ALERT MEMORANDUM

EU Court of Justice Confirms That Italian Deposit Guarantee Scheme Intervention in Support of Banca Tercas Did Not Constitute State Aid

April 2, 2021

On March 2, 2021, in dismissing the appeal brought by the European Commission against the judgment of the EU General Court in the *Tercas* case, the EU Court of Justice issued a landmark ruling on the standard of proof for the imputability to the State of support measures granted by private entities and the assessment under State aid rules of deposit guarantee scheme interventions in bank restructurings.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

ROME

Mario Siragusa
+39 06 6952 2210
msiragusa@cgsh.com

Giuseppe Scassellati-Sforzolini
+39 06 6952 2220
gscassellati@cgsh.com

Gianluca Faella
+39 06 6952 2690
gfaella@cgsh.com

MILAN

Alessandro Comino
+39 02 7260 8264
acomino@cgsh.com

1. Background: the FITD's intervention and the Commission's decision

The Fondo Interbancario di Tutela dei Depositi ("FITD") is the main Italian deposit guarantee scheme ("DGS"). It is a consortium of banks originally established on a voluntary basis in 1987, to pursue the common interests of its members. Following the transposition of Directive 94/19/EC on DGSs into the Italian legal system, the FITD was recognized by the Bank of Italy as a DGS authorized to operate in Italy.

Pursuant to the Italian Consolidated Banking Act (Testo Unico Bancario – "TUB"), the FITD was under an obligation to guarantee up to €100,000 the deposits made at its member banks, in the event of compulsory liquidation (*mandatory intervention*). However, the applicable rules also allowed DGSs to introduce in their statutes other forms of intervention, without specifying which intervention in case of bank restructurings could be envisaged and without requiring DGSs to adopt such measures. The FITD's statutes enabled it, *inter alia*, to voluntarily implement support interventions in favor of its member banks placed under special administration, provided that the distressed bank had prospects of recovery and the support intervention was less costly than reimbursing depositors in the case of liquidation of the bank (*alternative intervention*). Alternative intervention could consist of funding, guarantees, purchase of equity interests and other measures.

In April 2012, the Ministry of Economy and Finance placed Banca Tercas ("Tercas") under special administration, following irregularities identified by the Bank of Italy. In 2013, Banca Popolare di Bari ("BPB") expressed an interest in subscribing to a capital increase in Tercas, on condition that the FITD covered in full its negative equity.

In July 2014, after having verified that the intervention was less costly than reimbursing depositors in case of liquidation, the FITD voluntarily implemented measures in support of Banca Tercas, consisting of a capital injection (of €265 million) and guarantees (of €35 and €30 million), in order to cover the bank's losses and facilitate its recapitalization by BPB. The alternative intervention, decided unanimously by private banks' representatives in FITD's governing bodies, would have avoided the compulsory administrative liquidation of Tercas and the subsequent reimbursement of depositors by the FITD. The measures were not notified to the Commission, as they were not considered State aid.

In February 2015, the Commission opened an in-depth investigation into the support measures implemented by the FITD to prevent Tercas' compulsory administrative liquidation. In December 2015, the Commission issued a decision stating that the FITD's intervention constituted State aid to Tercas, granted in violation of Article 108(3) TFEU and incompatible with the internal market.[1]

In particular, the Commission held that: *(i)* the TUB entrusted the FITD with a "*public mandate of protecting depositors*," also through alternative interventions; (*ii*) the member banks' contributions to alternative interventions had a mandatory nature, because member banks were required to participate in the FITD and could neither individually veto a decision to intervene nor opt out from the intervention; (*iii*) public authorities and, in particular, the Bank of Italy exercised a strong influence over the intervention through effective supervision powers, including the power to approve the FITD's statutes and interventions.

2. The annulment of the Commission's decision by the General Court

In separate applications, the FITD, the Italian Government and BPB requested the General Court ("GC") to annul the Commission's decision.

In a judgment of March 19, 2019, the GC annulled the decision.[2] According to the GC, the Commission had erroneously considered that the alternative intervention in favor of Banca Tercas was imputable to

[1] Commission decision of December 23, 2015, SA.39451 (2015/C) (ex 2015/NN), *Aid to Banca Tercas*.

[2] General Court, March 19, 2019, joined cases T-98/16, T-196/16 and T-198/16, *Tercas*, EU:T:2019:167.

the State and financed through State resources, on the basis of an incorrect assessment of the available evidence.

In the GC's view, when a measure is not taken by a public undertaking (*i.e.*, an undertaking subject to the control of public authorities), but is implemented by a private entity (such as the FITD), the Commission is "*under an even more important obligation to specify and substantiate the reasons which justify its conclusion that the resources used are under public control and the measures are imputable to the State and, consequently, that there is aid within the meaning of Article 107(1) TFEU*" (§ 67).

According to the GC, the Commission had failed to prove that the intervention was adopted under the influence or control of public authorities. *Inter alia*, the GC found that: (i) the FITD is a consortium established under private law, which acts on behalf, and in the interest, of its members and has no capital links with public authorities; (ii) the FITD's alternative interventions in favor of distressed banks aim to pursue the private interests of its member banks, by avoiding the more onerous economic consequences of reimbursing deposits in the event of a bank's liquidation, as well as further negative effects for the banking sector in terms of its reputation and stability; (iii) the Bank of Italy limited itself to exercising its prudential supervisory functions and did not have any power to coerce the FITD to intervene.

The GC also stated that the Commission had failed to establish, to the requisite legal standard, that the resources were controlled by the Italian public authorities and, thus, at their disposal. In particular, the GC found that the funds granted to Tercas had been provided by the FITD's member banks, in their interest, on the assumption that the alternative intervention would have been less costly than reimbursing depositors.

On May 29, 2019, the Commission challenged the first instance judgment, on the grounds that it was vitiated by erroneous legal considerations and distortion of elements of fact and law.

3. The judgment of the Court of Justice

In a judgment issued on March 2, 2021, the Court of Justice, sitting as Grand Chamber, dismissed the appeal brought by the Commission.[3] The Court's ruling clarified its case-law on the imputability to the State of support measures granted by private entities.

3.1 The first ground of appeal

a. In the first limb of the first ground of appeal, the Commission claimed that the GC had committed an error of law with regard to the standard of proof to be discharged to establish that a measure adopted by a private entity – such as the FITD – is imputable to the State and granted through State resources.

According to the Commission, the GC had erroneously imposed a heavier standard of proof than that required by the case-law of the Court of Justice, solely on account of the fact that the FITD is a private entity. Due to this error of law, the GC had wrongly required the Commission to demonstrate that: (i) public authorities exercised a dominant influence over the entity granting the support, at every stage of the procedure leading to the adoption of the measures concerned; and (ii) the involvement of the public authorities had an impact on the content of those measures.

First, the Court noted that the Commission had not raised grounds specifically relating to the standard of proof of the use of State resources. Thus, the Court examined the first limb of the appeal only with reference to imputability.

Contrary to the Commission's view, the Court held that the GC had not imposed a higher standard of proof on the Commission, but had applied the established case-law on the imputability of advantages granted by entities distinct from the State, according to which it is

[3] Court of Justice, March 2, 2021, C-425/19 P, *Tercas*, EU:C:2021:154.

for the Commission to demonstrate that a measure is imputable to the State.

To this end, the Commission may rely on a "*set of indicators arising from the circumstances of the case and the context in which the financial assistance was given in order to establish the degree of involvement by the public authorities*".[4] However, according to the Court, when examining the circumstances and context of the case, the GC correctly noted the objective differences between a situation in which the entity granting the aid is a public undertaking, as such subject to State control, and one in which that entity is private (§ 71). When the measure is taken by a private entity, the Commission cannot rely on the existence of links of a capital nature between such entity and the State. The "*absence of a link of a capital nature between the entity concerned and the State is clearly relevant*" in assessing whether a measure is imputable to public authorities (§ 73). In the absence of capital links, the Commission has to provide other elements supporting the conclusion that the measure implemented by a private entity may be imputed to the State.

The Court then rejected the argument that the GC had imposed on the Commission the burden of proving that all the steps in the implementation of the measures adopted by the FITD were influenced by the Italian authorities. As the contested decision stated that national authorities had the authority and the means to influence all the steps in the implementation of the measures at issue, the GC considered it necessary to examine, for all such steps, the evidence on the basis of which the Commission had come to this conclusion (§ 74).

The Court also rejected the Commission's argument that the GC had required it to demonstrate an actual impact of the involvement of the Bank of Italy on the content of the measures. In the Court's view, in the paragraph of the first instance ruling contested by the Commission, the GC did not examine whether, in practice, the intervention of the Bank of Italy had an impact on the content of the measures at issue, but merely stated that the national authority did not have the power to influence the content of the measures and could only check their compliance with the regulatory framework, for the purposes of prudential supervision (§ 75).

b. In its appeal, the Commission further argued that, for the purposes of State aid rules, the FITD must be regarded not as a private entity, but as an "*emanation of the State*," as it was entrusted with specific tasks in accordance with Directive 94/19/EC. Accordingly, regardless of the more rigorous standard of proof allegedly applied to private entities, the judgment under appeal was vitiated by an error of law, as the GC had erroneously held that the FITD should be considered a private entity.

The Court also dismissed this line of argument. It recalled that the concept of "*emanation of the State*" was developed by the Court in the case-law on the direct effect of directives that are not transposed or are incorrectly transposed. This case-law aims at allowing individuals to rely on unconditional and sufficiently precise provisions of such directives "*against organisations or bodies which are subject to the authority or control of the State or which possess special powers beyond those which result from the normal rules applicable to relations between individuals*".[5] According to the Court, the notion of "*emanation of the State*" cannot be applied in State aid

[4] Based on established case-law, in the case of measures implemented by public undertakings, possible indicators to establish whether a measure is imputable include the following: (i) the fact that the public undertaking in question could not have taken the decision at issue without taking account of the requirements of the public authorities or the directives emanating from the public authorities; (ii) the integration of the public undertaking into the structures of the public administration; (iii) the nature of its activities and the exercise of those activities on the market in normal conditions of competition with private operators; (iv) the legal status of the undertaking; and (v) the intensity of the supervision exercised by public authorities (see, among other judgments, Court of Justice, May 16, 2002, *France v Commission*, C-482/99, EU:C:2002:294).

[5] See, among other judgments, Court of Justice, October 10, 2017, C-413/15, *Farrell*, EU:C:2017:745.

matters to classify as State aid the measures adopted by those organizations or bodies (§ 77).

In light of the above, the Court did not examine whether the FITD could be considered an emanation of the State within the meaning of the above-mentioned case-law. However, it seems unlikely that the FITD would have met the requirements set by such case-law, as it is not a public body, it is not subject to the authority or control of a public body, and it does not enjoy special powers exceeding those deriving from private law.

c. Further, the Court rejected the Commission's argument that, by raising the standard of proof and making it almost impossible to demonstrate that measures taken by DGSs constitute State aid, the GC's judgment would allow Member States to circumvent the application of Article 32 of Directive 2014/59/EU, according to which the grant of extraordinary public financial support to a credit institution triggers a resolution procedure.

The Court reiterated that the GC had not imposed a higher burden of proof on the Commission. Moreover, the Court noted that it remains always possible for the Commission to demonstrate that a measure adopted by a DGS constitutes State aid, taking into account the specific circumstances of the case, including the specific features of the DGS and the measures concerned (§ 78).

Indeed, the Commission has already considered that interventions implemented by DGSs of other Member States that are subject to substantial powers and influence of public authorities, constitute State aid.[6]

d. In the second limb of the first ground of appeal, the Commission submitted that the GC had failed to carry out an overall analysis of the evidence produced to demonstrate the imputability of the contested measures to the State.

The Court held that, contrary to the Commission's view, the GC had correctly based its conclusions on an overall analysis of all the elements taken into consideration in the contested decision, placed in their context. In particular, when examining the scope of the public mandate conferred on the FITD, the GC analyzed all the elements produced by the Commission. Moreover, in the Court's view, various paragraphs of the judgment under appeal explicitly demonstrated that the GC had carried out an overall assessment of the evidence relied upon by the Commission and taken into account the context in which the contested measures were adopted (§§ 80-85).

3.2 The second ground of appeal

In its second ground of appeal, the Commission argued that the GC had distorted the facts of the case and Italian law.

In particular, the Commission claimed that the GC manifestly distorted the content of Article 96-*ter* of the TUB, by finding that the Bank of Italy could only conduct a review of legality of the measures adopted by the FITD, and did not have the power to assess their appropriateness. On the contrary, according to the Commission, the fact that, based on Article 96-*ter* of the TUB, the Bank of Italy authorizes the measures adopted by the FITD "*having regard to the protection of depositors and the stability of the banking system*" confirms that all the FITD's interventions (including alternative ones) are aimed at protecting savers, on the basis of a public mandate.

The Court held that the GC had correctly assessed the regulatory framework in the light of which Article 96-*ter* of the TUB must be interpreted.

The Bank of Italy is the central bank of the Italian Republic and has been an integral part of the European System of Central Banks (ESCB) since 1998. It exercises the role of supervisory authority of the banking sector in Italy. Pursuant to Article 5 of the TUB, the Bank of Italy exercises its prudential supervisory duties "*having regard to the sound and prudent management of institutions subject to its supervision, overall stability, the effectiveness and the*

[6] See, *e.g.*, Decision of August 1, 2011, Case SA.33001, *Denmark - Part B - Amendment to the Danish winding up scheme for credit institutions.*

competitiveness of the financial system and compliance with the applicable provisions." Moreover, pursuant to Article 19 of the TUB, the Bank of Italy authorizes a number of initiatives and decisions taken by banks, such as those involving acquisitions (§§ 95-98).

In the Court's view, the authorization of the FITD's support intervention under Article 96-*ter* of the TUB was consistent with the Bank of Italy's prudential supervisory duties under the mentioned regulatory framework. Accordingly, the Court concluded that the GC had not distorted national law.

4. Conclusion

The Commission decision in the *Tercas* case has had a dramatic impact on the Italian banking system and retail investors.

Following the Commission's decision to launch a formal investigation in the *Tercas* case in February 2015 and its subsequent final decision, it became clear that, in the Commission's view, a support intervention implemented by DGSs constituted State aid and should comply with the compatibility requirements provided for in the 2013 Banking Communications, including burden sharing by shareholders and subordinated debt holders. As a consequence, it was thought that DGSs' resources could not be used to implement support measures aimed at preventing the failure of a bank, without ensuring at the same time full burden sharing by shareholders and subordinated debt holders.

The Commission's approach had a decisive influence on the management of banking crises in Italy until the General Court's judgment in March 2019, as it prevented Italian DGSs from implementing support interventions aimed at avoiding the resolution or liquidation of a bank, without adopting full burden sharing measures. The rulings delivered by the General Court and the Court of Justice in the *Tercas* case demonstrate that certain banking crises in Italy could have been dealt with at a lower overall cost for the banking system and taxpayers.

More generally, the judgment of the Court of Justice offers important clarifications on the application of the rules on State aid to private entities in charge of carrying out functions of general interest. In the case of private entities, which do not have capital links with public authorities, the Commission cannot simply rely on the "*likelihood of the involvement*" by public authorities or the "*unlikelihood of their not being involved*". In highly regulated sectors, such as the financial sector, a certain degree of involvement of public authorities may be normal and, actually, required under applicable rules, especially in the case of sensitive events and market developments. This is not sufficient to conclude that there is State aid. In order to demonstrate the grant of State aid, the Commission has to provide evidence capable of establishing, to the required legal standard, that the measure is adopted under the actual influence or control of public authorities and, thus, is imputable to the State.

The judgment of the Court of Justice also has important implications for the management of banking crises in other Member States. The Court acknowledged that, under certain conditions, interventions financed by DGSs in support of banks in difficulty do not constitute State aid. According to the Court, the supervisory powers exercised by a national central bank do not entail as such that a DGS is deprived of its autonomy and that its interventions must be imputed to the State. Ultimately, the issue of whether support measures by DGSs constitute State aid depends on their governance and the applicable regulatory framework.

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