The European Antitrust Review **2016**

Published by Global Competition Review
in association with

Vieira de Almeida & Associados

GCR
GLOBAL COMPETITION REVIEW

www.globalcompetitionreview.com

Portugal: State Aid

Miguel Mendes Pereira
Vieira de Almeida & Associados

Markets in Europe and the United States tumbled in the early spring of 2010 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 hard and Portugal entered an Economic Adjustment Programme agreed with the European Commission, the European Central Bank and the International Monetary Fund (IMF). State aid became an unavoidable topic.

Since then, Portugal used €7.25 billion out of the €12 billion bank support facility financed by the IMF and the EU to recapitalise four banks, three of which obtained final clearance decisions from the European Commission under state aid rules. Conditions of access by the country to financial markets improved significantly and Portugal opted for a 'clean exit' of the Adjustment Programme in May 2014, without requesting any further assistance mechanisms.

The Portuguese state aid landscape in 2014 was overwhelmingly dominated by the resolution of Banco Espírito Santo (BES). BES was the third-largest Portuguese banking group in Portugal, with €80.2 billion of assets, €36.7 billion in customer deposits and €5.8 billion in resources from other credit institutions as of 30 June 2014. It employed almost 10,000 people and was the second largest Portuguese banking private group by total reported net assets. A Resolution Fund was activated and a €4.9 billion injection to capitalise a temporary bridge bank ensued. The decision by the European Commission approving the state aid grant was adopted over the weekend.

The judgment of the General Court in December 2014 regarding the insolvency of Banco Privado Português and the final decision of the European Commission in May 2015 on the Viana do Castelo shipyards provided the finishing touches to the most recent state aid scenario concerning Portugal.

Recapitalisation of Portuguese banks

The recapitalisation process of Portuguese banks started in 2009 with the approval of the recapitalisation scheme by the Commission[1] and its renewal until 30 June 2013.[2] 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 Programmme. 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.[3] The objectives of the guarantee scheme were to provide solvent banks with access to liquidity to ensure the stability of the financial system and restore confidence in the economy.

Four banks were recapitalised with recourse to the bank support facility, involving a total of €7.25 billion. On 23 January 2013 the Commission adopted a rescue decision concerning Banif (€1.1 billion). In July 2013 the restructuring plans of BPI (€1.5 billion) and Caixa Geral de Depósitos (€1.65 billion) were approved by the European Commission, followed by Millennium BCP in August (€3 billion). The recapitalisations were found to be compatible with EU state aid rules 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 resolution of Banco Espírito Santo

Events triggering the measure

BES came under heavy pressure in May 2014, when audit by the Bank of Portugal of Espírito Santo International (ESI, the controlling shareholder in Espírito Santo Financial Group) found ESI to be in a serious financial condition. The likelihood of a negative impact on BES's solvency, given the magnitude of BES's direct exposure to other companies within the Espírito Santo Group (ES group), raised concerns about the potential risks to BES' financial profile and its liquidity position.

On 30 July 2014, BES announced losses for the first half of 2014 amounting to €3.5 billion, as the result of a number of extraordinary events linked to its shareholders, as well as losses of €356 million in its Angolan subsidiary. The transaction of securities was suspended on 1 August. Moreover, BES ceased to comply with the minimum solvency ratios and, consequently, the European Central Bank decided to suspend the bank's access to monetary policy operations (from 1 August) and to the Eurosystem's liquidity.

The resolution

On 3 August 2014 the Portuguese authorities notified to the European Commission the resolution of BES and the immediate creation and capitalisation of a temporary credit institution (bridge bank). Selected relationships of BES with third parties, as well as the sound business activities of BES, were transferred to the bridge bank. The bridge bank also received assets and liabilities such as cash, retail deposits and performing loans, central bank funding, government guaranteed bonds and T-bills. Overall, €64 billion of assets were transferred to the bridge bank.

Shares representing the capital of BES Angola, shares in Espírito Santo Bank and claims on this entity, shares in Aman Bank and claims on this entity and claims on a majority of entities which were part of the Espírito Santo Group were not transferred to the bridge bank and remained in BES, referred to as 'the bad bank'. The residual assets remaining in the bad bank were to be resolved through liquidation.

The sale of the assets of the bridge bank should be completed in a period of 24 months from the date of the Commission's decision and any unsold assets by that date would be wound down. The banking licence of the bridge bank should be revoked when the bank was sold entirely or after 24 months from the date of the decision, whichever came earlier.

The winding-down period of the bad bank started with the setup of the bridge bank and was supposed to end when the bad bank was wound up entirely, its banking licence revoked and its banking activity ceased. The banking licence of the bad bank was to be revoked no later than at the time of the conclusion of the sale process of the bridge bank, at which time the bad bank should have been properly wound down under normal insolvency judicial proceedings.

The aid measure

The Portuguese authorities considered that the situation of BES threatened financial stability and that an urgent intervention was necessary to avoid a serious disturbance in the economy of Portugal. The Resolution Fund was therefore activated, with the aim of providing the bridge bank with an initial share capital of €4.9 billion in exchange for common shares.

The Resolution Fund had been created in 2012 to provide financial assistance to the application of resolution measures adopted by the Bank of Portugal. However, as of July 2014 the Resolution Fund did not hold sufficient funds to ensure compliance of the bridge bank with regulatory requirements. The Resolution Fund levied funds from the remainder of the Portuguese banking sector and the Portuguese Republic granted a loan to the Resolution Fund in the amount required to complement the financing needs of €4.5 billion.

Even though the Resolution Fund is financed by private credit institutions and investment companies, the Commission considered that its financing had a public nature as the Resolution Fund is under public control. The Commission found that all funds from the Resolution Fund are attributable to the state and that therefore its resources must be considered as state resources.

The Commission also considered that given the circumstances of BES, no private operator acting on the basis of market logic would participate in the capital of the bridge bank, namely the fact that the bridge bank was per definition a temporary institution with the goal of selling all its assets in the short run. However, to maximise the value of the assets, the bridge bank was allowed to continue its business and compete with other private operators on the market. Since the capitalisation measure was available only to the bridge bank, according to the Commission the measure conferred a selective advantage to it.

The Commission also found that the measure distorted competition as it allowed the bridge bank to obtain the necessary capital to avoid insolvency. Moreover, the measure was likely to affect trade between member states as the financial services market is by its nature global and BES competed on an international level.

On the basis of the foregoing, the Commission found that the €4.9 billion capital injection in the bridge bank fulfilled all the conditions laid down in article 107(1) TFEU and that it qualified as state aid.

A new regime

This was the first state aid case in the EU concerning the resolution of a financial institution that was notified to and assessed by the Commission after the entry into force of the Bank Resolution and Recovery Directive (BRRD) and by far the largest in terms of the amount of state aid involved after the publication of the 2013 Banking Communication.

In its 2013 Banking Communication the Commission acknowledged that member states should encourage the exit of non-viable players, while allowing for the exit process to take place in an orderly manner so as to preserve financial stability. Owing to the specificities of credit institutions and in the absence of mechanisms allowing for the resolution of credit institutions without threatening financial stability, it might not be feasible to liquidate a credit institution under ordinary insolvency proceedings. State measures to support the resolution of failing credit institutions may therefore be considered as compatible aid, subject to compliance with several requirements.

The Bank of Portugal stated that without the proposed measure BES would have undergone a disorderly liquidation, with potential severe adverse impacts on other banks and the wider financial system in Portugal. The assessment of the Portuguese authorities was that the disorderly liquidation of BES would destabilise the Portuguese financial markets and trigger a general crisis of confidence.

Member states may choose several tools provided for in the BRRD for the organisation of the resolution of ailing credit institutions. In light of the assessment made by the Portuguese authorities, the Commission acknowledged that the unorderly resolution of BES could create a serious disturbance in the economy of a member state and that the creation of a bridge bank was apt to remedy that disturbance.

The compatibility assessment

According to the 2013 Banking Communication, in order to be compatible with state aid rules the liquidation of a financial institution has to:

- be designed in such a way as to limit liquidation cost to the minimum necessary;
- contain sufficient measures limiting the distortion of competition; and
- include sufficient own contribution by the beneficiaries (burden-sharing).

Considering the counterfactual, the Commission concluded that the orderly resolution of BES through the creation of a bridge bank and the resolution of the bad bank was the least costly option for Portugal. The resolution aid was found to be limited to the minimum necessary.

As regards limitations to competition distortion, the Commission positively valued the fact that the banking licence of the bad bank was to be revoked by no later than two years after the Commission's decision. The bad bank would gradually reduce its balance sheet and would not compete on the market or pursue any new activities. Its operation would be limited to completing pending activities for existing customers.

The bridge bank was allowed to pursue new activities but only to maximise its net present value and thus reduce the resolution costs. The fact that the bridge bank had been established for a limited for a period of two years and its assets were to be sold as soon as possible led the Commission to consider that the distortions of competition stemming from its market presence during the winding-down were limited.

Additional commitments on the part of Portugal included limits to the growth of loans and the implementation of a strict deposit and loan pricing policy to ensure that the bridge bank would not enter into aggressive commercial practices. Finally, Portugal committed to ensure that the brand BES would cease existing within two months from the date of the decision. In fact, the bridge bank has in the meantime been named Novo Banco.

As regards burden-sharing, all shareholders and subordinated creditors were left in the bad bank. Claims by related parties (that is to say, shareholders or board members) of a non-contractual nature also remained in the bad bank. As a result, the contribution of shareholders and of subordinated debt holders was achieved to the maximum extent possible, thereby minimising moral hazard. As per the Portuguese banking resolution law, the burden sharing was extended to also cover claims by related parties (eg, shareholders and board members) of a non-contractual nature (eg, deposits of qualified shareholders with more than 2 per cent shareholdings).

In addition, payment of coupon and dividends was suspended unless those payments were legally due. An advertising ban and an acquisition ban were implemented and Portugal also committed to apply strict executive remuneration policies both to the bridge bank and the bad bank, with embedded incentives for executives to sell the assets as quickly as possible.

The sale of BESI

The investment banking arm of BES – BESI – was sold in December 2014 for €379 million to Haitong, a financial services group listed in Honk Kong and Shanghai.

The European Commission cleared the sale under para. 82 of the 2013 Banking Communication in May 2015.

The sale of Novo Banco

The Bank of Portugal organised the sale of Novo Banco (the bridge bank) such as to comply with commitment to sell the assets as quickly as possible, within the maximum lifetime of the bridge bank as a stand-alone institution.

The European Commission assessed the sale under procedural rules such as to ensure that the process is open, transparent, competitive and non-discriminatory and that consequently no state aid is transferred to the buyer. But the sale was also assessed under rules of substance to ensure that no restrictions of competition flowed from the transaction.

General Court rules on Banco Privado Português

Banco Privado Português (BPP) was a small bank established in Portugal, with assets representing less than 1 per cent of all the assets of the Portuguese banking system. In started facing difficulties in 2008 and the Portuguese Republic granted BPP a €450 million state guarantee outside the scheme which had been previously approved by the European Commission. The Commission was notified of the urgency measure and decided on a provisional basis not to raise objections under article 107 (3)(b) TFEU (serious disturbance in the economy of a member state), provided Portugal presented a restructuring plan within six months.

Portugal did not present a restructuring plan and renewed the guarantee for another six months without notifying the Commission. Naturally, the Commission opened a formal investigation.

In April 2010 the Bank of Portugal withdrew BPP's banking licence and required its judicial liquidation. In July that same year the Commission concluded that the guarantee was inadmissible aid and ordered Portugal to recover the aid. Portugal appealed and in December 2014 the General Court of the EU (GC) delivered its judgment.

The judgment of the GC contains several interesting findings. Even if some of them are not entirely new, they gain accrued meaning in the context of the financial crisis.

The GC looks back to the German cases to recall that the notion of 'serious disturbance of the economy of a member state' must be interpreted restrictively and that the Commission enjoys a large margin of discretion in the application of the Treaty provision at stake. At the same time, the GC states that it is not up to the Judge of the Union to replace the Commission in this sort of economic and social assessment and that its role is confined to checking whether a manifest error has been committed. The GC confirms that at the beginning of the financial crisis the Commission had the discretion to allow or to prohibit the kind of massive support afforded to the banks in the EU since 2008. A political choice was therefore made to strongly support the banking sector and article 107 (3)(b) TFEU was used to soften the traditional strict approach in the application of state aid rules.

Portugal sustained that BPP had stopped operating in the market as from the moment it was granted the loan in 2008 and forced to prepare a restructuring plan. The GC, however, considered that the mere fact that BPP still had its banking licence at the time and that it was still pursuing the same economic activity, although at a much reduced level, showed it was an undertaking in the sense of article 107 of the Treaty. The GC recalled that, in any event, the Commission is not required to establish the existence of a real impact of the aid on trade between member states and an actual distortion of competition, but is required only to examine whether that aid is capable of affecting such trade and distorting competition. Therefore, the reduction of activity of BPP was not relevant and the mere possibility that it could pursue its activity was sufficient for the Commission to act. Only with the withdrawal of BPP's licence was it possible for Portugal to sustain that the bank had effectively left the market, only since then did it cease to fulfil the regulatory requirements to pursue banking activity.

Portugal also argued that the recovery ordered by the Commission did not pursue the aim of restoring the equilibrium of the market and eliminating distortions in competition but was rather in the nature of a penalty given the insolvency of BPP. The GC was not moved by the argument and considered that the obligation of member states recovering illegal state aid is not in any way compromised or called into question by the fact that the beneficiary has been declared insolvent, as was the case with BPP. Given the considerable number of bank insolvencies since the outset of the financial crisis in 2008, the vocal reinstatement of this approach is everything but destitute of meaning.

The Viana do Castelo shipyards

Estaleiros Navais de Viana do Castelo (ENVC) was founded in 1944 and nationalised by Portugal in 1975. It used to operate the largest Portuguese shipyard and was fully owned by the state through Empordef, a 100 per cent state-owned holding. ENVC had been heavily loss-making since at least 2000 and had had negative equity since at least 2009.

Since then, Portugal had directly and indirectly granted subsidies to ENVC via numerous measures, including a capital increase in 2006, several loans granted between 2006 and 2011 to cover operating costs, comfort letters and guarantees to underwrite financing agreements between ENVC and commercial banks. The total value of the support measures amounted to approximately €290 million.

The Commission opened a formal investigation in 2013 and found that no private investor would have accepted to subsidise a loss-making company over 13 years. The measures were therefore not granted on market terms and constituted state aid. They gave ENVC a significant economic advantage over its competitors, who had to operate without such subsidies. The Commission further concluded that the measures were not compatible with the applicable 2004 Guidelines on rescue and restructuring aid namely because:

- ENVC, at the time, had no realistic restructuring programme to ensure the company's long-term viability without further state support; and
- ENVC received repeated aid, at least over the 10 years, in breach of the 'one time last time' principle, which allows the grant of rescue or restructuring aid only once in a 10-year period.

The Commission thus concluded that the measures had breached EU state aid rules and that ENVC was liable to pay back the value of the advantage it had received.

ENVC was eventually wound up and part of its assets (including a sub-concession of the land on which ENVC operated) was acquired by the private operator WestSea, owned by Martifer and Navalria.

WestSea only acquired part of the assets and acquired them at market conditions following an open and competitive tender. The Commission therefore concluded that WestSea was not the economic successor of ENVC. The obligation to repay the incompatible aid therefore remained with ENVC and was not passed on to WestSea since the Commission considered that there was no economic continuity between ENVC and WestSea.

Notes

1. European Commission, IP/09/818, 20 May 2009.
2. Decision of 17.12.2012, OJ C 43, 15.02.2013, p. 21.
3. 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.

Miguel Mendes Pereira
Vieira de Almeida & Associados

Miguel Mendes Pereira has a law degree from the Faculty of Law of the University of Lisbon, an LLM in European legal studies from the College of Europe, Bruges, Belgium, and a master's in European legal sciences from the Faculty of Law of the University of Lisbon. He is a lecturer at the Faculty of Law of the University of Lisbon in EU law and competition law (postgraduates).

He joined VdA in 2011 and is currently a partner in the competition and EU area of practice. He is also active in the field of copyright, electronic communications, media and advertising.

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.

His work has also been recognised by the most important international rankings, including *Best Lawyers, Chambers Europe, The Legal 500* and *Who's Who Legal*, in all of which Miguel Mendes Pereira appears as a leading and recommended lawyer.

VIEIRA DE ALMEIDA
& Associados Sociedade de Advogados, R L

Av. Duarte Pacheco, 26
1070-110 Lisbon
Portugal
Tel: +351 21 311 34 00
Fax: +351 21 357 00 09

Miguel Mendes Pereira
mig@vda.pt

www.vda.pt

Established in 1976, VdA is a top-tier firm in Portugal. Our team of more than 175 lawyers has advised on the landmark financial, commercial and infrastructure transactions that took place in Portugal over the past three decades.

As a result of the firm's continuous efforts, VdA has been awarded the FT 'Innovative Lawyers Year 2013', the *IFLR* 'Portuguese Firm of the Year 2014', the *Who's Who Legal* 'Law Firm of the Year 2014', *The Lawyer Iberia* 'Law Firm of the Year 2014' and, for the fourth year in a row, VdA was distinguished in capital markets by the NYSE Euronext Lisbon Awards 2015.

The competition practice of VdA comprises two partners and six 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 €7.5 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.

Through VdAtlas, the firm's international platform, we provide our clients with a professional network based on exclusive or preferential relations in the Portuguese-speaking world. Thus, we have developed a particular expertise in Mozambique, Angola, Brazil and East Timor.

ABA Section of International Law
Your Gateway to International Practice

Strategic Research Sponsor of the
ABA Section of Internavtional Law

Law
Business
Research

THE QUEEN'S AWARDS
FOR ENTERPRISE:
2012

ISSN 1466-6065