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State aid NN 64/2008 - Sweden Rescue aid to Carnegie Bank

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EUROPEAN COMMISSION

Brussels, 15.12.2008
C(2008) 8660

**Subject: State aid NN 64/2008 – Sweden
Rescue aid to Carnegie Bank**

Sir,

PROCEDURE

- (1) Sweden informed the Commission of the measures covered by this decision by letter dated 26 November 2008, registered with the Commission on the same date. Complementary information was submitted by Sweden on 12 December 2008.

BACKGROUND AND BENEFICIARY

- (2) The listed holding company D. Carnegie & Co AB (hereinafter “the holding company”) has two wholly-owned subsidiaries, Max Matthiessen Holding AB and Carnegie Investment Bank AB. The holding company has no business operations outside these subsidiaries. Max Matthiessen Holding AB (hereinafter "Max Matthiessen") acts as an intermediary for insurance and savings, administering about SEK 90 billion. Carnegie Investment Bank AB (hereinafter "Carnegie Bank" or "the Bank") conducts operations in securities trading, investment banking, asset management and private banking.

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- (3) The securities arm of Carnegie Bank is one of the largest participants in equity trading in the Nordic region¹. The investment banking arm was ranked as number two in the Nordic area in ECM (Equity Capital Market) transactions during 2007, with a total value of USD 2 832 million and 31 transactions.² Carnegie Bank's market shares in the Nordic market for Asset Management and Private Banking are estimated at respectively about 2 % and 1.8 %.
- (4) On 30 September 2008 the Carnegie group's balance sheet amounted to around SEK 33 billion³ and the assets under management by Carnegie Bank to around SEK 122 billion. Carnegie Bank had more than four thousand customers in Sweden and deposits amounting to around SEK 2.5 billion.
- (5) Carnegie Bank is under the supervision of Finansinspektionen, the Swedish Financial Supervisory Authority (below referred to as "the FSA"). In 2007 the bank received a warning from the FSA due to serious deficiencies in its governance. In September 2008, the FSA considered that it had reasons to initiate a new investigation of Carnegie Bank. In view of the earlier warning, it was clear that a finding of new irregularities would carry a substantial risk of the FSA revoking the bank and securities market licences of Carnegie Bank.
- (6) On 10 November 2008 the FSA, finding that Carnegie Bank had failed to comply with the relevant legislation by applying insufficient internal controls and inadequate risk management, decided to revoke its bank and securities market licences.
- (7) As a result of losing its bank license, Carnegie Bank would be required by law to wind down its operations and liquidate.

THE FINANCIAL SUPPORT MEASURES

The Riksbank's liquidity assistance

- (8) As a result of the recent turmoil on the financial markets and the drying-up of interbank lending, Carnegie Bank experienced increasing difficulties to fund its operations. The situation was exacerbated on 24 October 2008 when the publication of the Bank's third quarter earnings revealed an exceptionally large credit exposure in one single engagement which forced the Bank to make provisions against credit reserves of about SEK 1 billion.
- (9) As Carnegie Bank's financing situation became so strained that it risked being unable to meet its payment obligations, the bank applied for and was granted special liquidity assistance by Sveriges Riksbank (Sweden's central bank, hereinafter "the Riksbank").

¹ The Nordic region is defined as Denmark, Finland, Norway and Sweden. In 2007 Carnegie Bank had a market share in equity trading for institutions of 17 %. During September this year the securities arm had a market share of approximately 4.5 % in the OMX Nordic Exchange (Stockholm, Helsinki, Copenhagen and Iceland). The securities arm is also an issuer of warrants. According to statistics from the OMX Nordic Exchange, Carnegie Bank had a market share in warrant trading of 30 % in September 2008.

² Carnegie Bank was also ranked as number two in the Nordic region in IPO's (Initial Public Offerings), with eight companies introduced equalling a value of USD 769 million. In M&A transactions the Bank was ranked as number 11 in the Nordic region with transactions of a total value of USD 8 938 million

³ Exchange rate EUR 1 = SEK 10.5 (indicative information only, rate as per 10 December 2008).

On 27 October 2008 the Riksbank accepted to give Carnegie Bank the requested liquidity assistance with an indicative ceiling of SEK 1 billion, raised to SEK 5 billion on 28 October. The Riksbank paid out a first tranche of SEK 1 billion on 27 October. On 28 October 2008, Carnegie requested and was granted a second tranche of SEK 1.4 billion. The total liquidity assistance granted was thus SEK 2.4 billion. The interest rate was the Riksbank repo rate increased by 150 basis points. Under the terms of the credit facility, the Riksbank had the right to call the loan at any time without stating reasons.

- (10) To secure the liquidity assistance to the Bank, the Swedish authorities explained that the holding company and Carnegie Bank had provided the following collateral (with values as indicated by the Swedish authorities):
- All shares in Max Matthiessen, valued at SEK [...] million.
 - All shares in Carnegie Bank, valued at SEK [...] million.
 - The overvalue in claims following repo transactions⁴, estimated to be SEK [...] million.
 - Claims of Carnegie Bank against its subsidiaries Carnegie Bank A/S and Banque Carnegie Luxembourg S.A., valued at approx. SEK [...] million.
 - Various bonds, valued at SEK [...] million.
- (11) The total value of the collateral is thus in the range of SEK [...] billion to SEK [...] billion. Sweden has stated that this valuation took into account the uncertainty linked to the FSA's investigation and should be considered moderate.

The loan from the NDO

- (12) On 10 November 2008 (at 10 AM) the Swedish National Debt Office⁵ (hereinafter "the NDO") signed a loan agreement (hereinafter "the loan agreement") with Carnegie Bank under which the NDO lent the bank SEK 2,406,178,509. This sum corresponds to the amount lent to Carnegie Bank by the Riksbank plus interest⁶. The applicable rate of interest is the same as for the Riksbank liquidity assistance. The loan can be increased up to a maximum of SEK 5 billion.
- (13) The NDO's decision to enter into the loan agreement was based on an empowerment from the government on the basis of the law on support measures to financial institutions, passed on 29 October 2009 as an instrument to counteract the effects of

* *Business secret*

⁴ This category of collateral is explained by Sweden as follows. Carnegie Bank sold shares (in other companies) at a price below their market value and against an agreement to repurchase the shares for the same price plus a premium. It is the difference between the market value of the shares and the price at which they will be repurchased that Carnegie has pledged as collateral.

⁵ The National Debt Office ("Riksgäldskontoret") is the Swedish state's financial administration. It is responsible for cash and debt management on behalf of the central government.

⁶ It also includes certain costs incurred by the NDO in connection with setting up the loan agreement.

the current international crisis in the financial sector⁷. This new legislation makes the NDO, rather than the Riksbank, the competent authority for providing assistance to banks in difficulty. The NDO loan would consequently be used to repay the money due by Carnegie Bank to the Riksbank (the NDO would pay out the amount directly to the Riksbank).

- (14) The collateral pledged against the Riksbank's liquidity assistance would instead be pledged against the loan from the NDO. Under the loan agreement the NDO was entitled to take over the collateral if, amongst other circumstances, the bank license of Carnegie Bank was revoked.
- (15) The FSA revoked Carnegie Bank's bank and securities licenses on 10 November at 2.30 PM, whereupon the NDO paid out the agreed loan, thus redeeming Carnegie's debt towards the Riksbank. The withdrawal of Carnegie Bank's licenses was made public at 3 PM. Immediately afterwards, the NDO informed the holding company that it had taken over the collateral, as a consequence of which the Swedish state, through the NDO, became sole shareholder of Carnegie Bank and Max Matthiessen.
- (16) Later on 10 November, the FSA, noting the change of ownership and considering that it provided sufficient guarantees that the shortcomings it had previously identified would be remedied, commuted its earlier decision to withdraw the license into a warning, allowing Carnegie Bank to keep its bank and securities licenses. This allowed the Bank to carry on operating.
- (17) Under the loan agreement, the value of the collateral is to be established in relation to the situation when it was called i.e. when Carnegie Bank had lost its bank and securities licenses. The valuation, which is to be carried out by a reputable expert, is ongoing. If, when its value has been established, the collateral turns out to be worth more than the amounts due under the loan agreement, the NDO will have to repay the excess value to the holding company. If the collateral turns out to be worth less than Carnegie Bank's debt to the NDO, the difference between the two amounts remains due.

SWEDEN'S ARGUMENTS

Carnegie Bank was in imminent danger of bankruptcy

- (18) Sweden argues that Carnegie Bank, in view of the market distrust generated by its third quarter reports and the FSA's investigations in conjunction with the drying-up of interbank lending in the present financial turmoil, was in a situation by 27 October where it risked being unable to meet its payment obligations which would have entailed a risk for the stability of Sweden's financial system. This is why the Riksbank decided to intervene in support of the Bank.
- (19) The problems of Carnegie Bank were exacerbated on 10 November when its bank and securities licenses were withdrawn. At this point, Carnegie was most unlikely to be able to repay the amounts due to the Riksbank since its position had not improved in the period following the granting of the special liquidity assistance. In addition,

⁷ The law on support measures to financial institutions was approved by the Commission in state aid decision N 53/2008, published on OJ C 308, 3.12.2008.

Sweden argues, the loss of the licenses would most probably, in the absence of government intervention, have led to other creditors terminating the Bank's credits or calling outstanding loans, followed by an uncontrolled winding up of its operations.

The failure of Carnegie Bank would entail a serious threat to Sweden's financial system

- (20) Despite the relatively small size of the institution, Sweden considers that a payment default by Carnegie Bank could, given the current unstable market conditions, lead to serious disruptions of the financial system. This assessment is shared by the Swedish government, the FSA, the NDO and the Riksbank, and in the latter's case evidenced by a letter from the Riksbank submitted to the Commission.
- (21) In a market where the level of trust is more normal, the effects of a payment default by Carnegie Bank would probably not have such serious consequences. However, in the present crisis in international finance, a situation where Carnegie Bank would not meet its payments, thus leaving its counterparts in the financial system with losses, would seriously compromise the trust in Swedish banks in general and undermine the confidence in Sweden's payment system. Experience from the banking crisis in the 1990's has shown that international investors tend to view Swedish banks as a homogenous group. Lower trust from international investors would have a significant negative impact on the major banks in Sweden, which are heavily dependent on international financing.

The loan agreement is state aid compatible with the common market under Article 87(3) b) of the Treaty

- (22) Sweden considers that the loan agreement constitutes state aid. However, in view of the risk that Carnegie Bank's failure would have entailed for Sweden's financial system, Sweden argues that the measures are compatible with the common market under Article 87(3)b) of the Treaty.

ASSESSMENT

Qualification as state aid under Article 87(1) of the Treaty

- (23) As set out in Article 87(1) of the Treaty, 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.

The Riksbank's liquidity assistance

- (24) Although Sweden has qualified only the loan agreement between the NDO and Carnegie Bank as state aid, the Commission considers that there are reasons to assess also the state aid implications of the liquidity assistance granted by the Riksbank.
- (25) The Commission considers that the liquidity assistance provided by central banks may be found not to constitute state aid when a number of conditions are met, such as i) the financial institution is solvent at the moment of the liquidity provision and the latter is

not part of a larger aid package, ii) the facility is fully secured by collateral to which haircuts are applied, in function of its quality and market value, iii) the central bank charges a penal interest rate to the beneficiary, and iv) the measure is taken at the central bank's own initiative and in particular is not backed by any counter-guarantee of the state⁸.

- (26) In the present case, the Commission notes that the Riksbank granted the liquidity assistance against collateral constituted mainly by shares in the holding company's subsidiaries. However, the value of shares is subject to market fluctuations and shares are not such high-quality collateral that central banks would normally accept as security within its liquidity facilities. The same applies for the so-called overvalues in claims following repo transactions. In addition, most of the pledged shares were in Carnegie Bank, i.e. in the troubled beneficiary itself.⁹ These shares do not therefore constitute adequate security for the loans because, in case of a default by Carnegie Bank, they would only constitute an additional claim against the same debtor but with an even lower rank than the loans they were supposed to secure. At the time, Carnegie Bank's financing position was, in the Riksbank's own words, "so strained that the bank [risked] being unable to meet its payment obligations"¹⁰. Furthermore, the Bank was under investigation by the FSA and faced the very real possibility of losing its banking licenses. In these circumstances, the risk of Carnegie Bank defaulting had to be considered as very real. The shares, the so-called overvalues in claims following repo transactions and the loans from Carnegie Bank to its subsidiaries can therefore not be considered as collateral that fully secures the liquidity assistance provided¹¹.
- (27) The above-mentioned conditions that would allow not considering the Riksbank's liquidity assistance a state aid are consequently not met. The Commission therefore finds that the liquidity assistance granted an advantage to Carnegie Bank. This advantage was selective as it was granted exclusively to Carnegie Bank. In addition, the intense intra-Community exchanges in banking and financial services (illustrated by the Bank's strong presence on the four Nordic markets) entails that this advantage is liable to distort competition and to affect trade between the Member States. As for the criterion of state resources, it should be noted that the Riksbank is established by the Swedish constitution, that its operations are governed by a special law and that its board of governors is appointed by Parliament. The Riksbank's funds are thus clearly state resources within the meaning of Article 87(1) of the Treaty and the Riksbank's actions are imputable to the state.

⁸ See the Commission's Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (OJ C 270, 25.10.2008, p. 8), hereinafter "the Banking Communication". See also the Commission's decision of 2.12.2007 in case NN 70/2007, "Rescue aid to Northern Rock" (OJ C 43, 16.2.2008, p. 1).

⁹ Using the valuation range for the collateral provided by the Swedish authorities, the Carnegie Bank shares represented between 51 % and 77 % of the value of the collateral.

¹⁰ The Riksbank's memorandum of 27 October 2008 concerning "liquidity assistance on special terms" published on www.riksbank.se.

¹¹ It could also be argued that the overvalues in claims following repo transactions and the loans from Carnegie Bank to its subsidiaries were in any case included as assets in the Bank's balance sheet, the value of which is reflected in the price of the shares, which suggests that these pledges were counted twice (or at least overestimated) in Sweden's valuation of the collateral.

- (28) For these reasons, the Riksbank's special liquidity assistance to Carnegie Bank constitutes state aid within the meaning of Article 87(1) of the Treaty.

The loan agreement

- (29) The considerations set out in point 27 above apply *mutatis mutandis* also to the loan agreement. The Commission consequently finds that the loan agreement constitutes state aid within the meaning of Article 87(1) of the Treaty. The Commission also notes that this view is shared by the Swedish government, which has qualified the loan agreement as state aid in its submissions.

Legality of the aid

- (30) The Commission notes that the aid has been put into effect without notification and prior approval by the Commission. Sweden has thus not complied with its obligations under Article 88(3) of the Treaty.

The conditions for applying Article 87(3) b) of the Treaty

- (31) Sweden argues that the loan agreement is compatible with the common market on the basis of Article 87(3) b) of the Treaty under which state aid may be found compatible with the common market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission recalls that the Court of First Instance has stressed that Article 87(3) b) of the Treaty is to be applied restrictively and must tackle a disturbance in the entire economy of a Member State¹².
- (32) The Commission agrees that the turmoil on the financial markets and in particular the mutual distrust between financial institutions, which has led to an almost total drying-up of interbank lending, has created exceptional circumstances in which the failure of one bank may have detrimental effects on the financial system at large.
- (33) This may be the case even of a bank of moderate size, in particular when – as Carnegie Bank – it has important international operations in securities trading and investment banking which means that it has several counterparts amongst institutional investors and providers of wholesale funding in other countries which would be affected by a default on its payments. This may particularly be the case in a small economy such as Sweden where counterparts may tend not to distinguish between individual banks, thus extending the lack of confidence generated by the failure of one bank to the whole sector.
- (34) The Commission therefore accepts that the failure of Carnegie Bank would have entailed a serious disturbance of the Swedish economy. Article 87(3) b) of the Treaty can therefore be applied.

¹² Cf. in principle case Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Confirmed in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ 1998 L 221/28, point 10.1, Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, points 153 *et seq* and Commission Decision in Case C50/2006 *BAWAG*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

Compatibility

- (35) In line with the Banking Communication¹³, in order for such aid to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 87(3) of the Treaty, viewed in the light of the general objectives of the Treaty and in particular Articles 3 (1) (a) and 4 (2) EC, which imply compliance with the following conditions:¹⁴
- a. *Appropriateness*: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the disturbance would also disappear in the absence of the measure or if the measure is not appropriate to remedy the disturbance.
 - b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.¹⁵
 - c. *Proportionality*: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from 3 (1)g of the Treaty and Article 4(1) and (2) of the Treaty, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87(1) of the Treaty prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87(3) b) of the Treaty which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.
- (36) The sixth chapter of the Banking Communication translates these general principles into specific compatibility conditions for, amongst other forms of aid, liquidity assistance scheme. These conditions apply *mutatis mutandis* also to cases of aid to individual undertakings. The Commission will therefore assess the compatibility of the state aid to Carnegie Bank using these criteria.

Appropriateness of the aid

- (37) The purpose of the aid – both the Riksbank's liquidity assistance and the loan agreement – was to eliminate the threat to the stability of the Swedish economy that the failure of Carnegie Bank would have entailed. In order to do so, the aid had to

¹³ See footnote 6.

¹⁴ Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 41.

¹⁵ Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in. Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, "As is clear from Case 730/79 [...], aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market [...]."

remedy the identified cause of Carnegie's problems, i.e. its inability to find sufficient liquidity on the market.

- (38) The Commission considers that the aid instruments chosen by the Swedish authorities, i.e. the immediate provision of liquidity through loans, was a necessary and appropriate means to address Carnegie's liquidity problems. The aid was consequently appropriate.

Necessity

- (39) The Commission considers that the loans provided first through the Riksbank's liquidity assistance and later through the loan agreement constitute an appropriate form of aid since it provides Carnegie with immediately available liquidity whilst the reversible character of the measure contributes to limiting any distortion of competition.
- (40) The Commission must also assess whether the remuneration for the aid was adequate to limit the aid to the minimum necessary. In this respect, the Commission considers that the Recommendation on government guarantees on bank debt issued by the European Central Bank on 20 October 2008 provides relevant guidance *mutatis mutandis* also for the remuneration of liquidity assistance. The ECB recommends that the pricing of debt with maturities of less than one year should be based on an overall flat fee of 50 basis points without an add-on fee. However, in this case, consideration must be had to the fact that Carnegie Bank was in difficulty. To ensure that the aid is limited to that necessary, the pricing of the assistance should reflect the increased risk. In view of the benchmark provided by the ECB recommendations, the Commission considers that the interest rate applied to the liquidity assistance i.e. the Riksbank repo rate (applied to normal one week repos) with an add-on of 150 basis points adequately reflect the risks involved and constitutes a sufficiently high price to ensure the Bank did not draw on the Riksbank assistance to a greater extent than strictly necessary. In addition, the Commission notes that according to the FSA's decision on 10 November 2008, the Bank at that date estimated that the liquidity provided by the Riksbank on 27 and 28 October would cover its funding needs for approximately another two weeks i.e. until the end of November¹⁶. This would indicate that the sums provided did not go beyond the short term funding needs of Carnegie Bank. The Commission consequently finds that the liquidity assistance was limited to the minimum necessary.
- (41) The loan agreement effectively only substituted the NDO for the Riksbank in relation to Carnegie Bank as debtor. The conclusion that the state aid granted by the Riksbank was limited to the minimum necessary therefore holds true also for the loan agreement (in particular as the position of Carnegie Bank was arguably worse, and its need of the state aid accordingly greater, when the loan agreement was concluded on 10 November than it was when the Riksbank granted its special liquidity assistance).
- (42) The Commission consequently finds that the state aid was limited to the minimum necessary to achieve its purpose.

¹⁶ Decision of the FSA of 10 November 2008 (Fi Dnr 08-10273), page 8.

Proportionality

- (43) The proportionality of the measure is ensured by a series of behavioural commitments designed to limit the risk that the aid may distort competition. Thus, under the loan agreement, the Bank may not undertake a significant expansion of activities which would not have taken place in absence of the loan agreement.
- (44) Furthermore, Sweden has committed to ensure for as long as the Bank benefits from the state aid that the growth in balance sheet will not exceed the highest of the following benchmarks:
- The annual rate of growth of Swedish nominal GDP in the preceding year;
 - The average historical growth of balance sheets in the Swedish banking sector during the period 1987-2007; or
 - The average growth rate of the balance sheet volumes in the banking sector in the EU in the preceding six months.
- (45) In addition, the Commission records Sweden's commitment to provide a restructuring or liquidation plan for Carnegie Bank by 25 April 2009 at the latest. This entails a limitation in time of the rescue aid which contributes to limiting the risk of a distortion of competition.
- (46) In view of these safeguards, the Commission finds that the state aid is limited to the minimum necessary and will not entail an undue distortion of competition.

CONCLUSION

- (47) For the above reasons, the Commission finds that the state aid in favour of Carnegie Bank, consisting in the special liquidity assistance of the Riksbank and the loan agreement, is compatible with the common market pursuant to Article 87 (3) b) of the Treaty.
- (48) The Commission underscores that this decision covers only the Riksbank's liquidity assistance and the aid effectively provided under the loan agreement. Any further state aid would naturally need to be notified and approved by the Commission before it is implemented. In particular, this decision is without prejudice to any potential state aid implications in the eventual valuation of the collateral and the settlement between the NDO and the holding company as mentioned in point 17 of this decision.

DECISION

The Commission finds that the abovementioned state aid is compatible with the common market and has accordingly decided not to raise objections.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter to agree to the disclosure to third parties and to the publication of the

full text of the letter in the authentic language on the Internet site.
http://ec.europa.eu/community_law/state_aids/index.htm.

Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Neelie KROES
Member of the Commission