Forfeiting financing and the construction of the waste-fuelled power station (Müllheizkraftwerk) MHKW Rothensee GmbH (1)

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Overview
On 22 March 2006, the Commission decided (2) that the forfeiting financing for the construction of the waste-fuelled power station MHKW Rothensee does not constitute state aid pursuant to Article 87(1) EC. The case concerned the financing of the construction of a waste-fuelled power plant operated by the enterprise MHKW Rothensee in Germany (Saxony-Anhalt). It is the first time the Commission had to deal with a forfeiting financing model in the context of a state aid case.

Forfeiting, a commercial financing instrument, is the purchase of receivables or claims without recourse to the selling party in the case of non-payment.

Internationally, this financing tool is mainly used in the export business. An exporter holding promissory notes (receivables, claims) from the buyer as payment for the exported goods is occasionally interested in raising funds by selling these notes to a bank and transforming a credit transaction into a cash transaction. For the bank, this purchase covers a risk of non-payment of the notes.

In practice, the bank as the ‘forfaiteur’ buys the claims, which the exporter would acquire against the importer after the delivery of goods and provides the exporter’s financing of the trade transaction. For the purchase of receivables or claims the forfeiting bank applies a discounting rate agreed with the exporter, which receives the net cash amount.

In particular in Germany, forfeiting is not only applied in the export business but also used for the financing of investments by both large banks and banks specialised on forfeiting.

The measure at stake concerned such financing of an investment project; this is the construction of the waste-fuelled power station MHKW Rothensee. Germany felt confident that the measure did not involve State aid pursuant to Article 87(1) EC, but nevertheless notified it to the Commission for reasons of legal certainty. In its assessment, the Commission concluded that taking into account all particular circumstances and conditions, no state aid was involved in this specific project.

The project outline
Based on the offers from a call for tender, the City of Magdeburg selected MHKW Rothensee as an enterprise for waste management (Abfallwirtschaftsbetrieb) to collect and dispose the waste in the area of Magdeburg. Both sides agreed on a waste disposal contract (Entsorgungsvertrag) including on the one hand MHKW Rothensee’s obligations on waste treatment and on the other hand the city’s commitment to remunerate for the waste disposal. Accordingly, MHKW Rothensee will dispose the waste in a waste-fuelled power station, which has been pre-financed by its shareholders, i.e. E.ON, which holds 51 % of the shares, and the Städtische Werke Magdeburg GmbH, which owns 49 % of MHKW. Since the City of Magdeburg owns itself 54 % of Städtische Werke Magdeburg, it is indirectly a shareholder of MHKW Rothensee.

MHKW Rothensee intends to finance a part of the investment by ‘forfeiting’, which in this case means the partial sale of MHKW’s claims to the City of Magdeburg for the remuneration of its services — ca. 62 % of the total remuneration for the waste disposal — to a bank consortium (Helaba and Commerzbank). The City of Magdeburg waives its pleas (‘Einredeverzicht’) concerning these claims by means of an Additional Agreement (‘Zusatzvereinbarung’). It follows from this agreement that the City cannot object paying MHKW Rothensee for this part of the remuneration as foreseen in the waste disposal contract.

According to Germany, favourable financing conditions for the project result not from the forfeiting financing but from the waiver of pleas stipulated in the Additional Agreement. Applying the model as proposed, MHKW Rothensee would receive financing for the construction of the waste fuelled power station at similar conditions as a municipality. As calculated by the bank consortium, the interest rate would decrease accordingly and result in a certain cash value, which MHKW Rothensee would, however, directly and without delay forward to the City in one lump sum.

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(1) The content of this article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the authors.

(2) State aid No N 339/2005 — Germany (not yet published).
It is to be underlined, that not the forfeiting project in total but a specific aspect — the Additional Agreement (‘Zusatzvereinbarung’) to waive the City of Magdeburg’s pleas (‘Einredeverzicht’) for 62% of its claims against MHKW — required particular attention in the Commission’s state aid analysis.

The financing arrangements in the context of state aid analysis

The Commission based its analysis and decision on potential state aid in favour of MHKW Rothensee in the meaning of Article 87(1) EC on the following reasoning:

1. In the framework of the forfeiting model MHKW Rothensee sells claims under the waste disposal contract, corresponding to a certain nominal value to the bank consortium. As usual and common practice for such business transactions, the sales price is calculated as the present value of the revenues to which the claims give entitlement over the duration of the contract. The discount rate used by the bank in such calculation will naturally include a risk premium reflecting the situation of the seller, MHKW Rothensee. However, the claims sold are those covered by the Additional Agreement to which the City of Magdeburg cannot object and therefore the City factually guarantees that it will pay them in full. From this follows that the risk for the bank consortium is no longer that relating to MHKW Rothensee but the one relating to the City. Hence, the forfeiting model with the Additional Agreement reflects in fact the conditions of a municipal credit (‘Kommunalkredit’).

2. Although the bank consortium receives an irrevocable claim and therefore an advantage as compared to the situation without the Additional Agreement, it pays a purchase price to MHKW Rothensee as if such change of debtor would not have taken place. The bank consortium calculates the purchase price by taking into account the net present value method, which is a market conform calculation method where the primary factors are the maturity of the claims and the discount interest rate. However, due to the Additional Agreement of the forfeiting model and the change of debtor, the bank consortium concedes a lower and for MHKW more favourable discount interest rate. From the reduced interest rate applied, results an increased price, which the bank consortium pays for the claims to MHKW (see also the following chart). It means that MHKW Rothensee receives a higher purchase price from the bank consortium than it would have got without the Additional Agreement.

The main task of the Commission was to verify whether the calculation of the amount forwarded is in line with market terms in order to avoid any indirect advantage resulting from the involvement of a public entity (the City of Magdeburg).

First of all, Germany demonstrated that MHKW Rothensee had asked several financial institutions for offers and negotiated the final financing conditions with the bank consortium. Further, it was guaranteed that MHKW Rothensee forwarded the advantage from the higher purchase price in full to the City of Magdeburg and that no advantage remained to MHKW Rothensee under the Additional Agreement. Apparently only the City obtains the benefit of its waiver of pleas under
that Agreement. Finally, Germany confirmed that there will be no advantage in MHKW Rothensee's taxation results from the forfeiting model and the Additional Agreement.

Additional risks and an adequate compensation

The Commission had also to assess whether the banks would not unduly benefit from the forfeiting financing with Additional Agreement. Such advantage would be created, if the compensation paid to the City of Magdeburg for bearing additional risks was inadequate. In any case, such advantage would be limited to the difference between the financing conditions with and without the Additional Agreement. With the aim of allowing a full assessment of the case, the banks involved submitted information on the alternative financing proposal (without Additional Agreement).

Since it could happen that MHKW Rothensee may not always fulfil its contract on waste treatment, the Commission analysed the value of the waiver of claims and assessed the additional risks for the City of Magdeburg. The Commission considered such risk as very small:

— First, the City of Magdeburg will be able to enforce 38% of its claims without any restriction until the total of claims will have arrived at the 62% it has waived. That level would only be reached when the service provided under the contract was totally inadequate.

— According to information submitted by Commerzbank and Helaba the banks would be prepared to finance the proposed transaction also in absence of the waiver by Magdeburg, however then subject to an increase of the interest rate requested for the financing of the project.

— When assessing the risks for Magdeburg due to the waiver of pleas it should be noticed that waste collection and treatment is a relatively stable business. MHWK Rothensee had already started operations without any delays and operated without any interruptions so far.

— Furthermore, the City of Magdeburg is also secured against the possibility of an insolvency of MHKW Rothensee. The shareholders of MHKW Rothensee have committed themselves with regard to Magdeburg to allow MHKW Rothensee an additional bank line.

— Since the City of Magdeburg is indirectly co-owner of MHKW Rothensee (via its co-ownership of Städtische Werke Magdeburg which owns 49% of MHKW Rothensee) it can intervene in the case of non-fulfilment of any contractual obligations.

— Furthermore, MHKW Rothensee is a member of the interruption network of Northern German waste-fuelled power plants (Ausfallsverbund Norddeutscher Müllverbrennungsanlage) and thus insured against breakdowns. Any additional costs caused by one of the network members would be covered by the breakdown insurance of MHKW Rothensee.

— Taking into account both the specific conditions accompanying the forfeiting financing in this case and the fact that the City of Magdeburg negotiated with several banks eventually entering into an agreement with two banks, which are not involved in other aspects of the financing of the project, the Commission considered that the remuneration for the waiver reflects a market price.

Conclusion

It follows from the above that the forfeiting financing at stake, which includes an additional agreement, involves neither an advantage to MHKW Rothensee nor to the bank consortium Commerzbank and Helaba.

The case is therefore a good example for an innovative financing mode, which involves a public entity without resulting in state aid pursuant to Article 87(1) EC.