

## EU policy and action on state aids and mergers | BY KIRAN S. DESAI AND JENS PETER SCHMIDT

The global crisis in the financial sector has resulted in a rapid formulation of how EU State aid rules should apply to the situation. To a large extent the European Commission, which is the authority with the power to decide whether or not a particular State aid proposal is lawful, has had to create the rules as it goes along, and has had to do so under severe time pressure and political pressure. The Commission analysed in record time around 40 national aid schemes, such as the German and UK rescue packages, designed to support financial institutions and the economy as a whole. It further approved individual grants and issued policy setting communications for the application of State aid rules to bail-outs. It has done so amid pressure from businesses and sometimes Member States to suspend State aid rules and competition rules of which State aid rules form a part.

While the Commission might be seen as generous in the past, the coming months will show how its flexibility in procedure but firmness in substance will play out as restructuring plans of distressed banks are subject to review of the Commission. Interestingly, on 13 March, the Commission started an in-depth investigation to establish whether or not the restructuring plan for Belgium's Dexia group will restore the group's long-term viability.

In relation to M&A, a key question is whether the Commission will pursue a more lenient approach towards mergers in the financial sector by taking into account the financial difficulty banks face, or by requesting less strict undertakings to remedy a too strong market position.

### Legal background

By Article 87 (1) EC Treaty Member States cannot grant State aid that has anticompetitive effects unless there is an exemption. When confronting bail-outs during Q3 last year, the Commission applied its guidance on exemption for rescue and restructuring aid to companies in difficulties that had been issued in 2004 but has its origins in guidance issued in 1994. Northern Rock, Bradford and Bingley, and IKB were all dealt with in this manner. Since then, the Commission has almost exclusively used Article 87 (3)(b) EC Treaty as the basis for proceeding, an extremely rarely used provision in the past which allows State aid to address "a serious disturbance of the economy of a Member State".

The Commission issued guidance documents which explain how it applies this exemption to State aid measures, such as state guarantees, recapitalisation, winding up, liquidity assistance, and the treatment of impaired assets. The Banking Communication of 16 October 2008 lays down general principles to ensure that state support does not result in recipients enjoying an artificially advantageous competitive position compared to non-beneficiary banks. State aid measures need to be well-targeted, proportionate and structured in a way to minimise negative spillover effects. It introduces the distinction between fundamentally sound banks and distressed banks characterised by endogenous problems. The Recapitalization Communication of 5 December 2008 provides supplementary guidance for recapitalisation schemes.

On 17 December 2008, the Commission issued a Communication on a temporary framework for State aid measures to support access to finance

in the current financial and economic crisis. It states that Member States, generally, are permitted to grant subsidised loans for the production of green products, loan guarantees at a reduced premium, risk capital for small or medium-sized enterprises and direct aid of up to €500,000. Germany was the first Member State to put in place respective measures at the end of 2008.

The Impaired Asset Communication of 25 February 2009 explains how the Commission will deal with asset relief measures by Member States (such as asset purchase, asset insurance, asset swaps and a 'bad bank') which are aimed at safeguarding financial stability and underpinning bank lending.

### Add oversight to regulation

The financial sector is already highly regulated, but the State aid regime will impose additional oversight on those who benefit from State aid. The various Commission communications provide the ground rules for putting in place various rescue measures such as State guarantees, recapitalisation and the treatment of impaired assets. Rather than describe those rules in this short article, it is particularly important going forward to note that the Commission requires, through various measures, a review by it of the implementation and effects of the measures taken by the State and the financial entities who are receiving, directly or indirectly, State aid. A good example is a State guarantee. If a State guarantee is activated for a particular bank, structural adjustment measures have to be reflected in a restructuring or even liquidation plan, and this will be reviewed after six months, and every six months thereafter by the Commission. Commission officials have recognised in public statements that the details of how the review exercise will be conducted have yet to be worked out.

Crucially, in the context of what is generally foreseen as a drawn-out period before recovery in the financial sector and the 'real' economy, some have expressed doubt as to the Commission's practical ability to impose painful obligations on financial entities whose restructuring plans are determined not to be sufficient. By the same token, there is doubt about those entities' ability to deliver against the restructuring plans already submitted. What will be clear is that it will not be a fully consensual environment. The Commission is the guardian of EU law, and DG COMP, which is the department dealing with both State aid and competition rules generally, will not wish to sacrifice competition rules – or be perceived to be doing so. Competitors that do not benefit from State aid can be expected to support DG COMP and the Commission in making sure that any 'bitter medicine' that is required to be taken by State aid beneficiaries is definitely taken.

Indeed, competitors that do not benefit from State aid can be expected in the medium term to press their case against State aid beneficiaries (an actual example in the real economy concerns the complaints against State aid in the context of the Lufthansa/Austrian Airlines transaction). For example, in relation to State guarantees, these competitors can be expected to encourage a strengthening of commitments on beneficiary banks in their marketing to actual and potential customers (e.g. no advertising of the guarantee), but other elements of competition are starting to be ques- ►►

tioned, such as a beneficiary's ability to offer apparently above market deposit interest rate to customers. As another example, in relation to recapitalisation, there should be incentives for the beneficiaries to exit as a beneficiary of State recapitalisation, and it can be expected that competitor banks will seek to ensure there are also exit 'sticks' as well as 'carrots'. At the same time, beneficiary banks will be subject to a restrictive policy on dividends, limitation of executive remuneration or the distribution of bonuses. Competitor banks will wish to ensure these are fully enforced, no doubt in an attempt not only to ensure a level playing field of competition, but to be able to place themselves more favourably with the investor community, and even to head-hunt talented managers and senior operators from beneficiary banks.

### Merger control

There has not yet been pressure on how the EU regulates large transactions under the EC Merger Regulation. This is in contrast to the position in the UK, where the UK government initiated and facilitated the merger between Lloyds TSB and HBOS on the basis of a public interest exemption newly introduced into UK merger law. The EC Merger Regulation does not provide such exemption, but there is a 'public interest' test which Member States might consider using. In the meantime, the Commission has already demonstrated an ability and willingness to fast-track merg-

ers where there are no substantive competition issues, e.g., in the BNP Paribas/Fortis deal. As to substance, the failing firm defence (allowing a merger where, broadly speaking, one party will be exiting the market in the absence of the merger) and the feasibility of remedies will likely be at the centre of negotiations with DG COMP when a relevant merger is considered by it, but a 'blank cheque' for abandoning remedies cannot be expected.

### Conclusion

In State aid, the coming months will be crucial as the Commission will analyse a great number of restructuring plans. In this respect, the Commission's 2004 Restructuring Guidelines do not provide an appropriate framework. The Commission is expected to publish a communication soon which should take into account the particularities of the current environment. In merger control, it remains to be seen what impact the crisis will have on the treatment of mergers in the financial sector that do raise substantive competition issues. ■

---

Kiran S. Desai and Dr. Jens Peter Schmidt are Brussels-based partners in the Antitrust & Competition Practice of Mayer Brown. Mr Desai can be contacted on +32 2 551 59590 or by email: [kdesai@mayerbrown.com](mailto:kdesai@mayerbrown.com). Mr Schmidt can be contacted on +32 2 559 5969 by email: [jpschmidt@mayerbrown.com](mailto:jpschmidt@mayerbrown.com)

---



**Kiran S. Desai**  
Partner  
T: +32 2 502 5517  
E: [kdesai@mayerbrown.com](mailto:kdesai@mayerbrown.com)  
[www.mayerbrown.com](http://www.mayerbrown.com)

Kiran Desai is widely regarded as one of Europe's leading legal practitioners in the areas of national and international competition law and EU regulatory matters. Kiran provides comprehensive, in-depth guidance on EU general law, with particular emphasis on procurement law and with demonstrated experience in governmental affairs. Recently,

Kiran has advised clients on regulatory issues concerning developments in nanotechnology.

Kiran has been representing clients on these and related topics for 16 years, practicing first in London and, since 1993, in Brussels. He joined Mayer Brown in 1987 and was named partner some ten years later. In 2006, Kiran

was recognized in The Legal Media Group's Guide to the World's Leading Competition and Antitrust Lawyers. He is also recognised in the Legal Business Report's European Legal Experts 2008 in its Belgian EU and Competition lawyers section.

MAYER • BROWN



**Dr. Jens Peter Schmidt**  
Partner  
T: +32 2 502 5517  
E: [jpschmidt@mayerbrown.com](mailto:jpschmidt@mayerbrown.com)  
[www.mayerbrown.com](http://www.mayerbrown.com)

Jens Peter Schmidt focuses his practice on antitrust and competition matters. He places particular emphasis on merger control notifications to the European Commission and the German Federal Cartel Office, and on the analysis, preparation, and coordination of multi-jurisdictional merger filings. He also

assists clients with complex merger control risk analyses, handles cartel case investigations, and provides assessments of vertical and horizontal arrangements as well as of state aid issues.

Jens Peter joined Mayer Brown in Cologne in 2001 and relocated to the firm's Brussels office

in 2002. Before 2001, he had practiced for three years in the Düsseldorf office of another major global law firm, and from 1995 to 1997 worked in the Institute for Public Law at Rheinische Friedrich-Wilhelms-Universität, Bonn. He is fluent in English in addition to his native German.

MAYER • BROWN