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.

([21]) Transfer agreement of 15 December 1994, Section 2(1).

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

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.

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

([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.

([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.

([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 %.

(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

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.

([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.

(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.

([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.