Press and Information

Court of Justice of the European Union
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Judgment in Case C-526/14
Tadej Kotnik and Others v Državni zbor Republike Slovenije

The Communication from the Commission on aid to the banking sector is valid

In particular, burden-sharing by shareholders and subordinated creditors as a prerequisite for the authorisation, by the Commission, of State aid to a bank with a shortfall is not contrary to EU law

Following the global financial crisis, which began in 2007, the Banka Slovenije (the Bank of Slovenia) determined, in September 2013, that five Slovenian banks[1] were showing capital shortfalls. Given the scale of those shortfalls, those banks did not have sufficient assets to satisfy their creditors and to cover the value of deposits. On 17 December 2013 the Bank of Slovenia adopted a decision putting in place exceptional measures to ensure the recapitalisation of the first two banks, the rescue of the third, and the winding up of the last two banks.

On 18 December 2013 the Commission authorised the granting of State aid to the five banks concerned, that aid having first been notified by the Slovenian authorities. The measures at issue, which were adopted on the basis of the law on the banking sector, included writing off not only equity capital, but also subordinated debt. Subordinated debt is constituted by financial instruments which share certain characteristics with debt products and certain characteristics with equity capital. In the event of the insolvency or winding up of the issuing entity, the holders of subordinated debt are paid after the holders of ordinary debentures, but before equity shareholders. In exchange for the financial risk thus assumed by their holders, those financial instruments offer a higher rate of return.

A number of applications for review of constitutionality of the law on the banking sector having been brought before the Ustavno sodišče (Constitutional Court, Slovenia), that court asks the Court of Justice to give a ruling on the validity and interpretation of provisions of the Banking Communication from the Commission.[2] That communication was adopted in order to provide guidelines on the criteria for the compatibility, with the internal market, of State aid granted to the financial sector in the financial crisis.

In today's judgment, the Court observes that, with respect to whether the Banking Communication is binding on the Member States, the Commission may adopt, in the exercise of its discretion, guidelines in order to establish the criteria on the basis of which it proposes to assess the compatibility, with the internal market, of aid measures envisaged by the Member States. In adopting such guidelines and announcing by publishing them that they will apply to the cases to which they relate, the Commission imposes a limit on the exercise of that discretion, with the result that, if a Member State notifies the Commission of proposed State aid that complies with those guidelines, the Commission must, as a general rule, authorise that aid. Further, the adoption of a communication such as the Banking Communication does not relieve the Commission of its obligation to examine the specific exceptional circumstances relied on by a Member State. On the contrary, the Member States retain the right to notify the Commission of proposed State aid which does not meet the criteria laid down by the Banking Communication and the Commission may authorise such proposed aid in exceptional circumstances. It follows that the Banking

[1] Nova Ljubljanska banka, Nova Kreditna banka Maribor, Abanka Vipa, Probanka and Factor banka.
[2] 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 ('Banking Communication') (OJ 2013, C 216, p. 1).

Communication is not capable of imposing independent obligations on the Member States and that it is therefore not binding on them.

As regards the burden-sharing by shareholders and subordinated creditors as a prerequisite to the authorisation of State aid by the Commission, the Court states that the Banking Communication was adopted on the basis of a provision of the TFEU to the effect that the Commission may hold to be compatible with the internal market aid designed to remedy a serious disturbance in the economy of a Member State.[3] The burden-sharing measures are designed to ensure that, prior to the grant of any State aid, the banks which show a capital shortfall take steps, with their investors, to reduce that shortfall, specifically by raising equity capital and obtaining a contribution from subordinated creditors, since such measures are likely to limit the amount of the State aid granted. To act otherwise would be likely to cause distortions of competition, since banks whose shareholders and subordinated creditors had not contributed to the reduction of the capital shortfall would receive State aid of an amount greater than that which would have been sufficient to overcome the residual capital shortfall. Further, in adopting that communication, the Commission did not encroach on the competences conferred on the Council of the European Union.

The Court states that the fact that, in the first phases of the international financial crisis, subordinated creditors were not called upon to contribute to the rescue of credit institutions does not put the creditors in a position to rely on the principle of protection of legitimate expectations. Such a circumstance cannot be regarded as a precise, unconditional and consistent assurance capable of engendering a legitimate expectation on the part of the shareholders and the subordinated creditors that they would not be subject to burden-sharing measures in the future. Further, since shareholders are liable for the debts of a bank up to the amount of its share capital, the fact that the Banking Communication requires that, in order to overcome the capital shortfall of the bank, prior to the grant of State aid, those shareholders should contribute to the absorption of the losses suffered by that bank to the same extent as if there were no State aid, cannot be regarded as adversely affecting their right to property.

The Court also observes that an EU directive[4] provides, in essence, that any increase or reduction in the capital of a public limited liability company must be subject to a decision by the general meeting of the company. The Court considers that, to the extent that the Banking Communication provides that certain alterations to the share capital of banks do not have to be decided upon or approved by the general meeting, the Banking Communication is not incompatible with that directive. While the Member States may possibly find it necessary, in a particular situation, to adopt such burden-sharing measures without the agreement of the general meeting of the company, that circumstance cannot however call into question the validity of the Banking Communication. Those measures can be adopted only in the context of there being a serious disturbance of the economy of a Member State and with the objective of preventing a systemic risk and ensuring the stability of the financial system.

As regards measures for conversion or write-down of subordinated debt, the Court considers that a Member State is not compelled to impose on banks in distress, prior to the grant of any State aid, an obligation to convert subordinated debt into equity or to effect a write-down of the principal of that debt, or an obligation to ensure that that debt contributes fully to the absorption of losses. In such circumstances, it will not however be possible for the envisaged State aid to be regarded as having been limited to what is strictly necessary. The Member State, and the banks who are to be the recipients of the contemplated State aid, take the risk that there will be a decision by the Commission declaring that aid to be incompatible with the internal market. The Court adds however that measures for conversion or write-down of subordinated debt must not go beyond what is necessary to overcome the shortfall of the bank concerned.

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[3] Article 107(3)(b) TFEU.

[4] Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ 2012 L 315, p. 74).

Lastly, the Court holds that the burden-sharing measures fall within the scope of the concept of ‘reorganisation measures’[5] within the meaning of the directive on the reorganisation and winding up of credit institutions.[6] Given that the aim of those burden-sharing measures is to restore the financial position of credit institutions and to overcome their capital shortfall, the purpose of those measures is to preserve or re-establish the financial situation of a credit institution.

NOTE: A reference for a preliminary ruling allows the courts and tribunals of the Member States, in disputes which have been brought before them, to refer questions to the Court of Justice about the interpretation of European Union law or the validity of a European Union act. The Court of Justice does not decide the dispute itself. It is for the national court or tribunal to dispose of the case in accordance with the Court’s decision, which is similarly binding on other national courts or tribunals before which a similar issue is raised.

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The full text of the judgment is published on the CURIA website on the day of delivery.

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[5] ‘measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties’ pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims’.
[6] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (OJ 2001 L 125, p. 15).