COMMISSION

COMMISSION DECISION

of 4 June 2008

on State aid C 9/08 (ex NN 8/08, CP 244/07) implemented by Germany for Sachsen LB

(notified under document number C(2008) 2269)

(Only the German text is authentic)

(Text with EEA relevance)

(2009/341/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

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

Whereas:

1. PROCEDURE

(1) The case originated as an ex officio request for information sent to Germany on 21 August 2007. By letter of 21 January 2008 Germany notified the measures as 'no aid' for reasons of legal certainty and indicated as a precaution that the measures should in any event qualify as rescue and restructuring aid compatible with the common market.

(2) By letter dated 27 February 2008, the Commission informed Germany that it had decided to initiate the procedure provided for in Article 88(2) of the EC Treaty in respect of the measures.

(3) The Commission decision to initiate the formal investigation procedure (hereinafter called 'the opening decision') was published in the *Official Journal of the European Union* [2]. The Commission invited interested parties to submit their comments on the aid.

(4) Germany submitted its own comments after the opening of the formal investigation procedure on 28 March and 10, 16, 23 and 30 April 2008. One observation from a third party was received on 16 April 2008. Germany submitted its comments on this third-party observation by letter of 30 April 2008.

(5) A number of meetings and regular telephone conferences took place with Germany, the beneficiary and Landesbank Baden-Württemberg (hereinafter called LBBW).

2. INTRODUCTION

(6) The present case originated with the still ongoing US subprime crisis in which Landesbank Sachsen Girozentrale (hereinafter called Sachsen LB) and in particular one of its off-balance conduits, Ormond Quay, was caught.

(7) A conduit — also known as a special purpose vehicle (SPV) or special investment vehicle (SIV) — is a corporate body (usually a limited company of some type or, sometimes, a limited partnership) created to fulfil narrow, specific or temporary objectives, primarily to isolate financial risk (usually bankruptcy but sometimes a specific taxation or regulatory risk). SIVs have been used because they can remain off balance sheet and not be consolidated by banks. This allows banks to fund lending at cheaper rates than those they would provide themselves (due notably to the obligations of regulatory liquidity ratios). The conduit refinances investments in asset-backed securities (ABSs) by borrowing in the short-term asset-backed commercial paper [3] (CP) market. Potential liquidity needs of the conduits (where the commercial papers are not sold completely) are bridged by credit lines provided by commercial banks.

(8) Ormond Quay was used by Sachsen LB to fund investments in ABSs which included US mortgage-backed securities. In order to guarantee the liquidity needs of the conduit in case the commercial banks withdrew the credit lines, Sachsen LB had to guarantee the liquidity of Ormond Quay and assume special liquidity facilities. In return for assuming the risk, Sachsen LB received the generated surplus of the

[1] OJ C 71, 18.3.2008, p. 14.
[2] See footnote 1.
[3] Commercial paper is a money market security issued by large banks and corporations.

conduit in the form of an annual fee. Ormond Quay generated a significant surplus by financing the long-term and high-yield ABS investments through short-term and low-yield commercial papers.

(9) Market conditions deteriorated, however, as a result of the subprime crisis. In the course of the ongoing crisis in the US subprime mortgage market, the three major rating agencies downgraded a huge part of assets backed by mortgages which ranged from A + to BB, to as low as CCC because of high default and foreclosure rates. This immediately had a negative impact on the valuations of these ABSs. In the light of these market conditions the hedge funds and institutional investors refused to reinvest in mortgage-backed commercial papers. SPVs were thus no longer able to borrow in the short-term asset-backed commercial paper market.

(10) Ormond Quay was seriously affected by this phenomenon. The commercial banks providing credit lines to Ormond Quay also withdrew, making it necessary that it draw upon the liquidity facility provided by Sachsen LB. In August 2007 it was unable to refinance itself any longer and needed liquidity of up to EUR 17,1 billion. Sachsen LB was not able to provide the credit facilities it had pledged. Fire sales ([4]) of assets in depressed market conditions would have led to considerable losses for Sachsen LB and would have resulted in the insolvency of the bank. For this reason various measures were taken.

3. **DESCRIPTION OF THE MEASURES**

3.1. *THE BENEFICIARY*

(11) The beneficiary is Sachsen LB. The shareholders of Sachsen LB were the Free State of Saxony (around 37 %) and Sachsen-Finanzgruppe (hereinafter called SFG), a holding company linking eight Saxony savings banks with the cross-regional Sachsen LB (around 63 %), which is itself owned by local authorities (77,6 %) and the Free State of Saxony (22,4 %).

(12) Sachsen LB had in 2006 a group balance-sheet total of EUR 67,8 billion and own capital of EUR 880 million. Sachsen LB acted as central bank to Saxony's savings banks. As a commercial bank, Sachsen LB executed banking transactions of all kinds. Sachsen LB Europe plc (hereinafter called Sachsen LB Europe) was a wholly owned subsidiary of Sachsen LB and was based in Dublin. It was a service provider for structured financial investments and was until mid-2007 the main source of profits for the Sachsen LB group.

([4]) Selling the securities very quickly even for a low price, at a loss.

(13) Until 18 July 2005 Sachsen LB still profited from the unlimited state guarantees '*Anstaltslast*' and '*Gewährträgerhaftung*', which had to be abolished following a number of understandings between Germany and the Commission. According to the first of the understandings dated 17 July 2001, within a transitional period until 18 July 2005 new liabilities could still be covered by *Gewährträgerhaftung* (so-called grandfathering), provided their maturity did not go beyond 31 December 2015 ([5]).

(14) On 26 October 2007 the legal form of Sachsen LB was changed from a public-sector institution (*Anstalt des öffentlichen Rechts*) into a joint stock company.

(15) On 26 August 2007 Sachsen LB was sold with effect from 1 January 2008 to LBBW. On 7 March 2008 the takeover by LBBW was finalised and Sachsen LB was subsequently integrated into LBBW.

3.2. *THE BUYER OF THE BENEFICIARY*

(16) LBBW is the Landesbank for the Federal State of Baden-Württemberg and acts as well as a universal and a commercial bank. Together with its regional retail bank BW-Bank it offers the whole range of banking products. LBBW functions as the central bank for the savings banks in Baden-Württemberg. For the savings banks in Rhineland-Palatinate it is the central banking institution together with Landesbank Rheinland-Pfalz, which was taken over by LBBW on 1 January 2005.

(17) The LBBW model, which has now been extended to Saxony, is based on locally rooted banks concentrating on SMEs and private banking (BW-Bank for Baden-Württemberg, RP-Bank for Rhineland-Palatinate, and now Sachsen Bank for Saxony) and centralised functions in Stuttgart, supported by one direct LBBW branch in each, Saxony and Rhineland-Palatinate.

3.3. *THE MEASURES*

(18) As described in detail in the opening decision ([6]) Sachsen LB got caught in the maelstrom of the still ongoing US subprime crisis in particular because of one off-balance conduit, Ormond Quay, which was unable to refinance itself and was in need of liquidity of up to EUR 17,1 billion in order to avoid fire sales.

([5]) See E 10/2000 for details (OJ C 146, 19.6.2002, p. 6 and OJ C 150, 22.6.2002, p. 7) and http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_e2000_0000.html#10

([6]) See the decision referred to in footnote 1.

3.3.1. THE LIQUIDITY MEASURE

(19) On 19 August 2007, a group of 10 German Landesbanken and DekaBank (an agency under public law which is jointly held by the German Landesbanken and by DSGV) (hereinafter called 'the banking pool') entered into a pool contract, committing them to buying the CPs emitted by Ormond Quay up to an amount of EUR 17,1 billion if these could not be placed on the market.

(20) Each pool bank would acquire the CPs in its own name and for its own account. The pool banks were not jointly liable. DekaBank had a share of around […] (*). The remaining part was taken over by the other Landesbanken according to their respective size and performance. According to the information received by Germany, the maximum amount of CPs actually bought until the beginning of January 2008 by the banking pool under the pool contract was EUR […] billion.

(21) The remuneration for the CPs was fixed at the reference rate (Euribor or Libor depending on the origin of the underlying assets) plus a margin of […] bps. The duration of the CPs could not exceed one month. The pool contract was limited to a period of six months. The pool banks only had to buy the CPs which could not be placed on the market.

(22) Whereas in August 2007 the demand for mortgage-backed CPs had completely dried up and there was no efficient market for this type of investment, the situation gradually improved. Since October 2007 some investors (mainly […(banks belonging to the public sector)]) had started again to buy CPs on the market outside the context and the detrimental conditions of the pool contract, i.e. for a remuneration of less than […(50-100)] bps, so that the pool contract lost its initial purpose. The pool contract came formally to an end on 23 February 2008.

3.3.2. THE SALE OF SACHSEN LB

(23) Sachsen LB had already in 2005 started to look for a strategic partner in particular among the other Landesbanken ([7]). Due to these pre-negotiations it was possible for negotiations on the sale of Sachsen LB to progress swiftly on 23 August 2007, i.e. one week after the signing of the pool contract, when Sachsen LB recorded losses of EUR 250 million as described in detail in the opening decision ([8]). Since the losses in Sachsen LB's structured finance portfolio would have implied a further decrease in Sachsen LB's equity, approaching the minimum regulatory capital requirements, the shareholders of Sachsen LB had to find a sustainable solution for the bank. Talks with interested buyers were therefore continued and intensive negotiations were held with several interested parties.

(24) This led to the sale to LBBW because it submitted, according to Germany, the economically best offer. LBBW had a particular interest in buying Sachsen LB in order to ensure its market expansion not only in Saxony but also in Eastern Europe.

(25) On 26 August 2007 a sales agreement was signed which stipulated that Sachsen LB would be sold with effect from 1 January 2008 to LBBW. However, the agreement envisaged that the price to be paid should be determined by an evaluation of an independent expert which should take place after the current financial market crisis had been overcome, which was then envisaged for the end of 2007. In the sales agreement a minimum price of EUR 300 million by way of shares in LBBW was determined. Moreover, a step-out-clause for LBBW in case the core capital ratio fell below a certain threshold was added.

(26) The signed sales agreement included immediate prepayment of EUR 250 million by LBBW to the shareholders of Sachsen LB, who in turn injected this capital into the bank to cover losses. According to Germany, this amount was sufficient to fulfil the regulatory capital requirements and to absorb potential additional losses.

(27) At the time of the sale, the parties expected that the crisis would soon be over. On the assumption that the markets would have normalised by the end of the year, LBBW did not make any special arrangements for the structured investment portfolio of Sachsen LB and would have acquired it. In particular, it was considered that Ormond Quay's problems would resolve themselves over time and it would again be able to re-finance itself on the market.

(*) Parts of this text have been deleted so as not to divulge confidential information; they are indicated by a series of dots between square brackets.

([7]) Talks were held with several Landesbanken, including WestLB and LBBW.

([8]) See the decision referred to in footnote 1. The entire transaction is described there in more detail.

(28) At the end of 2007, further risks involved in Sachsen LB's structured investment portfolio appeared. Before closure of the sale, the situation in the financial markets further deteriorated and in particular Ormond Quay became problematic because the mark-to-market ([9]) evaluation of its assets amounted to losses of about EUR […(0,5-1,5)] billion.

(29) This endangered the final sale of the bank, given that the core capital could potentially have fallen below the required minimum threshold. The mark-to-market devaluations had to be accounted as losses and as a consequence reduced the core capital in the balance sheet. It appeared that Sachsen LB's core capital ratios would fall below […] %, which gave LBBW the right to renegotiate the sale.

(30) Even if market conditions had improved from August ([10]) and selling the assets would have been a possibility, LBBW was neither capable nor willing to assume such high mark-to-market losses. To be able to conclude the deal, a solution had to be found to prevent these losses from being reflected in the valuation of Sachsen LB. Otherwise, LBBW would have to pay for these losses, in addition to the minimum purchase price of EUR 300 million that had been set in August.

(31) After intensive negotiations, a final and non-reversible agreement concluding the sale of the bank (*Eckpunktevereinbarung*) was signed on 13 December 2007. The solution found was to avoid consolidation of the mark-to-market losses coming from Sachsen LB's conduits and to protect LBBW from potential losses that could be incurred from the conduits if the securities in the portfolio were held to maturity. An alternative solution could have been e.g. to consolidate the mark-to-market losses and to obtain additional capital from the owners of Sachsen LB for the corresponding amount (estimated to be about EUR […(0,5-1,5)] billion), before selling the bank to LBBW. Instead of incurring the mark-to-market losses, the preferred solution was for the Free State of Saxony to provide a state guarantee on a portfolio of structured investments.

(32) The final agreement identified the entire structured investments of Sachsen LB and divided them into two portfolios. In order to avoid the consolidation of all the structured investments into LBBW, one portfolio with a nominal value of EUR 17,5 billion ([11]) was excluded from the sale. These assets were therefore transferred into a newly founded special investment vehicle (the so-called Super SIV). In this way only structured portfolio investments ([12]) with a refinancing requirement of about EUR 11,8 billion remained in Sachsen LB and thus were sold to LBBW. In order to cover potential losses from these investments, an amount of EUR 500 million was deducted from the sales price.

(33) The Super SIV is an investment vehicle which was created for the purpose of transferring structured investment portfolios with a low mark-to-market value out of Sachsen LB before the sale with the intention of holding them until maturity. In order to transfer the portfolio into the Super SIV its refinancing needed to be organised. This was provided partly by LBBW (junior tranche) and partly by the other Landesbanken (senior tranche). In order to avoid consolidation of the Super SIV in the LBBW balance sheet, LBBW's participation had to remain below 50 %. Following intensive negotiations, the Landesbanken took over 50 % of the refinancing of the Super SIV but only agreed to participate in the refinancing on condition that in case of losses their financing ranked above the financing provided by LBBW. LBBW, in turn, requested, in order to limit its risk to a normal commercial level, a guarantee by the Free State of Saxony covering any realistically assumed potential losses. The aim was to cover the portfolio from any possible losses that might occur if held to maturity. These losses would correspond to a risk of default. The Free State of Saxony finally agreed to grant a guarantee to the amount of EUR 2,75 billion for losses from the Super SIV. This amount was established during intensive negotiations between LBBW and the Free State of Saxony and based on valuations by investment banks which estimated that in this case the default risks for the refinancing banks was close to zero ([13]).

(34) In addition, the final agreement fixed a fee to be paid for the guarantee for the first four years at […] % per year of the amount of the guarantee which has not been used. It will then be reduced to 2/3 of the initial fee for the next 3 years and to 1/3 of the initial fee per year thereafter. This corresponds to EUR […(> 90)] million within 10 years assuming the guarantee is not used.

(35) As mentioned above, the Super SIV was financed in two tranches. The first tranche of just below 50 % (EUR 8,75 billion) was financed by LBBW. The second tranche of just above 50 % (EUR 8,75 billion) was provided by member banks of the Guarantee Fund (*Sicherungsreserve*, comparable to a deposit and institute guarantee scheme) of the Landesbanken. Owing to the allocation of risks between the two tranches, LBBW is liable with its liquidity for losses exceeding the maximum amount of the guarantee of EUR 2,75 billion of the Free State of

([9]) In accounting and finance, mark-to-market corresponds to assigning a value to a position held in a financial instrument on the basis of the current market price for that instrument or similar instruments. For example, the final value of a futures contract that expires in nine months will not be known until it expires. If it is marked to market, for accounting purposes it is assigned the value that it would fetch in the open market currently.

([10]) Risk premiums had gone from 4-5 basis points before the crisis to complete drying out of the market at the height of the crisis to around 40 basis points when markets were starting to work again.

([11]) The portfolio includes Ormond Quay, Sachsen Funding and Synapse ABS.

([12]) LAAM, Georges Quay, Synapse L/S + FI, Omega I + II and other synthesised assets (CDOs, ABSs, CDSs, CPPIs, etc.).

([13]) The banks would nevertheless have to provide liquidity and thus incur some refinancing costs.

Saxony, up to an amount of EUR 8,75 billion. Only further losses would be covered by the other Landesbanken.

(36) In December 2007 the Free State of Saxony commissioned auditors Susat & Partner to assess the value of Sachsen LB as agreed in the sales agreement. Susat & Partner concluded that the value of the bank amounted to EUR […] billion. Simultaneously LBBW asked […] (hereinafter called […]) to cross-check the valuation. […] arrived at the conclusion that Sachsen LB was worth about EUR […] billion. During the ongoing negotiations the parties then agreed to use the value of EUR […] billion for Sachsen LB.

(37) The final agreement determined the net sales price of Sachsen LB at EUR 328 million, to be paid in cash ([14]). This was the result of the estimated value of the bank of EUR […] from which were deducted losses of EUR […] million for portfolio 2 realised in 2007 and the agreed EUR 500 million loss set-off for portfolio 1 remaining with Sachsen LB. Including the EUR 250 million up-front payment, LBBW thus paid EUR 578 million to acquire Sachsen LB.

(38) The refinancing of the structured investment portfolio transferred to the Super SIV led to the expiry of the *Gewährträgerhaftung* of the Free State of Saxony for this portfolio.

3.4. *THE RESTRUCTURING PLAN*

(39) LBBW has produced a restructuring plan for Sachsen LB which originates from the time of the sale of Sachsen LB and which was last modified on 9 April 2008. The Commission understands that the restructuring plan commenced with the sale of Sachsen LB, i.e. on 1 January 2008 and covers a restructuring period of four years until the end of 2011.

(40) According to the plan Sachsen LB AG will be integrated into LBBW, but will continue to exist in the form of a dependent subsidiary (*unselbständige Anstalt*), named Sachsen Bank. This entity will also take over the corporate and private banking business of the existing local retail branches of LBBW in Saxony (BW-Bank). However, kinds of business other than corporate and private banking will be taken out of Sachsen LB and transferred to the LBBW branch in Saxony.

(41) As a result, Sachsen Bank will take over only one of the two legs of Sachsen LB, namely the corporate banking business, as well as the rather underdeveloped private banking business of Sachsen LB, and make it together with the corresponding business of BW-Bank its new second leg. Sachsen Bank will be able to compete in Saxony and outside on its own merits.

(42) The second leg of Sachsen LB, i.e. the capital markets business, will remain in LBBW and will be offered in Saxony by a branch of LBBW. LBBW will also take over back-office functions and will partly function as central bank for the savings banks in Saxony.

(43) The analysis of the restructuring plan regarding the restoration of viability is based on the business activities of Sachsen LB before its integration into LBBW ([15]). The restructuring includes the outsourcing of the first portfolio into the Super SIV. Moreover, the plan indicates as an option by way of compensatory measures the closing down of the whole of Sachsen LB's Dublin-based subsidiary (Sachsen LB Europe), which was in charge of developing and managing all of Sachsen LB's internationally structured portfolios.

(44) Therefore, no new international capital market activities will be performed by Sachsen LB. Only the assets of the second portfolio of EUR 11,8 billion remain in LBBW. On this basis the projections indicate that the bank will restore its profitability within the restructuring period of four years.

(45) As proof of viability, Germany provided in essence the following figures:

([14]) The final agreement included the option for the Free State of Saxony to transform the sales price into shares in LBBW.

([15]) In this respect the main structural measures of the restructuring plan are the reduction of staff from […] to about […], the introduction of improved risk controls and risk management, and the integration of central functions including IT into LBBW.

Gross revenues (worst case) (in EUR million)	2007	2008	2009	2010	2011	2012	CAGR 2007-2012 (1) (in %)
Corporate finance	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Capital markets (2)	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Others	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Total before synergies	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Revenue synergies (new business model)	[…]	[…]	[…]	[…]	[…]	[…]	
Total incl. synergies	[…]	[…]	[…]	[…]	[…]	[…]	[…]

(1) CAGR 2007 - 12 = Compound annual growth rate in the period 2007 to 2012.
(2) In the meantime it has been decided that this activity will be transferred to the LBBW bank in Saxony.

Operating income before tax (worst case) (in EUR million)	2007	2008	2009	2010	2011	2012	CAGR 2007-2012 (in %)
Corporate finance	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Capital markets	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Others	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Total before synergies	[…]	[…]	[…]	[…]	[…]	[…]	[…]
Synergies	[…]	[…]	[…]	[…]	[…]	[…]	
Total incl. synergies	[…]	[…]	[…]	[…]	[…]	[…]	[…]

(46) In addition, Germany indicated that LBBW expects as of 2009 a return on equity for the former Sachsen LB of […(> 8)] % and for the newly created Sachsen Bank of around […(> 15)] %.

4. THE FORMAL INVESTIGATION PROCEDURE

4.1. *REASONS FOR OPENING THE PROCEDURE*

4.1.1. THE LIQUIDITY MEASURE

(47) In the opening decision the Commission questioned the liquidity support because the measure seemed to confer a selective advantage upon Sachsen LB, it being unlikely that a market economy investor would have granted the credit facility to Sachsen LB on the same conditions as the banking pool. The Commission did not, however, rule out the possibility that the measure might constitute rescue aid compatible with the common market.

4.1.2. THE SALE OF SACHSEN LB

(48) The Commission further assessed whether the sale of Sachsen LB to LBBW involved state aid. It raised doubts as to whether the Free State of Saxony had behaved like a market economy investor because liquidation would have been less costly than accepting the sale with the guarantee, and thus the sale might involve state aid elements to Sachsen LB. However, it did not express concerns that the sales price was too low and thus involved state aid elements to the buyer (i.e. LBBW). Nor did it exclude that the guarantee might constitute restructuring aid compatible with the common market if the conditions of the Community Guidelines on State aid for rescuing and restructuring of firms in difficulty [16] (hereinafter called the Guidelines) were met.

5. COMMENTS FROM INTERESTED PARTIES

(49) The third party argued that the guarantee granted to the Super SIV constituted state aid, that LBBW's EUR 391 million contribution to Sachsen LB's 2007 results and the underwriting of the year's net loss to the tune of EUR 641,6 million likewise constituted state aid, and that the sales price paid by LBBW to the owners exceeded Sachsen LB's market value.

6. COMMENTS FROM GERMANY FOLLOWING THE OPENING DECISION

6.1. *AS REGARDS THE ASSESSMENT OF THE LIQUIDITY MEASURE*

(50) Germany argued that the liquidity measure provided by the banking pool would also have been provided by a market investor, because the remuneration the pool banks received for the CPs issued by Ormond Quay was above the market remuneration and thus market conform. Moreover, the banking pool would not cover potential losses related to fluctuations in the market price of the ABSs in the conduit. Even if the market value of the assets suffered, the default risk would be very low and in the case of a hold strategy the expected losses would be marginal.

(51) Furthermore, Germany argued that the banks had acted mainly in order to prevent a general banking crisis triggered by the insolvency of one of its sister Landesbanken. They had considered it less risky to buy the CPs than to deal with the insolvency of Sachsen LB, in particular if the deposit scheme were to be activated. In addition, Germany pointed out that, even in the absence of a market, market benchmarks could be determined hypothetically.

(52) Finally, Germany argued that, if the Commission were to consider the liquidity measure as involving state aid elements, it would in any event qualify as rescue aid compatible with the common market because the CPs provided by the banking pool were, first, similar to a loan, second, in any event not structural, and, third, limited to six months.

6.2. *AS REGARDS THE ASSESSMENT OF THE SALE OF SACHSEN LB*

(53) Concerning the sale of Sachsen LB, Germany argued that the Free State of Saxony had behaved like a market economy vendor. The purchase price, which was the result of negotiations conducted with several potential buyers and was based on valuations by auditors according to generally acknowledged auditor rules, reflected the fair market value of Sachsen LB. Furthermore, even including the liabilities stemming from the EUR 2,75 billion guarantee granted to the Super SIV, the owners of Sachsen LB had still sold the bank for an overall positive price.

(54) Germany reiterated that three different approaches had been considered in order to determine the risks inherent in the guarantee granted to the Super SIV. The first approach was based on a mark-to-market evaluation as at 30 November 2007 estimating potential losses when selling the investments on that date at about EUR […] billion. However, Germany explained that the results of the market value approach were distorted by the fact that there was at that time neither a market for such types of investment, nor the intention to sell them ad hoc given that the investments were to be held until maturity. The second approach, based on models reflecting potential macroeconomic developments, calculated the potential losses of the portfolio in three different scenarios. The expected losses were estimated at about EUR […(> 800)] million in a bad case, EUR […(< 500)] million in a base case and EUR […(< 200)] million in the best case. The approach was developed by LBBW and Sachsen LB on the basis of existing internal models. The third approach was based on the rating of the underlying assets. According to Germany, nearly all the assets included in the portfolio were AAA rated [17] and no downgrading had occurred. Based on the probability of failure of AAA-rated assets of nearly zero, the expected losses of the portfolio amounted to zero.

(55) According to Germany, the total amount of the guarantee, i.e. EUR 2,75 billion, was the result of negotiations between the parties, where LBBW tried to increase it as much as possible to limit its own liability, while the Free State of Saxony tried to reduce the guarantee to a minimum.

[16] OJ C 244, 1.10.2004, p. 2.

[17] Rating issued in December 2007.

(56) Germany submitted that the results of all three approaches were available at the time of the negotiations. It explained that the second, i.e. the model, approach was accepted by the negotiating parties as the appropriate way of determining the risks which needed to be covered by the guarantee.

(57) Germany provided different scenario calculations to demonstrate that the sale of the bank resulted in a positive price for the owners, even if the base default scenario of the guarantee was considered. It argued that it was the Commission's constant practice to rely on the base case scenario rather than a worse case scenario ([18]).

(58) Germany argued that, if the Commission were to consider the sale of the bank as involving state aid elements, it would in any event qualify under the Guidelines as restructuring aid compatible with the common market.

(59) To this end LBBW had provided the abovementioned restructuring plan which indicated how Sachsen LB was to restore its viability. Germany claimed that the plan indicated several internal measures, such as staff reductions, measures to improve risk management, integration of segments into LBBW and IT standardisation. Moreover, a clear aim of the business plan was to reduce the dependence of Sachsen LB on profits from capital markets and in particular from the 'asset management & structured products' business segment.

(60) Germany argued further that the investment of several hundred million euro which LBBW had made to acquire Sachsen LB had to pay off and that LBBW would therefore do its utmost to restore Sachsen LB's long-term viability.

(61) Regarding its own contribution, Germany argued that considerable own efforts had been made by LBBW and the other banks totalling EUR […(about 30)] billion and that this met the standards set forth in the Guidelines. The amount of EUR […(about 30)] billion was based on costs for the setting-up of the Super SIV (EUR […] million), the integration of Sachsen LB (EUR […] million) and the financing of portfolio 2 (EUR 17,5 billion) and portfolio 1 (EUR 11,8 billion).

(62) Finally, Germany was of the opinion that an important compensation to be considered was the sale of Sachsen LB by its former owners to LBBW. The sale underlined the joint wish for a durable restructuring of the bank. According to Germany, the sale of companies in difficulty constituted an essential step toward their durable restructuring. It could generally be assumed that a company would more likely be viable under the control of a well established major German bank and that this ensured that the company would not have to rely on state aid again. The sale would thus prove to be a central element of the restructuring of Sachsen LB.

(63) Furthermore, no competitor had submitted comments on the Commission's opening decision. The sale of the bank would thus not lead in the eyes of other competitors to a distortion of competition.

(64) Germany provided in agreement with LBBW (on behalf of the beneficiary of the aid, i.e. Sachsen LB) the following commitments ([19]):

(a) The following assets of Sachsen LB, which during the course of the integration have gone over to LBBW, will be sold or liquidated:

— Sachsen LB Europe will be sold or liquidated by […]. The LBBW group will not take over any staff from Sachsen LB Europe, unless it is required to do so by legal obligations, and will therefore neither propose to nor conclude with existing staff of Sachsen LB Europe any new working contracts ([20]). This commitment is valid for a period of two years from the date of the Commission's decision.

([18]) Commission Decision in Case C 28/02 *Bankgesellschaft Berlin* (OJ L 116, 14.5.2005, p. 1).

([19]) 'Die Regierung der Bundesrepublik Deutschland bietet der Europäischen Kommission in Abstimmung mit der Landesbank Baden-Württemberg (LBBW) die nachfolgend unter a. – c. abschließend angeführten Ausgleichsmaßnahmen an:

a. Die folgenden Beteiligungen der Sachsen LB, welche im Zuge der Integration auf die LBBW übergegangen sind, werden nach Maßgabe der folgenden Bestimmungen veräußert oder liquidiert:
   — Die Sachsen LB Europe PLC wird bis zum […] veräußert oder liquidiert,
   — Die Beteiligung an der East Merchant GmbH wird bis zum […] veräußert,
   — […],
b. Die Regierung der Bundesrepublik Deutschland verpflichtet sich, dass die Sachsen-Bank, vertreten durch die LBBW, in keiner ihrer Niederlassungen im Freistaat Sachsen über die Betreuung ihrer Kunden in ihren Kerngeschäftsfeldern hinausgehende Eigenhandelsgeschäfte auf eigene Rechnung und eigenes Risiko als eigenständiges Geschäftsfeld aktiv betreibt. Diese Verhaltenszusage gilt für den vorgesehenen Restrukturierungszeitraum von vier Jahren.
c. Die Regierung der Bundesrepublik Deutschland verpflichtet sich, dass die Sachsen-Bank, vertreten durch die LBBW, in keiner ihrer Niederlassungen im Freistaat Sachsen über die Betreuung ihrer Kunden in ihren Kerngeschäftsfeldern hinausgehende internationale Immobiliengeschäfte als eigenständiges Geschäftsfeld aktiv betreibt. Diese Verhaltenszusage gilt für den vorgesehenen Restrukturierungszeitraum von vier Jahren.'

([20]) The Commission understands that the caveat that staff might be retained by LBBW if required by law applies to not more than 10 employees and relates to portfolio 1 of EUR 11,8 million which is taken over by LBBW. It cannot be excluded that this portfolio is considered a partial transfer of operation which might have the consequence that LBBW is under an obligation to take over the related employees. This should, however, not have any impact on the overall effectiveness of the closure of Sachsen LB Europe.

— The participation in East Merchant GmbH will be sold by […].

— […] ([21]).

(b) Germany commits that SachsenBank, represented through LBBW, will not carry out actively in any of its branches in Saxony as an independent business activity proprietary trading activities on its own account and at its own risk going beyond those of customer service in its core business activities. This behavioural commitment is valid for the restructuring timeframe of four years.

(c) Germany commits that SachsenBank, represented through LBBW, will not carry out actively in any of its branches in Saxony as an independent business activity international real estate business going beyond that of customer service in its core business activities. This behavioural commitment is valid for the restructuring timeframe of four years.

(65) Germany confirmed that […]. Germany claims that the activity is profitable and not related to the current crisis in the subprime housing segment, which was triggered by increased lending to higher-risk borrowers with lower income or lesser credit history than prime borrowers.

(66) Germany further confirmed that […] ([22]).

6.3. *AS REGARDS THE OBSERVATIONS OF THE THIRD PARTY*

(67) Concerning the observations of the third party Germany argued that the guarantee granted to the Super SIV did not constitute state aid because, even including the potential liabilities stemming from the EUR 2,75 billion guarantee granted to the Super SIV, the owners of Sachsen LB had still sold the bank for an overall positive price, and that the contribution from LBBW to Sachsen LB's 2007 results as well as the EUR 250 million prepayment had been considered by LBBW to be part of the sales price and therefore the sales price paid by LBBW to the owners reflected the market price of the bank. Germany stressed that, apart from the EUR 391 million contribution from LBBW to Sachsen LB's 2007 results, no other loss compensation had been paid.

([21]) […]. This activity is profitable and not related to the current crisis in the subprime housing segment, which was triggered by increased lending to higher-risk borrowers with lower income or lesser credit history than prime borrowers.

([22]) 'Die Regierung der Bundesrepublik Deutschland bestätigt, dass […]'.

7. **LEGAL ASSESSMENT**

7.1. *EXISTENCE OF STATE AID*

(68) As stated in Article 87(1) EC, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

(69) The Commission adheres to its opinion as expressed in the opening decision that neither of the two financial interventions would have been provided by a market economy investor and hence both measures constitute state aid.

(70) It should be noted, however, that already in its opening decision the Commission did not raise any competition concerns about the refinancing by LBBW and the banking pool. This is further enlarged upon at the end of this section.

7.1.1. THE LIQUIDITY MEASURE

(71) DekaBank and most of the Landesbanken are agencies under public law. DekaBank is jointly held by the Landesbanken and the regional savings banks associations. The Landesbanken are generally held by the Länder and the regional savings banks associations. The credit facility of EUR 17,1 billion which has been made available by the banking pool to Sachsen LB is therefore attributable to the State and can be regarded as 'granted by a Member State or through state resources' within the meaning of Article 87(1) EC ([23]). Moreover, in view of Sachsen LB's cross-border and international activities any advantage from state resources would also affect competition in the banking sector and have an impact on intra-Community trade.

(72) Furthermore, the Commission notes Sachsen LB's cross-border and international activities, so that any advantage from state resources would affect competition in the banking sector and have an impact on intra-Community trade ([24]).

([23]) The imputability can be inferred from a set of indicators arising from the circumstances of the case and the context in which the measure was taken. For example, the supervisory boards of the Landesbanken are on a personal level closely affiliated with the State. In addition the action of the banking pool was in this case closely coordinated by Bafin and the Bundesbank.

([24]) Commission Decision of 27 June 2007 in Case C 50/06 *BAWAG* (OJ L 83, 26.3.2008, p. 7, paragraph 127).

(73) Germany denies that the measure confers a selective advantage upon Sachsen LB. The Commission would recall that under Article 87(1) EC any measure financed with state resources which favours an undertaking normally constitutes state aid, unless the measure would have also been taken by an investor operating under normal market economy conditions. Thus the behaviour of the banking pool in granting the liquidity measure at issue needs to be in conformity with the market economy investor principle in order to exclude state aid elements. It is therefore appropriate to analyse whether a market economy investor would have granted the credit facility to Sachsen LB on the same conditions as the banking pool.

(74) The Commission would observe that, at the time the pool contract was concluded, the demand for mortgage-backed CPs had practically dried up and that therefore there was no longer any effective market for this type of investment. Such lack of demand should, however, not be confused with the absence of a market benchmark. Instead the market benchmark was simply that such CPs had at that time no reasonable economic value. That implies that, even if the CPs issued by Ormond Quay were AAA rated, properly remunerated and the default risks were very low, there remained no commercial interest for this type of investment. The Commission therefore concludes that a market economy investor would not have granted the credit facility to Sachsen LB. Therefore the measure constitutes state aid.

7.1.2. THE SALE OF SACHSEN LB

(75) Germany disputes that the sale of Sachsen LB to LBBW could involve state aid. The Commission, however, maintains its view that the Free State of Saxony did not behave like a market economy investor when selling Sachsen LB. The sale of Sachsen LB to LBBW could involve state aid in two respects: first, to the buyer (i.e. LBBW), if too low a sales price was accepted, and, second, to Sachsen LB, if liquidation would have been less costly than accepting the sale with the guarantee.

(76) The Commission considers that the sales price paid by LBBW corresponds to the market value of Sachsen LB and observes that the Free State of Saxony conducted negotiations with several potential buyers and in the end decided to sell Sachsen LB to LBBW. The Commission would recall that the sales price is considered to be the market price if the sale is organised via an open and unconditional tender and the assets go to the highest or only offer. While such a tender, if carried out properly, can exclude the presence of state aid elements, its absence does not automatically mean that state aid is present. In the case at hand, the parties to the sales agreement decided to carry out a valuation in order to determine the value of Sachsen LB as at 31 December 2007, on the assumption that the financial market would have stabilised by then, allowing a more 'normal' market evaluation. While such an evaluation does not automatically exclude the presence of state aid elements, in the case at hand the Commission did not find any evidence putting the market orientation of the transaction into doubt. On the basis of the information available, the Commission has no reason to consider that the company was sold below market price. As explained in paragraph (37), the value of Sachsen LB in December 2007 was established at EUR 328 million ([25]), which is the price paid by LBBW. Also, within the formal investigation procedure no party submitted comments calling into doubt the adequacy of the sales price and the Commission is not aware of any party which would have been interested in acquiring Sachsen LB and would have been willing to offer a higher price. The Commission thus maintains its view that the sale took place at the market price and that no state aid was granted to LBBW in connection with the sale of Sachsen LB.

(77) In addition, the Commission assessed whether Sachsen LB received an advantage because liquidation would have been less costly for the Free State of Saxony than accepting the sale with the guarantee. The Commission's investigation could not confirm that the Free State of Saxony sold Sachsen LB for a positive sales price (i.e. received a higher sales price than the funds it provided). While the existence of a positive sales price cannot be disputed as regards the original sales agreement of August 2007, according to which LBBW would have paid at least EUR 300 million plus an up-front cash payment for Sachsen LB, it is no longer the case after the December renegotiations, because the Free State of Saxony has provided a guarantee of EUR 2,75 billion and received in return […] % of the sales price of EUR 328 million (EUR […] million) in cash plus the revenues resulting from the potential provision (nominal value of EUR […(> 90)] million) ([26]).

([25]) EUR […] billion (value of Sachsen LB according to […] valuation as commissioned by LBBW) minus EUR […] million (realised losses in 2007) minus EUR […] million (up-front payment for losses in the transferred investment portfolio 1) = EUR 328 million.

([26]) The Commission notes that the guarantee, although prima facie granted for securing the refinancing of the Super SIV, was in fact aid to Sachsen LB because it enabled the sale of Sachsen LB. Without the creation of the Super SIV, which was in turn only possible with the guarantee, the sale of Sachsen LB would have been impossible. The guarantee does, however, remain with the Super SIV and thus does not grant an advantage to LBBW, because the Super SIV is not transferred to LBBW.

(78) The investigation did not alter the Commission's view that the EUR 250 million prepayment of August 2007 would not have been taken into account by the owners when comparing the costs of liquidation and the sale with a guarantee as the amount was not reimbursable in the event of the sale falling through. In other words, as there was no obligation on Sachsen LB's previous owners to reimburse LBBW the prepayment should the sale fall through, the prepayment would not have been considered an additional cost by a market economy investor in a hypothetical counter-scenario.

(79) The Commission then had to establish whether Sachsen LB's costs under the guarantee go beyond the price received for Sachsen LB. This would at least be the case if the value of expected losses under the EUR 2,75 billion guarantee were to be above the amount received of EUR […] million (plus any potential nominal provisions of up to EUR […] million).

(80) Germany estimated the expected losses involved in the guarantee at EUR […(> 800)] million in a bad case, EUR […(< 500)] million in a base case and EUR […(< 200)] million in the best case. However, the Commission's doubts whether the model applied by LBBW to quantify the expected losses in the guarantee fully reflects the aid element involved in the guarantee could not be allayed. The Commission would point out that, based on established case law, the aid element involved in a guarantee to a company in difficulty may be as high as the amount effectively covered by the guarantee (i.e. in this case EUR 2,75 billion). The Commission would stress, moreover, that, even in the base case scenario, which was based on the assumption of a quick recovery of the markets, the expected losses would have meant a negative price for the Free State of Saxony.

(81) Furthermore, the Commission obtained confirmation in the investigation of the view that a market economy investor would, in such unpredictable circumstances, have taken into account at least the bad case scenario of EUR […(> 800)] million of expected losses. The Commission would observe that in reaching this conclusion it is in line with the previous case of *Bankgesellschaft Berlin* ([27]). Contrary to what is claimed by Germany, accepting the base case scenario is not an established practice ([28]).

(82) However, the Commission recognises that a negative sales price might exceptionally be accepted by a market economy investor if the liquidation costs for the seller would be higher. For the calculation of the liquidation cost only those liabilities can be considered which would have been entered into by a market economy investor ([29]). This excludes liabilities stemming from state aid as these would have not been taken over by a market economy investor ([30]). One such liability is *Gewährträgerhaftung* ([31]). The Commission has held that *Gewährträgerhaftung* is existing aid and has proposed appropriate measures to abandon it ([32]). Thus, potential costs under *Gewährträgerhaftung* cannot be part of the Free State of Saxony's assessment in its role as market economy investor when selling Sachsen LB. Also no other liabilities which could be taken into account in the quantification of the liquidation costs by a market economy investor were mentioned by Germany.

(83) The Commission confirms that it cannot accept Germany's argument that the own capital of EUR 880 million should still be of relevance for the Free State of Saxony, because it has already sold Sachsen LB and would thus not consider the losses of the firm in a potential liquidation, but only the additional costs it would be facing.

(84) Finally the Commission recognises that the whole guarantee was granted by the Free State of Saxony, which is only part-owner, and that the other owners were not contributing to the guarantee. In exchange for a guarantee worth, even in the best (and implausible) scenario, at least EUR […] million and up to EUR 2,75 billion, the Free State of Saxony only obtained EUR […] million from the sale of Sachsen LB.

(85) The Commission therefore concludes that the Free State of Saxony sold Sachsen LB for a negative sales price and granted state aid to Sachsen LB.

7.1.3. THE REFINANCING OF THE SUPER SIV

(86) The Commission did not raise any competition concerns about the refinancing of the Super SIV by LBBW and the other Landesbanken and maintains its view after the investigation that this measure does not constitute state aid.

([27]) Commission Decision in Case C 28/02 *Bankgesellschaft Berlin* (OJ L 116, 14.5.2005, p. 1, paragraph 140).

([28]) See Commission Decision of 27 June 2007 in Case C 50/06 *BAWAG* (not yet published, paragraph 155).

([29]) Joined Cases C-278/92, C-279/92 and C-280/92 *Hytasa* [1994] ECR I-4103 (paragraph 22).

([30]) See Case C-334/99 *Gröditzer Stahlwerke* [2003] ECR I-1139, paragraphs 133 *et seq.* and Commission Decision of 30 April 2008 in Case C 56/08 *Bank Burgenland* (not yet published).

([31]) See Commission Decision of 30 April 2008 in Case C 56/08 *Bank Burgenland* (not yet published).

([32]) See footnote 1. In any event, *Gewährträgerhaftung* would only become relevant once the bank declares that it is not in a position to honour its liabilities, i.e. once it declares its insolvency. The transaction at issue therefore seems to provide Sachsen LB with an additional advantage since not only does it protect creditors but it is also ensuring the survival of the bank.

(87) The creation of the Super SIV is clearly related to the restructuring and sale of Sachsen LB to LBBW. In the absence of the Super SIV, Sachsen LB would have had to cover mark-to-market losses of about EUR […(0,5-1,5)] billion. For that reason, the creation of the Super SIV is inextricably linked to the restructuring and sale of Sachsen LB. The price paid by LBBW and the valuation of the bank took account of the existence of the Super SIV and the liquidity provided by LBBW and the Landesbanken.

(88) Nevertheless, one could consider the refinancing of the Super SIV to constitute state aid in two cases: if LBBW and the other Landesbanken had obtained a disproportionate remuneration for the liquidity provided; and if LBBW and the other Landesbanken had not behaved as market economy investors when providing liquidity to the Super SIV.

(89) Providing liquidity and refinancing it is the essential activity of banks. Banks provide liquidity to market operators, which they subsequently refinance by borrowing similar amounts. Depending on the individual asset/liability structure, each bank will chose its appropriate refinancing strategy (in terms of duration and origins) in order to optimise its total refinancing costs and minimise the inherent risks. As a result of refinancing, the maturity of the debt may be extended or reduced, or the new debt may carry a lower interest rate, or some combination of these options. The opportunities to earn money come from differences between the revenues obtained from providing the liquidity (e.g. long term) and the cost of borrowing it (e.g. short term).

(90) The Commission considers that LBBW and the other Landesbanken did not obtain any advantage from the provision of the liquidity to the Super SIV. It is clear that LBBW and the Landesbanken could have found alternatives for the liquidity they gave to the Super SIV, given the vast possibilities offered on the national and international capital markets. The refinancing of the Super SIV did not therefore increase their refinancing volume. In addition, the refinancing of the Super SIV did not provide above-market returns, notably because the lower risk provided by the state guarantee was paid for through a fee. The whole purpose of the Super SIV is to hold the portfolio until maturity. Profits are generated from the reimbursement of the underlying assets backing the securities held in the portfolio and which have different maturities. However, it was agreed that the revenues regenerated by the Super SIV would solely be used to pay the guarantee fee which has to be paid by the Super SIV to the Free State of Saxony, the administrative costs of the Super SIV and a reasonable remuneration to LBBW and the other Landesbanken for the provision of the refinancing of the Super SIV.

(91) The Commission also considers that the provision of liquidity to the Super SIV by LBBW and the Landesbanken was on market terms and corresponded to what a market economy investor in the position of those banking institutions would have done, and therefore did not increase the volume of state aid connected with the Super SIV. As explained above, the banks obtained a reasonable remuneration for this operation from the revenues of the SIV. In addition, the structured portfolio investments in the amount of EUR 17,5 billion were transferred to the Super SIV with a view to holding them until maturity. The relevant criterion for the quantification of the risks involved in the transferred portfolio is therefore 'default' at maturity and not 'mark-to-market losses' due to the temporary absence of a market. The expected losses (default risk) in the bad case scenario was quantified at EUR […(> 800)] million, leaving an additional buffer of EUR […] billion for LBBW. From a commercial point of view, the risk undertaken by LBBW and the other Landesbanken can therefore be regarded as limited, and the same conclusion can be drawn as regards the risk to the State above and beyond the exposure of EUR 2,75 billion through the Free State of Saxony's guarantee. Given that the interest paid to LBBW and the other Landesbanken is at market level, there are in this very particular case no grounds for considering that the refinancing would not be in line with market terms.

(92) Moreover, the refinancing of the Super SIV by LBBW and the Landesbanken is not comparable to the first measure, which constitutes aid to the benefit of Sachsen LB. The market conditions in December 2007 and in August 2007 were substantially different. There was virtually no investor in August that would have been willing to invest in a conduit such as the Super SIV. The risk assumed by the banking pool for a remuneration of […] bps — especially given that there was in reality no one willing to give liquidity to these conduits at the time — was therefore not market conform. In December, market conditions had improved, however, and there were again investors buying asset-backed CPs. In addition, the Super SIV has a hold-to-maturity strategy, contrary to the pool of banks which acquired CPs valid for a limited duration and thus certainly not until maturity of most securities. The remuneration of the pool contract was very low, and investors started to buy CPs outside of it from October 2007. The re-emergence of a market meant that the securities could again attract an investor, although not at their nominal value. However, in view of the estimated defaults, it can be concluded that the refinancing by LBBW and the other Landesbanken would have been commercially acceptable to a market economy investor in the position of those banking institutions and therefore did not involve any further state aid above the value of the guarantee granted by the Free State of

Saxony. In conclusion, the Commission considers that the refinancing of the SIV did not involve further state aid.

7.2. *COMPATIBILITY WITH THE COMMON MARKET*

(93) The Commission considers that the measures at issue that have been found above to constitute state aid can be found compatible with the common market only on the basis of Article 87(3)(b) and (c) EC, as all the other compatibility clauses are clearly not applicable.

7.2.1. ARTICLE 87(3)(B) EC — AID TO REMEDY A SERIOUS DISTURBANCE IN THE ECONOMY OF A MEMBER STATE

(94) Article 87(3)(b) EC declares aid to remedy a serious disturbance in the economy of a Member State to be compatible with the common market. However, the Commission would first like to point out that the Court of First Instance of the European Communities has stressed that Article 87(3)(b) EC needs to be applied restrictively so that aid cannot be benefiting only one company or one sector but must tackle a disturbance in the entire economy of a Member State. The Commission has consequently decided that a serious economic disruption is not remedied by an aid measure that 'resolve[s] the problems of a single recipient […], as opposed to the acute problems facing all operators in the industry'. Also in all cases of banks in difficulty, the Commission has to date not relied on this provision of the EC Treaty.

(95) The investigation has confirmed the Commission's observation that the problems of Sachsen LB are due to company-specific events. Moreover, the information provided by the German authorities has not convinced the Commission that the systemic effects that might have resulted from a bankruptcy of Sachsen LB could have reached a size constituting 'a serious disturbance in the economy' of Germany within the meaning of Article 87(3)(b) ([33]). Therefore, the present case must be regarded as based on individual problems, and thus requires tailor-made remedies, which can be addressed under the rules on firms in difficulty. The Commission therefore finds no grounds for compatibility of the measures on the basis of Article 87(3)(b) EC.

([33]) See Commission Decision of 30 April 2008 in Case NN 25/08 *Rescue aid to WestLB* (not yet published).

7.2.2. ARTICLE 87(3)(C) EC – AID TO FIRMS IN DIFFICULTY

(96) The Commission considers that Sachsen LB was pursuant to point 9 of the Guidelines a firm is in difficulty given that without the liquidity measure by the banking pool and LBBW's EUR 250 million pre-payment it was highly unlikely that Sachsen LB would have been able to cope with the liquidity squeeze for much longer. The imminent losses would have led to closure of the bank, thus meeting the conditions of point 10(c) of the Guidelines. Germany has not contested this opinion already put forward in the opening decision.

7.2.2.1. ***Rescue aid***

(97) The investigation confirmed the Commission's view indicated in the opening decision that the first measure (but not the second measure) can be regarded as rescue aid compatible with the common market as it meets all the conditions set out in point 25 of the Guidelines, in particular:

Form of aid

(98) Rescue aid must comply with the conditions of point 25(a) of the Guidelines, according to which the rescue aid must be provided by way of a loan or guarantee to a loan which must be reimbursed (and any guarantee ended) within a period of not more than six months after the disbursement of the first instalment to the firm ([34]).

(99) In the present case, the banking pool provided a liquidity support facility to Sachsen LB by acquiring the CPs issued by Ormond Quay. Given that Germany confirmed that the default risk of the underlying assets remains with Sachsen LB, the liquidity facility can be regarded as a six months current account line of maximum EUR 17,1 billion. In other words, the provision of liquidity is similar to a loan from the banking pool to Sachsen LB. Moreover, the support is terminated and any liquidity reimbursed within a period of not more than six months after the disbursement of the first instalment to the firm. The measure has no structural element as it does not go beyond the mere provision of liquidity and is designed to be reversible as it is limited to six months.

([34]) An exception may, however, be made from the restriction as to form of rescue aid in the banking sector See the footnote to point 25(a) of the Guidelines, which states that, notwithstanding this, aid granted in a form other than loan guarantees or loans fulfilling the conditions in point 25(a) should fulfil the general principles of rescue aid and cannot consist in structural financial measures related to the bank's own funds. See Commission Decision of 5 December 2007 in Case NN 70/07 *Northern Rock* (not yet published, paragraph 43) and Commission Decision of 30 April 2008 in Case NN 25/08 *Rescue aid to WestLB* (not yet published).

(100) Moreover, the liquidity facility does not lower Sachsen LB's level of refinancing costs to a level below the respective levels of a market rate. The rate paid by Sachsen LB (as indicated in paragraphs (21) and (22)) was Euribor, which on 6 August 2007 was 4,112 ([35]), plus […] basis points, giving […]. This is above the reference rate for Germany, which in August 2007 was 4,62.

Minimum necessary

(101) The measure must according to point 25(d) be restricted to the amount needed to keep the firm in business for the period of six months. In this respect the Commission notes that the banking pool only committed itself to buying CPs which could not be placed on the market. Thus the banking pool was only obliged to buy the CPs emitted by Ormond Quay if these could not be placed on the market. On this basis, the Commission concludes that the liquidity facility is the minimum necessary for Sachsen LB to continue its business.

(102) Since the duration of the CPs could not exceed one month, the issuance was repeated anew every month. However, already in October 2007 some investors (mainly […(banks belonging to the public sector)]) started again to buy CPs on the market outside the context of the pool contract so that the pool contract had de facto lost its initial purpose.

No undue distortion of competition

(103) The measure can also be justified on grounds of serious social difficulties and does not have unduly adverse effects which spill over onto other Member States, as stipulated in point 25(b) of the Guidelines. The measure at issue is warranted on grounds of serious social difficulties as, in the absence of the measure, Sachsen LB would have had to be liquidated and this would have led to a series of redundancies. The measure does not have any unduly adverse effects which spill over onto other Member States, as the bank is unable to act aggressively in the market under the financial conditions of the pool contract.

One time, last time

(104) The one time, last time condition is met as Sachsen LB has not benefited from rescue or restructuring aid in the past.

([35]) The banking pool refinanced the portfolio on a monthly basis. Therefore Euribor one month is applied.

7.2.2.2. ***Restructuring aid***

(105) The investigation allowed the Commission to reach the conclusion that the second measure, which does not qualify as rescue aid, can be considered restructuring aid compatible with the common market because it meets all the criteria of the guidelines.

Restoration of long-term viability

(106) The present investigation first confirms that the restructuring will restore the long-term viability of Sachsen LB. The Commission considers that the sale of Sachsen LB to LBBW is key to solving the difficulties and will allow a positive economic development of the bank within the LBBW group. The new business approach established for Sachsen LB has already been successfully implemented by LBBW in Rhineland-Palatinate. Moreover, Germany has indicated that the return on equity of Sachsen Bank is going to be in line with that of its private competitors.

(107) Moreover, the investigation confirmed that LBBW has redirected the Saxony-based activities of the bank. It has abandoned the loss-making activities in Saxony in so far as structured investment activities are no longer undertaken in Saxony.

(108) The new business model of LBBW shows first that the future activities of former Sachsen LB will be limited and refocused on corporate and private banking activities in Saxony and the bordering regions, while the central functions will be integrated and performed by LBBW. The Commission is of the view that the refocusing of Sachsen LB on corporate clients and wealthy private clients is a sustainable business model as underlined by the forecasts submitted. These activities are complementary to the savings banks business model and LBBW has already proved in Baden-Württemberg and in Rhineland-Palatinate that such a business model is viable. The Commission assessed the underlying market assumptions as appropriate and is of the view that the expected revenues are achievable. In view of the results indicated above, Sachsen Bank should be able to compete in the Saxony and cross-border financial market on its own merits. Second, as shown by the detailed description of the circumstances that led the bank into difficulties, the Commission views the transfer of the capital market activities and the proprietary trading to LBBW and the reduction of the activities of Sachsen LB Europe as included in the restructuring plan as essential to avoiding repeating the mistakes of the past.

(109) For reasons of completeness the Commission notes that the restructuring plan for Sachsen LB also pointed to a sustainable restoration of Sachsen LB on a stand-alone basis at the time of the sale of the bank even if this plan as such never materialised due to the integration of Sachsen LB into LBBW, which in turn reinforced the return to viability. In particular the plan, which was accompanied by a market study and was based on sound financial projections, made it clear that the chosen business model would work. This follows from the above figures, which indicate that even in the worst case Sachsen LB would have shown a general positive trend for its gross revenue and operating income every year from 2007 until 2012 […]. Gross revenue for the 'corporate finance' business segment will increase from EUR […] million to EUR […] million, which corresponds to a compound annual growth rate of […]. In total, this represents an increase of […] before synergies and […] including synergies. The […] is due to the restructuring costs and is decreasing from EUR […] million to EUR […] million. The Commission also analysed the underlying assumptions of the restructuring plan and has no reason to doubt that they are realistic.

7.2.2.3. ***Aid limited to the minimum — own contribution***

(110) The Commission's doubts as regards the aid being limited to the minimum have been allayed. The Commission considers that the aid has been limited to the minimum and is accompanied by a significant own contribution in line with the targets indicated in the Guidelines, i.e. it is above 50 % of the restructuring costs.

(111) In reaching this conclusion the Commission has taken into account the following elements.

(112) First, the bank has been sold through an aid-free transaction to a new owner, i.e. LBBW. LBBW is bearing all the restructuring costs related to the creation of the Super SIV and the integration of Sachsen LB, of about EUR […] – […] million.

(113) Second, LBBW has prepaid an up-front loss coverage of EUR 250 million. It has further taken over part of the losses and the refinancing needs concerning portfolio 1. LBBW has also committed itself to selling certain assets of Sachsen LB. However, the proceeds from these sales are not exactly quantifiable at this stage. They consequently cannot be taken into account as an own contribution.

(114) Third, Sachsen LB was in need of EUR 17,5 billion liquidity to finance its conduit, which had invested in structural investments. Although this is in principle a normal operation for a bank (and would thus not normally constitute restructuring costs), in the particular case of Sachsen LB, which was not able to arrange such re-financing any longer, the situation is different ([36]).

(115) It could be questioned whether this refinancing can be accepted as an own contribution.

(116) The Commission considers that the refinancing conditions accepted by LBBW and the other Landesbanken correspond to commercial terms that would have been accepted by a market economy investor in the position of those banking institutions, account being taken of the provision by the Free State of Saxony of the EUR 2,75 billion guarantee. Such re-financing would, in the case of independent private investors, have to stem from own funds of the purchasing bank or from external financing by the other investing banks at market conditions (see above, point 7.1.3). The guarantee would clearly be deemed to pollute EUR 2,75 billion of the refinancing, and this pollution could also arguably affect the entire junior tranche financed by the purchaser bank ([37]). Such pollution does not, however, turn the measure at issue into state aid, the measure being merely favoured by state aid.

(117) On the other hand, the Commission does not consider that the financing by other, distinct market economy investor banks of a second, senior tranche, could be regarded as polluted in such a scenario. In such a case, the other investing banks would be protected by the whole junior tranche of EUR 8,54 billion (and this irrespective of the guarantee of the Free State of Saxony). Their decision to take over the refinancing of the senior tranche would be determined by the protection afforded by the whole of the first tranche. Any possible pollution would in such circumstances be limited to the first tranche and at least the second tranche could be considered a market based and own contribution.

(118) On this basis the own contribution within the refinancing of the Super SIV is slightly above EUR 8,75 billion.

([36]) The provision of liquidity by banks was also assessed in the Commission Decision in Case C 58/03 *Alstom* (OJ L 150, 10.6.2005, p. 24, paragraph 216). Commission Decision of 12 September 2007 in Case C 54/06 *Bison Bial* (OJ L 46, 21.2.2008, p. 41, paragraphs 62 *et seq.*).

([37]) However, the Commission has accepted in the past in restructuring cases that parts of a loan which were not covered by a guarantee could be considered an own contribution. See Commission Decision of 7 March 2007 in Case C 10/06 *Cyprus Airways* (OJ L 49, 22.2.2008, p. 25, paragraph 139).

(119) In conclusion, out of the restructuring costs of EUR […] billion, EUR […] billion ([…]) can be accepted as an own contribution. The Commission concludes, therefore, that the entire own contribution amounts to 51 % and thus exceeds 50 % of the restructuring costs, as required by the Guidelines.

7.2.2.4. ***Avoidance of undue distortions of competition – compensatory measures***

(120) After the investigation and following discussions with Germany, the Commission is convinced that sufficient measures are being taken to mitigate as far as possible any adverse effects of the aid on competitors. The Commission considers that the measures are in proportion to the distortive effects of the aid stemming mainly from the survival of Sachsen LB, even if only as part of LBBW.

(121) A clear reduction in Sachsen LB's financial market activities has taken place. This concerns in particular the entire closure or divestiture of Sachsen LB Europe, which goes beyond the original intentions in the restructuring plan. LBBW had the intention to continue the business of the Dublin subsidiary, albeit on a smaller scale. Sachsen LB Europe is a well established service provider for structured financial investments with considerable know-how, independently from the fact that some of its portfolios turned loss making in the market turmoil. Sachsen LB Europe could have continued activities for third parties, thereby generating commission income for Sachsen LB/LBBW. Sachsen LB Europe was until the developments in summer 2007 the main source of profits for the Sachsen LB group. Finally, the activities of Sachsen LB Europe are also the ones where the distortions due to the competitive behaviour of Sachsen LB took place. The Commission thus considers the complete closure or divestiture of Sachsen LB Europe to be a valid compensatory measure.

(122) The Commission also considers the divestment of East Merchant GmbH, a subsidiary which was a key player in Sachsen LB's structured finance activities, as a valid compensatory measure. East Merchant is active in various areas of structured finance, in particular in the area of leasing in the field of transport and logistics. The company contributed regularly with substantial positive results to Sachsen LB's profits.

(123) The same applies to the divestiture of […]. Given that they were targeting […], they cannot indeed be associated with any subprime activities, as indicated above. Moreover, since LBBW did not intend to sell these two subsidiaries under the restructuring plan for Sachsen LB, their sale can be considered a compensatory measure.

(124) Finally, Germany and LBBW gave the commitment that Sachsen Bank would abandon proprietary trading and international real estate activities.

(125) The divestitures described here concern entities which were planned to account in 2008 for about […(> 25)] % of the profits of the Sachsen LB group. This constitutes compensatory measures of a size and form sufficient to adequately limit the distorting effects of aid of such significant size ([38]). This is especially so as, despite the significant aid amount, the presence of Sachsen LB on its markets is relatively small and the measures taken by LBBW also contribute to stabilising the financial markets.

(126) In addition, the Commission recognises that the old owners of the bank and the management are not involved any more in the activities of Sachsen LB, which provides a valuable signal against moral hazard.

(127) In sum, the Commission considers that the compensatory measures are in proportion to the distortive effects of the aid granted to Sachsen LB.

(128) The Commission will need to be kept informed of progress in the implementation of the above mentioned compensatory measures.

8. **PROPOSAL**

(129) In view of the above, the Commission finds that both measures at issue — the liquidity facility and the provision of a guarantee — have been implemented in breach of Article 88(3) EC. However, the Commission concludes that the liquidity facility constitutes rescue aid and the guarantee granted for Sachsen LB constitutes restructuring aid which can be considered compatible with the common market pursuant to Article 87(3) EC provided that the conditions imposed are fulfilled,

HAS ADOPTED THIS DECISION:

Article 1

The liquidity facility and the guarantee granted to Landesbank Sachsen Girozentrale (Sachsen LB) in connection with its sale constitute state aid within the meaning of Article 87(1) EC that is compatible with the common market subject to the obligations and conditions set out in Article 2.

([38]) See Commission Decision in Case C 58/03 *Alstom* (OJ L 150, 10.6.2005, p. 24, paragraph 201).

Article 2

1. The plan for restructuring Sachsen LB, as communicated to the Commission by Germany in April 2008, shall be fully implemented.

2. The following assets shall be sold to a third party that is independent of the Landesbank Baden-Württemberg group (LBBW group) or be liquidated:

(a) Sachsen LB Europe plc will be sold or liquidated by […]. The LBBW group will not take over any staff from Sachsen LB Europe plc, unless it is required to do so by legal obligations, and will therefore neither propose to nor conclude with existing staff of Sachsen LB Europe plc any new working contracts. This commitment is valid for a period of two years from the date of this Decision.

(b) The participation in East Merchant GmbH will be sold by […].

(c) […] will be sold […].

3. The following commitments shall be respected:

(a) Germany commits that Sachsen LB, represented through LBBW, will not carry out actively in any of its branches in the Free State of Saxony as an independent business activity proprietary trading activities on its own account and at its own risk going beyond those of customer service in its core business activities. This behavioural commitment is valid until the end of 2011.

(b) Germany commits that Sachsen LB, represented through LBBW, will not carry out actively in any of its branches in the Free State of Saxony as an independent business activity international real estate business going beyond that of customer service in its core business activities. This behavioural commitment is valid until the end of 2011.

4. For the purpose of monitoring compliance with the conditions set out in paragraphs 1, 2 and 3, Germany shall provide until 2012 regular updates on progress with the implementation of the restructuring plan and the commitments set out above.

Article 3

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 4 June 2008.

For the Commission

Neelie KROES

Member of the Commission