Bank (1,65 % above 10-year federal loans) and thus to get some idea of the level of the perpetuity premium. In the above table, the remuneration premium for the same *perpetual* is put at 1,15 % a year in relation to 30-year federal loans, since these are equivalent to the relevant period (30 years are regarded on the market as being 'quasi-permanent'). The remuneration premium in relation to 30-year federal loans is lower, since with a normal interest rate curve, as is the case here, longer-term (30-year) loans yield a higher return than shorter-term (10-year) loans and thus represent a higher deduction item from the agreed fixed-interest remuneration of 6,60 % a year.

([37]) 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.

([38]) 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).

contribution which from the outset is made in liquid form. In comparison to the latter, which, as stated above, provides the appropriate market test, no further tax advantage arises. The bank's net result is thus reduced in both cases by the amount of the interest paid for the liquidity. The entire refinancing costs are thus deductible.

(186) This situation distinguishes Helaba significantly from WestLB and the other Landesbanks, which were also the subject of proceedings, since in the case of the latter the promotion-related assets were entered in the balance sheet as reserves and the entire remuneration is to be regarded as profit utilisation, but not as operating expenses, and must be paid from taxable profit. In the case of the others, therefore, there is a tax advantage if the costs for liquidity to be procured once more are deductible from tax as operating expenses, while this would not be the case with an investment which was from the outset cash, but otherwise identical, and which represents the relevant comparative reference.

(187) In the absence of any (further) tax advantage, consequently, Helaba has to pay only the remuneration for the risk to which the *Land* of Hessen is exposing its promotion-related assets in the form of the silent partnership contribution, i.e. the liability remuneration, expressed in basis points, above the relevant reference interest rate.

(2) *Determination of a minimum remuneration for the capital required to underpin the promotion-related business and for the capital not initially used, on the basis of the phased arrangement, to underpin competitive business*

(188) In the WestLB Decision of 1999, the Commission applied a bank guarantee commission of 0,5-0,6 % before tax and 0,3 % after tax for the amount entered in the balance sheet, but not usable to underpin competitive business. This guarantee commission is in line with the rate of 0,3 % before tax which Germany had indicated as the appropriate commission on a bank guarantee for a bank like WestLB at the end of 1991. The Commission raised this rate to 0,5-0,6 % before tax (0,3 % after tax) for two reasons. Firstly, the amount of DEM 3,4 billion (EUR 1,74 billion) in the case of WestLB exceeded what was normally covered by such bank guarantees. Secondly, bank guarantees were normally associated with certain transactions and limited in time.

(189) In the present proceedings on Helaba, the Commission similarly asked Germany to specify a guarantee provision that could be regarded as corresponding to market terms for a bank such as Helaba. Germany did not do so, but argued that guarantees were always issued only for certain transactions and that there was therefore no market from which the remuneration for such guarantees could be deduced. However, if, despite these objections, the Commission insisted on a remuneration being specified, the level of such remuneration could, in Germany's view, only be calculated individually taking account of the specific risk which, on the basis of this approach, the *Land* had incurred in view of the differential amounts involved. Since the planned growth of the risk assets, at only DEM [...] million a year, represented a modest growth policy compared to WestLB, the very low probability of the differential amount, which was decreasing annually, being called on by the bank's creditors should at all events result in the application of a very low liability remuneration. Furthermore, Helaba had only partly used the graduated amounts that had to be remunerated in full and, in contrast to WestLB, more than filled the minimum core capital ratios required for banking supervisory purposes, so that Helaba's business risks were as a result more than adequately covered. This safety margin meant that neither the basic remuneration rate of 0,3 % a year before tax nor a premium on this rate of 0,2-0,3 % a year before tax could be transferred from the WestLB Decision (a total of 0,3 % a year after tax) to the Helaba case.

(190) The Commission therefore must itself examine an appropriate guarantee commission for a bank such as Helaba. In view of the basic similarity of WestLB and Helaba and in the absence of other criteria, the Commission assumes here that, as in the case of WestLB, a basic rate of 0,3 % a year before tax can be regarded as appropriate. However, in the Commission's view, premiums on this rate are not appropriate. In the first place, the amount of the silent partnership contribution (EUR 50 to 100 million) available in the long term to underpin the promotion-related business is much smaller than the corresponding amount of some EUR 1,7 billion in the case of WestLB. Secondly, the amount which, under the phased arrangement, was not usable to underpin competitive business was, as a result of the phased arrangement, limited in time and accordingly fell to zero by 2003. These facts show clearly that the risk to the *Land* of Hessen was no higher than in the case of a market guarantee for a bank such as Helaba and does not accordingly justify any increase in the basic rate of 0,3 % a year before tax. Since the remuneration for the entire silent partnership contribution is, as operating expenses, deductible from tax and, on this point too, differs from the tax treatment of the remuneration in the WestLB Decision, the Commission establishes the guarantee commission in this Decision as a pre-tax rate which is fully eligible as operating expenditure.

e) ***Aid element***

(191) As stated above, the Commission considers a remuneration of 0,3 % a year before tax to be appropriate for the part of the capital which is not usable by Helaba to underpin its competitive business, but was entered in Helaba's balance sheet with effect from 31 December 1998.

(192) Helaba pays a remuneration of 1,4 % a year only on the amount which, in accordance with the phased arrangement, is usable to cover risk assets, but not on the part of the silent partnership contribution which is entered in the balance sheet, but not used to underpin competitive business.

(193) The aid element can therefore be determined as the product of the guarantee commission of 0,3 % a year before tax regarded by the Commission as corresponding to market terms and the part of the silent partnership contribution entered in the balance sheet but not used to underpin competitive business, in accordance with the following table:

	Year-end values in EUR millions	1999	2000	2001	2002	2003
1)	Nominal value in the balance sheet	1 264,4	1 264,4	1 264,4	1 264,4	1 264,4
2)	Core capital actually usable for competitive business in accordance with the phased model	[…]	[…]	[…]	[…]	[…]
3)	Core capital used for promotion related business	[…]	[…]	[…]	[…]	[…]
4)	Core capital usable for competitive business, but whose usability is governed by the phased model	[…]	[…]	[…]	[…]	[…]
5)	Difference between (1) and (2), corresponds to the sum of (3) and (4)	[…]	[…]	[…]	[…]	[…]
6)	Safety margin deduction because of lower preliminary determination in the balance sheet as at 31.12.1998 (*)	[…]	[…]	[…]	[…]	[…]
7)	Capital base to be remunerated with guarantee commission of 0.3 % a year (before tax)	[…]	[…]	[…]	[…]	[…]
8)	Remuneration to be paid that is deductible as operating expenses, corresponds to aid element	1,92	1,95	1,34	0,73	0,15

(*) Remark on item (6) Safety margin deduction because of lower preliminary determination in the balance sheet as at 31 December 1998: according to information provided by Germany, ([39]) the process of banking supervisory recognition had not yet been completed on 31.12.1998, so that initially a figure of EUR 1 023 million (DEM 2 000 million) had been entered in the balance sheet. The figure of EUR 1 264 million produced by the assessment process had been entered directly after the assessment and had accordingly featured in the annual accounts for 1999. In view of this process, the Commission considers it appropriate to make a safety margin deduction on behalf of Helaba from the capital base to be remunerated for 1999. Helaba's creditors based their assessment of its financial strength during 1999 on the figures in the 1998 annual accounts, which contained the preliminary lower amount of EUR 1 023 million for the silent partnership contribution. Consequently, in 1999 only the difference between this amount and the core capital usable, under the phased arrangement, to underpin competitive business is to be remunerated with the guarantee commission of 0,3 % a year (before tax), i.e. EUR [...] million. For the following years, the figure in the previous year's balance sheet corresponds to the figure for the silent partnership contribution specified in the annual balance sheet.

([39]) See Germany's reply of 23. August 2004, p. 6-7.

f) ***Preliminary result***

(194) The Commission thus concludes that Helaba was favoured only in so far as it did not pay an appropriate liability remuneration for that part of the capital made available in the form of a silent partnership contribution by the *Land* of Hessen which was required to underpin its promotion-related business and, on the basis of the phased arrangement, was initially not used to underpin its competitive business. In the Commission's view, a liability remuneration of0,3 % a year (before tax) would have been appropriate. In so far as it was possible for the capital to be used to underpin the competitive business, however, this was remunerated appropriately through the agreed remuneration of 1,43 % a year (taking account of the trade tax) for the silent partnership contribution. In this respect, no favourable treatment exists.

1.3. DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATES

(195) As a result of 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.

(196) Helaba carries on regional and international banking business. It defines itself as an all-purpose commercial bank, central bank for the savings banks and the bank of the *Land* and its municipalities. Despite its name, tradition and legally stipulated tasks, Helaba is much more than a mere local or regional bank.

(197) These facts show clearly that Helaba 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. It is clear, therefore, that aid given to Helaba distorts competition and affects trade between Member States.

1.4. RESULT

(198) In so far as Helaba did not pay an appropriate liability remuneration for the part of the capital made available which was required to underpin its promotion-related business and, on the basis of the phased arrangement, was not initially used to underpin its competitive business, all the preconditions for state aid within the meaning of Article 87(1) of the EC Treaty are met. With regard to the part of the capital which was used to underpin the competitive business, the remuneration of 1,43 % a year (taking account of the trade tax) that had to be paid only on this amount is to be regarded as being in conformity with the market. In this respect, there is no favourable treatment and hence no state aid within the meaning of Article 87(1) of the EC Treaty for Helaba.

2. *COMPATIBILITY WITH THE COMMON MARKET*

(199) In so far as the transfer of the silent partnership contribution involves state aid within the meaning of Article 87(1) of the EC Treaty, an assessment must be made as to whether the aid can be considered compatible with the common market.

(200) None of the exemption clauses of Article 87(2) of the EC Treaty are applicable. The aid does not have a social character and is not granted to individual consumers. Nor does it make good the damage caused by natural disasters or exceptional occurrences or compensate for the economic disadvantages caused by the division of Germany.

(201) 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 is not aimed either at promoting culture or heritage conservation.

(202) Since the economic survival of Helaba was not at stake when the measure was implemented, there is no need to consider whether the collapse of a single large credit institution like Helaba 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.

(203) 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. Helaba was not an undertaking in difficulty whose viability had to be restored with the support of state aid.

(204) Article 86(2) of the EC Treaty, which allows exemptions from the Treaty's state aid rules 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. ([40]) However, the formal conditions are not met in this case: the tasks which Helaba carries out in providing services of general economic interest are not specified, and nor are the costs generated by such tasks. It is therefore clear that the transfer was effected without any regard to any services of general economic interest. Accordingly, this exemption clause does not apply either in the case at hand.

(205) 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.

3. *NOT EXISTING AID*

(206) Nor, contrary to what was argued by Germany in other Landesbank proceedings, can the capital injection be regarded as being covered by the existing state aid scheme for 'institutional responsibility' (*Anstaltslast*) and 'guarantor liability' (*Gewährträgerhaftung*), but must be regarded as new aid.

(207) *Gewährträgerhaftung* is a default guarantee offered to creditors in the event that the bank's assets are no longer sufficient to satisfy their claims, and this is not the case here. The capital injection is not intended to satisfy the Landesbank's creditors and the bank's assets have not been exhausted.

(208) Nor does *Anstaltslast* apply. *Anstaltslast* requires the guarantor, the *Sparkassenverband Hessen-Thüringen*, to provide Helaba with the resources it needs to function properly for as long as the *Sparkassenverband Hessen-Thüringen* decides to maintain it in existence. However, at the time of the capital injection, Helaba was far from being in a situation where it was no longer able to operate properly for lack of sufficient resources. The capital injection was therefore not needed in order to keep the Landesbank in operation. The conscious economic calculation by the *Land* as (joint) owner also enabled the Landesbank to seize future opportunities in its competitive business. The 'necessity requirement' for *Anstaltslast* does not apply to such a normal economic decision by the *Land* as (joint) owner of the bank. In the absence of another applicable existing state aid scheme pursuant to Articles 87(1) and 88(1) of the EC Treaty, the capital injection must be classed as new aid within the meaning of Articles 87(1) and 88(3) of the EC Treaty, and examined as such.

VII. **CONCLUSION**

(209) The aid cannot be found compatible either under Article 87 (2) or (3) or under any other provision of the Treaty. The aid should therefore be declared incompatible with the common market and the aid element of the measure illegally put into effect should be recovered by the Germany,

HAS ADOPTED THIS DECISION:

Article 1

1. The waiver of an appropriate remuneration amounting to 0,3 % a year (before corporation tax) for the part of the capital transferred by the *Land* of Hessen to the Landesbank Hessen-Thüringen — Girozentrale which the latter has been able to use as a guarantee as from 31 December 1998 is aid which is incompatible with the common market.

2. The aid referred to in paragraph 1 amounts to EUR 6,09 million for the period from 31 December 1998 to 31 December 2003.

Article 2

1. Germany shall discontinue the aid referred to in Article 1(1) by 31 December 2004.

2. Germany shall take all necessary measures to recover the aid referred to in Article 1(1) which was unlawfully made available to the beneficiary. The amount to be recovered shall include the following:

(a) for the calculation period 31 December 1998 to 31 December 2003, the amount specified in Article 1(2);

(b) for the calculation period from 1 January 2004 to the time when the aid is discontinued, an amount determined in accordance with the calculation method specified in Article 1(1).

Article 3

Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of this Decision.

The amount to be recovered shall include interest from the date on which the unlawful aid was at the disposal of the beneficiary until the date of its recovery.

([40]) 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.

Interest shall be calculated in accordance with the provisions of Chapter V of Commission Regulation (EC) No 794/2004 ([41])

Article 4

Germany shall, using the form set out in the Annex, inform the Commission, within two months of notification of this Decision, of the measures which it has taken in order to comply with it.

Article 5

This Decision is addressed to Germany.

Done at Brussels, 20 October 2004.

For the Commission

Neelie KROES

Member of the Commission

([41]) OJ L 140, 30.4.2004, p. 1.

COMMISSION DECISION

of 25 January 2006

on the State Aid implemented by the Netherlands for AZ and AZ Vastgoed BV

(notified under document number C(2006) 80)

(Only the Dutch version is authentic)

(Text with EEA relevance)

(2006/743/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:

I. PROCEDURE

(1) By letters registered as received on 26 June 2002 and 6 February 2003, the Commission received complaints regarding the state aid granted by the Netherlands to the football club AZ Alkmaar. In the course of the preliminary investigation of the complaints, it received additional information from the complainants and from the Dutch authorities.

(2) By letter dated 23 July 2003, the Commission informed the Netherlands that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the measures. The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [2]. The Commission invited interested parties to submit their comments.

(3) The Netherlands requested an extension of the deadline for submitting comments; its request was granted. It responded to the decision to initiate the procedure by letters registered as received on 29 October and 5 November 2003.

(4) In December 2003 the Commission received several letters containing comments from interested parties. The interested parties sent additional comments by letters registered as received on 9 February, 6 April and 6 October 2004.

(5) In the spring of 2004 the Commission received information that the municipality intended to renegotiate the agreement with AZ and AZ Vastgoed. It therefore asked the Dutch authorities for additional information by letter of 3 June 2004, to which they replied by letter of 5 July 2004, stating that the municipality, AZ and AZ Vastgoed were indeed considering whether to conclude a new agreement. They reiterated that, on account of the suspension injunction imposed by the Court of Appeal in Amsterdam, the agreement could not be implemented [3]. They provided additional information by letter registered as received on 5 November 2004, in which they confirmed that a new agreement had been concluded between the parties and that the previous agreement had been dissolved.

II. DESCRIPTION

(6) On 7 December 2001 the municipality of Alkmaar reached an agreement with Stichting AZ and AZ Vastgoed BV (hereafter referred to as 'AZ' and 'AZ Vastgoed' respectively) concerning a new location for the football stadium. The agreement between the municipality of Alkmaar, on the one hand, and AZ and AZ Vastgoed, on the other, concerned four transactions connected to the sale of several plots of land.

(7) According to the Dutch authorities, two plots of land were sold to AZ and AZ Vastgoed for the construction of a new stadium, business premises and a car park. The municipality of Alkmaar sold the land on which the existing stadium was built to AZ. AZ and AZ Vastgoed would demolish the old stadium, develop the land and build 150 apartments. Lastly, a plot of land was sold to AZ for the construction of training facilities. The agreement imposes obligations on the buyers of the land. Certain items of infrastructure have to be developed and maintained by AZ and AZ Vastgoed.

(8) In July 2003 the Commission decided to initiate the formal investigation procedure; if the agreement constituted state aid within the meaning of Article 87(1) of the EC Treaty, it was doubtful whether the aid to AZ and AZ Vastgoed was compatible with the EC Treaty.

(9) As the Court of Appeal in Amsterdam issued an order in April 2004 for implementation of the agreement to be suspended, the land has never been transferred pursuant to the agreement of 7 December 2001.

[1] OJ C 266, 5.11.2003, p. 8.

[2] See footnote 1.

[3] Gerechtshof Amsterdam, 1.4.2004, LJN: AO6912, 206/03 KG (www.rechtspraak.nl).

(10) However, in November 2004 the Dutch authorities informed the Commission that the agreement concluded on 7 December 2001 between the municipality of Alkmaar, on the one hand, and AZ and AZ Vastgoed BV, on the other, had been dissolved.

(11) According to the Netherlands, new negotiations were conducted and an independent expert evaluation of the plots had been carried out in accordance with the Commission communication on state aid elements in sales of land and buildings by public authorities ([1]). After this evaluation, a new agreement was concluded between the municipality and Egedi BV (the legal successor to AZ Vastgoed).

(12) Under the circumstances, the agreement which is subject of the investigation has been dissolved, with the result that the formal investigation procedure no longer serves any useful purpose and should be terminated.

III. **CONCLUSION**

(13) Since the agreement subject to the formal investigation procedure has been dissolved, the investigation no longer serves any useful purpose.

(14) Accordingly, the formal investigation procedure of Article 88(2) of the EC Treaty in respect of the abovementioned agreement between the municipality of Alkmaar, on the one hand, and AZ and AZ Vastgoed, on the other, should be terminated,

HAS ADOPTED THIS DECISION:

Article 1

The formal investigation procedure under Article 88(2) of the EC Treaty initiated on 23 July 2003 against AZ and AZ Vastgoed BV is hereby terminated.

Article 2

This decision is addressed to the Kingdom of the Kingdom of the Netherlands.

Done at Brussels, 25. January. 2006.

For the Commission

Neelie KROES

Member of the Commission

([1]) OJ C 209, 10.7.1997, p. 3.

COMMISSION DECISION

of 8 March 2006

on the State Aid implemented by Germany for Magog Schiefergruben GmbH & Co. KG

(notified under document number C(2006) 641)

(Only the German text is authentic)

(Text with EEA relevance)

(2006/744/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:

I. PROCEDURE

(1) On 12 November 2003, the Commission received a complaint concerning alleged state aid for Schiefergruben Magog GmbH & Co. KG ('Magog') from a German competitor of Magog. The Commission requested information from Germany on 25 November 2003, which Germany submitted by letter dated 4 March 2004, registered as received on the same day.

(2) On 6 October 2004 the Commission initiated the formal investigation procedure with respect to the alleged state aid. The Commission decision to initiate the procedure was published in the Official Journal of the European Communities ([2]). The Commission invited interested parties to submit comments on the presumed aid. Comments were submitted by letter dated 14 December 2004, registered as received on 16 December 2004, from Rathscheck Schiefer und Dach-Systeme KG, I.B. Rathscheck Söhne KG Moselschiefer-Bergwerke and Theis-Böger GmbH ('Rathscheck and Theis-Böger') and by letter dated 7 December 2004, registered as received on 13 December 2004, from a third party that wished to remain anonymous.

(3) The comments were transmitted to Germany by letters dated 3 January 2005 and 7 July 2005. Germany replied to the comments by letters dated 11 March 2005, registered as received on the same day, and 31 August 2005, registered as received on 1 September 2005.

([1]) OJ C 282, 19.11.2004, p. 3.

([2]) See footnote 1.

(4) Germany's response to the initiation of the formal investigation procedure was submitted by letter dated 6 December 2004, registered as received on 13 December 2004. The Commission requested further information on 5 October 2005, which Germany submitted by letter dated 15 November 2005, registered as received on 16 November 2005. The annexes were submitted by letter dated 18 November 2005, registered as received on 24 November 2005. Germany submitted additional information by letter dated 21 December 2005, registered as received on the same day.

II. DESCRIPTION OF THE AID

2.1. The recipient

(5) The recipient, Magog, which is based in Bad Fredeburg, North Rhine-Westphalia, is active in the production of slate. In 2002 the company had 43 employees and a balance sheet total of below EUR 5 million. As the independence criterion is also met the company qualifies as a small company as defined by the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises ([3]).

2.2. The project

(6) At the request of the Westfälischer Schieferverband e.V. (Westphalian State Federation) the *Land* of North Rhine-Westphalia supported a project for the development of a new system for the cutting of roofing slate (project title: 'development and testing of digitally controlled and robot-supported roofing slate production') in 2002 and 2003. The project was carried out by Magog, which is a member of the Westfälischer Schieferverband, in collaboration with a university of applied science.

(7) According to Germany the objective of the project was the development of an innovative technology for the treatment of roofing slate in order to reduce health risks for the employees. Up to then the treatment of roofing slate was to a large extent manual work, which resulted in a physical burden for the employees. Germany claims that the project has contributed significantly to an increase in occupational safety and as such serves as a model for the whole roofing slate industry.

([3]) OJ L 124, 20.5.2003, p. 36.

(8) According to the application, the project 'development and testing of digitally controlled and robot-supported roofing slate production' consisted of three stages. In a first stage a prototype was to be developed. The second stage foresaw the construction of a hall, which was to be followed by the implementation of the new technology as a third stage.

(9) Only the first stage was subsidised by the *Land* of North Rhine-Westphalia. Originally the costs for the first phase were estimated to amount to EUR 1 293 110 and the *Land* of North Rhine-Westphalia was to finance 60 % of these costs, i.e. EUR 775 866. In the end the eligible costs of the first stage amounted to EUR 1 223 945, of which EUR 702 093 (57 %) were financed by the *Land* North Rhine-Westphalia.

(10) The final costs of the first stage can be further broken down as follows

Table 1:

	EUR
Feasibility study	25 565
Development of a prototype (installation 1)	464 410
Development and construction of two installations for production (installations 2 and 3)	733 970
TOTAL	**1 223 945**

(11) Magog commissioned a feasibility study for the development of a digitally controlled and robot-supported installation for the production of roofing slate, which was delivered in March 2002. The costs of the study amounted to EUR 25 565.

(12) Following the feasibility study, a prototype, which was not designed for commercial production but only for testing purposes, was developed and constructed on the premises of Magog (installation 1). Testing took place in November and December 2002; the prototype was dismantled in January 2003. The costs of the prototype amounted to EUR 464 410.

(13) On the basis of the experience acquired through the testing of the prototype the company proceeded with the construction of an installation designed for commercial production. The tests with the prototype had shown that at least two installations would be necessary for commercial production because of the different sizes of the roofing slate. The first installation which would be used for commercial production was set up in January 2003 (installation 2), the second in April 2003 (installation 3). Continued testing of both installations 2 and 3 took place in 2003 to further improve their operation. Since the beginning of 2004 the production process has been running smoothly on installations 2 and 3. The costs of installations 2 and 3 amounted to EUR 733 970.

(14) Stage 1 described above in paragraphs 8 to 13 was part of an overall plan to modernise the production process of Magog and comprising further stages. Stages 2 and 3 started in 2003 and were finalised in 2005. Moreover, since 2002 continued investments have taken place in the field of slate extraction (tunnelling). According to the information submitted by Germany, stages 2 and 3 and tunnelling comprised the following investments which were part of the overall modernisation plan

Table 2:

		EUR
1	Hall 2002	16 576
2	Hall 2005	213 175
3	Sawing machine	267 774
4	Water treatment	35 740
5	Office connection	2 570
6	Digging device	105 840
7	Costs for patents	65 128
8	Tunnelling 2002 — 2005	557 378
9	Tunnelling 2006 — 2007	176 800
10	Wages for project leader and engineer 2004/2005	84 247
11	Demolition of old building	8 245
12	Architect's fee	5 733
	TOTAL	**1 539 205** (1)

(1) Figures do not add up because of rounding.

(15) The indicated costs of EUR 16 576 for 'hall 2002' concern the repair and renovation of an existing sawing hall in 2002 (point 1 in Table 2).

(16) The investments in 'hall 2005' concern a former storage hall which was significantly modified in 2004 and 2005 and is now used for production (point 2). The conversion of the hall became necessary for the implementation of the new production process on the basis of the newly developed robots. The modification of the hall also includes the construction of a new sawing machine (point 3) which became necessary for the installation of the new robots.

(17) In order to implement the new production process the construction of new water treatment facilities was also necessary for the cooling of the new sawing machine (point 4). The new sawing machine is bigger than the old one and consequently also needs more water. The costs for office connection (point 5) are also linked to the investments in the hall 2005 and the sawing machine.

(18) The digging device (point 6) is a machine which is used for the cutting of the slate in the mine and was acquired by Magog in 2004.

(19) The costs for the patents as presented under point 7 above are the lawyers' fees for the notification of the patents linked to the project.

(20) As regards tunnelling 2002 to 2005, the related costs are for investment in extending the mine (point 8). The costs for tunnelling 2006 to 2007 are the estimated costs to the company of extending the mine in these two years (point 9). The costs for project leader and engineer 2004/2005 (point 10) are linked to the mining activities mentioned under point 8 and 9.

(21) The costs for the demolition of the building (point 11) were incurred in July 2005 and concerned the demolition of an unspecified building.

(22) The architect's fee (point 12) can be further broken down into EUR 3 600 for the construction of 'hall 2005' and EUR 2 133 for other items.

2.3. **The financial measure**

(23) The *Land* North Rhine-Westphalia provided a grant of EUR 702 093 on the basis of the 'Technologieprogramm Bergbau' (technology programme for mining). The objective of this programme was to promote projects to improve safety and health protection of employees in mining as well as projects to improve environmental protection in the field of mining. Potential aid recipients under this programme were joint technological research institutes. The programme was discontinued at the end of 2003.

(24) The grant decision was taken on 19 December 2001. The subsidy was paid out in several instalments between August 2002 and December 2003 as the project progressed.

(25) Magog has all property rights to the results of the project and owns the licences. It has to transfer to the *Land* North Rhine-Westphalia part of the proceeds which it will potentially generate from the property rights and licences. The grant decision contains provisions to ensure that the results of the project are widely disseminated. Magog is required to publish the results in at least one acknowledged German professional journal. According to the information submitted by Germany, Magog has licensed some patents to a competitor. An article on the results was published in the mining association's journal entitled 'Bergbau' ('Mining').

III. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

(26) The Commission initiated the formal investigation procedure as it doubted that the financial measure did not constitute state aid, as claimed by Germany. The Commission considered that the financial measure provided a selective advantage to Magog as the introduction of the new technology increased the productivity of the company and improved its competitiveness without the company having to bear all its cost. The Commission also considered that trade among Member States was affected.

(27) As regards potential exemptions under Article 87(3) of the Treaty, the Commission first noted that Magog was not located in an assisted area pursuant to Article 87(3)(a) or (c) of the Treaty.

(28) The Commission considered that the project might qualify as an investment project within the meaning of Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to state aid to small and medium-sized enterprises ([4]), but doubted that the permissible ceilings of up to 7,5 % gross aid intensity of the eligible investment cost for medium-sized enterprises and up to 15 % gross aid intensity for small enterprises were complied with.

(29) The Commission also considered that part of the project might potentially qualify as a precompetitive development activity under the Community framework for state aid for research & development ([5]) ('R&D framework'), which allows state aid for fundamental research, industrial research and precompetitive development. However, the Commission doubted that the maximum allowable aid intensity of 35 % for small and medium-sized enterprises (SMEs) was complied with.

(30) The Commission also pointed out that it would examine the compatibility of the aid with the common interest in general, and in particular with the objective of the protection of workers' health and safety, as set out in Article 137 of the Treaty.

IV. COMMENTS FROM INTERESTED PARTIES

(31) The Commission received comments from Rathscheck and Theis-Böger and from a competitor that wished to remain anonymous.

4.1. **Rathscheck and Theis-Böger**

(32) In their comments on the initiation of the formal investigation procedure Rathscheck and Theis-Böger explain that the roofing slate market constitutes one single market and that there is no separate market for 'Altdeutsche Deckung' ('old German' style roofing). Even if 'Altdeutsche Deckung' were a separate market, the subsidy would still

([4]) OJ L 10, 13.1.2001, p. 33.

([5]) OJ C 45, 17.2.1996, p. 5.

lead to distortions of competition as the new robot could also be used for the production of commodity slate and as Spanish slate producers compete not only in the market for the final product, but also in the market for the intermediate product. Rathscheck and Theis-Böger point out that they increasingly produce 'Altdeutsche Deckung' from Spanish raw slate.

(33) As regards potential compatibility of the aid with the common market, Rathscheck and Theis-Böger argue that the aid is not compatible because it allows Magog to offer its products on the market at prices below those of its competitors and even below those of Spanish companies.

(34) Rathscheck and Theis-Böger reject Germany's argument that the subsidy did not provide an advantage to Magog. Magog itself would not conceal that the subsidy contributed to a significant increase in its profitability.

(35) Rathscheck and Theis-Böger also provide background information on the market for roofing slate. They point out that total production of roofing slate in the EU has decreased since 2001. Spain accounts for 95 % of EU production and is the only country with a significant export surplus. All EU producers of roofing slate are small and medium-sized companies.

(36) Rathscheck and Theis-Böger argue that the development of digitally controlled, robot-supported roofing slate production does not constitute a real innovation. Commodity roofing slate has been produced with the help of highly modern machines for several years in Spain. As regards the classification of part of the project as precompetitive development, Rathscheck and Theis-Böger point out that in any event the allowable aid intensities are not complied with.

(37) Rathscheck and Theis-Böger reject Germany's argument that the aid led to an improvement of the working conditions of the employees. They argue that the aid cannot therefore be considered compatible with the common market on the grounds that it pursues the objective of the protection of workers' health and safety as set out in Article 137 of the Treaty.

4.2. **Competitor that wished to remain anonymous**

(38) In its comments to the initiation of the formal investigation procedure the competitor that wished to remain anonymous points out that the German construction and roofing market has been declining in recent years. The provision of a subsidy to a German producer would therefore be particularly harmful. The competitor also states that it produces raw slate used for the production of 'Altdeutscher Schiefer' in Germany.

V. **COMMENTS FROM GERMANY**

(39) In its comments to the initiation of the formal investigation procedure Germany argues that the grant does not constitute state aid as trade between Member States is not affected. The slate which Magog produces with the newly developed installation is a special high-quality roofing slate, the so-called 'Altdeutsche Decksteine'. The market for this slate is a regional market and is limited to certain areas of Germany. There is thus no effect on trade between Member States.

(40) In the event that the Commission considers that trade between Member State is affected, Germany argues that the grant can be considered compatible with the common market on the basis of Article 87(3)(c) of the Treaty. The measure fulfils the conditions of a study preparatory to precompetitive development activities within the meaning of point 5.4 of the R&D framework and of a precompetitive development activity of a small enterprise. In addition, the aid could be considered compatible with the common market directly on the basis of Article 87(3)(c) of the Treaty. The measure contributes to the achievement of an important Community objective laid down in Article 137 of the Treaty, and it concerns an economic activity for which in so far as competition is affected at all, there is no intense competition at Community level. Moreover, Germany submits a detailed description of the project, information on the project costs and the SME status of the company.

(41) In its response to the comments of Rathscheck and Theis-Böger, Germany reiterates its position that trade between Member States is not affected. Germany points out that there is intense competition in the regional market. Germany explains that the implementation of the project did not lead to a reduction in the production costs of Magog. Moreover, Germany points out that the project is eligible under the R&D framework and that the aid can be considered compatible on this basis. Germany expresses doubts as regards the correctness of the statement by Rathscheck and Theis-Böger that they produce 'Altdeutsche Deckung' from Spanish raw material.

(42) In its response to the comments of the competitor that wished to remain anonymous, Germany explains that the subsidised robot will not be used for the production of commodity slate that is prevalent in Spain. There is therefore no distortion of competition with respect to Spanish slate. The statement by the competitor that wished to remain anonymous that it produces slate which is used in Germany for the production of 'Altdeutscher Schiefer' is not in Germany's view correct.

VI. ASSESSMENT

6.1. Existence of aid within the meaning of Article 87 (1) EC Treaty

(43) According to Article 87(1) of the Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market. Pursuant to the established case law of the European Courts, the criterion of trade being affected is met if the recipient firm carries out an economic activity involving trade between Member States.

(44) The Commission considers that the project and the grant by the *Land* North Rhine-Westphalia did confer an advantage on Magog. The grant supported the company in modernising its production process by setting up new installations. This is confirmed by the company's own website, which states that the project was carried out to automate the cutting process, which would allow the company to produce high-quality slate at lower cost and would thus increase the competitiveness of the company. The grant favours Magog as the company would not have obtained the grant on the market. It therefore threatens to distort competition.

(45) As regards the question of the effect on trade between Member States, the Commission considers that the special high-quality roofing slate that Magog produces does not constitute a separate market but is part of the market for roofing slate. According to Germany the production and distribution of 'Altdeutsche Deckung' is limited to certain regions and there is no demand side substitutability of 'Altdeutsche Deckung' by commodity roofing slate because of its cost and utilisation. Nevertheless, the Commission considers that the fact that 'Altdeutsche Deckung' is more expensive than commodity roofing slate and is only demanded by certain consumers with a special historic interest does not justify considering it a separate market.

(46) According to the complainant the total production volume of roofing slate amounts to an estimated 743 000 tons in the EU. Spain is by far the largest producer of roofing slate and exports a significant part of its production. Germany produces around 9 000 to 10 000 tons of roofing slate. According to Germany Spanish imports of roofing slate into Germany amounted to more than 100 000 tons in 2002. The Commission thus comes to the conclusion that there is trade between Member States in the market for roofing slate and that Magog is in competition with producers from other Member States.

(47) The measure is provided by the *Land* North Rhine-Westphalia. It thus stems from state resources and is attributable to the state.

(48) On the basis of the above the Commission concludes that the grant constitutes state aid within the meaning of Article 87(1) of the Treaty and its compatibility with the common market has to be assessed accordingly.

6.2. Derogations under Article 87(2) and (3) of the Treaty

(49) Article 87(2) and (3) of the Treaty provides for exemptions from the general ban on state aid laid down in paragraph (1).

(50) The exemptions in Article 87(2) of the Treaty do not apply in the present case because the aid measure does not have a social character and is not granted to individual consumers, nor does it make good the damage caused by natural disasters or exceptional occurrences, nor is the aid granted to the economy of certain areas of the Federal Republic of Germany affected by its division.

(51) As regards potential exemptions under Article 87(3) of the Treaty, it should first be noted that the project was not carried out in an assisted area pursuant to Article 87(3)(a) or (c) of the Treaty and is thus not eligible for regional aid.

Research & development

(52) Commission Regulation (EC) No 70/2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises, as amended by Commission Regulation (EC) No 364/2004 [6], extending its scope to include aid to research and development allows state aid to be granted to SMEs for fundamental research, industrial research and precompetitive development. Although the measure being examined here was granted before the entry into force of Regulation (EC) No 364/2004, Regulation (EC) No 70/2001 as amended is applicable since, according to Article 9a thereof, individual aid granted before the date of the entry into force of Regulation (EC) No 364/2004 in the absence of a Commission authorisation and in breach of the notification requirement of Article 88(3) is compatible with the common market if it fulfils the conditions laid down in Regulation (EC) No 70/2001 as amended.

(53) Article 2 of Regulation (EC) No 70/2001 defines fundamental research as an activity designed to broaden scientific and technical knowledge not linked to industrial or commercial objectives. Industrial research is defined as planned research of critical investigation aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful in developing new products, processes or services or in bringing about a significant improvement in existing products, processes or services. As the project in question concerns the development of a prototype and two installations which will be used in the production process, it clearly does not qualify as fundamental or industrial research.

(6) OJ L 63, 28.2.2004, p. 22.

(54) According to the same Article, a precompetitive development activity is defined as the shaping of the results of industrial research into a plan, arrangement or design for new, altered or improved products, processes or services, whether they are intended to be sold or used, including the creation of an initial prototype which could not be used commercially. This may also include the conceptual formulation and design of other products, processes or services and initial demonstration projects or pilot projects, provided that such projects cannot be converted or used for industrial applications or commercial exploitation.

(55) The Commission notes that the first stage of the project consisted of the development of a prototype followed by the development of two installations which were incorporated into a production process. The setting-up of the latter two installations does not qualify as a precompetitive development activity as they were used in production. Nevertheless, the Commission considers that the development of the prototype can be considered to be precompetitive development activity. The prototype is part of a project for an improved production process. It will not be used in production as it was dismantled in 2003. As regards the innovative character, the Commission notes that according to Germany the developed prototype differs significantly from machines used in Spain for the production of commodity slate which could not be used for the production of 'Altdeutsche Deckung'. Moreover, following the implementation of the project Magog also acquired patents.

(56) According to Article 5a (3) of Regulation (EC) No 70/2001, the maximum allowable aid intensity for small and medium-sized enterprises for precompetitive development activities is 35 % gross of the eligible project costs. Article 5a (4) allows an increase of 10 percentage points if the project's results are widely disseminated through technical and scientific conferences or published in peer-reviewed scientific and technical journals.

(57) A part of the results of the project is licensed as patents to another company. The results of the project also have to be published in a technical journal. The Commission thus comes to the conclusion that a further bonus of 10 percentage points can be added to the aid intensity of 35 %, which results in maximum allowable aid intensity of 45 %. As the costs of the prototype amounted to EUR 464 410, the allowable aid amounts to EUR 208 985.

(58) In addition, the feasibility study that was part of stage 1 can be considered to be a technical feasibility study preparatory to a precompetitive development activity as defined by Article 5b of Regulation (EC) No 70/2001 as amended, for which aid with an intensity of up to 75 % can be granted. The costs of the feasibility study amounted to EUR 25 565, which results in an allowable aid amount of EUR 19 174. The total allowable aid on the basis of Regulation (EC) No 70/2001 thus amounts to EUR 228 158.

Investment in tangible and intangible assets

(59) As pointed out above in paragraph 55, the construction of the installations 2 and 3 which are used for commercial production cannot be considered to be precompetitive development and is thus not eligible for R&D aid. Nevertheless, the construction of these installations qualifies as investment in tangible and intangible assets under Regulation (EC) No 70/2001 as it involves a fundamental change in the production process of Magog through the rationalisation and modernisation of the existing production process.

(60) Article 4 of Regulation (EC) No 70/2001 allows aid for investment in tangible and intangible assets of up to 15 % gross aid intensity for small enterprises. According to Article 2, an investment in tangible assets is defined as investment in fixed physical assets relating to the creation of a new establishment, the extension of an existing establishment or the engagement in an activity involving a fundamental change in the product or in the production process of an existing establishment (in particular through rationalisation, diversification or modernisation). An investment in intangible assets means an investment in the transfer of technology by the acquisition of patent rights, licences, know-how or unpatented technical knowledge.

(61) The costs of the installations 2 and 3 amounted to EUR 733 970. Germany claims that also the costs of stages 2 and 3 and of tunnelling should be regarded as investments in tangible and intangible assets within the meaning of Regulation (EC) No 70/2001 and should be eligible for aid on this basis.

(62) The Commission considers that the costs relating to the construction of a hall for the new production process (point 2 in Table 2), the construction of a sawing machine for the new production process (point 3), the investments in water treatment (point 4) and in the office connection (point 5) indeed constitute investments in tangible assets as defined by Regulation (EC) No 70/2001. These investments are part of the project to rationalise and modernise the production process of Magog and as such are eligible on the basis of Regulation (EC) No 70/2001. The Commission also considers that the architect's fee which is linked to the construction of 'hall 2005', i.e. EUR 3 600, is eligible because it is part of the costs of 'hall 2005'. The costs for the above measures together amount to EUR 522 859.

(63) Contrary to Germany the Commission comes to the conclusion that the remaining costs of stages 2 and 3 and the tunnelling are not eligible. The investments related to 'hall 2002' (point 1 of Table 2) concern the repair and renovation of an existing sawing hall in 2002 and as such are mere replacement investments which are not eligible under Regulation (EC) No 70/2001.

(64) The digging device is a machine which is used for the cutting of the slate in the mine (point 6). The Commission considers that the acquisition of this machine does not constitute an investment in tangible assets as defined by Regulation (EC) No 70/2001 but that the costs for the acquisition of this machine constitute a pure operating expense. The acquisition of this digging device is not part of the investment project to rationalise and modernise Magog's production process.

(65) As regards the costs for the patents in the form of lawyers' fee for the notification of the patents (point 7), although these costs are linked to the rationalisation and modernisation project, they do no constitute eligible costs under Regulation (EC) No 70/2001 as they do not fulfil the condition of an investment in tangible assets.

(66) As regards the costs of tunnelling for the years 2002 to 2005 (point 8) as well as the estimated costs of tunnelling for the years 2006 to 2007 (point 9), the Commission considers that these costs constitute normal operating expenses and do no qualify as investments in tangible assets as defined by Regulation (EC) No 70/2001. The same holds for the costs for project leader and engineer 2004/2005 which are linked to the tunnelling (point 10).

(67) The Commission moreover considers that the costs for the demolition of the building that were incurred in 2005 (point 11) are not eligible as this demolition is not part of the investment project to modernise and rationalise the production process. Instead it is related to the normal activities of Magog and as such does not fulfil the definition of an investment in tangible and intangible assets under Regulation (EC) No 70/2001. As regards the remaining part of the architect's fee (point 12) not linked to 'hall 2005', the Commission considers that this measure is not part of the investment project either as these fees are not linked to any investments that are considered to be part of the modernisation and rationalisation project.

(68) On the basis of the above the Commission comes to the conclusion that the total eligible costs for investments in tangible and intangible assets under Regulation (EC) No 70/2001 are EUR 733 970 for stage 1 and EUR 522 859 for stages 2 and 3. They thus amount to EUR 1 256 829 in total. As the allowable aid intensity is 15 % for small enterprises, this results in an allowable aid amount of EUR 188 524 for investments in tangible and intangible assets.

(69) The Commission considers that none of the other Community guidelines and regulations, such as those for rescue and restructuring aid, for environmental aid, for training aid, for employment aid, or for risk capital, could apply to the case.

(70) The Commission also investigated the compatibility of the aid with the common interest in general and in particular with the objective of the protection of workers' health and safety, as set out in Article 137 of the Treaty. Article 137 of the Treaty provides that the Community will support and complement the activities of the Member States *inter alia* in the following fields: (a) improvement in particular of the working environment to protect workers' health and safety and (b) working conditions. The Commission comes to the conclusion that the aid cannot be considered compatible on this basis as the primary objective of the aid was not the improvement of the working environment to protect worker's health and safety but the rationalisation and modernisation of the production process of Magog. The fact that the project (as a side effect) also contributed to an improvement of the working conditions of the employees as it reduced manual work and noise at the work place does not invalidate this conclusion.

VII. CONCLUSION

(71) The Commission finds that Germany has unlawfully granted aid amounting to EUR 702 093 to Magog in breach of Article 88(3) of the Treaty. The Commission considers that an amount of EUR 416 683 can be considered compatible with the common market under Regulation (EC) No 70/2001 (EUR 228 158 for R&D and EUR 188 524 for investment in tangible and intangible assets [7]. The remaining amount of EUR 285 410 is incompatible with the common market and has to be recovered,

HAS ADOPTED THIS DECISION:

Article 1

The state aid amounting to EUR 416 683 which Germany has implemented for Schiefergruben Magog GmbH & Co. KG is compatible with the common market pursuant to Article 87(3) (c) of the Treaty.

Article 2

The state aid amounting to EUR 285 410 which Germany has implemented for Schiefergruben Magog GmbH & Co. KG is incompatible with the common market.

Article 3

1. Germany shall take all necessary measures to recover from the recipient the aid referred to in Article 2 and unlawfully made available to the recipient.

2. Recovery shall be effected without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the Decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient's until the date of its recovery.

(7) The figures do not fully add up because of rounding.

3. The interest to be recovered under paragraph 2 shall be calculated in accordance with the procedure laid down in Articles 9 and 11 of Commission Regulation (EC) No 794/2004 ([8]).

4. Within two months of notification of this Decision Germany shall formerly request the aid recipient referred to in Article 2 to reimburse the unlawful and incompatible aid and the interest due.

Article 4

Germany shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it. It will provide this information using the questionnaire attached in Annex 1 to this Decision.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 8 March 2006.

For the Commission

Neelie KROES

Member of the Commission

([8]) OJ L 140, 30.11.2004, p. 1.

ANNEX

INFORMATION REGARDING THE IMPLEMENTATION OF COMMISSION DECISION C(2006) 641

1. **Calculation of the amount to be recovered**

1.1. Please provide the following details on the amount of unlawful state aid that has been put at the disposal of the recipient:

Date(s) of payment (°)	Amount of aid (*)	Currency	Identity of recipient

(°) Date(s) on which the aid or individual instalments of aid were put at the disposal of the recipient if the measure consists of several instalments and reimbursements, use separate rows)
(*) Amount of aid put at the disposal of the recipient (in gross aid equivalent)

Comments:

1.2. Please explain in detail how the interest payable on the amount of aid to be recovered will be calculated.

2. **Measures planned and already taken to recover the aid**

2.1. Please describe in detail what measures are planned and what measures have already been taken to bring about the immediate and effective recovery of the aid. Please also explain what alternative measures are available in national law to bring about recovery? Please also indicate, where relevant, the legal basis for the measures taken/planned.

2.2. By what date will the recovery of the aid be completed?

3. **Recovery already effected**

3.1. Please provide the following details on the amounts of aid that have been recovered from the recipient:

Date(s) (°)	Amount of aid repaid	Currency	Identify of recipient

(°) Date(s) on which the aid was repaid

3.2. Please attach proof of repayment of the aid amounts specified in the table under point 3.1 above.

COMMISSION DECISION

of 8 March 2006

on State Aid — France — Aid to rescue and restructure the Air Lib company

(notified under document number C(2006) 649)

(Only the French text is authentic)

(Text with EEA relevance)

(2006/745/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]),

Whereas:

I. PROCEDURE

(1) By letter of 22 January 2002 France notified the European Commission of aid to rescue the airline parent holding company AOM Air Liberté (hereinafter referred to as 'Air Lib' or 'the company').

(2) Having been implemented unlawfully, before its approval by the Commission, this measure was registered as non-notified aid under number NN 42/2002.

(3) By letter of 24 January 2003 (SG (2003) D/228222), the Commission informed France of its decision to initiate the procedure under Article 88(2) of the Treaty in respect of this aid.

(4) The Commission decision initiating the procedure was published in the *Official Journal of the European Communities* ([2]). The Commission invited interested parties to comment on the aid in question within one month of the date of publication, i.e. by 11 May 2003.

(5) The Commission has received comments on this subject from one interested party by letters of 9 and 12 May 2003. Following the Commission's request made on 21 May, this third party agreed to waive the confidentiality of its comments. The comments were therefore conveyed to France by letter of 23 June 2003 and France was given one month to respond. At the same time, France responded to the initiation of the procedure by letter of 19 May 2003.

(6)

II. DETAILED DESCRIPTION OF THE AID

Context

(7) Following the decision by their former shareholders, and particularly Swissair, to no longer continue their investment strategy, and confronted with a lack of new investors, the companies Air Liberté AOM (formerly AOM Minerve), Air Liberté and five subsidiary companies were subject to compulsory administration proceedings by the Créteil Commercial Court on 19 June 2001. On 27 July 2001, the Court handed over the assets of the administered companies for one symbolic franc to the Holco company, then to any subsidiary which it controlled. Air Lib (the trade name of the parent holding company AOM Air Liberté SA), a subsidiary of Holco SAS, itself owned almost 100 % by Mr Corbet, was constituted to this effect on 24 August 2001.

(8) On 1 August 2001, the Court also endorsed the principle of the transaction proposed by the former shareholders through which Swissair undertook to pay FRF 1,5 billion (i.e. €228,7 million). By the beginning of September 2001, before its own bankruptcy, Swissair had in fact paid over only FRF 1 050 million (or €160 million). Following this lack of funding and the additional difficulties caused by the events of 11 September 2001, the company forecast losses in 2001 and 2002. So France provided aid to rescue the company. €16,5 million of this aid, to last for a maximum of six months, but renewable and as a part of a maximum amount of €30,5 million (FRF 200 million) had already been paid by 9 January 2002. The balance of €14 million was paid on 28 February 2002. This aid would have covered only a part of the company's short-term requirements. In the absence of any notification of a plan to restructure the company or proof that the loan had been reimbursed, the Commission pointed out to France on 9 July 2002 that it was pursuing its analysis of this dossier from the angle of an aid for restructuring that had been granted unlawfully.

([1]) Decision of 21 January 2003 published in OJ C 88, 11.4.2003, p. 11.

([2]) See footnote on page 1.

(9) It appeared that the company had proceeded to open many new routes according to information which appeared in the press or on its own Internet site. Initially, as from winter 2001, a new route to North Africa was opened while from April 2002 low-cost flights were offered in France under the name of Air Lib Express. Finally, as from the end of October 2002, Air Lib introduced low-cost flights from Paris to Italy. Meanwhile, it also appeared that commercial debts had remained outstanding or specific advances had been granted; these included the deferment of social security contributions, advances paid by Air France, exemption from VAT, etc. Thus, on 1 November 2002, still according to the press, Air Lib owed debts totalling approximately €90 million to various public bodies or companies. There were also plans for a Community shareholder, the Dutch group IMCA, to take over Air Lib.

III. COMMENTS FROM INTERESTED PARTIES

(10) In its comments to the Commission, the interested party, the French airline SA Corse Air International (hereinafter referred to as 'Corsair') basically transmitted legal documents showing the action it had taken before the French courts. At the beginning of 2003, Corsair had summoned Air Lib to appear before the Créteil Commercial Court because of the unlawful aid from which Air Lib had benefited according to Corsair, demanding that the aid be paid back and asking the Court to order the cessation of the abovementioned commercial activities which Corsair deemed to be unfair practices resulting from the said unlawful aid.

(11) By a ruling of 12 February 2003, the Court, having regard *inter alia* to the procedure initiated by the Commission, declared that it had no jurisdiction in this matter. By submitting information, Corsair had hoped that the Commission would formulate the opinion that the decision of the Court was in conflict with its own decision-making practice and with Community case law.

(12) Corsair had also adduced arguments in support of the criticism levelled by the Commission at the initial State aid, the company's commercial development and the other fiscal and social support measures from which the company was alleged to have benefited.

IV. COMMENTS BY FRANCE

(13) On 19 May 2003 the French authorities informed the Commission that, following the failure of IMCA's bid to take over Air Lib, they had decided on 5 February 2003 not to renew Air Lib's temporary operating permit which expired on that date. Consequently, faced with serious financial difficulties, Air Lib filed for bankruptcy with the Créteil Commercial Court on 13 February 2003 and the Court ruled on 17 February that the company should be wound up; this ruling was upheld on appeal on 4 April.

(14) As there appeared to be no way of resuming the company's activity, the coordinator of the airports of Paris in the meantime reallocated the slots, totalling about 35 000 , that had thus become available.

(15) Accordingly, France has pointed out that in its opinion the formal investigation procedure initiated on 21 January 2003 was now no longer relevant as court-ordered liquidation is one of the grounds for ending entitlement to State rescue aid provided for in the Community guidelines.

V. CONCLUSIONS

(16) The Commission notes that the activities of the beneficiary of the aid came to an end without its activities being taken over by any third party in the course of legal proceedings or any other procedure. Consequently, this ended all potential distortion of competition resulting from the measure implemented by the French authorities for the benefit of Air Lib.

(17) Moreover, the Commission recalls that paragraph 23d of the Community guidelines on State aid for rescuing and restructuring firms in difficulty, published in 1999 [3], provides that the liquidation of a company is one of the grounds for terminating rescue aid.

(18) In view of the above, the formal investigation procedure initiated on 21 January 2003 pursuant to Article 88(2) of the EC Treaty has become devoid of purpose,

HAS ADOPTED THIS DECISION:

Article 1

The procedure of Article 88(2) of the EC Treaty initiated on 21 January 2003 against the holding company AOM Air Liberté, known as 'Air Lib', shall be terminated.

Article 2

This Decision is addressed to the French Republic.

Done at Brussels, 8 March 2006.

For the Commission

Jacques BARROT

Vice-President

[3] OJ C 288, 9.10.1999, p. 2.

COMMISSION DECISION

of 4 April 2006

on State Aid No C 33/2005 (ex N 277/2004) which the Netherlands is planning to implement under the Marktpassageplan project in Haaksbergen

(notified under document number C(2006) 1184)

(Only the Dutch text is authentic)

(Text with EEA relevance)

(2006/746/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,

Whereas:

1. PROCEDURE

(1) By letter dated 23 January 2004, registered as received on 23 February, a complaint was sent to the Commission about possible aid concerning a building project in Haaksbergen in the Netherlands. By letter dated 15 April 2004, the Commission asked the Dutch authorities to provide clarification of the measure. By letter dated 18 May 2004, registered as received on 25 May, the Netherlands informed the Commission that the measure would be notified shortly.

(2) By letter dated 25 June 2004, registered as received on 30 June, the Netherlands notified the Commission that the Haaksbergen municipal authorities were planning to grant aid to the construction companies involved in the Marktpassageplan project. By letter dated 12 July 2004, the Commission requested further information, which was provided at a meeting on 8 October 2004 and by letter dated 30 December 2004, registered as received on 10 January 2005. The Netherlands submitted additional information by letter dated 11 May 2005, registered as received on 18 May.

(3) By letter dated 21 September 2005, the Commission informed the Netherlands that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid.

(4) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [1] . The Commission invited interested parties to submit their comments on the aid. It received no comments from interested parties.

(5) The response of the Netherlands to the initiation of the formal investigation procedure was submitted by letter dated 29 December 2005, registered as received on 5 January 2006.

2. DESCRIPTION

2.1. The project

(6) The municipal council of Haaksbergen, a municipality with 24 000 inhabitants located in the province of Overijssel close to the German border, had been hoping to regenerate its neglected centre since the beginning of the nineties. With the help of consultants, different construction plans were studied in order to provide quality housing and commercial premises. However, neither an initial construction company with which the municipality intended to carry out the project nor the municipality itself was able to acquire the necessary plots of land.

(7) At the end of the nineties, six construction companies acquired the plots of land concerned and then joined forces. They drew up a building project consisting in the building of 58 apartments and 11 commercial premises. The project did not involve the construction companies in any public works, such as infrastructure, that would subsequently be handed over to the municipality. The project was for the construction of apartments and shops that were to be sold or leased to private investors. However, the calculations showed that the project would not be profitable.

2.2. Support from the public authorities

(8) Given the great importance it attached to the project presented by the six construction companies for regenerating the centre of the municipality, the local authority, in the knowledge that it could count on receiving a financial contribution from the province, agreed to support the project, mainly by covering the expected losses. The municipality has already signed the cooperation agreement with the construction companies, but the aid provided for in the agreement has not yet been granted.

(9) The public support will mainly take the form of a grant of €2,98 million from the municipality to the construction companies (Measure 1). This amount includes the financial support of €453 780 (NLG 1 000 000) granted by the province for this project and represents the expected project losses calculated on the basis of the anticipated costs and revenues.

[1] OJ C 333, 29.12.2005, p. 2.

(10) One provision of the cooperation agreement stipulates that, at the end of the project, an independent expert will calculate actual costs and revenues. If the actual losses calculated *ex post* by the expert turn out to be smaller than the expected losses on the basis of which the grant will be made available, only 50 % of the part of the grant in excess of the actual losses has to be paid back to the municipality. In other words, the project developers can keep 50 % of the part of the grant which does not cover actual losses. This provision will be referred to below as 'the partial repayment provision'. If the actual losses are greater than the expected losses, the grant from the municipality will not be increased.

(11) Besides support in the form of a grant (Measure 1), the Commission has also initiated proceedings in respect of three other measures which may include aid. The second measure is the transfer free of charge to the construction companies of some plots of land belonging to the municipality [1] (Measure 2). According to the notification by the Dutch authorities, the plots of land were worth €233 295, but the Commission did not receive any valuation report. In addition, the municipality will be liable for 35 % of the costs that could result from claims for damages under Article 49 of the Regional Planning Law (*Wet op de Ruimtelijke Ordening*) after completion of the project (Measure 3). Liability for the remaining 65 % will rest with the construction companies. Finally, it was not clear whether the municipality will sell a plot of land and a building to the project developers at their book value or at their market value (Measure 4).

(12) On completion of the project, the municipality will receive free of charge a number of plots of land that, according to the building permit, will be developed as public spaces. The notification did not provide a precise valuation of the plots concerned (Measure 2a).

2.3. The beneficiaries

(13) The beneficiaries of the aforementioned measures are the construction companies involved in the project.

(14) The first direct beneficiary, Rabo Vastgoed B.V., belongs to a large group which is active at international level, mainly in the financial sector. It is responsible for 25 % of the project.

(15) On the basis of the cooperation agreement, the second direct beneficiary is Centrum Haaksbergen B.V., which is the undertaking set up by five construction companies to carry out this project. These five companies will perform all the construction operations entrusted to Centrum Haaksbergen B.V, which is therefore mainly an *ad hoc* legal vehicle without any 'real' economic activities of its own. Accordingly, it can be concluded that the aid granted to Centrum Haaksbergen will be transferred to these five companies. According to the Dutch authorities, each of the companies is responsible for 15 % of the project. The Netherlands has also indicated that RoTij Bouwontwikkeling Oost B.V. is active at national level, whereas the other four companies (Besathij B.V., Bouwbedrijf Assink Eibergen B.V., Bouwbedrijf Deeterink B.V. and Bouwburo Jan Scharenborg B.V.) are regional or local players.

(16) Even if the beneficiaries are referred to as 'construction' companies in this decision, their activities are not limited to mere construction work. They cover the entire range of real estate project development.

2.4. The relevant markets

(17) The relevant markets concerned are the markets for the construction and sale of residential housing and the market for the construction and renting of commercial premises. As Haaksbergen is located close to the German border, it is likely that certain Dutch and German suppliers and customers active on these markets also operate in the neighbouring country.

3. REASONS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

(18) The Commission initiated the formal investigation procedure as it had doubts as to whether some measures that the municipal council was planning to implement did not constitute state aid and whether the aid could be considered compatible with the common market.

(19) Regarding the classification of the public measures as aid, the Commission indicated in particular that the 'partial repayment provision' conferred an advantage on the construction companies.

(20) Regarding possible exemptions from the general prohibition on state aid in Article 87(1), the Commission first noted that the automatic exemptions provided for in Article 87(2)(b) and (c) were not applicable to the present aid measures. Nor could the aid be deemed under Article 87 (2)(a) to support a project having a social character, among other things because the purchase of the newly built apartments is not reserved for disadvantaged persons.

(21) As regards the exemptions in Article 87(3), the Commission noted that the municipality of Haaksbergen is not located in an assisted area and does not therefore qualify for regional aid on the basis of Article 87(3)(a) and (c). The derogation in Article 87(3)(b) is obviously not applicable. The Commission has laid down various guidelines and frameworks setting out rules for aid that may be covered by the exemption provided for in Article 87(3)(c). None of these guidelines appear to apply in the present case. The

[1] The six construction companies have now acquired about 90 % of the necessary plots from the previous private owners.

exemption for deprived urban areas ([1]) was also considered. However, the project is not eligible for that exemption because, among other things, Haaksbergen is not an urban area within the meaning of the Commission notice. Logically, the area is not covered either by the European URBAN II programme. Finally, the cultural exemption in Article 87(3)(d) does not apply as this project consists in the construction of new buildings and not in the renovation of existing buildings or some other cultural purpose.

4. COMMENTS FROM INTERESTED PARTIES

(22) The Commission has received no comments from interested parties.

5. COMMENTS FROM THE NETHERLANDS

(23) In its response to the initiation of the formal investigation procedure, the Netherlands provided additional information on the transfer of plots of land free of charge by and to the municipality (Measure 2 and Measure 2a) respectively. The transfer of plots of land free of charge to the construction companies (Measure 2) will represent a surface area of 674m². In turn, the municipality will receive 1 077m² (Measure 2a). The Dutch authorities have provided an expert report according to which the value of the land concerned was €135 per m².

(24) Regarding the sale to the construction companies of another plot of land and a building belonging to the municipality (Measure 4), the Dutch authorities have provided information showing that the transaction price was significantly above the price paid by the municipality for these properties a few years earlier.

6. ASSESSMENT OF THE AID

6.1. Existence of aid within the meaning of Article 87 (1) of the EC Treaty

State resources

(25) The five measures examined clearly involve state resources. The grant (Measure 1) is a direct transfer of municipal resources. The transfer of ownership of plots of land and buildings modifies the total value of the assets owned by the municipality (Measures 2, 2a and 4). Lastly, by granting a guarantee which involves a payment in the future and by not requesting the payment of an appropriate guarantee premium, Measure 3 also involves municipal resources.

Benefit

(26) The grant from the municipality (Measure 1) confers a benefit on the companies since they receive funds which they would not have received on market conditions.

(27) The transfer free of charge of land by the municipality (Measure 2) is compensated for by the transfer in the opposite direction of a larger surface area (Measure 2a), as stipulated in the same agreement. On the basis of the expert valuation submitted by the Netherlands, the municipality will receive in net terms land worth €54 405 ([2]). Accordingly, these two measures, taken together, do not confer a benefit on the construction companies.

(28) The municipality will also be responsible for 35 % of the costs that could result from claims for damages consecutive to the project (Measure 3). Point 2.1.2 of the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees ([3]) states that: '*The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. This carrying of a risk by the State should normally be remunerated by an appropriate premium. Where the State forgoes such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under Article 87(1). The aid is granted at the moment when the guarantee is given, not the moment at which the guarantee is invoked or the moment at which payments are made under the terms of the guarantee. Whether or not a guarantee constitutes State aid, and, if so, what the amount of that State aid may be, must be assessed at the moment the guarantee is given.*' In the present case, the Commission notes that the risk of compensation payments resulting from claims for damage is carried in part by the State and that the municipality does not receive any premium for this partial guarantee. This measure therefore relieves the companies of costs they would normally incur in the case of a construction project, either in the form of a guarantee/insurance premium or, if they do not take out insurance, in the form of provisions for possible payments to compensate for damage. Consequently, it confers a benefit.

(29) Regarding the sale of plots of land and property by the municipality to the construction companies (Measure 4), the additional information provided by the Dutch authorities on the price paid by the municipality to acquire these assets is sufficient to dismiss the doubts raised in the decision to initiate proceedings regarding the possible sale at the book value. Indeed, the additional documents demonstrate that the municipality has made a significant capital gain over a short period of time. Consequently, it has not forgone potential revenues. The transaction therefore confers no benefit on the construction companies.

(30) In conclusion, two measures confer a benefit on the construction companies (Measures 1 and 3), whereas the others do not (Measures 2, 2a and 4). The latter therefore do not constitute state aid and will not be further examined.

(31) The preceding paragraphs examine the potential benefit for the construction companies. The Commission must also investigate whether the benefit is not partially transferred to the buyers or tenants of the apartments and commercial

([1]) Commission notice on the expiry of the guidelines on State aid for undertakings in deprived urban areas (OJ C 119, 22.5.2002, p. 21).

([2]) Transfer to the construction companies: 674m² × €135 = €90 990; transfer to the municipality: 1 077m² × €135 = €145 395.

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

premises. This is because they can buy or rent apartments or commercial premises that would otherwise probably not have existed or at least would have been more expensive. However, this benefit would be indirect and diffuse. In any case, any benefit for the 58 households is not likely to fall under the state aid rules for the indirect aid recipients carrying out economic activities. For the economic operators, such as the 11 retail shops, any benefit would be very small and, in any case, below the level defined by the *de minimis* rules. The Commission will therefore limit its analysis to potential state aid for the construction companies.

Selectivity

(32) The measure is clearly selective since it is restricted to the companies involved in this project.

Distortion of competition

(33) Thanks to the state aid, the companies will undertake an otherwise loss-making project consisting in the construction and sale or rental of apartments and commercial premises. Consequently, the aid directly distorts competition since new apartments and commercial premises add to the supply on the market.

(34) There may be an additional distortion if the state aid exceeds the losses incurred by the companies in connection with the present project. With this 'excess' grant, they could, for example, quote lower prices in *future* construction projects and/or use it for other activities. The Commission points out that this additional distortion would not exist if, on the basis of the actual losses calculated by the expert at the end of the project, the companies had to repay in full the part of the grant in excess of the actual losses. It notes that the 'partial repayment provision' allows the companies to keep 50 % of the part of the grant exceeding the losses. This additional distortion can therefore not be ruled out.

Effect on trade between Member States

(35) The Commission notes that Haaksbergen is located close to the German border. Therefore, some German construction companies are present on the market for the construction and sale or rental of apartments and commercial premises. However, it also notes that a number of the companies concerned are active at international level. Consequently, there is a potential effect on trade.

(36) The grant (Measure 1) and the partial guarantee (Measure 3) thus qualify as state aid pursuant to Article 87(1) of the EC Treaty. The net transfer of plots of land free of charge (Measures 2 and 2a taken together) as well as the sale of a plot of land and a building (Measure 4) do not constitute state aid.

6.2. **Compatibility with the common market**

(37) In its notification, the Netherlands did not refer to any special exemption from the general prohibition on state aid under Article 87(1) on the basis of which the aid could be authorised.

(38) As previously indicated, the Commission expressed doubts in the decision to initiate the formal investigation procedure as to whether the aid can be found to be compatible in the light of the exemptions in Articles 87(2) and (3)(a), (b), and (d) or the guidelines and frameworks drawn up on the basis of Article 87(3)(c). In their response to the decision, the Netherlands made no comments on the compatibility of the aid. Further analysis undertaken by the Commission has not brought any new elements to light in this regard either. Therefore, the Commission concludes that the aid cannot be considered compatible with the common market by virtue of the aforementioned legal basis.

(39) Regarding possible compatibility on the basis of Article 86 (2), the Commission considers that the economic activity facilitated by the aid in question, namely the construction and sale or rental of high-quality apartments and commercial premises access to which is not restricted to any particular social category can certainly not be deemed to constitute a service of general economic interest. Nor has the Netherlands claimed that this is the case. Accordingly, Article 86(2) is not applicable to the aid.

(40) In this connection, the Commission will examine whether the aid contained in Measures 1 and 3 cannot be found to be compatible directly on the basis of Article 87(3)(c), which stipulates that '*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*' may be considered to be compatible with the common market.

(41) When examining whether aid is compatible directly under Article 87(3)(c), the Commission, firstly, takes into account the Community's objectives and, secondly, analyses whether the proposed aid measure is appropriate and proportionate to its intended objectives and does not have disproportionate effects on competition and trade.

(42) Regarding the objectives to which the assisted project contributes, the Commission notes the following: The Dutch authorities indicated that, according to a 2001 survey, 65 % of the inhabitants of Haaksbergen felt insecure and thus avoided the centre of the municipality. This feeling of insecurity is borne out by police records of offences

committed. The project, with commercial premises on the ground floor and apartments above and with new residential buildings on what was until now waste ground, is designed in particular to tackle that feeling of insecurity. The Dutch authorities also indicated that three shopping streets have been successfully developed around the centre, which is still though underdeveloped commercially and forms a barrier of sorts in the midst of those three economically successful areas. The project is designed to make the centre more attractive and therefore to prevent further squalor and abandonment of the existing shops. Accordingly, it can be concluded that the project has positive repercussions on the common interest, as claimed by the municipality in support of the aid.

(43) With regard to the proportionality of the aid, the Commission notes that the aid is intended to cover the losses incurred by the companies in carrying out the project, which would not otherwise be undertaken. To the extent that it covers actual losses incurred by the six companies, which will sell or rent the apartments and premises at prices corresponding to the customary prices for comparable property in that area, the aid is proportionate. However, the project also contains potential 'extra' aid as a consequence of the 'partial repayment provision'. That provision of the cooperation agreement between the municipality and the construction companies means that the actual project losses will be calculated at the end of the project by an expert on the basis of the realised costs and revenues. If the actual losses are smaller than the estimated losses on the basis of which the grant (Measure 1) is to be awarded during the course of the project, only 50 % of the part of the grant which is in excess of the actual losses needs to be repaid to the municipality. The construction companies can therefore retain 50 % of the part of the grant not covering actual losses. For instance, if the actual losses were around zero instead of the expected €2,98 million, the companies would repay €1,49 million and retain a similar amount for themselves. The amount of state resources in excess of the actual losses is not necessary for the execution of the project. It can therefore be concluded that only a provision stipulating repayment in full of the part of the subsidy in excess of the actual losses could restrict the aid to the minimum necessary and, in so doing, render it proportionate. The Commission also notes that such a 'full repayment provision' must also cover the aid included in the partial guarantee (Measure 3), and not only the grant (Measure 1), as is the case with the present 'partial repayment provision'.

(44) With regard to the extent of the distortion of competition and of the effect on trade, the Commission notes that the aid increases the supply on the market by 58 apartments and 11 commercial premises, which will be offered at prices corresponding to the prices customarily observed for similar property in that area. It would point out that the distortion of competition and the consequent effect on trading conditions generated by such a local, limited project are small and do not outweigh the positive effects identified earlier.

(45) As already indicated in connection with the additional distortions of competition, the Commission considers that the aid, to the extent that it covers losses actually incurred, does not provide the six companies with resources that they can use for future projects in order to distort competition and affect trade. However, this conclusion does not hold for the aid granted in excess of actual losses. As stated above, the 'partial repayment provision' leaves the door open for such 'extra' aid.

(46) The Commission concludes that the part of the aid that covers the actual project losses calculated *ex post* by an independent expert facilitates the development of certain economic activities or of certain economic areas without adversely affecting trading conditions to an extent contrary to the common interest. It also concludes that the part of the aid in excess of the actual project losses calculated *ex post* by an independent expert is not necessary for the realisation of the project and, at the same time, adversely affects trading conditions.

7. CONCLUSION

(47) On the basis of the foregoing considerations, the Commission concludes that the part of the aid that covers the actual project losses calculated *ex post* by an independent expert, up to a maximum of €2,98 million (Measure 1), plus an appropriate guarantee premium (Measure 3), is compatible with the common market on the basis of the Article 87(3)(c). The part of the aid in excess of the actual project losses calculated *ex post* by an independent expert is not compatible on the basis of Article 87(3)(c) or on the basis of any another exemption. It is therefore incompatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The transfer of plots of land free of charge (Measure 2) that the Netherlands is planning to implement in favour of the construction companies involved in the Marktpassageplan project in Haaksbergen does not constitute state aid as it is accompanied by a large transfer free of charge in the opposite direction (Measure 2a).

The sale of a plot of land and a building to those companies (Measure 4) does not constitute state aid either.

Article 2

The grant of €2 984 000 (Measure 1) and the 35 % coverage of potential payments resulting from claims for damages (Mea-

sure 3) that the Netherlands is planning to award to the companies involved in the Marktpassageplan project in Haaaksbergen constitute state aid.

Article 3

The part of the aid mentioned in Article 2 that covers the actual project losses as calculated *ex post* by an independent expert is compatible with the common market.

The part of the aid mentioned in Article 2 that exceeds the actual project losses as calculated *ex post* by an independent expert is incompatible with the common market.

Article 4

The Netherlands shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it.

Article 5

This Decision is addressed to the Kingdom of the Netherlands.

Done at Brussels, 4 April 2006.

For the Commission

Neelie KROES

Member of the Commission

COMMISSION DECISION

of 26 April 2006

on State Aid which France is planning to implement for Euromoteurs (C 1/2005 (ex N 426/2004))

(notified under document number C(2006) 1540)

(Only the French text is authentic)

(Text with EEA relevance)

(2006/747/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 letter registered as received on 5 October 2004, France notified the Commission of its intention to contribute an amount of €2 million to the restructuring of Euromoteurs. The case was registered as N426/2004. By letter dated 18 October 2004, the Commission asked for additional information concerning the notification. France replied by letter dated 1 December 2004.

(2) By letter dated 19 January 2005, the Commission informed France that it had decided to initiate the procedure laid down in Article 88(2) of the Treaty in respect of the measure. The decision was published in the *Official Journal of the European Communities* ([2]). The Commission invited interested parties to submit their comments on the measure.

(3) The Commission received comments from the French authorities on 19 May 2005. A meeting between the French authorities and Commission representatives took place on 12 October 2005. The French authorities sent information to the Commission by letter dated 10 November 2005 and by email dated 31 January 2006.

([1]) OJ C 137, 4.6.2005, p. 16.

([2]) See footnote 1.

2. DESCRIPTION OF THE MEASURES

2.1. The recipient

(4) Euromoteurs S.A.S. ('Euromoteurs') has its origins in a former subsidiary of Moulinex responsible for producing electric motors intended primarily for the household appliances market.

(5) More precisely, in December 1999, Moulinex set up Compagnie Générale des Moteurs Electriques ('CGME') in order to turn its motors production business into a subsidiary. In September 2001, Moulinex went into receivership, followed by CGME. When the SEB group ('SEB') acquired part of Moulinex in 2001, it did not take over CGME but instead concluded with the latter a four-year supply contract which enabled it to start up in business again.

(6) In January 2002, 12 executives from CGME established the private limited company Compagnie Financière des Moteurs Electriques ('COFIME'), which acts as a consultancy and has a majority stake in Euromoteurs, which was formed in September of the same year.

(7) In September 2002, COFIME and Euromoteurs took over CGME's assets. The judgment of the commercial court authorising the operation prohibited until September 2004 any economic layoffs or asset disposals.

(8) This prohibition runs counter to the purchasers' original plan, which was to concentrate CGME's means of production on one site instead of two and to dismiss more than half the workforce. Moreover, the company is faced with a sharp decline in sales due, in France's view, to the poor state of the world economy, SEB's shrinking order book and the falling dollar/euro exchange rate.

(9) The trend in Euromoteurs' accounting figures is as follows:

(EUR millions)	2002 (4 months' operations)	2003	2004
Turnover	13	25	18
Net profit	-0	-1	-5
Own capital	4	3	-3

(10) In 2004, sales to SEB accounted for 93 % of Euromoteurs' turnover.

2.2. **The market**

(11) According to the information communicated in December 2004, Euromoteurs' production of universal motors for household appliances is equivalent to 25 % of European consumption. As part of its diversification strategy, the company envisages producing nearly 10 % of European consumption of seat motors in 2006.

(12) According to the French authorities, Euromoteurs' main competitors are in Europe and Asia both for universal motors (Ametek, Domel, LG, Johnson Electric, Sun Motors) and for permanent magnet motors (Valeo, Bosch, Meritor, Johnson Electric).

2.3. **Restructuring programme**

(13) The restructuring programme communicated by the French authorities extends over a period of two years from the date of payment of the notified aid. It consists of three components: industrial, financial and social, for a total amount of €5,95 million:

— the industrial restructuring will cost an estimated €1,10 million and includes:

1) the closure of one of the two production sites;

2) a search for cheaper suppliers;

3) a search for new business partners;

4) diversification into the motor vehicle industry (seat motors).

— the financial restructuring is aimed at clearing the company's €2,5 million worth of debts;

— the social restructuring is aimed at helping the 246 dismissed employees find a new job and will cost €2,35 million.

(14) The programme is to be financed as follows:

— sale of one of the two production sites: €1,45 million;

— advance on an order from SEB: €1,5 million;

— freeing-up of shareholders' capital: €1 million;

— restructuring aid.

2.4. **Description of the aid**

(15) According to the notification of 5 October 2004, the restructuring aid amounts to €2 million.

(16) In the letter from the French authorities dated 1 December 2004, the notified aid takes the form of a €1 million government grant and a €1,25 million debt write-off towards local authorities (€1 million by the Regional Council and €0,25 million by the General Councils of La Manche and Calvados), giving a total of €2,25 million.

(17) Lastly, in their letter of 10 November 2005, the French authorities state that 'a minimum of €2,65 million is needed in the way of public financing (…).'

(18) Consequently, uncertainty still surrounds the amount of the notified aid, which may be either €2 million, €2,25 million or €2,65 million.

3. **GROUNDS FOR THE INITIATION OF THE PROCEDURE UNDER ARTICLE 88(2) OF THE TREATY**

(19) The decision to initiate the procedure laid down in Article 88(2) of the Treaty includes a preliminary assessment of the measure in the light *inter alia* of the 1999 Community guidelines on state aid for rescuing and restructuring firms in difficulty ([3]) ('the guidelines').

(20) In its decision, the Commission expressed doubts about whether the restructuring plan was capable of restoring Euromoteurs' viability, whether undue distortions of competition would be prevented and whether the aid would be restricted to the necessary minimum.

(21) The Commission also pointed out that Euromoteurs had benefited from certain tax exemptions under Article 44 *septies* of the General Tax Code ('Article 44 *septies*'). This aid had been declared unlawful and incompatible by Commission Decision 2004/343/EC of 16 December 2003 on the aid scheme implemented by France for the takeover of firms in difficulty ([4]), and the Commission expressed doubts about the compatibility of the notified aid under the 'Deggendorf' case law.

([3]) OJ C 288, 9.10.1999, p. 2.
([4]) OJ C 108, 16.4.2004, p. 38.

4. OBSERVATIONS FROM THIRD PARTIES AND COMMENTS FROM FRANCE

(22) Following the initiation of the procedure, the Commission has received no observations from third parties. The comments from France may be summarised as follows:

Unlawful incompatible aid received by Euromoteurs under Article 44 septies

(23) By letter dated 19 May 2005, the French authorities confirmed that Euromoteurs had benefited from certain tax exemptions under Article 44 *septies*.

(24) In a previous letter to the Commission dated 15 March 2005, the French authorities estimated the financial advantage thus received at a maximum ([5]) of €1,7 million for Euromoteurs and €1,5 for COFIME.

(25) At the time when Euromoteurs was in receipt of the advantages provided for by Article 44 *septies*, the company did not belong to the category of small and medium-sized enterprises as defined in Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises ([6]) and was not located in an area eligible for regional aid. Consequently, even though it is not known at the time of this Decision exactly how much incompatible aid has to be recovered, the Commission considers that Euromoteurs will have to repay a sum close to €1,7 million. To this sum must be added interest in accordance with Article 14(2) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ([7]).

(26) In their comments dated 19 May 2005, the French authorities stated that the amount of aid needed to restructure Euromoteurs did not take into account the prospect of a reimbursement of the unlawful incompatible aid received by the company and that 'such a reimbursement, were it to take place, would have the effect of seriously undermining Euromoteurs' financial situation'.

Restoration of viability upon completion of the restructuring

(27) The French authorities have informed the Commission that, in the middle of 2005, Euromoteurs concluded with Johnson Electric Industrial Manufacturing Ltd ('Johnson') a three-year tapered supply contract (replacing Euromoteurs' contracts with SEB) worth €12 million in 2005 and €9 million in 2006. This contract also enables Euromoteurs to obtain supplies of raw materials and sub-assemblies from Johnson on advantageous terms.

(28) France points out that, according to the Groupement Interprofessionnel des Fabricants d'Appareils d'Equipement Ménager (Inter-trade organisation of household goods manufacturers), supply contracts are infrequent in the household goods sector and rarely exceed one year's duration. It concludes from this that this three-year contract signals the contractor's wish to establish a lasting relationship with its supplier.

(29) The French authorities have also transmitted a forecast profit and loss and cash flow account for Euromoteurs for 2006. In addition to the €9 million in sales to Johnson, Euromoteurs plans on achieving €6 million in turnover by diversifying its customer base. In November 2005, 25 % of this target was covered by orders, and contracts for sales totalling €0,6 million were being negotiated.

Avoidance of undue distortions of competition

(30) The French authorities have stressed that, by the time it had completed its industrial restructuring, Euromoteurs had dismissed 60 % of its workforce, closed one production site out of two and become a medium-sized enterprise within the meaning of Community legislation. They point out that the company faces competition from large groups such as Ametek in Italy, Domel in Slovenia and Goldstar in Korea, which have much bigger sales networks than Euromoteurs.

(31) Lastly, the French authorities suggest that, as Euromoteurs has become a medium-sized enterprise, the Commission's analysis should be based on the new restructuring aid guidelines ([8]).

5. ASSESSMENT

5.1. Existence of state aid

(32) The measure notified by France is in effect state aid within the meaning of Article 87(1) of the Treaty. Granted by the State, it will be financed through state resources for the benefit of a specific undertaking, Euromoteurs. What is more, Euromoteurs has competitors in the common market, such as Ametek in Italy and Domel in Slovenia, and its products are traded internationally (Euromoteurs has customers in Germany and Egypt, for example). Consequently, the notified measure affects trade between Member States and distorts, or threatens to distort, competition.

(33) France has therefore fulfilled its obligations under Article 88 (3) of the Treaty.

([5]) Advantage calculated without taking account of the deductions allowed by the applicable Community frameworks.

([6]) OJ C 124, 20.5.2003, p. 36.

([7]) OJ C 83, 27.3.1999, p. 1. Regulation as amended by the 2003 Act of Accession.

([8]) OJ C 244, 1.10.2004, p. 2.

5.2. **Compatibility of the aid with the common market**

Preliminary remark

(34) As the Court of Justice of the European Communities held in its judgment of 3 October 1991 in *Italy* v *Commission* ([9]), 'when the Commission considers the compatibility of a State aid with the common market it must take all the relevant factors into account, including, where relevant, the circumstances already considered in a prior decision and the obligations which that decision may have imposed on a Member State'.

(35) In its judgment of 15 May 1997 in *Deggendorf* ([10]), the Court went so far as to state that, where earlier unlawful incompatible aid has still not been recovered despite a Commission decision to that effect, the assessment of new aid to the same recipient must take into consideration, first, any cumulative effect of the earlier, unlawful incompatible aid and the new aid and, secondly, the fact that the earlier aid had not been repaid.

(36) In its assessment of the compatibility of the measure notified by France, the Commission will therefore take into account all the relevant factors, including the fact that, according to the information furnished by the French authorities, Euromoteurs has received earlier aid under a scheme declared unlawful and partly incompatible by the Commission and that that aid, which does not form part of the measures either considered not to constitute aid or declared compatible by the Commission, has still not been recovered despite Decision 2004/343/EC.

Derogations from the prohibition in principle of state aid

(37) In the context of the present investigation, the aid falls to be assessed as ad hoc state aid. Article 87(2) and (3) of the Treaty provides for derogations from the general incompatibility rule set out in Article 87(1).

(38) The derogations in Article 87(2) of the Treaty are not applicable here, given that the aid does not have a social character and is not granted to individual consumers, does not serve to make good the damage caused by natural disasters or other exceptional occurrences and is not granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany. The same holds true for the derogations provided for in Article 87(3)(b) and (d), which are manifestly not applicable here.

(39) Further derogations are provided for in Article 87(3)(a) and (c) of the EC Treaty. As the primary objective of the aid is not regional but concerns the restructuring of an undertaking in difficulty, only the derogations provided for in Article 87(3)(c) apply. Article 87(3)(c) provides for the authorisation of state aid granted to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has published specific guidelines for assessing aid for rescuing and restructuring firms in difficulty. Contrary to what the French authorities maintain, the aid in this case, having been notified before 10 October 2004, must be assessed in the light of the criteria set out in the 1999 guidelines ([11]). Clearly, the measure has no other horizontal objective in view. Moreover, France mentions no other objective and bases itself on the said guidelines to justify the compatibility of the notified measure.

Assessment of the aid as restructuring aid

Eligibility: firm in difficulty

(40) In order to be eligible for restructuring aid, a firm must qualify as a firm in difficulty. Point 2.1 of the guidelines defines this concept. With a subscribed capital of €4 million, Euromoteurs recorded a loss in 2004 of €5,4 million, which reduced its own capital to minus €2,6 million. The firm may therefore be considered to be a firm in difficulty within the meaning of point 5(a) of the guidelines.

(41) Point 7 of the guidelines stipulates that a newly created firm is not eligible for restructuring aid even if its initial financial position is insecure. Having been set up two years and a month prior to the notification, the company cannot, under the Commission's practice in applying the guidelines, be considered to be newly created.

Prevention of distortions of competition (points 35 to 39 of the guidelines)

(42) By the time it had completed its industrial restructuring, Euromoteurs had dismissed 60 % of its workforce, closed one production site out of two and become a medium-sized enterprise. As a result, the Commission considers that, viewed in isolation from the unlawful incompatible aid, the restructuring aid is not likely to give rise to any undue distortions of competition.

([9]) Case C-261/89 [1991] ECR I-4437.

([10]) Case C-355/95 P *Textilwerke Deggendorf GmbH* v *Commission and Germany* [1997] ECR I-2549.

([11]) See point 103 of the new guidelines.

(43) However, as stressed by the Court's case law ([12]), when the Commission assesses whether an aid scheme is compatible with the common market, it has to take into account all relevant factors, including the circumstances already considered for the purposes of an earlier decision and any obligations which that decision might have imposed on a Member State.

(44) In the present case, the Commission would point out that, until such time as Euromoteurs pays back the unlawfully granted aid, that aid and the newly notified aid would have the cumulative effect of giving Euromoteurs an excessive, undue advantage which would adversely affect trading conditions to an extent contrary to the common interest. Until such time as the unlawful incompatible aid is repaid, the undue distortion of competition to which it has given rise will not have been remedied. This distortion would be further increased if Euromoteurs were to receive restructuring aid on top of the unlawful incompatible aid.

(45) In conclusion, in order to prevent the creation of undue distortions of competition, it is essential that Euromoteurs repay the unlawfully granted aid before it can receive the notified restructuring aid.

Restoration of viability (points 32 to 34 of the guidelines)

(46) According to point 3.2.2 of the guidelines, the grant of the aid is conditional on implementation of a restructuring plan which must restore the long-term viability of the company within a reasonable time scale and on the basis of realistic assumptions as to its future operating conditions.

(47) If Euromoteurs' viability is to be restored, the company will have to meet two challenges: it will have to rationalise its production facilities, and it will have to diversify its customer base so as to end its reliance on orders from SEB (which have been trailing off since 2002 and are now channelled through Johnson).

(48) On the first point, the Commission would observe that the closure of the Carpiquet plant and the dismissal of 246 people have enabled Euromoteurs to reduce its operating costs substantially (France estimates the savings from focusing production on one site at €1,491 million) and to tailor its production facilities to the volume of its sales.

(49) On the second point, the contract with Johnson, which covers the period 2005-07, gives the company time to find its legs by guaranteeing it a significant level of sales until 2007. On the basis of the information in its possession, the Commission is of the opinion that, in the electric motors sector, Euromoteurs' diversification strategy is starting to bear fruit. On the other hand, in the motor vehicle seat motor market, the second pillar of Euromoteurs' diversification plan, none of the negotiations have reached an advanced stage.

([12]) See paragraph 34 of this Decision.

(50) The Commission has received only forecasts for 2006 from the French authorities. According to these forecasts, Euromoteurs' turnover will be €15 million, with an operating result of €0,2 million and a net result of €1,7 million. The Commission considers that, inasmuch as they are limited to one year and show an operating margin of 1,3 %, these forecasts do not enable it to conclude that the restructuring plan will succeed in restoring the company's viability on a lasting basis. In 2006, Euromoteurs still benefits from the contract signed with Johnson. The contract ends, however, in 2007. The results for the 2006 financial year alone are therefore not sufficient to enable the Commission to conclude that the company's viability will be restored on a lasting basis.

(51) Moreover, as France stated in its comments of 19 May 2005, the notified aid and the accompanying restructuring plan do not take into account the possibility that the unlawful incompatible aid which Euromoteurs received under Article 44 *septies* might have to be repaid. Its repayment was ordered by the Commission in its Decision 2004/343/EC, and the amount to be recovered from Euromoteurs is estimated at €1,7 million. Such repayment will worsen the company's financial problems, and the Commission considers that, under the circumstances, the plan cannot be deemed realistic. This assessment is borne out by the fact that, in November 2005, the French authorities informed the Commission that the difficulties inherent in the restructuring of Euromoteurs (in particular its financing needs) had been underestimated at the time of the notification and that the company's public financing need had to be revised upwards (+132,5 %).

(52) In the light of the above, the Commission concludes that the French authorities have not demonstrated that the notified restructuring plan is based on realistic assumptions and will help restore the company's viability.

Aid limited to the minimum (points 40 to 41 of the guidelines)

(53) The cost of the restructuring plan communicated to the Commission is estimated by the French authorities at €5,95 million. The plan calls for €2 million of public financing. In their letter dated 10 November 2005, the French authorities informed the Commission that the difficulties inherent in the restructuring of Euromoteurs (in particular its financing needs) had been underestimated at the time of the notification and that the company's public financing need could be estimated at not less than €2,65 million. No details as to how this new need was calculated (whether in terms of additional restructuring costs or of new cash flow requirements) were communicated to the Commission.

(54) The Commission accordingly considers that, at all events, the French authorities have not demonstrated that aid in excess of €2 million is needed to restore the company's viability and it cannot therefore conclude that the notified aid is limited to the minimum necessary.

One time, last time

(55) According to the French authorities, no restructuring aid has been paid to Euromoteurs in the past,

HAS ADOPTED THIS DECISION:

Article 1

The state aid which France is planning to implement for Euromoteurs for an amount of €2 million, €2,25 million or €2,65 million is incompatible with the common market.

The aid may accordingly not be implemented.

Article 2

This Decision is addressed to the French Republic.

Done at Brussels, 26 April 2006.

For the Commission

Neelie KROES

Member of the Commission

COMMISSION DECISION

of 4 July 2006

on State Aid No C 30/2004 (ex NN 34/2004) implemented by Portugal exempting from corporation tax on capital gains certain operations/transactions by public undertakings

(notified under document number C(2006) 2950)

(Only the Portuguese version is authentic)

(Text with EEA relevance)

(2006/748/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 article cited above [1],

Whereas:

I. PROCEDURE

(1) Following information relating to alleged tax exemptions on capital gains granted by the Portuguese authorities to certain public undertakings under Article 25 of the Portuguese Tax Relief Regulations, *Estatuto dos Benefícios Fiscais* (hereinafter referred to as 'EBF') [2], the Commission asked the Portuguese authorities for detailed information by letter dated 14 March 2001.

(2) The Portuguese authorities replied by letter of 25 April 2001. A second request for information was sent on 28 October 2003 and a reply was received on 30 January 2004. The Portuguese authorities submitted further information by letter of 8 September 2004.

(3) By letter dated 6 October 2004 the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty on the aid measure in question [3]. In this decision, published in the Official Journal of the European Union [4], the Commission invited interested parties to submit their comments on the measure.

(4) By letter received by the Commission on 21 December 2005, the Portuguese authorities submitted their comments.

(5) No interested parties submitted any comment.

II. DETAILED DESCRIPTION OF THE AID SCHEME

(6) The tax exemptions are provided for in Article 25 of the EBF, entitled *Mais-valias no âmbito do processo de privatização* (capital gains as part of the privatisation process) which corresponds to Article 32-C in the original version of 2000 before the amendment of the EBF by Decree-Law 198/2001 of 3 July 2001.

(7) For the purposes of establishing the profit liable for corporation tax in the case of wholly publicly owned companies and companies controlled by them, Article 25 EBF provides for the exclusion from the taxable amount of capital gains from privatisation and restructuring operations carried out in accordance with the strategic guidelines for the performance of the State's shareholder function and recognised as such by order of the Finance Minister.

(8) Article 25 of the Portuguese EBF entered into force on 1 January 2000 pursuant to Article 103 of Law 3-B/2000 of 4 April 2000.

III. GROUNDS FOR INITIATING THE PROCEDURE

(9) The decision to initiate the formal investigation procedure stated that Article 25 EBF seemed to constitute a state aid scheme within the meaning of Article 87(1) of the EC Treaty. The scheme appeared to be an operating aid and, on the basis of the information available, was incompatible since it did not seem to be directed to any eligible investments or expense items. Furthermore, none of the exemptions provided for in Article 87(2) and (3) of the EC Treaty appeared applicable. Indeed, it constituted unjustified aid that gave public undertakings an advantage over their private competitors.

IV. COMMENTS FROM PORTUGAL

(10) By letter received by the Commission on 21 December 2005 Portugal confirmed the information already provided during the Commission's preliminary assessment.

[1] OJ C 256, 15.10.2005, p. 26.

[2] Decree-Law 215/89 of 1 July 1989.

[3] C(2004) 2637, 6.10.2004.

[4] See footnote 1.

(11) The Portuguese authorities summarise developments in corporation tax on capital gains in Portugal as follows:

— From 1993 reinvested capital gains received preferential tax treatment, provided they derived from tangible fixed assets or shares held by holding companies (SGPS) ([5]). In such cases reinvestment of the proceeds leads to their exclusion from taxable profit.

— This situation changed from 2001 ([6]). A positive balance between capital gains and capital losses was taxable as follows: when the proceeds were reinvested in the year they were realised, one fifth of the proceeds were taxable in the year they were realised and a further fifth in each of the following four years.

— From 2002 half of the capital gains became taxable, even if they were reinvested ([7]).

— In 2003 the situation changed again: SGPS (and risk capital companies, SCR) enjoyed total tax exemption of capital gains realised on shares they held, provided they held them for not less than one year ([8]).

(12) The Portuguese authorities argue that the tax relief legislation merely applies to public-sector undertakings the same rules of capital gains taxation and tax neutrality as have applied to private companies engaged in corporate restructuring since the 1988 tax reform and the establishment of corporate income tax, *Imposto sobre o Rendimento das Pessoas Colectivas* (IRC).

(13) The Portuguese authorities further argue that under Portuguese tax relief legislation reinvested capital gains receive preferential tax treatment, provided they derive from tangible fixed assets or shares held by holding companies. In such cases, reinvestment of the proceeds leads to their exclusion from taxable profit, something which is an integral part of the Portuguese tax system.

(14) Article 25 EBF also excludes from the taxable base for IRC capital gains realised by 100 % state-owned companies and companies controlled by them. It only extends to such bodies the tax treatment applicable to the capital gains reinvested by holding companies and to corporate restructuring operations carried out by other private companies. Eligible companies therefore derive no financial advantage when they are involved in privatisation, reorganisation or restructuring operations.

(15) According to the Portuguese authorities, the intention behind Article 25 EBF was precisely to avoid making privatisations and corporate restructuring operations in the public sector conditional on the involvement of a public holding company, thus facilitating the State's role as shareholder.

(16) The Portuguese authorities affirm that Article 25 EBF contains no provision which creates an exceptional system of taxation of capital gains compared with the ordinary system. Its application confers no additional advantage on beneficiary companies involved in reorganisation or restructuring operations.

(17) The Portuguese authorities also notified their intention of repealing Article 25 EBF. So, once it was repealed, every restructuring or privatising operation involving a public company would be treated under Portugal's ordinary tax relief system applicable to private enterprises.

(18) With regard to recovery the Portuguese authorities argued that: (a) only four transactions had benefited from the scheme, and in any case a private company would have obtained the same tax advantages by setting up a holding company and reinvesting the amount in financial assets; and (b) three of the four transactions had already been approved by the management of the Caixa Geral de Depósitos (CGD) with a view to privatisation (creation of an SGPS), given that at the time Article 25 EBF had not yet been adopted. Therefore, given that no financial advantage was granted to the public undertakings, the Portuguese authorities deny that there is anything to recover.

(19) The four transactions that benefited from the scheme are:

— The sale by Mundial Confiança (MC), an insurance subsidiary of the Portuguese financial institution CGD, of its holding (5,46 %) in *Crédito Predial Português* (CPP) to *Banco Santander Central Hispano* (BSCH) on 5 April 2000. The capital gain realised by MC was EUR 9,3 million.

— The sale by *Banco Pinto & Sotto Mayor* (BPSM), controlled by CGD at the time of the transaction, of its holding (94,38 %) in *Banco Totta & Açores* (BTA) and

([5]) Article 7(2) of Decree-Law 495/88 of 30 December 1988 and EBF Article 31(2) implemented Article 44 (now 45) of the *Código do Imposto sobre o Rendimento das Pessoas Colectivas* (CIRC).

([6]) Law 30-G/2000 of 29 December 2000.

([7]) Law 109-B/2001 of 27 December 2001.

([8]) Under Article 31(2) EBF, in the revised wording introduced by Law 32-B/2002 of 30 December 2002 approving the state budget for 2003: 'capital gains and capital losses realised by SGPSs or SCRs through conveyance in return for payment, whatever the grounds of the transaction, of shares in capital which they hold, provided they have held them for a period of not less than one year, plus the financial charges incurred in acquiring them, shall not count towards the taxable profits of such companies'.

its holding (7,09 %) in CPP to BSCH on 7 April 2000. The capital gain realised by BPSM was estimated at EUR 310 million.

— A share exchange between MC and BCP. MC sold its holding (53,05 %) in BPSM to BCP in exchange for approximately 10 % of BCP on 19 June 2000. The capital gain realised by MC was EUR 1 566,4 million.

— The capital gain from the sale of CGD's stake in the Brazilian bank ITAÚ SA, which took place between 2000 and 2003. The total capital gain realised by CGD was EUR 357,4 million.

(20) The first three transactions were decided following agreements between the Champalimaud Group and BSCH. To this end CGD and BSCH signed a contract on 11 November 1999 under which:

— BSCH bought António Champalimaud's holdings in the Champalimaud Group and then sold them to CGD.

— The holdings in BTA and CPP were sold to BSCH.

(21) The aim of restructuring the Champalimaud Group was to split up the banking and insurance activities in order to improve the efficiency of the Portuguese supervisory authorities (Banco de Portugal and Instituto de Seguros de Portugal).

(22) In the fourth case the divestiture was decided following a new agreement between CGD and Unibanco (União de Bancos Brasileiros *SA*).

(23) The objective of the measure in question was to ensure the fiscal neutrality of privatisation and restructuring operations involving wholly publicly owned companies and companies controlled by them.

(24) The Portuguese authorities, in their role of shareholder in CGD, sent on 18 October 2000 and 31 March 2000 letters signed by the Finance Minister authorising the transactions referred to above in accordance with the strategic guidelines.

V. ASSESSMENT OF THE MEASURE

V.1 Does the scheme constitute state aid?

(25) The Commission confirms the decision to open the formal procedure to decide whether the measure is state aid. Article 25 EBF, which exempts from corporation tax public undertakings' capital gains from privatisation and restructuring operations, constitutes a state aid scheme.

(26) The Court of Justice has consistently held that a measure whereby the public authorities grant certain undertakings a tax exemption which, although not involving a transfer of state resources, places the persons to whom the exemption applies in a more favourable financial position than other taxpayers constitutes state aid within the meaning of Article 87(1) of the Treaty ([9]).

State resources

(27) The measure provided for in Article 25 EBF uses state resources because it is based on the non-collection of corporation taxes which would normally be due to the State. The decision to forego this revenue fulfils the criterion for state resources.

Selective advantage

(28) Article 25 EBF, compared with the normal tax arrangements applicable to capital gains in Portugal, grants an advantage to the beneficiaries.

(29) The normal tax arrangments to be taken into consideration are those applicable to undertakings without distinction as to ownership (public-owned or not) or nature (holding or not).

(30) The normal tax arrangements are not those applicable exclusively to holding companies because the transactions covered by Article 25 EBF (restructuring operations) may involve both holding and non-holding companies.

(31) The preferential tax regime applicable to capital gains obtained by holdings in Portugal, became applicable from 1993. However, at the time the transactions in question took place this preferential treatment applied only if the proceeds realised were reinvested. This means that even by comparison with the arrangements applicable to holding companies, which were not the normal tax arrangements in Portugal, a selective advantage was accorded to wholly publicly owned companies and companies controlled by them.

(32) An exemption from capital gains tax puts the publicly owned companies which benefit from it at an advantage compared with other companies operating in the same economic sectors because these public companies enjoy an increased cash flow for running their business. Whatever the purpose of the measure may be, state aid is determined on the basis of effects and not objectives.

(33) The advantage is granted only to certain undertakings, namely undertakings that are wholly publicly owned and those controlled by them, undergoing privatisation or

([9]) Case C-6/97 *Italian Republic* v *Commission* [1999] ECR I-2981, paragraph 16.

restructuring operations that comply with government policy objectives. It excludes all other undertakings, including privately owned companies competing with the publicly owned beneficiaries. The Commission notice on the application of the state aid rules to measures relating to direct business taxation states that, when some public undertakings, for example, are exempt from company taxes, such rules, which accord preferential treatment to undertakings having the legal status of public undertaking and carrying out an economic activity, may constitute state aid within the meaning of Article 92 of the Treaty ([10]).

(34) The tax provisions of Article 25 EBF are *de jure* selective since they concern only certain companies (i.e. public companies or companies controlled by them). Moreover, the measure applied *de facto* exclusively to banking or insurance public undertakings or undertakings controlled by them. This is clear from the information provided by the Portuguese authorities.

(35) The Portuguese authorities deny that the measure is selective, arguing that the measure addresses public-sector entities as a category of undertakings, and is thus a general measure. This argument cannot, however, be accepted by the Commission for the following reasons.

(36) Firstly, there is no such concept as public-sector companies relevant for tax purposes as the companies that may potentially enjoy the advantage accorded by Article 25 EBF may in principle intervene on a wide variety of markets.

(37) Secondly, this measure does not identify any aspects specific to public companies compared with private ones. Private companies and foreign public companies with branches in Portugal may also engage in restructuring programmes. Their shareholders may decide to sell the companies, but would not be covered by the scheme.

(38) Thirdly, only a subsector of public undertakings is targeted by this measure: those which are in a process of privatisation or restructuring where such operations are recognized by the Finance Minister. This measure is selective even in respect of undertakings in the public sector, also because of the discretionary power enjoyed by the competent authority.

(39) Therefore, the Commission concludes that Article 25 EBF grants a selective advantage. The selectivity implied by the measure concerned is not justified by the nature and the structure of the Portuguese tax system.

Effect on trade and distortion of competition

(40) By enabling public companies undergoing privatisation or regulated restructuring to enjoy reductions in the tax on their capital gains, Article 25 EBF grants them an operating advantage and strengthens their position compared with other companies. In its assessment the Commission is not required to establish that the aid has a real effect on trade between Member States or that competition is actually being distorted, but only to examine whether that aid is liable to affect trade and distort competition ([11]). Where aid granted by a Member State strengthens the position of a company in relation to other companies competing in intra-Community trade, these other companies must be regarded as affected by that aid ([12]).

(41) What is more, all the identified beneficiaries of the scheme operate in the banking and insurance sectors, sectors that have been open to competition for many years. Progressive liberalisation has enhanced the competition that may already have resulted from the free movement of capital provided for in the EC Treaty.

(42) The effect on trade between Member States and the impact of the aid in terms of distortion of competition is particularly sensitive in these sectors ([13]).

(43) The aid scheme is therefore liable to affect this trade and distort competition.

Conclusion

(44) It follows from the above that the exceptional scheme provided for in Article 25 EBF, which exempts from corporation tax public undertakings' capital gains from privatisation operations and from restructuring processes, constitutes a scheme granting state aid within the meaning of Article 87(1) of the EC Treaty.

V.2 **Does the scheme constitute illegal aid?**

(45) Portugal has implemented the aid scheme without notification. Therefore, by unlawfully implementing Article 25 EBF, Portugal is in breach of Article 88(3) of the Treaty.

([10]) OJ C 384, 10.12.1998, p. 3.

([11]) See for instance the judgment of the Court of Justice in Case C-372/97 *Italy* v *Commission* [2004] ECR I-3679, paragraph 44.

([12]) See Case 730/79 *Philip Morris Holland* v *Commission* [1980] ECR 2671 paragraph 11.

([13]) For the effect on trade and distortion of competition in the banking sector, see in particular the Court of Justice's judgment of 15 December 2005 in Case C-222/04 *Fondazioni bancarie*, paragraph 139 *et seq.*, and the case law cited.

V.3 **Compatibility of the illegal aid scheme**

(46) The aid is not compatible with Article 87(2). It is not aid of a social nature, granted to individual consumers, nor aid to make good the damage caused by natural disasters or exceptional occurrences; nor is it aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

(47) The aid is applicable uniformly across the whole territory of Portugal, and therefore cannot be considered compatible with Article 87(3)(a) and (c), which covers the development of certain regions.

(48) The Commission considers that the operating aid concerned cannot be regarded as favouring the development of certain economic activities within the meaning of Article 87 (3)(c), notably because this provision requires that the aid 'not adversely affect trading conditions to an extent contrary to the common interest', a condition which the Commission deems not satisfied in this case. This aid does not meet any of the conditions of the rescue and restructuring guidelines in force when the aid was granted [14]. It does not target any other horizontal objective of common interest. Finally, the fact that application is restricted to the financial sector does not change the conclusion of the assessment, especially since this sector is particularly sensitive to the effect on trade between Member States and the impact of this aid in terms of distortion of competition.

(49) Nor is the aid compatible with Article 87(3)(d) (aid to promote culture and heritage conservation) or (e) (such other categories of aid as may be specified by decision of the Council). Portugal has never invoked any of these derogations.

(50) Furthermore, the aid is not compatible with Article 87(3) (b). The aid cannot be considered a 'project of common European interest' since it will benefit the public undertakings of one Member State and not the Community as a whole and it will not promote a specific and well-defined project; nor does it 'remedy a serious disturbance in the economy of a Member State' since there is no evidence that, without the aid, the Portuguese economy would have suffered from a serious disturbance.

(51) In any case, apart from very general statements, Portugal has not specifically invoked any of the derogations of the Treaty.

(14) Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 288, 9.10.1999, p. 2).

VI. **RECOVERY**

(52) According to Article 14 of Regulation (EC) No 659/1999, where negative decisions are taken in respect to unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary. However, the Commission may not require recovery of the aid if this would be contrary to a general principle of Community law.

(53) The Commission considers that, in the present case, there is no general principle of Community law which would impede recovery.

(54) The Portuguese authorities argue that the four transactions that benefited from the scheme would have been exempted from tax anyway under the Portuguese tax arrangements for holding companies. Moreover, three of the four transactions were already decided under the previous arrangements as Article 25 EBF had not yet been approved at the time. The Portuguese authorities therefore argue that no recovery should take place.

(55) According to ECJ case-law [15] and the Commission notice on business taxation [16], it is at the stage of recovery that re-establishing the status quo ante has to be considered in order to assess if an alternative tax treatment existed which, in the absence of unlawful aid and in accordance with domestic rules which are compatible with Community law, would have granted a similar advantage to the undertakings in question.

(56) The amount to be recovered in order to restore the previous situation is the difference between: (i) the total discounted advantage granted to the public undertakings or undertakings controlled by them resulting from the application of Article 25 EBF; and (ii) the 'normal' tax treatment which would have applied if the operations in question had been carried out without the aid measure. In the *Unicredito* case the ECJ states that it would not be right to determine the amounts to be repaid in the light of various operations which could have been implemented by the undertakings if they had not opted for the type of operation covered by the aid [17]. In this context, the Commission must not to take into account the hypothetical choices which could have been made by the operators concerned, such as operations structured in other ways.

(57) Consequently, in order to assess the situation that would have prevailed if the operations in question had been carried out without the tax reduction, an analysis must be made of each of the transactions that benefited from

(15) Case C-148/04 *Unicredito Italiano SpA*.

(16) Commission notice on the application of the State aid rules to measures relating to direct business taxation (OJ C 384, 10.12.1998, p 3).

(17) Paragraphs 113 to 119.

Article 25 EBF. In this case, such an analysis can be made on the basis of the information provided by the Portuguese authorities, without prejudice to a further assessment of each transaction on the basis of any further information available.

First two transactions

(58) The first transaction was MC's sale of its holding in CPP to BSCH on 5 April 2000. The second transaction was the sale by CDG-controlled BPSM of its holding in BTA plus its holding in CPP to BSCH on 7 April 2000.

(59) Since Article 25 EBF was not published at the time the sales were proposed, both transactions were planned and approved by the CGD management under the tax legislation applicable to holding companies (SGPS). The setting-up of the holding companies and the successive sales or swaps of shares would have resulted in a tax exemption for both transactions under the normal Portuguese tax arrangements. The Portuguese authorities have transmitted all the relevant documents to the Commission.

(60) Indeed, the choice of operators for the transactions in question was not at all accidental but the decisions had been already planned and approved by the managements of the groups concerned. The conditions for carrying out the transactions under the general tax legislation applicable to holding companies were also already met. The Portuguese authorities confirmed there was no need to obtain the prior approval of the tax authorities for such transactions.

(61) To conclude, the Commission considers that no recovery is necessary in these two cases. For these transactions there was no advantage in applying Article 25 EBF since, in view of the nature of the operation, MC and BPSM would have been exempted, even without this article, under the exemption arrangements for holding companies, which is the normal tax treatment under Portuguese legislation.

Third transaction

(62) The third transaction was the exchange of shares between MC and BCP described above.

(63) Thus the capital gains realised by MC from the swap of a majority shareholding in BPSM for shares accounting for about 10 % of the authorised capital of BCP, would be subject to the 'special system applicable to mergers, divisions, transfers of assets and share swaps' of Articles 67 to 72 CIRC. These articles implement Directive 90/434/EEC [18], which leaves the Member States no other possibility than to exempt the operation from taxation.

(64) What is certain is that by order of 14 November 2000 the Finance Minister decided to apply Article 25 EBF to this transaction. However, in this case there was no advantage in applying Article 25 EBF since the exemption imposed by the Community Directive and transposed by CIRC Article 71(1) is the normal tax treatment which, in the absence of unlawful aid and in accordance with domestic rules compatible with Community law, would have been granted for the operation actually carried out. Therefore, no recovery is necessary in this case either.

Fourth transaction

(65) The fourth and last transaction is the capital gain from the sale of CGD's stake in the Brazilian bank ITAÚ SA, which took place between 2000 and 2003. Unlike the other three transactions, this one is not related to agreements between the Champalimaud Group and BSCH.

(66) The complete sale took several transactions between 2000 and 2003. Although the Portuguese authorities argue that this transaction could have been done via a holding company, the fact is that doing it in this way in order to obtain a more favourable tax treatment than that offered by the ordinary system was not effectively planned. Therefore, in light of the *Unicredito* case, the Commission believes that applying the tax exemption for holding companies in this case would entail reconstructing past events on the basis of hypothetical elements. The Portuguese authorities did not provide enough detailed evidence on the different steps of the operation in question that would have led to tax neutrality, even if Article 25 EBF had not been applied.

(67) Therefore, the Portuguese authorities have not shown, at this stage, that the amount to be calculated by applying the effective tax rate to the capital gains actually realised (EUR 357,4 million) plus interest, should not be recovered.

VII. **CONCLUSION**

(68) The Commission finds that Portugal was in breach of Article 88(3) of the Treaty in implementing Article 25 of

[18] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (OJ L 225, 20.8.1990, p. 1). Article 8(1) lays down that: 'On a merger, division or exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder'.

the Portuguese EBF. The aid scheme is incompatible with the common market and has to be repealed, as pledged by the Portuguese authorities.

(69) This Decision concerns the scheme as such and must be implemented immediately, including the recovery of aid granted under the scheme. However, it is without prejudice to the possibility that all or part of the aid granted in individual cases may be deemed compatible with the common market.

(70) The Portuguese authorities have shown that no recovery needs to be undertaken in the first three transactions. Therefore, on the basis of the information provided by the Portuguese authorities, and without prejudice to a further assessment of that transaction on the basis of any further information available, only the aid granted for the transaction relating to the capital gains from the sale of CGD's stake in the Brazilian bank ITAÚ S.A. has to be recovered,

HAS ADOPTED THIS DECISION:

Article 1

The state aid scheme implemented by Portugal under Article 25 EBF is incompatible with the common market.

Article 2

Portugal shall repeal the scheme referred to in Article 1.

Article 3

1. Portugal shall take all necessary measures to recover from the beneficiaries the aid referred to in Article 1 that was granted to them unlawfully.

2. Recovery shall be effected without delay and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of this Decision.

3. The aid to be recovered shall bear interest from the date on which it was paid to the beneficiary until the date of its recovery.

4. Interest shall be calculated on the basis of the reference rate used for calculating the grant-equivalent of regional aid.

Article 4

Portugal shall inform the Commission within two months of notification of this Decision of the measures taken to comply with it. It will provide this information using the questionnaire in Annex I to this Decision.

Article 5

This Decision is addressed to the Portuguese Republic.

Done at Brussels, 4 July 2006.

For the Commission

Neelie KROES

Member of the Commission