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**Managing the Financial Crisis in Europe:
Why Competition Law is Part of the Solution,
Not of the Problem**

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EU Competition Commissioner Kroes likes using catchphrases to encapsulate policy statements. Since early October, one of her favorite lines is that competition law, and State aid law in particular, is part of the solution to the financial crisis, not part of the problem. Understand: competition rules do not stand in the way of a solution to the crisis, they are part of that solution.¹ She used it for the first time on October 2 when announcing the approval of a Euro 35 billion aid package laid down by Germany to rescue Hypo Real Estate Holding AG, a German bank holding that became troubled as a result of its involvement in the national and international mortgage business and its short-term refinancing strategy.² She repeated it on October 6 in an address to the Economic and Monetary Affairs Committee of the European Parliament outlining her enforcement priorities in the framework of the financial crisis.³ She resorted to it again on December 2

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¹N. Kroes, “*Competition policy and the financial/banking crisis: taking action*”, open letter available at http://ec.europa.eu/commission_barroso/kroes/financial_crisis_en.html.

²Commission press-release IP/08/1453 of October 2, 2008: “*State aid: Commission approves German rescue aid package for Hypo Real Estate Holding AG*”.

³N. Kroes, “*Dealing with the current financial crisis*”, address to the Economic and Monetary Affairs Committee, European Parliament, Brussels, October 6, 2008.

to defend her record in front of the 27 EU Economics and Finance Ministers,⁴ some of them clearly upset at the Commission's active involvement in the design of general financial recovery plans and individual rescue measures.

Indeed, within the European Union, economic and financial policy remains first and foremost a competence belonging to each of the 27 Member States; there is nothing like an EU Treasury, a centralized EU economic policy institution, or a common EU financial services regulator. Some economic coordination takes place at the EU level, though, notably in the framework of the so-called "Stability and Growth Pact," but it is driven by Member States' representatives seating in the Economic and Financial Affairs Council (ECOFIN). As a result, in mid-September, when the crisis spread to the whole financial system following the bankruptcy filing of Lehman Brothers, thus affecting credit institutions across Europe, Member States remained in front to devise urgent recovery measures. It was at the ECOFIN meeting of October 7 that Member States came together to devise common principles to guide their respective reactions to the crisis.⁵ Those principles were turned into a concerted action plan on October 10 by the Eurogroup, (a meeting of those EU countries that share the Euro as currency), which was then endorsed by the European Council of October 15, 2008.⁶

Originally, in the design of a coordinated effort to contain the financial crisis, the Commission appeared to be largely only a witness to the Member States' initiatives,

⁴Commission press-release MEMO/08/757 of December 2, 2008: "*State aid: Commissioner Kroes briefs Economic and Finance Ministers on financial crisis measures*".

⁵Conclusions of the ECOFIN Council held in Luxembourg on October 7, 2008 (Doc. 13784/08).

⁶"*Declaration on a concerted European action plan of the euro area countries*", October 10, 2008, available at www.ue2008.fr; European Council of October 15 and 16, 2008, Presidency Conclusions (doc. 14368/08).

under the leadership of the French Presidency. However, in parallel, it was also taking steps to preserve the possibility of playing its own role in managing the crisis, notably to ensure compliance of Member States' measures with EU single-market principles. The European Council's support for the continued implementation of EC competition rules in spite of the exceptional circumstances, including "the principles of the single market and the system of State aids,"⁷ combined with a lack of resources at ECOFIN's level to monitor Member States' adherence to the concerted action plan, in effect enabled the Commission to play a critical role in the design of the general recovery plans and individual rescue measures envisaged by various Member States. Eventually, the circumstances led to the emergence of State aid rules as a conduit for "positive" economic policy coordination rather than solely for "negative" control of compliance with the EC Treaty. Some Member States consider such *de facto* evolution as undue encroachment on their competences while the Commission finds its action legitimized by the magnitude of the amounts at stake and the associated potential for competition distortive effects due, notably, to the massive flow of money to banks benefiting from State backing and the disparity in Member States' resources to address the challenges posed by the crisis.⁸

This paper describes three factors that contributed to shaping the role played so far by the Commission, in its capacity as antitrust enforcement authority, in the

⁷European Council of October 15 and 16, 2008, Presidency Conclusions (doc. 14368/08), ¶5.

⁸See, *e.g.*, the inflow in customers and deposits that followed the nationalization of UK bank Northern Rock, just weeks after it suffered from an impressive bank run in September 2007, which signaled the contamination of Europe by the subprime crisis.

management of the financial crisis in Europe and, hence, the contribution of EC competition law to a solution of the crisis, as advocated by Commissioner Kroes.

I. PROVIDING LEGAL CERTAINTY TO ECONOMIC OPERATORS

Since the subprime crisis hit Europe around mid-September 2007 and even more so a year later when it spread to the whole financial system, the primary concern of the Commission has been to ensure the compatible implementation of EC competition law with the need for legal certainty on the part of economic operators. In other words, the Commission endeavored to react with adequate responsiveness to the crisis situation by taking actions necessary to reassure markets that rescue measures envisaged by Member States were “not going to be jeopardized by EU rules.”⁹ To appreciate the Commission’s efforts in that respect, it is useful to introduce some chronological points of reference. Indeed, two phases can be distinguished in the financial crisis so far:¹⁰

- a Phase I period corresponding to the “subprime crisis,” which lasted from mid-September 2007 and the bank run on Northern Rock to mid-September 2008 and the Chapter 11 bankruptcy filing of Lehman Brothers. Over that period, the Commission authorized six individual rescue packages, pursuant to established rules on subsidies for firms in difficulty,¹¹ in favor of banks largely exposed to the

⁹N. Kroes, “*Dealing with the current financial crisis*”, cited above, note 3.

¹⁰Note that a third phase is now emerging following the contamination of the crisis to the real economy. An important concern is now the need to keep a stable flow of credit to the economy, which may require providing capital incentives to fundamentally sound banks while avoiding abuses in the use of public funding. The Commission has addressed that issue in a new communication of December 5, 2008: *Communication from the Commission - The recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*, C(2008) 8259 final.

¹¹Communication from the Commission—Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, *O.J.*, 2004, C 244/2.

- U.S. subprime crisis and/or heavily dependent on mortgage securitization to meet their refinancing needs. At the time, the Commission viewed those issues essentially as “individual problems” requiring “tailor-made remedies.”¹²
- a Phase II period that started in mid-September 2008 with the general crisis of confidence and unprecedented freeze in interbank lending that followed the bankruptcy filing of Lehman Brothers. At that point, the crisis took a systemic turn and started affecting “even fundamentally sound financial institutions,”¹³ a situation that prompted the Commission to recognize the likelihood of bank failures leading to “a serious disturbance in the economy of [Member States].” As a result, the Commission resorted to a rarely-used and more lenient provision to authorize national recovery plans and individual rescue measures,¹⁴ namely Article 87(3)(b) of the EC Treaty (“EC”).¹⁵

¹²Commission Decision of December 5, 2007 in Case NN 70/2007 (ex. CP 269/07) – *United Kingdom Rescue aid to Northern Rock*, C(2007) 6127 final; Commission Decision of April 30, 2008 in Case NN 25/2008 (ex. CP 15/08)—*WestLB riskshield, Germany*, C(2008)1628 final; Commission Decision of June 4, 2008 in Case C 9/2008 (ex. NN 8/2008, CP 244/2007)—*Sachsen LB, Germany*, C(2008)2269 final; Commission Decision of July 31, 2008 in Case NN 36/2008—*Denmark/Roskilde Bank A/S*, C(2008)4138; Commission Decision of October 1, 2008 in Case NN 41/2008—*UK/Bradford & Bingley* (no decision available, see press-release IP/08/1437: “*State aid: Commission approves UK rescue aid package for Bradford & Bingley*”); Commission decision of October 2, 2008 in Case NN 44/2008—*Germany/Hypo Real Estate Holding AG* (decision available only in German, see press-release IP/08/1453: “*State aid: Commission approves German rescue aid package for Hypo Real Estate Holding AG*”).

¹³See, e.g., Commission Decision of October 10, 2008 in Case NN 51/2008 – *Denmark/Guarantee scheme for banks in Denmark*, C(2008)6034, ¶40 and Commission Decision of October 13, 2008 in Case N 507/2008—*UK/Financial support measures to the banking industry in the UK*, C(2008)6058, ¶44.

¹⁴For a comprehensive list of the decisions adopted since October 2008 pursuant to Article 87(3)(b) EC, see http://ec.europa.eu/competition/sectors/financial_services/financial_crisis_news_en.html.

¹⁵In a nutshell, Article 87(3)(b) EC, compared to State Aid rules for rescuing and restructuring firms in difficulty adopted pursuant to Article 87(3)(c) EC, offers additional flexibility as to the nature of acceptable aids (e.g., structural interventions), the duration thereof (i.e., going beyond 6 months) and, particularly, the absence of structural compensatory measures.

Legal certainty is conditional upon: (i) clarity in the applicable legal framework and (ii) rapidity of action. The Commission has been particularly keen on acting swiftly in the framework of the financial crisis, undoubtedly well aware that, absent drastic measures to speed up the State aid review process, in particular, it would have been quickly sidelined by Member States. Already during the Phase I period, the Commission significantly shortened the decision-making process leading to the authorization of rescue packages involving State aids.¹⁶ Since a prohibition of such rescue measures was not an option given the circumstances, the Commission also became involved early on in the design of those measures to make them State aid law compatible. Likewise, during that somewhat less pressing period, the Commission was able to gain experience and to “test and improve [its] ability to meet the urgent demands that face banks in [...] crisis situations.”¹⁷

In turn, when the crisis entered the Phase II period, while remaining involved in the design of financial recovery plans, the Commission was able to take further actions to accommodate the increased need for speedy and definitive action. Thus, on October 1, in a move that is rather uncommon as far as the adoption of final decisions in the area of competition law enforcement is concerned, the College of Commissioners decided to empower Commissioner Kroes, in agreement with President Barroso and Commissioners Almunia (Economic and Monetary Affairs) and McCreevy (Internal Market), with the

¹⁶See, e.g., Case NN 70/2007—*UK/Northern Rock*, decided on December 5, 2007 following a notification filed on November 26, 2007 but with background information already provided to the Commission on September 28 and October 14, 2007.

¹⁷N. Kroes, “*Dealing with the current financial crisis*”, cited above, note 3.

responsibility to authorize so-called “emergency rescue measures.”¹⁸ The empowerment, valid for three months, is expressly designed to allow the Commission to take decisions “if necessary within hours” and “at any moment in time in particular over the weekend, during the evening or at night and also on bank holidays” in order to “positively contribute to the resolution of the current crisis.”¹⁹ As a result, the Commission was able, for example, within 24 hours to decide on the compatibility with State aid principles of the measures designed to ensure the orderly winding down of U.K.-based Bradford & Bingley.²⁰ Over the 8 week period following the empowerment, more than 20 positive State aid decisions were adopted.

In the area of merger control, the Commission also announced its readiness to grant acquirers of ailing banks derogations to the standstill obligation enshrined in Article 7 of the European merger control regulation (“ECMR”) “where there is urgency and where there are no ‘a priori’ competition concerns.”²¹ In effect, such derogation enables the immediate implementation of transactions (or elements of any transactions) that are part of rescue operations, pending merger control clearance; *e.g.*, to enable acquirers to

¹⁸Minutes of the 1845th meeting of the Commission, October 1, 2008, PV(2008) 1845 final, ¶10.4; Communication from the President in agreement with Ms Kroes—Temporary empowerment, SEC(2008) 2575/2. The authorization of “*emergency rescue measures*” includes: (i) decisions finding that rescue measure does not constitute aid pursuant to Article 4(2) of Regulation 659/1999; (ii) decisions not to raise objections against a notified aid pursuant to Article 4(3) of Regulation 659/1999; and (iii) decisions not to raise objections against a non notified (so-called “unlawful”) aid pursuant to Articles 13(1) and 4(3) of Regulation 659/1999.

¹⁹Communication from the President in agreement with Ms Kroes—Temporary empowerment, SEC(2008) 2575/2.

²⁰Commission press-release IP/08/1437 of October 1, 2008: “*State aid: Commission approves UK rescue aid package for Bradford & Bingley*”.

²¹N. Kroes, “*Dealing with the current financial crisis*”, cited above, note 3.

monitor the nature and structure of the target's risks portfolio and take appropriate measures to protect the value of certain assets.

II. ACTING AS A STABILIZING FORCE THROUGHOUT THE CRISIS

As noted, legal certainty is also conditional upon clarity and stability in the applicable legal framework. So far, the Commission has resisted calls to show greater flexibility in the interpretation of EC competition law principles in view of the conditions created by the financial crisis. Rather, it has endeavored to demonstrate that, contrary to what some Member States like to pretend, the current legal framework is flexible enough to accommodate exceptional and country-specific circumstances.

With respect to State aid law enforcement, the Commission consistently refused to authorize rescue measures pursuant to Article 87(3)(b) EC during the Phase I period, standing by the principle that such justification

“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”.²²

Instead, taking the view that the solvability issues faced by banks embroiled in the subprime crisis were not systemic in nature, the Commission followed the established methodology and conditions set forth in its guidelines for rescuing and restructuring firms in difficulty, including those rules specifically designed for the banking sector.²³ Later on, however, when the crisis spread to the whole financial system as a result of the freeze in interbank lending, *i.e.*, since the start of the Phase II period, the Commission

²²See, *e.g.*, *WestLB riskshield/Germany* case, ¶41; *Sachsen LB*, ¶94. See also Joined Cases T-132 and 143/96, *Freistaat Sachsen and Volkswagen AG/Commission* [1999] ECR II-3663, ¶167.

²³Communication from the Commission – Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, cited above, note 11, in particular ¶24(a), footnote 3.

acknowledged that the change in the nature of the crisis and the magnitude of the potential consequences thereof permitted action on the basis of Article 87(3)(b) EC. Since that provision is rarely used,²⁴ there was no established practice as to the conditions regulating the compatibility of aid granted under that provision. Given the urgent need for clarity, though, the Commission issued on October 13 (at the same time as the announcement of the concerted action plan) detailed guidelines on the application of that provision to recapitalization and guarantee schemes aimed to contain the financial crisis.²⁵

In the merger control area, Commissioner Kroes also indicated her willingness “to continue applying existing rules,” including “where applicable, the failing firm defense.”²⁶ The merger control activity of the Commission in direct relation with the financial crisis is still limited, though, and no instance of reliance on the failing firm theory has been reported yet. However, that commitment to abide by existing merger control principles, even if designed for exceptional circumstances, stands in sharp contrast with the rather pragmatic approach adopted by some Member States, most notably the United Kingdom. Facing the prospect of the government-engineered acquisition of HBOS by Lloyds creating a so-called “relevant merger situation” warranting further inquiry by the U.K. Competition Commission, the U.K. government

²⁴C. Quigley and A. M. Collins, in their leading treatise on EC State aid law (Hart, Oxford, 2003) refer to aid granted by several Member States in the mid-1970s to protect employment during recession and to the privatization of hundreds of Greek firms and public-sector banks as part of a national economic recovery plan in the early 1990s (p.86).

²⁵Communication from the Commission—The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, *O.J.*, 2008, C 270/2.

²⁶N. Kroes, “*Dealing with the current financial crisis*”, cited above, note 3.

introduced a bill providing for the “stability of the UK financial system” to justify, along with national security, an exception to the referral of relevant merger situations to the Competition Commission. The bill was turned into law,²⁷ becoming effective on October 24. On October 31 the Secretary of State for Business took the decision not to refer the Lloyds/HBOS transaction to the Competition Commission.²⁸

III. PREVENTING NEGATIVE SPILL-OVER EFFECTS FROM MEMBER STATES’ FINANCIAL RECOVERY PLANS AND INDIVIDUAL RESCUE MEASURES

Beyond legal certainty and stability, enforcing EC competition law and, in particular, State aid rules, has also enabled the Commission to make a more substantive contribution to the management of the crisis; to “maintain a level playing field and to make sure that national measures would not simply export problems to other Member States.”²⁹ In a nutshell, the concern is to prevent unfair competition among banks and avoid a subsidy race among Member States by promoting compliance with general EU single market principles, notably those of non-discrimination and proportionality. Achieving those objectives necessarily requires coordination among the various and tremendously diverse national approaches to solving the crisis, a role that the

²⁷See “The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008”, available at http://www.opsi.gov.uk/si/si2008/uksi_20082645_en_1#f00001 (last visited on December 1, 2008).

²⁸Decision by Lord Mandelson, the Secretary of State for Business, not to refer to the Competition Commission the merger between Lloyds TSB Group plc and HBOS plc under Section 45 of the Enterprise Act 2002, October 31, 2008 (available at <http://www.berr.gov.uk/files/file48745.pdf>, last checked on December 1, 2008). The decision has been appealed by a group of account holders, bank employees, and business people calling themselves the “Merger Action Group” (see the submission available at <http://www.mergeractiongroup.org.uk/>, last visited December 2, 2008).

²⁹Commission press-release MEMO/08/757 of December 2, 2008: *State aid: Commissioner Kroes briefs Economic and Finance Ministers on financial crisis measures*.

Commission was the only entity entitled to endorse and that was bound to be unpopular. Practically, the Commission has done so by attaching conditions to the authorization of financial recovery plans and individual rescue measures pursuant to Article 87(3)(b) EC.

First of all, to be held compatible with that provision, general recovery plans adopted in the framework of the financial crisis must contain objective and therefore non-discriminatory eligibility criteria.³⁰ Guarantee and recapitalization plans, in particular, must be open to all credit institutions with systemic relevance to the economy of the relevant Member States, regardless of their origin, *i.e.*, including subsidiaries and branches of banks headquartered abroad. Second, the Commission has insisted that State guarantees be granted with adequate remuneration from individual financial institutions and/or the financial sector as a whole; fees being set according to the degree of risk and the beneficiaries' respective credit profiles and needs.³¹ Likewise, capital injections must be provided against properly valued and remunerated securities,³² ideally carrying corresponding rights. Third and most important, guarantee and recapitalization schemes must be tied to duly monitored behavioral constraints preventing aggressive commercial conduct on the part of beneficiaries, *e.g.*, by introducing GDP-related, market share, or

³⁰Communication from the Commission—The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, cited above, note 25, ¶16. Compliance with that criterion was at the core of discussions between the Commission and Ireland during the review of the general guarantee scheme for banks in Ireland (Commission Decision of October 13, 2008 in Case NN 48/2008—*Ireland/Guarantee scheme for banks in Ireland*, C(2008)6059).

³¹Generally, fees are based on market benchmarks comprising various elements including a measure of institution-specific risk and a fixed mark-up designed to compensate the State. In that respect, the European Central Bank issued on October 20, 2008 *Recommendations on government guarantees on bank debt*, which have, since then, often been referred to by Member States.

³²The level of remuneration payable to the State was at the core of discussions between the Commission and the French government in relation to a capital-injection scheme for banks designed to stabilize financial markets and incentivize French banks to increase lending to the real economy (see Commission press-release IP/08/1900 of December 8, 2008: *State aid: Commission authorizes French scheme to inject capital into certain banks*).

balance sheet growth ceilings,³³ potentially combined with other safeguards aimed to address more diffuse moral hazard issues.³⁴

IV. CONCLUSION

The financial crisis poses a myriad of challenges to public authorities around the world, including to those in charge of competition law enforcement. In the EU, the rules on State aids have enabled the Commission to become involved in the design of the various financial recovery plans and individual rescue measures adopted at national levels and, as a result, to play an important role so far in the management of the crisis. Given the circumstances, that role has virtually become one of economic policy coordination even though economic and financial policy is primarily a competence belonging to Member States. Eventually, it may be only one among various institutional implications for the EU that could arise from the crisis. To fulfill its task, the Commission has taken decisive actions to ensure legal certainty for economic operators confronted by the crisis by improving its responsiveness and ability to adopt decisions swiftly, on the one hand, and by ensuring clarity and stability in the applicable legal

³³Communication from the Commission—The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, cited above, note 25, ¶¶26-27.

³⁴The U.K. Bank Recapitalization Scheme imposes, among other items, that no cash bonuses be paid to Directors for the current year's performance, appointing new independent directors, making commitments to maintain the availability and active marketing of competitively priced lending to homeowners and to small business, and supporting schemes to help people struggling with mortgage payments to stay in their homes (UK, ¶12). The German scheme includes similar behavioral constraints (e.g., with respect to executives' remuneration and bonuses) and conditions the distribution of dividends to shareholders with the sale of the Recapitalization Fund's shares to a third party or the repurchase thereof (Commission Decision of October 27, 2008 in Case N 512/2008—Germany/*Rescue package for credit institutions in Germany*, C(2008) 6422, ¶¶14 and 57). The French capital-injection scheme also requires beneficiary banks to adopt measures concerning the remuneration of senior management and market operators (including traders) and limiting severance packages for executives (see Commission press-release IP/08/1900 of December 8, 2008: *State aid: Commission authorizes French scheme to inject capital into certain banks*).

framework, on the other hand. More fundamentally, it has attempted to demonstrate the resilience of EC competition law principles and in particular of the State aid policy, *i.e.*, its ability to combine the protection of competition with the pursuit of other important economic policy objectives. So far, so good, but a long road lies ahead.