THE CHANGING SCOPE OF EU COMPETITION RULES IN THE FINANCIAL STORM

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Neelie Kroes – 13 mars 2009:" ***Competition policy is at the heart of the economy : it should be at the heart of the recovery"***

I. European competition law : a flexible law well adapted in times of crisis

- **Preliminary remark : European competition law includes both behaviour of companies as well as behaviour of Member States.**

The behaviour of companies is regulated by:

- the Treaty of the European Community (ECT) :
  - article 81 prohibits cartels and concerted practices
  - article 82 prohibit abuses of a dominant position
- Regulation 139/2004 of 20 January 2004 on merger control

The behaviour of Member States is regulated by the State aids rules set out in articles 87 to 89 ECT. State aids are controlled by the European Commission. They have to be notified to the Commission by the Member States. The purpose of State aid rules is to increase the development of the internal market, by preventing Member States to act in favor of their own national firms and by avoiding distortion of competition.

In one hand, State aids may have positive effects, by encouraging research and development or by enabling employees to benefit from lifelong learning.

In another hand, State aids may have negative effects: they may help inefficient companies to continue business which, ultimately, could trigger adversarial effects for consumers such as price increase. Enterprises may also threat public authorities from a Member State to invest in another Member State offering more important subventions.

Competition Commissioner Neelie Kroes said: "State aid can be of real help to society. When used effectively it helps to improve our environment, support research and development and boost the skills of workers, thus improving our standard living. When applied badly, however, State aid often has harmful and unintended effects. For example, support which helps inefficient firms stays on the market often results in higher prices for consumers and means that better companies may suffer from the unfair advantage given to the subsidised company".

The European Commission has developed a real State aid policy reflected by several Regulations, Guidelines and Notices.

- **The European sensitivity to transitory circumstances**

European competition law is flexible. It is well adapted in times of crisis.

EC competition law integrates a transitory dimension. EC Competition Law integrates that although on a long term period, free competition leads to an efficient allocation of resources, a more flexible application is necessary to face crisis. From the beginning, the European competition policy took into consideration that departing from strict application of free competition may be justified in certain circumstances, the interest of the consumer being better served by undertakings protected or which have to comply with more flexible competition rules.

In the United States, the belief in the free market makes the adaptation of competition law to circumstances less flexible : interventionism could stop pro-competition effects. Without subscribing to the extreme thoughts of Hayek, US law is as less intrusive as possible.

Although article 81 paragraph 1 ECT prohibits cartels and concerted practices, paragraph 3 introduces an economic and social balance.

Paragraph 3 provides that the prohibition of the 1st paragraph can be set aside when the agreement between undertakings or concertive practice :

" contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which

does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

The guidelines of the European Commission, adopted in 2004, on the application of Article 81 paragraph 3 of the Treaty underline that "the objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources".

The approach used in the regulatory framework on state aid is similar.

Article 87 paragraph 1 provides that « 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 ».

However, article 87 paragraph 3 underlines certain types of state aid which may be considered compatible with the common market.

Examples :
- aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

- 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;

To decide whether a State aid is compatible with the common market, the Commission draws a balance between "distortion of competition and community interest".

In the European Union, competition law is therefore fully integrated to general policies such as social policy, environmental policy, consumer policy etc. It departs when necessary from the dogma of free market. That enables a realistic view on difficulties faced and on solutions to solve them.

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In Europe, flexibility in times of economic crisis is possible since the text of regulation and case law permitted it. At the same time, that flexbility is limited in time to a period of economic crisis and regulated. Therefore, rules and case-law are the guarantors of the legal certainty.

As Neelie Kroes stressed in a speech given in Toronto on 30 March 2009, "*aside from the European Commission having the crucial power to control national government subsidies, we have spent the last five years developing, updating and streamlining our competition systems. Now we are cashing in on them as their efficiency and* ***flexibility*** *help us to cope with the current volatile market conditions.* ***These reforms cover subsidy controls, cartels, mergers, antitrust and all the tools we possess to make markets work better****. After four years – when the financial and then economic crisis hit - the systems were lean and fast and ready to deal with a moving target. It is better to have clear and strong rules in the first place and then stick to them – it lifts standards and markets know what to expect*".

In periods of economic crisis, competition should not however be ignored.

In that respect, Neelie Kroes, Competition Commissioner, stated in a speech given on 8 January 2008 : ***« Social justice will be achieved not only by promoting welfare security. It will also be achieved by providing equality of opportunities, in particular through fee and competitive market »***.

II. Antitrust (cartels, abuse of a dominant position)

Neelie Kroes is making reference to article 81 paragraph 1 of the Treaty many times since the beginning of the economic crisis that ***"we are crystal clear that cartels are harmful no matter what current economic growth rates are"***.

However, paragraph 3 of article 81 is a useful instrument to adapt the cartels' rules in period of economic crisis. It should be recalled that, under article 81 paragraph 3, four conditions should be met in order to authorize agreement between undertakings or concerted practice :

- efficiency gains
- fair share for consumers
- Indispensability of the restrictions
- No elimination of competition

1. The exception of "crisis cartels"

At the beginning of the 80's, the principle of crisis cartels was accepted by the European Commission but under strict and cumulative conditions in order to fall under the scope of recession cartels: the crisis must be structural and the measures taken to overcome the crisis must be limited.

With regard to the nature of the crisis, a mere price fall or a mere fall of the profitability of the sector is not sufficient to benefit from the exception of crisis cartels. The crisis is established only if (i) an important structural overcapacity generating substantial operating losses over a long period of time, (ii) no improvement can be foreseeable at medium term except the measures envisaged under the crisis cartels.

Moreover, the crisis must be harmful for the consumer by reducing the quality and the diversity of goods, by making them more expensive and by impairing the sustainability of the supply.

With regard to the measures which can be adopted, they must enable a genuine and sustainable rehabilitation of the business sector, that's why they must be of structural nature and they must mainly aimed at reducing production overcapacity. Measures such as closing the less efficient production facilities or limiting the creation of new production capacities meet the criteria.

The crisis cartel is limited to what is strictly necessary. The cartel must be limited in time and the exchanges of information or agreement on prices are prohibited.

In 1984, after having established that the **synthetic fibres industry** had important production overcapacity due to fast technological development, the European Commission authorised an agreement between the producers aiming at reducing, in a coordinate manner, the production capacities and, therefore, the investments.

In 1994, the European Commission authorized an agreement to reduce, in a coordinate manner, the production capacities of **bricks** because of a crisis of this sector in the Netherlands. The agreement was aiming at overcoming difficulties that the brick sector in the Netherlands were facing for many years (unfavourable evolution of the market, important fall of the demand, increase of stocks and of production capacity) and at rehabilitating progressively a sustainable balance between the offer and the demand as well as reaching a better utilization rate of production capacities maintained.

In those two decisions, the Commission noticed that the market alone could not trigger the reduction of the production capacities for maintaining an efficient competition within that sector. Thanks to the agreement concluded, an increase of the profitability of the industries concerned and the return to normal conditions of competitiveness were foreseeable. The users could therefore benefit from an improvement of the production because, on a long term, the sector would be rehabilitated and the offer would be competitive.

It appears, from these two decisions that the current context of economic crisis could justify some temporary agreement between undertakings which, by ensuring the safeguard of companies lacking profit-making capacity or even of an entire sector, would benefit, in fine, to the consumer.

2. Abuse of a dominant position

With regard abuse of a dominant position, it is interesting to note that the European Commission, in its guidance on its enforcement priorities in applying Article 82 to abusive exclusionary conduct by dominant undertakings published in December 2008, put the welfare of the consumer at the heart of its action. "In applying Article 82 to exclusionary conduct by dominant undertakings, the Commission will focus on those types of conduct that are most harmful to Consumers".

This approach founded on the effects must allow more flexibility.

More precisely, the Paper outlines the general framework that the Commission will apply to assess whether to pursue a particular conduct. The first step is for the Commission to explain how the allegedly abusive conduct is likely to restrict competition and thereby harm consumers. It looks at issues such as the conditions on the market, including the relevance of entry barriers, the position of and counterstrategies available to competitors, the part of the market affected by the conduct, and possible evidence of actual foreclosure and implementation of an exclusionary strategy. In the case of pricing conduct, the Commission will, as part of its general assessment, investigate whether the conduct is capable of excluding also equally efficient competitors, in which case the conduct can restrict effective competition and harm consumer welfare. The second step is for the firm to rebut this finding of a likely negative effect by showing that it is likely to create efficiencies which leave consumers better off overall. The dominant firm can subsequently explain whether and how its conduct is allowing it to provide customers with a better product in a more cost effective way, thereby benefiting overall the customers.

III. Merger Control

Neelie Kroes – Bruxelles 12 mars 2009 «***We think the merger regulation will be able to handle anything thrown at it in 2009. There may be difficult decisions, but we have the flexibility we need to take account of changing market circumstances***".

Neelie Kroes – Toronto 30 mars 2009: "***We have a Merger Regulation that can handle the complex cases that will no doubt be thrown at it***".

The Commission considers that the application of the merger control rules ultimately ensure the protection of consumer welfare in all its dimensions, that is, both in terms of financial stability in the short term and competitive market structures in the medium term.

The relevant rules, especially since the reform in 2004, must allow the taking into consideration of a crisis context in the assessment of mergers operations.

1. The new approach of the mergers control

The reform of 2004 was aiming at modernizing the European framework of the merger regulation.

In the previous regulation adopted in 1989, the competition test was based on the notion of dominant position : the creation or strengthening of such a position was leading to the prohibition of the operation, except if the companies were subscribing relevant commitments.

It is from now on provided that a merger which may significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, is declared incompatible with the common market.

This new method of analysis is more suitable to take into consideration a contingent contribution of the merger operation to the economic progress, by ensuring that the savings made would benefit to the welfare of the consumers.

In period of crisis, the question of the revival of certain types of behavior commitments instead of structural commitments remains open. A commitment for a company to abandon a part of its activities is a delicate issue as it could be difficult, in the context of an economic crisis, to find potential buyers. Therefore, the Commission could facilitate its authorization by accepting behavioral commitments.

2. The notion of failing company

The notion of failing firm defense has been invoked in very few cases and the Commission always took a strict approach in its appreciation of the three criteria set out by case law and by its guidelines of 2004.

The European Community adopted guidelines which develop the applicability of the failing firm defense (Guidelines 2004/C 31/2003 on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings - entered into force the 5th February 2004).

Two paragraphs of the guidelines (in line with the previous case law) deal with the subject:

> ***89. The Commission may decide that an otherwise problematic merger is nevertheless compatible with the common market if one of the merging parties is a failing firm.*** *The basic requirement is that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger. This will arise where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger.*
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> *90. The Commission considers the following three criteria to be especially relevant for the application of a "failing firm defense". First, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Second, there is no less anti-competitive alternative purchase than the notified merger. Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market.*

First condition : the firm must be deemed to disappear within a short time. The theory of the failing firm can only serve as defense in desperate cases. The Mdk firm, in the Kali und Salz case, perfectly illustrates this kind of situation, as if no potential-buyer had been found, Mdk would have disappeared from the market.

The failing firm defense can be applied to entire firms but also to parts of them. In this case, we speak about the "failing division defense". The Commission admitted this expression in 1999 in the Rewe/Meinl case, but only on condition that "highly convincing proofs" were provided.

Moreover, it should be precised that the failing firm is often the target firm, but in exceptional cases, the failing firm can be the purchaser. This was for example the case in the Stream / Telepiu case of April 2003. However in this particular case, the failing firm defense could not be invoked, as the three criteria were not fulfilled.

Second condition : there is no possible less harmful alternative for the competition than the aimed operation. In the Blokker / Toys 'R'Us case of 1997, the Commission noticed that many repurchase offers had been submitted to Toys 'R' Us. However, Blokker's offer had been chosen, only because it was the most powerful operator on the market. Therefore, the Commission considered in this case that the proof that no other less harmful solution existed was not fulfilled. Thus the deal was prohibited.

However, in BASF / Euridiol / Pantochim case, the Commission considered that only BASF could afford to purchase the integrality of the Eurodil and Pantochim factories. No other alternative could be found.

Third condition: the operation must be neutral, that is to say that in the absence of the merger, the asset of the failing firm would disappear from the market.

In the Kali und Salz case, which is the first case in community law where the bases of the theory of failing firm defense have been set up, the Commission considered that the condition of neutrality was fulfilled, if in the absence of the merger, the market shares of the failing company were taken over by the purchaser.

However today, this condition is often replaced by another wider condition. The deal will now only be considered as neutral if it doesn't cause any worsening of the competition. In other words, there mustn't be any causal link between the deal and a deterioration of the competition. Indeed, the damage to the competition can only result from the disappearing of the failing company, but not from the merger.

The Seb/Moulinex case (*Court of First Instance of the European Community, 3rd April. 2003, case T-119/02, Royal Philips Electronics c/ Commission)* is an illustration of these strict conditions.

The Commission refused the application of the failing firm defense exception, since competitors were pretending to be in a situation of buying parts of the activity of Molinex. At this time, the Commission did not take into account the fact that the acquisition by Seb put on it heavy burdens in terms of finance and social responsibilities.

However, in the current crisis context, we reasonably could expect a change, since the Competition Commissioner Neelie Kroes indicated, in a speech dated on 6 October 2008 that :

« *The Commission is committed to continue applying the existing rules, taking full account of economic environment.*

That means the Commission can and will take into account the evolving market conditions and, where applicable, the failing firm defence.

- *The existing rules allow the Commission to permit take-overs to be implemented without having to wait for the Commission's approval in cases where there is urgency and where there are no 'a priori' competition concerns.*
- *The Commission can indeed grant derogations from the standstill obligation, pending a definitive outcome of the proceedings, so as to enable the immediate implementation of the transactions which are part of rescue operations.*

In all cases, we are therefore committed to act diligently and in close cooperation with all interested stakeholders.

National Competition Authorities are able to take a similar approach under their national merger rules ».

Nothing is said about the failing firm notion but it is reasonable to think that Commission could have a more flexible approach than before.

At national level, the British government has recently authorized the purchase of HBOS by Lloyds TSB in order to guarantee "the stability of the English financial system" (*Decision by Lord Mandelson not to refer to the Competition Commission the merger between Lloyds TSB Group plc and HOS plc under Section 45 of The Enterprise Act 2002 dated 31 October 2008*).

In France, the recent French competition law reform transferred the merger control to a single authority. Moreover, the Minister for Economic Affairs is able to authorize merger projects by invoking the "general interest". This new power to raise certain issues (pouvoir d'évocation) could allow the Minister to authorize mergers with potential anti-competitive effects.

What will be its conception concerning the failing firm defense? It is too early to answer to the question. However, we could suppose that the current crisis, combined with the new Minister power and the creation of that new competition authority, will undoubtedly lead to a position taking.

IV. State aids

The EU has a judicial tradition and a real experience in this matter.

Neelie Kroes stated that: « ***In the absence of State aid rules, governments would be tempted to start subsidy races, which would weaken the European economy further. Perfectly healthy companies could be put out of business just because their competitors received unfair state subsidies and that would not be fair".***

"Certain State aids "waste taxpayer's money or stop other jobs from being created or put healthy competitors at risk".

In times of crisis, it is clear that European state aid rules are of high importance. As Mrs Kroes stated on 2 December 2008: ***« State aid rules are part of the solution, not part of the problem »*.**

"***I can assure you after many long hours of debates and discussions that the flexibility of our system and our experience really helped to deliver financial stability and legal certainty in the days when it was needed most***".

1. The European experience

Art. 87 § 3, b), deals expressly with times of crisis: "*shall be compatible with the common market : aid to promote the execution of an important project of common European interest or* ***to remedy a serious disturbance in the economy of a Member State***".

Therefore, in times of crisis, the Treaty itself allows States to be flexible and adopt a pragmatically approach.

That specific provision has already been used for the benefit of Greece in 1987 (*Commission decision 88/167/EEC of 7 October 1987*). On that basis, the Commission had authorized the Greek government to grant aid to the industry in order to fight the country's economic problems (the aid concerned industrial firms which were very involved in the export business)

Since the beginning of the crisis, Neelie Kroes remembers Member States that « ***There is tremendous scope for Member States to give more aid under the existing rules » "State aid reforms since 2005 have ensured the system is fit to meet the test of this crisis".***

A. The general block exemption regulation (GBER - 2008)

In the framework of this reform, the last most important regulation adopted by the European Commission is the general exemption Regulation applicable from 29th August 2008 to 31st December 2013.

Its purpose is to simplify Sate aid proceedings and provide a better targeting of aids in order to promote growth and employment in the European Union.

This Regulation authorizes 26 block exemptions, which do not need to be notified to the Commission in advance, provided that the aid respect the requirements of the Regulation. Member States communicate their information to the Commission after the aid has been granted. This enables the Member States to grant aid quicker.

The general exemption Regulation concerns most of the economic fields. Nevertheless, the Regulation does not apply to export activities and *ad hoc* aids granted to large firms.

Types of exemptions:

- **Aid limited to SMEs**

Small and medium-sized enterprises aid
Different types of aid are specifically designed to help SMEs to overcome the specific "market failures" they face. The SMEs could be subsidized in their different development stages.

- SME investment and employment aid
- Consultancy aid in favour of SMEs
- Aid for SME participation in fairs

Aid in the form of risk capital
Risk capital constitutes an important instrument for the financing of SMEs. The GBER exempts from notification aid for risk capital in the form of constitution of private equity investment funds in which the State is a partner, investor or participant, even if on less advantageous terms than other investors. The investment fund may invest up to EUR 1.5 million per target undertaking over twelve month period.

Aid for promoting female entrepreneurship
The GBER allows Member States to support the small enterprises newly created by female entrepreneurs to allow these entrepreneurs to overcome the specific market failures which they face, especially access to finance. The Regulation allows supporting different kinds of operating costs including child and parent care costs.

The GBER determines eligible beneficiaries, sets maximum aid intensities, defines eligible expenses and may include additional conditions for certain aid measures.

- **Aid for all enterprises**

Aid for Research & Development &Innovation (R&D&I)
Beyond the more traditional categories of R&D aid, the GBER also includes a series of innovation measures to foster the competitiveness of European industry via more money spent in R&D&I.

- Aid for research and development projects
- Aid for technical feasibility studies
- Aid for industrial property right costs for SMEs
- Aid for young innovative enterprises
- Aid for innovation advisory services and for innovation support services
- Aid for the loan of highly qualified personnel
- Aid for research and development in the agricultural and fisheries sectors

Environmental aid
The GBER facilitates national authorities granting an important number of aid measures favouring environmental protection and tackling climate change.

- Investment aid to go beyond Community standards for environmental protection
- Aid for acquisition of transport vehicles which go beyond Community environmental standards
- Aid for early adaptation to future Community environmental standards for SMEs
- Investment aid in energy savings measures
- Investment aid in high efficiency cogeneration
- Investment aid for the promotion of energy from renewable energy sources
- Aid for environmental studies
- Aid in the form of reductions in environmental taxes

Regional aid
National regional aid promotes the economic, social and territorial cohesion of the EU by addressing the handicaps of the disadvantaged regions.
- Regional investment and employment aid
- Aid for newly created small enterprises in assisted regions

Training aid
The regulation authorises aid for general training as well as for specific training.

Aid for disadvantaged and disabled workers
The GBER covers aid that incentivises companies to hire disabled or otherwise disadvantaged workers.
- Aid for the recruitment of disadvantaged workers in the form of wage subsidies
- Aid for the employment of disabled workers in the form of wage subsidies
- Aid for compensating the additional costs of employing disabled workers

B. The general Framework

Since the beginning of the current crisis, the Commission invites Member States to use all the opportunities which are included in this regulation.

Beside the GBER, the Commission invites the Member States to use the comprehensive body of legislation developed those last years. **It enables the Member States to take actions within the framework set up by competition authorities.** The Commission has for example adopted "Community frameworks", "Guidelines" and "Regulations of exemption per category".

→ **Guidelines on state aid for rescuing and restructuring firms in difficulty (Entered into force the 1st October 2004)**.

This aid aims to avoid social and regional harmful consequences for small and medium-sized enterprises.

→ **Community framework for State aid for research, development and invention (Entered into force the 30th December 2006)**

In particular, Member States may grant State aid, inter alia, as follows aid for R & D projects, in particular aid for fundamental research, of up to 100 % of the eligible costs and aid for industrial research of up to 80 % for small enterprises, aid for young innovative enterprises of up to EUR 1 million, aid for the loan of highly qualified personnel, aid for technical feasibility studies, aid for process and organisational innovation in services and aid for industrial property rights costs for SMEs.

→ **Guidelines on state aid for promoting risk investments action plans for small and medium-seized enterprises (Entered into force the 18th August 2006).**

The purpose of that text is to make State aid compatible with the Treaty. Guidelines envisage a "security tolerance token" of 1,5 millions EUR per small and medium-sized company for a twelve months period, a simplified procedure for making an assessment for simple cases, and rules ensuring that public investments are proportionate). We will see further that those rules may be completed by an optional and temporary framework adopted by the Commission to tackle effects of credit squeeze on real economy.

→ **Community framework for State aid for environmental protection (Entered into force the 3rd February 2001)**

Under those guidelines, Member States may grant State aid, inter alia, as follows: aid for companies which improve their environmental performance beyond Community standards, aid for early adaptation to future Community standards ; in the field of renewable energies and cogeneration, Member States may grant operating aid to cover all extra production costs ; in order to attain environmental targets for energy saving and for reductions in greenhouse gas emissions, Member States may grant aid enabling undertakings to achieve energy savings and aid for renewable energy sources and cogeneration of up to 80 % of the extra investment costs for small undertakings and of up to 100 % of the extra investment costs if the aid is granted following a genuinely competitive bidding process.

→ **Regulation of December 2006 concerning the *de minimis* rule (Entered into force the 28th December 2006).**

The *de minimis* rule is updated to exempt aid of less than EUR 200 000 from the requirement to notify the Commission in advance. In order to prevent any abuse, the Regulation applies only to transparent *de minimis* aid. A transparent aid is for instance, an aid granted under a loan-guarantee scheme when the guaranteed part of the underlying loan does not exceed EUR 1 500 000. However, the Regulation does not apply to aid for firms in difficulty.

2. State aid rules in the current crisis

« In the current crisis, the Commission has played and will continue to play a central role in coordinating Member States' action with a view to maintaining a level playing field, preserving the integrity of the Single Market and fighting protectionism.

The comprehensive reform of the state aid rules over the past four years already provided a sound basis of assessment. Once it emerged that the crisis required additional adaptability, the Commission rapidly adopted additional guidance in order to ensure a coordinated approach across Europe".

The real economy and the temporary legal framework

On 17 December 2008, **the Commission adopted a temporary legal framework to enable the Member States to fight the effects of the credit freeze on the real economy. This framework is in line with the European programme for the economic recovery of 11 November 2008.**

The Commission would like state aid rules to be applied in such a way that a maximum flexibility to fight the crisis could be reached, while guaranteeing fair conditions for all by avoiding unnecessary competition restriction.

This temporary framework aims on the one hand to remind the Member States that they can benefit from a wide official support regarding state aid rules, and on the other hand, to grant them additional ways to fight against the credit freeze on real economy. Thus this new framework establishes a number of temporary measures enabling the Member States to solve the exceptional difficulties of companies to obtain sources of finance.

Neelie Kroes has stated that "We have to fight against the crisis, and not fight against each other. State aid have to be targeted, in order to enable companies, and especially small and medium-sized enterprise, to overcome the financial problems occurred by the current credit freeze, without aggravating the situation of other companies and hence the crisis. **Beside the**

existing possibilities supporting investments in sustainable growth, these new measures will grant the Member States new means to put the economy back on track."

Different types of measures are being considered:

- Measures aiming to ensure sufficient bank loans for companies
- Measures enabling companies confronted with a liquidity shortage due to the crisis to benefit from temporary aid by means of a limited grant
- Measures aiming to boost companies' investments in a sustainable future, in particular by producing green products

All these measures are limited in time (until the end of the year 2010) and depend on several conditions. These measures can only benefit companies hampered by the crisis, that is to say, those which weren't facing difficulties before 1 July 2008.

More precisely, Member States can grant:

- Flat-rate aids amounting a maximum of 500 000 euro per company during the next two years, in order to help companies to deal with current difficulties;
- State guarantees for loans and Premium relief;
- Low-interest loans, in particular for the production of green products meeting environmental protection rules;
- Venture capital aids, which could reach a maximum of 2.5 million euro a year per small and medium-sized enterprise, provided that at least 30% of the investment cost is covered by private investors.

Finally, each measure taken by the Member States within this framework will have to be examined every six month and reported to the Commission.

➔ **During the last six months, the Commission has adopted more than fifty decisions within this framework.**

Examples:

Commission authorizes France to introduce temporary aid scheme for businesses up to a maximum of €500 000. The scheme allows state, regional or local authorities and certain public bodies to grant aid of up to €500 000 in 2009 and 2010 to businesses which find themselves in difficulty as a result of the current economic crisis or are experiencing financing problems because of the credit squeeze. The scheme meets the conditions imposed by the Commission's temporary framework (amount of aid does not exceed €500 000 per company and the scheme applies only to businesses which were not in difficulty on 1 July 2008 or which were not in difficulty then but became so subsequently as a result of the economic crisis).

Commission authorizes a temporary French scheme allowing aid to firms in the form of reduced interest rates. The scheme allows government, local authorities and some public bodies to grant aid in the form of reduced interest rates on loans of any duration concluded by 31 December 2010. The scheme meets the conditions of the Commission's temporary framework for state aid measures

Commission authorizes France to introduce a temporary scheme to grant reduced interest loans to businesses producing green products. The scheme will support businesses faced with financing problems because of the credit squeeze, while at the same time making it easier for them to invest in products with an environmental benefit. It will allow state, regional or local authorities to grant until 31 December 2010 reduced-interest loans with

a maximum term of two years. It meets the conditions imposed by the Commission's temporary state aid framework. In particular, the investment must relate to products that will meet or surpass future Community environmental protection standards. The reduction in the interest rate may not exceed 50% for small and medium-sized enterprises (SMEs) and 25% for large businesses, in relation to the reference rate, and must take into account the enterprise's risk profile when the loan is granted. The aid scheme applies only to businesses that were not in difficulty on 1 July 2008 or that were not in difficulty on that date but have since fallen into difficulty because of the economic crisis. Lastly, the monitoring reports to be produced by the French authorities must include additional information, in particular the sectors of activity covered and the environmental benefits of the measure.

The European Commission has authorized a Spanish scheme allowing interest rate subsidies for the production of environmentally-friendly ('green') cars. The scheme will make it easier for producers to invest in products with environmental benefits, the development of which otherwise might have been hampered by the economic crisis. The scheme meets the conditions laid down by the Commission's Temporary Framework: In particular, the measure is limited in time and scope, takes into account the risk profile of the beneficiary and requires a significant environmental effort. The scheme would allow subsidized loans to be granted only for investments in products that meet or go beyond future EU environmental product standards, in particular the standards for low emission vehicles (known as 'Euro 6'). The measure is open to the car and car component industry. Subsidized loans may be granted until 31 December 2009 with a maximum term of two years. The reduction in the interest rate may not exceed 50% for small and medium-sized enterprises (SMEs) and 25% for large businesses, in relation to the reference rate, and must take into account the enterprise's risk profile when the loan is granted. The measure applies only to businesses that were not in difficulty on 1 July 2008, that is, before the crisis. Lastly, the monitoring reports to be produced by the Spanish authorities must include additional information, in particular the environmental benefits of the measure.

These schemes are therefore compatible with Article 87(3)(b) of the EC Treaty, which permits aid 'to remedy a serious disturbance in the economy of a Member State'.

Framework for the financial sector

EU state aid rules require that measures taken do not give rise to disproportionate distortions of competition, for example by discriminating against financial institutions based in other Member States and/or allowing beneficiary banks to unfairly attract new additional business solely as a result of the government support.

Three new Commission communications provide a clear framework for the financial sector, setting out the conditions under which unprecedented support measures can be taken during the financial crisis by Member States while preserving the integrity of the Single Market and avoiding harmful subsidy races between Member States.

The Commission is taking an active role in ensuring that national responses to emerging problems in times of crisis take into account the European dimension. DG Competition – the Commission's competition department - has allocated more than 20 case teams to work on these issues, and ensuring the Commission acts a stabilising force in the markets. Moreover, the College of Commissioners has granted new powers to increase the speed of Commission decisions. For example, this allowed the Commission to grant formal approval to a rescue aid package for Bradford and Bingley bank in less than 24 hours.

- **The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis**

The first Commission's Communication on this topic was the guidance on how national responses can comply with State aid rules and so avoid excessive distortions of competition. This communication was published on 13 October 2008.

The Commission intended to support Member States in addressing the crisis quickly and forcefully in compliance with the rules of the Treaty. The Communication is based on the principles underpinning the existing Rescue and Restructuring Guidelines, taking into account the particular circumstances applying to the financial sector in the context of the current exceptional crisis that can be considered to constitute a serious disturbance in the economy of a Member State within the meaning of the state aid rules (Article 87.3.b).

The Commission's guidance indicates how the Commission intends to apply EC Treaty state aid rules to state support schemes and individual assistance for financial institutions in the current crisis.

Support schemes such as guarantees or recapitalisation schemes have to fulfill conditions which guarantee that they are well-targeted and proportionate to the objective of stabilising financial markets and contain certain safeguards against unnecessary negative effects on competition.

The specific conditions include:

- **Non-discriminatory access** in order to protect the functioning of the Single Market by making sure that eligibility for a support scheme is not based on nationality;
- State commitments to be **limited in time** in such a way that it is ensured that support can be provided as long as it is necessary to cope with the current turmoil in financial markets but will be reviewed and adjusted or terminated as soon as improved market conditions so permit;
- State support to be clearly defined and **limited in scope to what is necessary** to address the acute crisis in financial markets while excluding unjustified benefits for shareholders of financial institutions at the taxpayer's expense;
- **An appropriate contribution of the private sector** by way of an adequate remuneration for the introduction of general support schemes (such as a guarantee scheme) and the coverage by the private sector of at least a significant part of the cost of assistance granted;
- **Sufficient behavioral rules for beneficiaries** that prevent an abuse of state support, like for example expansion and aggressive market strategies on the back of a state guarantee ;
- **An appropriate follow-up** by structural adjustment measures for the financial sector as a whole and/or by restructuring individual financial institutions that had to rely on state intervention.

Measures must be limited in time and foresee adequate contributions from the private sector. In the guidance, the Commission precise : « the Commission considers it a necessary element for the compatibility of any general scheme for the Member State to carry out a **review every six months**, covering the justification for the continued application of the scheme and the potential for adjustments to deal with evolution in the situation of financial markets. **The results of this review will have to be submitted to the Commission**. Provided that such regular review is ensured, the approval of the scheme may cover a period longer than six months and up to two years in principle. It may be further extended, upon Commission approval, as long as the crisis in the financial markets so requires".

❖ The recapitalisation of financial institutions in the current financial crisis

5 December 2008, the Commission published a new detailed guidance (in the form of a Communication) on how Member States can recapitalise banks in the current financial crisis in line with EU state aid rules. This Communication, based on the same purpose of limitation of aid to the minimum necessary and safeguards against undue distortions of competition, complements and refines the broader guidance document adopted on 13 October 2008.

The Commission takes account of the fact that the credit crunch is beginning to affect the real economy and that financially sound banks may need state capital to ensure an adequate level loans to companies. But state support for banks must not result in recipient banks enjoying an artificially advantageous competitive position compared to banks not receiving aid e.g. in other Member States.

Competition Commissioner Neelie Kroes said : " ***This Communication strikes the right balance between keeping a stable flow of credit to the real economy, stabilizing financial markets and preserving a level playing field for banks in Europe. It demonstrates that these objectives can not only be reconciled but are mutually reinforcing. The establishment of a framework that guarantees a consistent approach to state recapitalization of banks while taking account of a range of different circumstances testifies once more to the Commission's important role in overcoming the current crisis***".

In this Communication, the Commission distinguishes between:

- banks that are fundamentally sound and receive temporary support to enhance the stability of financial markets and foster undisturbed access to credit for citizens and companies on the one hand;
- distressed banks whose business model has brought about a risk of insolvency on the other hand.

State support for distressed banks implies a greater risk of competition distortions, therefore safeguards must be stricter and a thorough restructuring is necessary.

For example, the Communication establishes principles for the pricing of state capital injections into fundamentally sound banks based on base rates set by central banks to which a risk premium is added that has to reflect the risk profile of each beneficiary bank, the type of capital used and the level of safeguards accompanying the recapitalisation to avoid abuse of the public funding. Riskier banks will have to pay a higher rate of remuneration. The pricing mechanism needs to carry a sufficient incentive to keep the duration of state involvement to a minimum, for example through a remuneration rate that increases over time.

Banks in distress that face a risk of insolvency should in principle be required to pay more for state support and to observe stricter safeguards. The use of state capital for such banks can be accepted only on the condition of a far-reaching restructuring restoring their long-term viability, including where appropriate a change in management and in corporate governance.

Six months after an individual measure or after the introduction of a recapitalisation scheme authorized by the Commission, the Member State concerned will report to the Commission on how the state capital has been used. The report must also include an exit strategy for fundamentally sound banks and a restructuring plan for distressed banks.

To limit the anti-competitive effects of aid, European state aid rules lay down that a restructuring plan must restore the enterprise's long-term viability within a reasonable timescale on the basis of realistic assumptions. After reviewing the plan notified by the Member States, the Commission must check that these criteria are met.

❖ The Treatment of Impaired Assets in the Community Banking sector

25 February 2008, the European Commission has provided guidance on the treatment of asset relief measures by Member States which also complements and refines the Banking Communication.

"*We have already taken important steps towards financial stability through bank rescues and recapitalisation. Now, we need transparency, disclosure and correct valuation of impaired assets in order to clean the balance sheets of banks and address the root cause of lack of confidence. But we also require that the banks contribute adequately to the costs. They may have to be restructured in exchange for the State aid they receive. The Commission can play a key role through coordinated and rapid action, and thus contribute to restart lending*", said Competition Commissioner Neelie Kroes.

"*We have taken, since last October, a series of measures that have stabilised financial markets, but the job will only be complete if companies and households continue to have access to credit, the lifeblood of economic activity. Dealing with impaired assets is crucial to achieve this, to restore confidence and to guarantee a gradual recovery of the economy,*" said Economic and Monetary Affairs Commissioner Joaquín Almunia.

"*These guidelines will help Member States deal with impaired assets on bank's balance sheets. If we don't face up to this issue then we risk prolonging this crisis with zombie banks that are incapable of performing a useful role in our economies*", said Internal market and services Commissioner Charlie McCreevy.

Impaired assets correspond to categories of assets on which banks are likely to incur losses. The Commission intends to make sure that foreseeable losses are disclosed and properly handled and banks can use their capital to resume their normal function of lending to the economy instead of fearing they would need this capital to cushion against possible losses.

The Commission's Communication outlines various methods to deal with impaired assets, notably through asset purchase (including bad bank scenarios) or asset insurance schemes. It explains the budgetary and regulatory implications of asset relief measures and presents details concerning the application of the State aid rules to such measures. In particular, the guidance provides methodologies concerning the valuation of the impaired assets, the necessary remuneration of the State for the asset relief and the procedural steps that will be followed as well as the criteria that will be used to evaluate the State aid given to the banks as a result.

The guidance for the application of the State aid rules is based on a number of principles:

- **full transparency and disclosure of impairments,** which has to be done prior to government intervention;

- coordinated approach to the **identification of assets eligible** for asset relief measures through development of eligible categories of assets ("baskets");

- coordinated approach **to valuation of assets ex-ante**, based on common principles such as valuation based on real economic value (rather than market value), implemented by independent experts and certified by bank supervisors;

- **validation by the Commission** of the valuation of the assets, in the framework of the State aid procedures on the basis of uniform assessment criteria;

- adequate **burden-sharing of the costs** related to impaired asset between the shareholders, the creditors and the State;

- adequate **remuneration for the State**, at least equivalent to the remuneration of State capital;

- **coverage of the losses** incurred from the valuation of the assets at real-economic-value by the bank benefiting from the scheme;

- aligning **incentives** for banks to participate in asset relief with public policy objectives, through an enrolment window limited to six months during which the banks would be able to come forward with impaired assets;

- **management** of assets subject to relief so as to avoid conflicts of interests;

- **appropriate restructuring** including measures to remedy competition distortion, following a case by case assessment and taking into account the total aid received through recapitalisation, guarantees or asset relief, with a view to the long-term viability and normal functioning of the European banking industry.

The design of the asset relief scheme, be it asset purchase, insurance, swap, guarantee or hybrid models, is the responsibility of the Member State. Their treatment from the State aid point of view is however subject to uniform assessment criteria, which should maintain a level playing field.

The Commission approval for asset relief measures will be granted for a period of six months, and conditional on the commitment to present details of the valuation of the impaired assets, as well as an viability assessment and restructuring plan for each beneficiary institution within 3 months from its accession to the asset relief programme.

- **Examples:**

    - **Dexia Case**

In November 2009, in accordance with the state aid rules of the EC Treaty, the European Commission has approved a state guarantee for the Dexia financial group following the crisis in the Belgian financial market.

The aid, to be provided jointly by Belgium, France and Luxembourg, is to be granted to ensure the group's survival, to restore investor confidence and to encourage inter-bank lending. Given Dexia's size, market share and the prevailing financial crisis, the group's collapse would have given rise to a systemic risk. The Commission has decided that the measure constitutes an appropriate, necessary and proportionate means of remedying a serious disturbance in the Belgian economy and is, therefore, compatible with the EU rules on state aid (Article 87(3)(b) of the EC Treaty), as explained in the Communication on how these rules apply to banks in times of crisis.

The decision has approved the aid as an emergency rescue measure for a period of six months which may be extended if the crisis continues and required the Member States to submit a restructuring plan for Dexia in the six months.
In March, in accordance with the decision of 19 November 2008, the Member States have notified the Commission a restructuring plan for the bank.

The plan is accompanied by a capital injection of €6.4 billion, announced in September 2008, and maintenance of a guarantee of up to €150 billion granted jointly by Belgium, France and Luxembourg, which was earlier approved as rescue aid by the decision of 19 November 2008.

The Commission has doubts about the viability of the proposed business model, whether Dexia's own contribution to its restructuring costs is sufficient and about the compensatory measures to eliminate the distortions of competition that may be caused by state aid.

So the European Commission has started an in-depth investigation under EC Treaty state aid rules to establish whether the restructuring plan for the Dexia group will restore the group's long-term viability.

NB: The opening of an in-depth investigation gives interested parties an opportunity to comment on the proposed measure. It does not prejudge the outcome of the procedure and the measures approved as rescue aid remain valid while the plan is being studied: Aid measures approved by the decision of 19 November 2008 (the guarantee for bonds issued by Dexia and the liquidity support provided by the Member States) may stand until the Commission has completed its investigation into the restructuring plan.

By the same decision of March, the Commission approved a guarantee granted by Belgium and France to cover Dexia's potential losses from the assets of its US subsidiary FSA. The sale of the loss-making subsidiary is essential for Dexia's recovery. The sale of FSA, however, may not be achieved unless FSA is relieved of some "toxic" assets whose market value is currently extremely low. As Dexia is not able to shoulder this risk alone, the guarantee provided by the Member States is necessary for the sale of FSA, itself a prerequisite for any restructuring. The Commission has therefore approved the guarantee in principle. Nevertheless, as part of its in-depth investigation, the Commission reserves the right to analyse in greater detail certain aspects of the contractual relations between Dexia and the Member States in respect of this guarantee. **This analysis will be carried out taking into account the new Commission communication on the treatment of impaired assets that was adopted on 25 February 2009. This case is the first application of the new communication.**

- **Bank of Ireland case**

The European Commission has approved, under EC Treaty state aid rules, an emergency recapitalisation worth €3.5 billion that the Irish authorities intend to grant to Bank of Ireland. The Commission found the measure to be in line with its Guidance Communications on state aid during the current financial crisis. The measure constitutes an adequate means to remedy a serious disturbance in the Irish economy and is therefore compatible with Article 87.3.b. of the EC Treaty. In particular, the measure is limited in scope, requires an adequate remuneration and provides safeguards to minimise distortions of competition.

The shares to be issued will qualify as core tier 1 capital. They will produce a dividend of 8% payable annually, at the discretion of the bank and in priority to dividends on ordinary shares, with detachable warrants after five years. Dividends on the shares are payable in cash, or - if the bank is not able to pay in cash - in ordinary shares in lieu. The shares will carry 25% of the voting rights in Bank of Ireland. The bank can repurchase the shares at par during maximum five years. After that period, shares can be repurchased at 125% of par. No dividends on ordinary shares are allowed when no dividend on the shares to be issued is paid to the State. On purchase of the preference shares, the State will also receive an option to purchase 25% of the existing ordinary shares in the bank (the 'warrants'). This option may be exercised from the fifth to the tenth anniversary of the preferred shares' purchase.

The Commission concluded that the measure complies with the conditions laid down in its Guidance Communications. In particular, the measure meets the following criteria:

- **Necessity:** Bank of Ireland has an important role within the Irish financial sector and a loss of confidence could have led to a further disturbance of the financial situation and harmful spill-over effects to the economy as a whole.
- **Appropriate own contribution:** a remuneration of 8% per annum is consistent with the Commission's Recapitalisation Communication. The Commission also took into account that the probability of return for the State is reinforced through the possibility of combining the dividend payment in cash and ordinary shares and the existence of warrants.
- **Avoidance of undue distortions of competition**: the package foresees sufficient behavioral rules to prevent an abuse of the state support, e.g. prohibition of advertising of the aid, restrictions on the payment of dividends, restrictions on executives' remuneration, nomination of public interest representatives to the bank's board as well as the submission of a plan for restructuring within 6 months for the Commission's assessment and approval.