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Portugal: State Aid

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In April 2010, rating agency Standard & Poor's slashed Greek debt to junk status and downgraded Portugal's, as investors worried political pressures could block a multibillion euro bailout of Greece. Markets in Europe and the United States tumbled in reaction to signs that the Greek debt crisis was spreading to other highly indebted states on the periphery of the eurozone, as was the case with Portugal. The financial and economic crisis hit Portugal hard and state aid became an unavoidable topic.

Compliance with EU state aid rules by Portugal has since been subject to strict supervision by the European Commission at three levels:

- recapitalisation of the Portuguese banks in the framework of the Economic Adjustment Programme agreed between Portugal and the European Commission, the European Central Bank and the International Monetary Fund;[1]
- privatisation of state-owned enterprises in the framework of the Economic Adjustment Programme; and
- ordinary aid as a means to revive struggling sectors.

Recapitalisation of Portuguese banks

The recapitalisation process of Portuguese banks started in 2009 with the approval of the recapitalisation scheme by the Commission[2] and its renewal until 30 June 2013.[3] The stated aims of the recapitalisation of banks were to increase their creditworthiness, allow them access to market funding, ensure their compliance with solvency requirements and strengthen financial stability at large.

The recapitalisation exercise was awarded a €12 billion bank support facility financed by the IMF and the EU in the framework of the Economic Adjustment Programme. The efforts made to secure the stability of the Portuguese financial system were backed-up by a guarantee scheme approved by the Commission in 2008 with a budget of €24.2 billion.[4] The objectives of the guarantee scheme were to provide solvent banks with access to liquidity to ensure the stability of the financial system, and to restore confidence in the economy.

Four banks were recapitalised with recourse to the bank support facility, involving a total of €7.25 billion. On 29 June 2012, Millennium BCP (€3 billion) and BPI (€1.5 billion) were recapitalised under the Recapitalisation Scheme for credit institutions in Portugal. On 18 July 2012, the Commission adopted the rescue decision concerning the recapitalisation of Caixa Geral de Depósitos (€1.65 billion);[5] and on 23 January 2013, the Commission adopted the rescue decision concerning Banif (€1.1 billion).[6]

In the meantime, the restructuring plans of *Millennium BCP*, *BPI* and *Caixa Geral de Depósitos* have been approved. and the Commission found the aid to be compatible with EU State aid rules. At the time of writing, discussions were still ongoing in respect of *Banif*.

Mechanics

The recapitalisation scheme rests on the issuance of a combination of special shares and hybrid securities held by the state. The special shares afford limited voting rights to the state but offer a preferred dividend and ensure a minimum return if bought back and are subscribed at a discount. The discount is linked to the amount of the capital injection, set in relation to the outstanding capital: the higher the capital need in relation to the outstanding capital, the higher the required discount. They are convertible into ordinary shares in case of nonfulfilment by the bank of the commitments undertaken in relation to the Commission.

The existing shareholders of the beneficiaries of the scheme may be granted a pre-emptive right to buy back the special shares. Where such right is granted, the buy-back price will be set so as to allow the state to have a return of at least 10 per cent per annum and a share of any upside.

The hybrid securities are remunerated by the issuing bank, as a minimum, at 8.5 per cent for the first year of the investment, to be increased thereafter through annual step-ups. The rate of remuneration shall be increased by 25 basis points in the two years after the year in which the public investment was made and by 50 points for each additional year that the investment is maintained. They are convertible into ordinary shares in case state aid is not paid back within the committed deadline or if there is a material breach of the underlying terms and conditions. The hybrid instruments also contain an 'alternative coupon satisfaction mechanism' whereby coupons that cannot be paid out in cash shall be paid to the state in the form of shares.

Any conversion of the hybrid instruments into shares is to be done with a discount to market prices as set for the capital injection. Furthermore, it is subject to prior authorisation by the Commission to ensure compliance with state aid rules.

The recapitalisation of Millennium BCP and BPI was made by means of hybrid instruments only. In *Caixa Geral de Depósitos*, the injection was made through a mix of ordinary shares (the state being the only shareholder) and hybrid instruments, and in *Banif* there was a mix of special shares and hybrids.

Commitments

The capital injections into the banks were approved by the Commission upon a large number of structural and behavioural commitments undertaken by Portugal and by the beneficiary banks. The structural commitments are mostly provided for in the individual restructuring plans that banks had to submit, the compliance with which is intended to ensure both a significant turnaround and long-term viability.

Behavioural commitments included a ban on:

- the payment of dividends;
- the buy-back of hybrid instruments and subordinated debt other than instruments held by the state;
- the payment of coupon and interest;
- the acquisition of other companies; and
- the adoption of aggressive commercial strategies.

Most of these commitments are meant to last for as long as the beneficiary bank hasn't paid back in full the received state aid.

Legal basis

Both the Commission and the Bank of Portugal considered in 2012 that state aid was required to stabilise the Portuguese banking sector: 'the Commission considers and the BdP confirms that exceptional circumstances still persist in Portugal and, therefore, recognises the need for the approval of the Scheme'.[7] A scheme was accordingly approved on 30 May 2012, setting the general rules for the recapitalisation of the Portuguese banks.

Final decisions were adopted on 24 July 2013 for BPI and CGD and on 30 August 2013 for Millennium BCP. At the time of writing, a final decision on *Banif* was still pending.

The Commission adopted the recapitalisation decisions on the basis of article 107(3)(b) TFEU, which determines that 'aid to remedy a serious disturbance in the economy of a Member State may be deemed compatible'. The framework for the concrete application of article 107(3)(b) TFEU was developed by the Commission since 2008 through the adoption of a vast number of Communications.[8]

The Economic Adjustment Programme for Portugal

An interesting feature of the recapitalisation of Portuguese banks is that in May 2011, Portugal, unlike other countries where banks also received recapitalisation aid, entered into an agreement with the International Monetary Fund, the European Central Bank and the European Commission further to which €78 billion would be made available from 2011 to mid-2014. The grant of assistance was subject to a strong conditionality consisting of the implementation of reforms to promote growth and jobs, the adoption of fiscal measures to reduce the public debt and deficit, and the pursuit of actions to ensure the stability of the country's financial sector.

As regards in particular the stabilisation of the financial sector, the envisaged strategy was based on recapitalisation and deleveraging, with efforts to safeguard the financial sector against disorderly deleveraging.[9]

Economic adjustment programmes and state aid

The conciliation of an economic adjustment programme, such as the one currently in force in Portugal, and state aid rules is not straightforward given the possibly divergent perspectives underlying the microeconomic approach typical of the case-by-case analysis in state aid matters and the general macroeconomic approach that necessarily characterises a conditional economic adjustment programme involving major international creditors. There is nonetheless some common ground.

At a micro level, both types of intervention aim to restructure each of the banks in question and to ensure their long-term viability. No major difference is theoretically perceptible upon the application of either set of rules to a particular bank.

At the macro level, however, there may be differences. State aid rules aim to foster economic integration in the EU and ensure a level playing field for companies across the internal market. An economic adjustment programme such as the one being currently applied, on the other hand, aims at the economic reform of the country under assistance, rather than economic integration within a larger economic area, and takes up financial stability as a core objective. Thus, the strict application of state aid rules to a particular bank may not necessarily favour financial stability, namely when the prohibition of granting public aid results in the disorderly winding-up of the bank or the imposition of particularly harsh conditions prevents the bank from returning to profitability. An excessively rigorous application of state aid rules may also put the financing of the economy at risk if the straightjacket imposed on banks prevents them from providing to companies the liquidity required for the revival of the economy. If that is the case, reaching the broader economic goals of the adjustment programme may be called into question by a mechanical enforcement of state aid rules. A delicate fine-tuning is therefore required to ensure consistency between the objectives sought by state aid rules and the aims pursued by an economic adjustment programme.

Unquestionably, enforcing state aid rules in the banking sector amid significant instability amounts to a serious challenge and, what is worse, one that is haunted by systemic risk. In most of the member states where banks required public aid for recapitalisation, the Commission had to perform a delicate balancing act with little margin for error, and Portugal was no exception in this respect.

First, the Commission had to achieve a balance between urgency, certainty and equality: the urgency of a concrete and individual response to banks in dire straits versus the certainty required by legally binding measures aimed at stabilising markets, all of this making sure that the principle of non-discrimination is upheld. Second, the Commission had to reconcile the imperative need to grant public support to banks in order to ensure systemic stability, on the one hand, with the prohibition of state aid, and the mandate flowing from the Treaty to ensure the subsistence of undistorted competition in the internal banking market on the other.

Despite all the challenges, the recapitalisation of Portuguese banks has so far been successful and compliance with state aid rules has been ensured.

Privatisations

Airports

The first privatisation to be completed under the Economic Adjustment Programme was ANA Aeroportos de Portugal SA. ANA holds a 50-year concession to operate the eight main airports in Portugal, (Lisbon, Porto, Faro, Beja), four airports in the Azores and, via a subsidiary, two further airports in the Madeira Islands. In December 2012, ANA was sold to the French group Vinci for €3 billion.

On 19 June 2013, the Commission adopted a decision declaring that the privatisation did not involve any state aid as the competitive bid procedure was carried out on market terms (ie, on terms that a private player operating under market conditions would have accepted when selling equivalent assets).

Postal services

In December 2013, the incumbent postal services operator, and provider of the universal service, CTT was privatised by means of the disposal of 70 per cent of the state's holding at a highly successful IPO, with proceeds exceeding €500,000.

As stated by the Commission, when 'the privatisation is effected by an IPO or sale of shares on the stock exchange, it is generally assumed to be on market conditions (as the price will be the market price) and not to involve state aid. Therefore, there is no obligation to notify the operation to the Commission in advance.'[10] No state aid file was therefore opened by the Commission.

Ordinary aid

Shipyards

Shipyards across the EU have been providing abundant raw material for state aid investigations by the Commission. Portugal's turn arrived recently.

On 23 January 2013, the Commission opened a formal investigation procedure into various public measures granted by the state in favour of Viana do Castelo Shipyards, the largest Portuguese shipyard, fully owned by EMPORDEF, a 100 per cent state-owned holding. The investigated aid measures comprise several loans granted between 2006 and 2012 to cover operating costs, a capital increase carried out in 2006, as well as the issuance by EMPORDEF of numerous comfort letters and guarantees in support of financing agreements between the shipyard and commercial banks.

At the time of writing, the case hadn't been closed yet.

Notes

1 European Commission, European Economy, Occasional Papers 79, The Economic Adjustment Programme for Portugal June 2011, p22.

2 European Commission, IP/09/818, 20 May 2009.

3 Decision of 17.12.2012, OJ C 43, 15.02.2013, p21.

4 European Commission, IP/08/1601, 30 October 2008. The scheme was subsequently renewed, see European Commission, *Midday Express*, 22 February 2010, and IP/10/997, 23 July 2010.

5 European Commission, case SA. 35062 (2012/NN), decision of 18 July 2012.

6 European Commission, case SA. 34662 (2013/N), decision of 21 January 2013.

7 European Commission, case SA.34055 (2011/N) – Portugal, decision of 30 May 2012, p27.

8 Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 010, 15.01.2009; Communication from the Commission on the Treatment of Impaired Assets in the Community Banking sector, OJ C 72, 26.03.2009, p1; Communication from the Commission 'The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules' OJ C195, 19.8.2009, p9; Communication from the Commission on the application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis OJ C329, 7.12.2010, p7; Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p7; Communication from the Commission on the application, from 1 August 2013 , of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 216, 30.7.2013, p1.

9 European Commission, European Economy, Occasional Papers 79, The Economic Adjustment Programme for Portugal June 2011, p. 22.

10 Commission Staff Working Document, Guidance paper on state aid compliant financing, restructuring and privatisation of state-owned enterprises, 10.12.2012, pg. 11.

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Before joining the firm, he was a partner at Abreu Advogados (2008 to 2011), lead legal counsel at the Portuguese Competition Authority (2006 to 2008), legal secretary at the chambers of the Portuguese judge at the General Court of the EU in Luxembourg (2004 to 2006), administrator at the Directorate-General for Competition of the European Commission in Brussels (2000 to 2004), head of legal affairs at Lusomundo and Warner Lusomundo (1997 to 2000) in Lisbon and an associate lawyer, as well as trainee, with Athayde de Tavares, & Associados (1992 to 1997) also in Lisbon.

He is the author of various articles and publications, including the 2009 'Commentary to the Portuguese Competition Act', and speaks regularly at conferences and seminars.

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The competition practice of VdA comprises two partners and eight associates. Its track record includes the successful defence of Portugal Telecom in all the abuse of dominance cases argued before the Competition Authority and the courts, as well as the advice to the Portuguese government in the state aid case concerning the €7.25 billion recapitalisation of Portuguese banks. Telecoms, media, pharmaceuticals and banking are among the industries where clients work with VdA on a daily basis. The practice has invariably been commended by colleagues and clients over the years.

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