WORLDBANK / FINSAC

JUDICIAL PRACTICE OF BANK RESOLUTION

COLLECTION OF SELECTED EUROPEAN UNION AND UNITED STATES COURT RULINGS

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Acknowledgements and Disclaimer

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Glossary

APA	Administrative Procedure Act
AT1	Additional Tier 1
BES	Banco Espírito Santo S.A.
BFA	Banco Financiero y de Ahorro, S.A.
BRRD	Bank Recovery and Resolution Directive
CET	Common Equity Tier 1
CD	Certificates of Deposits
DGS	Deposit Guarantee Scheme
DGSD	Deposit Guarantee Schemes Directive
ECB	European Central Bank
ECHR	European Court of Human Rights
ECJ	European Court of Justice
EEA	European Economic Area
EFTA	European Free Trade Association
ESA	EFTA Surveillance Authority
EU	European Union
FDIC	Federal Deposit Insurance Corporation
FOLTF	Failing or Likely to Fail
FROB	Spanish Fund for Orderly Bank Restructuring
FTCA	Federal Tort Claims Act
HRE	Hypo Real Estate Holding AG
IPS	Institutional Protection Scheme
JPMC	JPMorgan Chase Bank, N.A.
LOLR	Lender of Last Resort
MEF	Italian Ministry of Economy and Finance
MOU	Memorandum of Understanding
NCWO	No Creditor Worse Off
OCC	Office of the Comptroller of the Currency
OLA	Orderly Liquidation Authority
OTS	Office of Thrift Supervision
P&A	Purchase and Assumption
SRB	Single Resolution Board
SRMR	Single Resolution Mechanism Regulation
TEU	Treaty on the EU
TFEU	Treaty on the Functioning of the EU
WAMU	Washington Mutual Bank
WMI	Washington Mutual Inc

Contents

1. INTRODUCTION AND OVERALL SUMMARY OF THE MAIN ASPECTS COVERED IN THE RULINGS

Court proceedings play a key role in contributing to the [in]effectiveness of bank liquidation and resolution procedures. European Union (EU) countries that took resolution action in recent years have experienced a significant number of related court cases, many still pending. This highlights the complexity of the legal issues inherent in dealing with failing banks while aiming to safeguard financial stability and without resorting to public support. In the wake of the global financial crisis, many jurisdictions have made significant legislative progress in adopting new resolution frameworks based on the Financial Stability Board's Key Attributes of Effective Resolution Regimes.[1] Also the EU toolkit for troubled banks is based on the Key Attributes and is regulated in the Bank Recovery and Resolution Directive (BRRD).[2] This was required to be transposed into national legislation by each EU Member State by 2015. For the euro area, a parallel resolution regime was established with powers largely centralized at the Single Resolution Board (SRB) but execution of resolution action was, as a rule, left to national resolution authorities. While resolution cases in the EU are still relatively rare, legal practice is evolving and a body of settled case law is emerging.

New concepts, such as open bank bail-in going beyond the 'burden sharing' requirements under state aid rules, were introduced to redress the balance between (risk) investments of shareholders and creditors and the public interest in bailing out banks. Financial Stability Board-based resolution proceedings place responsibility for exercising resolution powers with administrative authorities, subject only to ex-post judicial review.[3] In many EU Member States, bank insolvency regimes for small banks continue to exist in parallel. Often these follow court-based general insolvency law, but some are based on an administrative regime and include "resolution like" transfer powers (as in Italy). This parallelism and the wide discretionary assessment left to resolution authorities in deciding whether application of resolution powers under the BRRD is justified under the so called "public interest test", opens the door for circumvention of current BRRD conditions. The main differences in applying resolution powers under BRRD rules or under national insolvency rules, relate to the prior 8% bail-in requirement as well as the use of public support and deposit guarantee scheme (DGS) money.

This collection of rulings aims to provide an overview of the emerging case law on failing banks in the EU, all of which are related to resolution decisions taken in the wake of the global financial crisis (both pre- and post-BRRD). Rulings in other jurisdictions are included as a comparative benchmark. The U.S. was selected due to its long history of the Federal Deposit Insurance Corporation (FDIC) taking resolution action as well as for highlighting conceptual differences. It is worth noting that even with the FDICs many years of experience, new challenges still arise for example when dealing with more complex big regional banks, as demonstrated in the *Washington Mutual Bank* case, or the as yet untested application of resolution powers under the Orderly Liquidation Authority (OLA).

The European resolution system is of particular importance for FinSAC client countries, as most of them are EU Members or accession countries which have significantly aligned their resolution framework with the EU acquis in recent years. Interestingly and unlike most EU countries (see above), most

[1] Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, October 15, 2014; (http://www.financialstabilityboard.org/2014/10/r_141015/)

[2] https://ec.europa.eu/info/law/bank-recovery-and-resolution-directive-2014-59-eu_en

[3] In some jurisdiction a prior [24-48] hours review by Courts have been introduced limited to a review under the arbitrary and capricious standard or procedural aspects.

FinSAC client countries already had a pre-existing administrative based bank resolution and liquidation system in place.

The following introductory summary highlights some key aspects of justifying the taking of resolution action and implementation of legal safeguards. It further offers some guidance for a harmonized resolution framework for small and big banks by clarifying the legal context of the public interest test under current BRRD rules, in light of the evolving European resolution case law.

1.1 Irreversibility of resolution action / non-suspensive effect of litigation

It is complex to strike the balance of taking fast decisive resolution action needed to maintain financial stability while at the same time ensuring legal safeguards and judicial overview in accordance with constitutional principles and fundamental property rights. This is recognized by the Financial Stability Board in Key Attribute 5.5 stressing the de facto irreversibility of resolution actions when stating that "the legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified". An analogous provision is included in Article 85 BRRD. In many cases summarized in this collection, a stay of the resolution action was requested but in no case have courts admitted the suspension of the effects of the challenged resolution decision.[4] The Court reasoning was in all cases based on similar arguments: the irreversibility of the resolution action justified by an overriding public interest in safeguarding financial stability. Examples include the Portuguese cases on Banco Internacional do Funchal, S.A. (Banif) and Banco Espírito Santo S.A. (BES), in which the Court also made reference to the legislators' intention not to question the execution of resolution decisions (under Article 85 BRRD). Reference was also made to the need for speedy action and the alternative option of monetary compensation in case of unjustified or illegal action by the resolution or supervisory authority (see, for example, *Meritor* where damages were granted).

In the EU *Dowling* case, prior judicial involvement by way of an ad-hoc Court order was ensured before the administrative authority took action, providing for additional procedural safeguards. The BRRD includes the options of involving Courts for a 24-hours review prior to taking resolution action, an option which was hardly used by Members States in the national transposition; see also case Italy / *Banca Marche*). Under the (so far untested) U.S. OLA procedures such ex-ante judicial check is obligatory stipulated for.[5]

1.2 Judicial review of the exercise of discretionary administrative powers

Crisis management and the exercise of resolution powers requires discretionary judgment. The exercise of discretionary powers is by nature an entry point for litigation. Administrative discretion is usually understood in a way that judicial review does not extend to the 'content of the decision': the aim of the court is not to supplement or replace the decision taken, but to judge if the parameters of the legal framework and the room for discretion has been exceeded or not.[6] In the U.S., the principle of "judiciary restraint" was confirmed in 2013 in the *United Western* case (see section 2.1) by stressing that, "The

[4] With the exemption of an interim approval which was revised by the Court in Banco Popular (see 7.2).

[5] 12 U.S. Code § 5382/ In case the Board of the failing bank does not agree to the appointment of the FDIC as receiver (acquiescence = consent) the Secretary of Treasury shall petition to the US District court for the District of Columbia for an order authorizing it to appoint the FDIC as receiver under the capricious and arbitrary standard. If no determination is made by the Court within 24 hrs the appointment of receivership is considered approved.

[6] Goldmann M (2016) Constitutional pluralism as mutually assured discretion. Maastricht J Eur Comp Law 23:125; See for the central bank independence: Goodhart and Lastra Open Econ Rev 29:49–68, 2018.

law does not invite the court to make its own judgment about whether it would have been feasible, appropriate, or even preferable, for the agency to wait [to declare the bank failing]; **the sole question is whether the agency action was unreasonable**" and that the Court "will not intervene unless the [agency] failed to consider relevant factors or made a manifest error in judgment". Already earlier, the Court held in the *Golden Pacific* case (see section 2.4) that "the government cannot be held liable in damages merely because in a particular case the [supervisors] conclusion or some aspect of it turns out to be legally vulnerable" due to the exercise of discretionary supervisory assessment. Also the ECHR stressed in *Grainger* that the Courts role was limited, and "the national authorities are in principle better placed than the international judge to appreciate what is "in the public interest" on social or economic grounds" (…) as long as authorities act within their [wide] margin of appreciation and their decisions are not "manifestly without reasonable foundation".

Under EU law, the judiciary are explicitly required to rely on the economic assessment undertaken by the supervisory/resolution authority, which shall also be used by the court as a basis for its assessment under Article 85 BRRD. This approach of judiciary constraint while stressing the need to assess that the administrative decision is based on reasonable and reliable grounds was not yet ruled upon by the European Court of Justice (ECJ) but was confirmed by ECJ Advocate General Wahl in the Slovenia *Kotnik* case (see section 3.3) who stated "(…), that court may also need to check whether the economic evaluations made by the public authorities (for example of the capital shortfall of the bank and of the real economic value of the investments pre- and post-State intervention) were, despite the urgency within which they had to be made, reasonable and based on reliable data."[7] Rulings at the national level in Italy have taken a very similar approach, stressing that "a judge can only review a resolution decision for incompetence, violation of law, manifest irrationality, error, and abuse of power (so called "extrinsic" judicial review) but it cannot replace "the authorities technical assessment". More specifically, the Italian Court stressed that differences in the provisional and the final valuation are not unreasonable and both valuation conclude that shareholders and subordinated creditors are not made worse-off by taking resolution action, while the claimant failed to prove that he would have been better-off under liquidation (see *Banca Marche*, section 10.4). The principle of confined judicial review was also upheld by the Greek court in *Agricultural bank* case (see section 6.1) emphasizing that "the judicial review was confined to verifying whether the rules on procedure have been followed and the reasons for adopting the resolution measures substantiated". The court did not proceed to its own economic assessment but relied on the assessments carried out by the Bank of Greece, which were based on the reports of the independent advisors.

In *Kotnik*, the ECJ also clarified that past behavior of an authority, in that case the European Commission not putting any burden on subordinated creditors – though the law would have allowed it-, does not create any legitimate expectations for such creditors to assume they would be saved from facing losses in the future. This statement seems to support the view that resolution authorities may exercise discretionary powers in a different way depending on the individual case and affected parties do not necessarily have a right on equal treatment as long as discretionary powers are not exercised contrary to the law.

Regarding the burden of proof, in all cases it was up to the claimant to provide evidence that the agency's action was erroneous. Obviously, as stated in the U.S. with regard to *Franklin* (see section 2.3), the agency's record must contain sufficient data to allow the reviewing court to determine whether the

[7] Point 91, Advocate General's Opinion, Kotnik and Others Case C-526/14, 18 February 2016.

agency had a rational basis for its decision to appoint an administrator / or put a bank into resolution and decide in the amount of loss, transfer of liabilities, or bail-in e.g. by way of (independent) valuations.

1.3 Transparency and due process

With regard to the lack of following due process rights, like prior hearings before appointing administrators or putting a bank into resolution, an early U.S. ruling from 1947 *Fahey v. Mallonee* (see section 2.6) confirmed the need for speed. It found that putting a bank into resolution does not constitute a due process defect as the requirement of a pre-seizure hearing could expose depositors / investors as well as the DGS to further losses and stressed the overriding public interest to swiftly deal with a failing bank (see also case James Madison in section 2.2). Alleged lack of due process with regard to the right of the bank to be heard before liquidation/resolution action was taken, was also rejected by the Italian Courts due to the overriding public interest (see section 10.1). Lack of due process is one of the pleas not yet decided in the first resolution case decided by the SRB, *Banco Popular* (see section 8.2), but it is worth noting that the SRB granted hearing rights with regard to the ex-post valuation taking place after resolution.

The limitation of the principle of transparency was upheld in the Agricultural Bank of Greece case (section 6.1) where the court argued that the legislators choice to (also) allow for a closed non-public tender was in the interest of the national economy and the protection of public confidence in the banking system, since "a confidential bidding procedure which resulted to the swift completion of the implementation of the resolution measure of the transfer of the assets of the resolved bank a viable credit institution best protected financial system stability, addressed depositors' concerns that they would suffer losses and limited the possibility of massive withdrawal of deposits which would have unjustified negative impacts on viable banks."

1.4 Competent court

In almost all cases, claims are brought against the administrative resolution authority and in front of an administrative court. In many cases, parallel action is started under civil law and criminal law. In the Greece *Proton Bank* case (see section 6.2), the court reiterated that central bank measures when exercising its powers related to protecting financial stability and public confidence in the financial system are regarded as administrative acts, irrespective of the nature of the legal relations they regulate and whether they are public or private. Actions may also be brought in front of civil courts with regard to claims arising from the failing bank, e.g. with regard to the liability of an acquiring bank for legal legacy issues like mis-selling or contingent liabilities (see section 8.2 on *Banco Popular*, not yet decided). In some cases, criminal court proceedings investigate possible criminal behavior, such as whether former management or financial auditors committed a crime by making false financial statements (see for example the case of Banco Popular: the criminal ruling is still outstanding, though it was clarified that the acquiring bank would not inherit any criminal liabilities (without impact on civil law liability).

1.5 Civil liability in a transfer

The collection also covers some rulings on the complex question of which assets and liabilities were transferred under a Purchase and Assumption (P&A), for example the Washington Mutual Bank (WAMU) (section 2.7), *Goldman Sachs* (section 5.2), *BES* (section 9.2) and *Banco Popular* (section 8.2) cases. In the *WAMU* case, the question of who bears losses stemming from alleged defects in WAMU mortgage underwriting held by Deutsche Bank was settled after a partial summary judgment decision, finding that under the terms of the P&A agreement transferring (substantially all) assets and liabilities to JP Morgan, the FDIC as receiver (FDIC-R) retained liability for Deutsche Bank's claims to the extent that such claims were not reflected at a stated book value in the financial accounting records of WAMU as of the failure date. In the case of *Banco Popular*, Santander is allegedly liable on the civil side (not criminal – see above) for any misdeeds committed by Banco Popular (unless otherwise agreed in the Fund for Orderly Bank Restructuring (FROB)/SRB transfer agreement; case not yet decided, see section 8.2).

1.6 Interference with property rights and legal safeguards

AT the EU level three early cases pre-BRRD allowed the ECJ to rule on the "constitutionality" of the new resolution toolkit with regard to property rights and interference with (EU) fundamental rights protection. In its judgment *Dowling* (see section 3.2), the ECJ held that while there was a clear public interest in ensuring strong and consistent protection of shareholders and creditors, that interest did not prevail over the public interest in ensuring the stability of the financial system and concluded that a public recapitalization was the only means to prevent the failure of the bank, despite its rejection by the shareholders general meeting.

With regard to bail-in, it is important to distinguish between the write down and the conversion part (both for capital and debt).[8] In *Kotnik*, the ECJ confirmed that due to safeguards built into the law, in particular the NCWOL principle and the public interest, the burden-sharing requirement i.e. the write down of equity and junior debt, cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within a counterfactual insolvency loss (see section 3.3). The *Kotnik* ruling seems to allow the conclusion that the loss absorption under resolution may not be considered as interference into property rights as long as the loss that shareholder and creditors face is not higher than the hypothetical liquidation counterfactual under the NCWOL principle. The importance of the hypothetical liquidation counterfactual was highlighted by an EU General Court ruling related to *Banco Popular* (see section 7.2). This found that the SRB was not obliged to conduct a final Valuation 2 under the sale of business tool (prior to resolution the independent valuer could only conduct a provisional Valuation 2 and stressed that the affected shareholders and creditors could only be entitled to compensation under the NCWOL Valuation (that is Valuation 3 in EU terminology).

For the conversion part, creditors will receive value in the form of new equity or other type of ownership. A statutory debt to equity swaps comes with related ownership rights and responsibilities for converted creditors for which justification by a public interest and proportionally could be required regardless whether the conversion amount is protected under the NCWOL safeguard (contrary to the loss absorption which does not constitute an interference into property rights insofar as protected under

[8] Even though the NCWOL legal safeguard under the BRRD explicitly only applies to bail-in, in light of fundamental rights protection it must also be ensured for the write down and conversion of capital : see also EBA https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2015_2181

the NCWOL safeguard, see above). This view seems to be reflected by the ECJ in the *Ledra* case (see section 3.1 and 3.2) where the resolution action included the conversion of depositors into shareholders and where no direct reference to the NCWOL safeguard was made: "In view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the two banks concerned would have been exposed if the latter had failed, such measures do not constitute a disproportionate and intolerable interference impairing the very substance of the appellants' right to property. Consequently, they cannot be regarded as unjustified restrictions on that right".

At the national level an Italian Court in *Banca Marche* held in a similar vein as the ECJ in *Kotnik*, that the resolution decision did not violate constitutionally guaranteed property rights as actually no expropriation has taken place as shares and bonds have the prescribed function to cover bank losses (see section 10.3). Also in the *Proton* case a Greek court ruled that the appellant failed to prove interference into property rights arguing that "the value of the equity held by the applicant no longer corresponded to the real value" (see section 6.2).

In the Grainger case (see section 4.1), the ECFHR ruled with regard to loss absorption by shareholders "that legitimate objectives in the "public interest", such as those pursued in measures of economic reform or measures designed to achieve greater social justice, may call for "less than reimbursement of the full market value" not permitting shareholders "to benefit from the value which had been created and maintained only through the provision of State support [LOLR]." The court reiterates that the "purpose of the statutory assumptions was to put the shareholders in the position they would have occupied had no LOLR support been provided. If the assumptions produced a nil value for the shares, this was only because the business was shown to be worthless without the support put in by the Government." This case is different from loss absorption under resolution protected under the NCWOL safeguard, as the LOLR was provided before nationalization of the bank and the shareholder's value was not recognized in light of public interest arguments (due to prior LOLR) when putting the bank under temporary public ownership.

1.7 A harmonized resolution framework for big and small banks - what legal safeguards?

If resolution action that is compliant with the NCWOL safeguard, does not constitute an interference into property rights (no expropriation) as held in the Italian case and in *Kotnik*, the question to be asked is whether there is actually a need for a public interest justification for the loss or write down part, as currently stipulated for in Article 32 BRRD.[9] The conceptual differences between the EU and the U.S in the use of the two main legal safeguards for exercising bank resolution powers i.e. i) the "public interest/systemicity assessment" and ii) the lesser cost than liquidation (NCWOL) principle as well as related case law can help to explain current circumventions in the use of resolution like powers under national insolvency in the EU.

The BRRD requires a public interest test for all types of resolution powers. Application of BRRD powers is meant only "for the few not the many",[10] though interpretation of the public interest test varies significantly among Member States and the SRB. There are examples of small banks having qualified for the application of resolution powers (as in Denmark and Italy in 2015) and also examples of a

[9] This is different from a "general public interest" in the sense of social, economic, and financial stability public interest in regulating and applying bank resolution rather than putting failing banks into piecemeal liquidation as any other business.

[10] See for example: https://srb.europa.eu/en/node/972

stricter interpretation of the public interest test (as in recent SRB cases or the Italian case of *Crediveneto* (section 9.1) and *Banca Popolare di Vicenza* and *Veneto Banca* (section 9.2). The burden of proof that resolution would be "necessary and proportionate" and able to achieve public interest objectives to a greater degree than liquidation lies with the claimants (section 9.1). In the U.S. a systemic risk determination is necessary to invoke OLA which allows for resolution of large bank holding companies and financial companies with a bail-in component.[11] For traditional resolution powers under the Federal Deposit Insurance Act[12] - similar in substance to part of the BRRD powers like closed bank transfer to a private acquirer or a bridge bank - no systemicity assessment is stipulated, unless in case of divergence from the least cost test.[13]

The US least cost test overlaps in part with the NCWOL principle. While the NCWOL is broader in scope and provides a legal safeguard to all affected shareholders and creditors not to suffer higher loss than under liquidation, the US least cost determines the least costly action with regard to the costs of the FDIC[14] (prior "lesser cost test"[15]). Though the analysis is done for FDIC costs only, the assumption on the value of the assets under liquidation would be the same for all creditors (with recovery depending on the hierarchy) and in that aspect equivalent the NCWOL calculation.

Recent publications call for a reform of the EU resolution framework and the harmonization of resolution powers for "non systemic" banks in the EU.[16] One way forward could be an extension in scope of part of the BRRD powers to non-public interest banks creating a harmonized approach for applying resolution powers to big and small banks under a two-tier legal safeguard along the following lines:

- Application of the P&A and bridge powers to all banks (including to non-systemic ones) justifying the taking of resolution action under the NCWOL safeguard, similar to the traditional FDIC resolution powers under the lesser cost test (now least cost) and in line with the *Kotnik* ruling.

- Bail-in conversion powers should continue to apply only to the few "public interest or systemic" banks, which otherwise would be too big to fail (similar to the OLA) under an extended and more specific public interest test, justifying the bail-in conversion power (not covered by the loss compensation under the NCWOL test, see above) by systemic effects and the need to continue critical economic functions.

Under a harmonized framework, the public interest test would be tailored to the type of resolution powers applied. Such two-tier legal safeguard under a harmonized framework could help avoid circumvention of BRRD rules via national de facto resolution powers under national liquidation and enhance legal certainty with regard to the exercise of discretionary powers under the current public interest test.

[11] See 12 U.S.C. 5381(a)(11), 5383 ; for a summary see also https://www.govinfo.gov/content/pkg/FR-2013-06-10/pdf/2013-13595.pdf

[12] This is without questioning the justification of the FDIC powers in a wider understanding of public interest.

[13] While the FDIC normally has to follow the least cost test, there is a "systemic risk exception" which would allow the FDIC to resolve the institution without using the least cost test and to protect depositors for more than their insured deposits as well as creditors. This can occur only if there is an emergency determination by the Secretary of the Treasury (in consultation with the President) upon a written recommendation by not less than two-thirds of the members of the FDIC and the Board of Directors of the Federal Reserve Board that the FDIC's compliance with the least cost test and limiting the use of the deposit insurance fund would have serious adverse effects on economic conditions or financial stability and action or assistance would avoid or mitigate such adverse effects. The FDIC may then take other action or provide assistance for the purpose of winding up the insured depository institution for which it has been appointed receiver "as necessary to avoid or mitigate such effects." 12 U.S.C. 1823 (c)(4)(G)(i)

[14] Under the U.S. model, FDIC ranks pari passu with uninsured depositors and regularly contributes to resolution financing under the FDIA under the least cost test (including the hypothetical liquidation counterfactual). In the EU a lower protection coverage and the super-preference of the DGS constitute a high barrier for the use of DGS money for resolution purposes. Unlike in the U.S., the net liquidation counterfactual is merely designed as a legal safeguard under the BRRD, while the trigger to use DGS money requires a loss for insured depositors under resolution (Art 109 BRRD).

[15] Prior to 1991, the FDIC could consider other factors, such as the availability of local banking services and banking stability, before making its final selection, as long as the bid was less costly than liquidation. See: https://www.fdic.gov/bank/historical/reshandbook/resolutions-handbook.pdf

[16] See Gelpern, A and Véron, N, Nonviable Banks: U.S. Experience and Considerations for EU Reform (2019); Document prepared at the request of the European Parliament's Committee on Economic and Monetary Affairs; also: J. Deslandes, C. Dias and M. Magnus, Liquidation of Banks: Towards an 'FDIC' for the Banking Union?; European Parliament Papers, 2019.

2. UNITED STATES

2.1 United Western Bank v. Office of the Comptroller of the Currency[17]

Summary: The Court upheld the decision of the Office of Thrift Supervision (OTS) to appoint a receiver and put the bank into resolution, finding it was not unreasonable for the supervisory authority to determine the bank was facing a liquidity crisis and was undercapitalized, as the bank failed to provide sufficient support for its assertion that additional investors would invest money into the bank in a timely manner. The burden was on the bank to show the OTS's actions were unreasonable or contrary to law. The court noted, "The law does not invite the court to make its own judgment about whether it would have been feasible, appropriate, or even preferable, for the agency to wait [to declare the bank failing]; **the sole question is whether the agency action was unreasonable**" and that it "will not intervene unless the [agency] failed to consider relevant factors or made a manifest error in judgment".

Background: United Western Bank was a federally chartered savings association in Colorado. On January 21, 2011, the Director of the OTS appointed FDIC as receiver of the bank, finding three separate statutory grounds for appointing a receiver; that the association: (1) was in an unsafe and unsound condition to transact business; (2) was likely to be unable to pay its obligations or meet depositors demands in the normal course of business; and (3) was undercapitalized per applicable regulations and failed to submit an acceptable capital restoration plan.[18]

Limits on Right to Challenge Resolution: The statute authorizing OTS to appoint a receiver for United Western Bank provided the bank with the right to bring an action within 30 days of appointment in the judicial district in which the association's home office is located, or the U.S. District Court for the District of Columbia, for an order requiring the OTS to remove the receiver.[19] The action challenging the appointment was filed by the bank, the holding corporation, and five individual directors against OTS and FDIC as receiver for the bank, and FDIC in its corporate capacity. OTS and FDIC filed motions to dismiss the action. The court held that the former directors did not have standing to bring the action in their own right but had the power to institute the action "on behalf of" the bank. "[W]hile the statute fully authorizes OTS to decapitate the bank, it also grants the severed head one final request – to ask to be reattached."[20] In sum, the holding corporation and individual directors lacked standing because the statute only authorized the bank to bring suit. The court also dismissed the action against FDIC because the statute only authorized actions against the OTS.[21]

MAIN PLEAS

Request to Stay Resolution due to Arbitrary Exercise of Powers: The bank argued it was not necessary for the OTS to appoint a receiver because there were potential investors and it had a recapitalization plan that would have worked. The bank contended that the OTS's appointment order should be set aside because the determination that the three statutory grounds existed was conclusory and

[17] No. 11-0408 (U.S. District Court for the District of Columbia March 5, 2013) (Civil Action). After the case was filed, the OTS was abolished and the OCC took over its functions as the regulator of federal savings associations on July 21, 2011. Therefore, the action went forward against the OCC which was substituted into the case for OTS.

[18] 12 U.S. Code 1821(c)(5)(C), (F), (K).

[19] 12 U.S. Code 1464(d)(2)(B

[20] United Western Bank v. OTS, 793 F. Supp. 2d 357, 362 (District Court for the District of Columbia 2011

[21] Id. at 365 and 367-68.

unsupported by the administrative record and the decision was therefore arbitrary, capricious, an abuse of discretion, and not in accordance with the statutory requirements.

JUDGMENT AND COURT REASONING

No arbitrary or capricious decision by the OTS (supervisory authority): The court reviewed the administrative record and upheld OTS's finding of three statutory grounds for placing the bank in receivership. The court found OTS's rejection of the bank's capital restoration plan was not arbitrary and capricious. In the absence of legal commitments from investors or a timeline, it was not unreasonable for the OTS to find that the bank failed to provide sufficient support for its optimistic assumption that additional investors would invest significant money into the bank in a timely manner.[22] Moreover, the court found that OTS reasonably concluded that the capital restoration plan would unreasonably increase the bank's level of risk because: (1) the plan increased the institution's concentration in an already excessive concentration of institutional deposits; and (2) was unacceptable in light of the association's poor ratings, troubled condition, high level of existing problem assets, and poor earnings.[23] The court also found that the OTS reasonably determined that the bank was facing a liquidity crisis.[24] OTS had expressed concern about the bank's concentration in institutional deposits during the global financial crisis because contractual agreements with some investors allowed them to withdraw their funds if the bank's capital fell below the "well capitalized" level and a continued decline of capital could place the bank into a precarious liquidity position.[25] In addition, the record showed that the bank did not have sufficient liquidity to cover a potential withdrawal by institutional depositors.[26] Finally, the court found that the third ground for appointment–that the bank was unsafe and unsound–was not irrational. The appointment order articulated several events that presented a reasonably foreseeable undue risk to the bank, including significant operating losses, weak capital position, significant asset problems, and reliance on a small number of institutional investors for liquidity.[27]

Evidence Required by Court: The court limited its review of OTS's appointment decision to the administrative record before the agency when the appointment was made.[28] This included the appointment recommendation, prior bank examinations, enforcement orders, and supervisory correspondence between the bank and its regulators, including the bank's recapitalization plan. Prior to issuing its final decision, the court did grant the bank's motion to compel production of the complete administrative record and permitted it to obtain information beyond what OTS had designated as the administrative record.[29]

Economic Assessment and Burden of Proof: The court reviewed the OTS's valuation on which the decision to put the bank into resolution was based and reviewed the record to determine if the agency's grounds for appointing a receiver were reasonable. The burden was on the bank to show that OTS's actions were unreasonable or contrary to law. The court noted, "The law does not invite the court to make its own judgment about whether it would have been feasible, appropriate, or even preferable, for the agency to wait; the sole question is whether the agency action was unreasonable." and found that it had reviewed the appointment decision to determine if it was "arbitrary, capricious, an abuse

[22] United Western Bank (2013) at 24.
[23] Id. at 25.
[24] Id. at 29-37.
[25] Id. at 31
[26] Id. at 35-37
[27] Id. at 37-39.
[28] Id. at 20.
[29] Id. at 17-18

of discretion, or otherwise not in accordance with the law."[30] It further explained that "[a]rbitrary and capricious review 'focuses on the reasonableness of the agency's decision making processes.' By referring to prior rulings – in other highly technical areas - it argued that the standard is highly deferential and that "An agency need only articulate a rational connection between the facts found and the choice made, and the court will not intervene unless the [agency] failed to consider relevant factors or made a manifest error in judgment"[31] and that "Where a highly technical question is involved, courts necessarily must show considerable deference to an agency's expertise." (…) Although the court must conduct "a thorough, probing, in- depth review" of the agency's decision, it may not "substitute its judgment for that of the agency."[32]

The party challenging the agency action as arbitrary and capricious bears the burden of proof.[33]

2.2 James Madison Ltd v. Ludwig[34]

Summary: The lack of a prior hearing before putting the bank into FDIC receivership does not constitute a due process defect as the requirement of a pre-seizure hearing could expose both depositors and the FDIC insurance fund to further losses from the continued operation of a failed institution. Equally strong is the Government's interest in swiftly disposing of assets and liabilities after a seizure takes place in order to ensure the smooth transfer of a bank's deposits and branches to other institutions.

Background: In 1991, Madison National Bank and Madison National Bank of Virginia were examined by the OCC, the bank's primary regulator. The OCC found that the banks' loan loss reserves should be increased by $31.6 million, leaving the banks $15 million insolvent. The OCC appointed FDIC as receiver for the banks. FDIC entered into a P&A with Signet Banking Corporation under which Signet agreed to acquire certain assets including bank branches and deposits but did not take on the bad loans.

Limits on Right to Challenge Resolution: At the time this case was filed there was no specific statute addressing a failed national bank's right to challenge an OCC decision to appoint FDIC as receiver. The banks' holding company James Madison Ltd. (Madison) sought review of the OCC decision in the U.S. District Court for the District of Columbia. After the court rejected the claims, Madison appealed the decision to the U.S. Court of Appeals for the District of Columbia Circuit. The appellate court rejected the FDIC's claim that there was no right to judicial review, holding that agency actions are reviewable under the Administrative Procedure Act (APA)[35]. Subsequently, in 2006 the U.S. Congress amended the OCC statute to explicitly provide that a failed bank may bring an action within 30 days after the appointment of a receiver in the judicial district in which the bank's home office is located or the U.S. District Court for the District of Columbia for an order requiring OCC to remove the receiver.[36]

[30] Id. at 19 n. 7.

[31] American Radio Relay League, Inc. v. FCC, 524 F.3d 227, 233 (District of Columbia Circuit 2008), citing Motor Vehicle Manufacturers. Association of the U.S., Inc. v. State Farm Mutual Automobile Insurance Company, 463 U.S. 29, 43 (1983).

[32] Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 415–16 (1971), overruled on other grounds by Califano v. Sanders, 430 U.S. 99, 105 (1977).

[33] San Luis Obispo Mothers for Peace v. U.S. Nuclear Regulatory Commission, 789 F.2d 26, 37 (District of Columbia Circuit 1986)." Id. at 19-20.

[34] 82 F.3d 1085 (District of Columbia Circuit 1996), cert. denied, 519 U.S. 1077 (1997) (Civil Action – Constitutional Challenge).

[35] 12 U.S. Code 701

[36] 12 U.S. Code 191(b).

MAIN PLEAS

Arbitrary exercise of powers: Madison sued in U.S. District Court alleging that the federal agencies abused their discretion, acted arbitrarily and capriciously in requiring $31.6 million in additional reserves, and failed to follow statutory prescribed procedures.

Violation of Due Process Clause: Madison also alleged that the federal statute providing for the appointment of FDIC as receiver violated the Due Process Clause of the U.S. Constitution's Fifth Amendment by allowing the government to seize national banks without an adequate hearing. The Due Process Clause provides that no person shall "be deprived of life, liberty, or property, without due process of law."

Request to stay resolution: Madison sought an injunction removing the FDIC as receiver; returning bank assets that the FDIC still had in its possession, as well as the proceeds from the FDIC's prior sales of the banks' assets; restoring the banks' charters to allow them to resume business; and returning the banks' files. Alternatively, Madison sought money damages.

JUDGMENT AND COURT REASONING

No violation of due process: The court reviewed the written summaries that the examiners prepared for each of the loans and found that the agency exercised reasoned judgment in requiring the banks to add $31.6 million to cover potential losses in their portfolios.[37] The court also found that Madison's due process rights were not violated. The court considered three factors: (1) "the government's interest," (2) "the private interest affected by the official action," and (3) "the risk of erroneous deprivation of that interest through the procedures used, as well as the probable value of additional safeguards" provided by a pre-deprivation hearing. The court found that the government has a substantial interest in moving quickly to seize insolvent institutions. Requiring a pre-seizure hearing could expose both depositors and the FDIC insurance fund to further losses from the continued operation of a failed institution by its management. Equally strong is the government's interest in swiftly disposing of assets and liabilities after a seizure takes place in order to ensure the smooth transfer of a bank's deposits and branches to other institutions, as well as to minimize losses for both depositors and taxpayers that could occur if the government had to hold on to a bank's assets when the value of those assets was declining. Considering the second factor, the court found that while Madison's stockholders had a valid interest in avoiding the arbitrary seizure of their business, "the banks' interest is not as strong as the public's interest in protecting the stability and integrity of the banking system."[38] As to the third factor–risk of error– "the OCC's examination process included numerous safeguards against an arbitrary seizure of the banks." The court noted that for at least three years prior to the examination leading to the takeover, the OCC repeatedly expressed its concern about the inadequacy of Madison's methodology for calculating its loan loss allowances. "From the very beginning, Madison had many opportunities to express its views. Through memoranda and meetings, loan officers and senior management had the chance to respond to the risk ratings that the examiners proposed to assign to the banks' loans." In light of the government's need to act swiftly, the limited nature of Madison's interest, and the procedures in place to minimize the risk of an erroneous decision, the court found there was no due process defect in the timing of Madison's hearing.

[37] Id. at 1097-99.

[38] Id. At 1100

Evidence Required by Court: The court reviewed the record that was before the OCC at the time the decision was made. The record included detailed memoranda describing the examiner's findings and recommendations. There were detailed contemporaneous reports from the examiner-in-charge and members of her examination team explaining how and why they reached conclusions regarding the banks' reserves. The court noted that Madison did not contend that the agency deliberately or negligently excluded documents that may have been adverse to its decision, or that there was a need to supplement the record with background information (such as all of the banks' loan files, underwriting materials, and credit documents the examiners may have seen) in order to determine whether the agency considered all relevant factors. The court also reviewed Madison's claim that the agency acted in bad faith. Madison relied on affidavits of two former officers and a consultant Madison had retained who stated that „it appeared" from the examiners' hostile attitudes, their unwillingness to correct errors, and the „severity" of the reserves, that the examiners were „expected," „instructed," or had a „predetermined agenda" to render the bank insolvent by requiring additional loan loss reserves. The court found that the affidavits were the only evidence of bad faith and were unsupported by other evidence. The court found that these conclusory statements fell far short of the „strong showing" of bad faith required to justify supplementing the record.[39]

Burden of Proof and Economic Assessment: The court reviewed the OCC's valuation on which the decision to put the bank into resolution was based and reviewed the record to determine if the agency's grounds for appointing a receiver were reasonable. "Generally speaking, district courts reviewing agency action under the APA's arbitrary and capricious standard do not resolve factual issues but operate instead as appellate courts resolving legal questions. Like appellate courts, district courts do not duplicate agency fact-finding efforts. Instead, they address a predominantly legal issue: Did the agency 'articulate a rational connection between the facts found and the choice made'?"[40]

2.3 Franklin Savings Association v. Office of Thrift Supervision

Summary: The appellant court held that a district court improperly expanded its scope of review as it allowed testimony by the problem bank's experts giving opinions on such matters as acceptable levels of brokered deposits and high-risk assets. It stressed that the Congress has given the director [of the supervisory agency], not the courts, the power to define what is an unsafe and unsound condition.

Background: On February 15, 1990, the OTS Director found three statutory grounds existed to appoint a conservator for Franklin Savings Association (Franklin), a federally insured, state-chartered savings and loan association.[42] OTS found that Franklin: (a) was in an unsafe and unsound condition to transact business, including having substantially insufficient capital; (b) incurred and was likely to incur losses that would deplete all or substantially all of its capital and there was no reasonable prospect for Franklin's capital to be replenished without federal assistance; and (c) had a violation or violations of laws or regulations, or an unsafe or unsound practice or condition which was likely to cause insolvency or substantial dissipation of assets or earnings. The district court reviewed the administrative record and allowed additional evidence from expert witnesses for the bank and OTS during an eighteen-day bench trial. The district court characterized this case as „a dispute over accounting practices."[43] The court found OTS „lacked any factual basis which would justify its appointment of a conservator" and further concluded OTS „acted arbitrarily and capriciously in appointing the conservator." The court

[39] Id. at 1097

[40] Id. at 1096

[41] 934 F.2d 1127 (10th Cir. 1991), cert. denied, 112 S.Ct. 1475 (1992) (Civil Action)

[42] 12 U.S. Code 1464(d)(2).

[43] Franklin v. OTS, 742 F. Supp. 1089, 1094 (District Court for the District of Kansas 1990).

ordered OTS to remove the conservator and return control of Franklin to its former board and management. OTS appealed the district court decision to the U.S. Court of Appeals for the Tenth Circuit, which stayed the district court decision while it considered the appeal.

Limits on Right to Challenge Resolution: The statute authorizing OTS to appoint a conservator or receiver for Franklin provided the institution with a right to seek review of the action within 30 days of appointment in the judicial district in which the association's home office is located or the U.S. District Court for the District of Columbia.[44]

MAIN PLEA

Requests to Stay Resolution: Franklin sought a court order requiring OTS to remove the conservator. The complaint alleged the absence of the statutory grounds for the appointment of a conservator and asserted the regulatory action was arbitrary and capricious.

JUDGMENT AND COURT REASONING

No abuse of discretionary power: The Appellant Court found that the district court erroneously considered evidence that was not before the OTS when the decision was made and did not give appropriate deference to the agency. In reviewing the record, it found that OTS's decision was not arbitrary, capricious, or an abuse of discretion. The court found the record supported the agency's finding that Franklin was in an unsafe and unsound condition based on its high level and undue concentration of high-risk assets. Although the bank's experts disagreed with the agency's concerns, the court found the disagreement insufficient to allow a reviewing court to determine the agency decision was arbitrary.[45] The court also upheld the agency's finding that Franklin placed undue reliance upon brokered deposits. The bank's data which was part of the record revealed that over 70 percent of the deposits were brokered. The court found the record showed Franklin's net income margin had steadily and progressively declined, the OTS accounting standards were reasonable although more conservative than Franklin's, and the increase OTS ordered in loan loss reserves was reasonable.[46] Franklin reported its capital to be $380 million, although OTS felt there should be write-offs of $472 million. Under OTS's most optimistic view Franklin had a net worth of only $70 million, falling well short of its capital requirements. The court also found the OTS concerns regarding capital depletion were applicable.[47] The OTS outlined numerous concerns regarding depletion of capital. This included that Franklin, by its figures, had a $9 million loss from June 30, 1988 to June 30, 1989 and was paying dividends and large bonuses notwithstanding the loss. "During 1988 and 1989, after being ordered to stop growing, Franklin nevertheless continued an aggressive growth rate in its assets (22.3 per cent) while its capital was decreasing. Franklin was also unsuccessful in obtaining outside capital. Nonetheless, for its fiscal year ending June 30, 1989, Franklin paid its eight executive officers $3.5 million in cash compensation and paid its owners dividends of $15 million. It 'pumped up' its capital by $120.7 million with an unauthorized tax forgiveness agreement between it and its holding company. Franklin's core capital was only 2.1 percent on November 30, 1989, after an adjustment for the tax forgiveness contract. [OTS] deemed this a clear capital failure. While this finding was sufficiently dire itself, [OTS] also noted [its] deep concern regarding Franklin's deferral of actual cash losses, which understated its current losses. By June 30, 1989: the deferred hedging

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[44] 12 U.S.C. 1464(d)(2). A timely challenge was filed by the association and holding company. On appeal the court noted that the statute limits those who may request relief to the association but declined to rule on whether the holding company could sue because the parties did not raise the issue and it was not necessary for the court's decision. Franklin v. OTS, 934 F. 2d 1127, 1135 .

[45] Id. at 1144.

[47] Id. at 1148-49.

losses were approximately $374 million, of which [OTS] ordered $127 million be taken immediately; [OTS] had significant evidence that the entire economic value of Franklin was only $70 million; [OTS] was concerned that Franklin ran the risk of default on the bonds Franklin had issued having face value of $2.9 billion, but which could cost Franklin $185 million to defease the possible default; and [OTS] felt Franklin should increase its valuation loss allowances to $49 million as a result of expected losses on its letters of credit."[48] Reviewing the evidence contained in the record and giving OTS predictive judgments due deference, the decision to appoint a conservator was supported by substantial evidence and the OTS conclusions were reasonable. Accordingly, the Tenth Circuit reversed the district court decision and ordered that the action be dismissed.

Evidence Required by Court: The Tenth Circuit held that that review should have been confined to the administrative record before the OTS at the time the appointment decision was made. The record must contain sufficient data to allow the reviewing court to determine whether the agency had a rational basis for the appointment decision. When the agency learns the appointment decision has been challenged, it has the obligation to produce the information relied upon in making its decision to the district court and to certify such information is accurate and complete. The agency's obligation does not extend to all information contained in its files. Should the association challenging the appointment decision desire additional information from the agency record than that presented by the agency to the district court, it may request such information in accordance with the applicable rules of discovery and evidence.[49] In this case, the voluminous administrative record contained the examination and supervisory history of the bank, the OTS Director's orders, and was adequate to permit meaningful judicial review. "The district court first improperly expanded its scope of review as it allowed testimony by Franklin's experts giving opinions on such matters as acceptable levels of brokered deposits and high-risk assets. Secondly, the district court erred by improperly applying the standard of review when it accepted such expert opinion. By so doing, the district court effectively usurped Director's regulatory and enforcement powers and placed these powers into the hands of Franklin. Congress has given the director [of the supervisory Agency], not the courts, the power to define what is an unsafe and unsound condition."[50]

Burden of Proof and Economic Assessment: The court reviewed the valuation on which the decision to put the bank into resolution was based and reviewed the record to determine if the OTS action was reasonable. Franklin was permitted to challenge the determination by OTS, but the challenge was limited to the administrative record which included numerous recitations of Franklin's views and reasons therefor. The focus of the judicial review was on whether there was sufficient evidence in the administrative record to form a reasoned opinion that the statutory ground for the appointment of a conservator existed.

The standard of review is the APA's arbitrary and capricious standard.[51] That is whether the appointment decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." The agency's findings are entitled to deference, and the appointment decision itself is entitled to a presumption of regularity. The failed bank has the burden to overcome these presumptions. "There exist compelling reasons for this statutory provision: A savings association's assets consist principally of its depositors' funds; assets can be quickly dissipated; liabilities may be just as quickly created; and liquidity may suddenly disappear. If there is inadequate capital to absorb losses, the losses fall upon the FDIC, and if these funds are depleted, then upon taxpayers. For these reasons, Congress made clear it

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[48] Id. at 1146
[49] Id. at 1137-40
[50] Id. at 1150-51
[51] 5 U.S. Code 706(2).

expects the director to be vigilant and responsive. FIRREA's statutory scheme, the specific statute at issue [citation omitted], and the legislative history, all agree it is essential the director act promptly in appointing a conservator once he is of the opinion that a statutory ground exists. The close supervision, broad discretion, and quick response directed by FIRREA dictates a narrow and limited scope of review that gives deference to the director's judgment, knowledge, and expertise."[52]

2.4 Golden Pacific Bancorp v. Clarke[53]

Summary: The court held that "judicial intervention in such decision making [whether to declare a bank insolvent] through private tort suits would require the courts to 'second guess' the political, social, and economic judgments of the [supervisory] agency" and that it is for the supervisor "to decide on the content of safe and sound bank practice by making judgments that draw upon a mix of law, accounting, bank custom, and policy"; and that "the government cannot be held liable in damages merely because in a particular case the Comptroller's conclusion or some aspect of it turns out to be legally vulnerable" due to the exercise of supervisory discretionary assessment.

Background: Golden Pacific National Bank was a national bank, with its principal place of business in New York City. The bank was subject to regulatory authority of the OCC. The OCC undertook an investigation of the bank's practice of issuing high interest certificates, called "yellow" certificates of deposits (Yellow CDs) because they were printed on yellow paper. The bank regarded the Yellow CDs as non-book investments it made on behalf of the holders. The OCC determined that the Yellow CDs were deposits and liabilities of the bank that required offsetting assets. Rumors of the OCC's investigation precipitated a run on the bank. On June 21, 1985, the OCC declared the bank insolvent and appointed FDIC as receiver.

Limits on Right to Challenge Resolution: At the time this case was filed there was no specific statute addressing a failed national bank's right to challenge OCC decisions appointing FDIC as receiver. Golden Pacific Bancorp (Golden Pacific), the bank holding company which owned 90 percent of the stock of the bank, filed an action in the U.S. District Court for the District of Columbia challenging the closing. The District Court granted summary judgment to OCC. Golden Pacific appealed the decision to the U.S. Court of Appeals for the District of Columbia Circuit.

MAIN PLEAS

Requests to Stay Resolution Due to Arbitrary Exercise of Powers: Golden Pacific challenged the closing, seeking: (i) review of the OCC's actions under the APA, alleging that the OCC's actions were arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law; (ii) damages under the Federal Tort Claims Act (FTCA)[54] and (iii) damages and injunctive relief under the takings clause of the Fifth Amendment. On December 1, 1986, the district court granted summary judgment for the OCC. On appeal, Golden Pacific limited its claims to monetary relief. It argued that the documentation should have led the OCC to conclude that the bank was solvent and had sufficient liquidity to meet depositors' demands.

[52] Id. at 1137

[53] 837 F.2d 509 (D.C. Cir.), cert. denied, 488 U.S. 890 (1988) (Civil Case/ Damages)

[54] 28 U.S. Code 1346, 2680(a);

JUDGMENT AND COURT REASONING

Agency acted within its discretionary powers: The district court reviewed the administrative record and concluded that the OCC had acted within the scope of the Comptroller's statutory authority and the actions were not arbitrary, capricious, or an abuse of discretion. On appeal, the District of Columbia Circuit found that Golden Pacific's action "is nothing more than a claim for damages under the FTCA, and that cause of action is not available."[55] The District of Columbia Circuit noted that the FTCA waives sovereign immunity and authorizes damage suits against the U.S. for negligent or wrongful acts of its employees but limits such actions by prohibiting claims based on the acts or omissions of government employees involving performance or failure to perform a discretionary function or duty on the part to a federal agency or employee.[56] The OCC's "determinations as to whether the yellow CDs were to be regarded as liabilities and whether the bank made an adequate showing of non-booked offsetting assets to cover those liabilities appear to be obvious policy judgments regarding what constitutes safe and sound bank practices. And surely the decision to close the bank – made after a week of examination and in the face of a run of withdrawals – could not possibly be thought of as other than a discretionary act that was committed by Congress to the OCC's judgment."[57] The court noted that "judicial intervention in such decision making through private tort suits would require the courts to 'second guess' the political, social, and economic judgments of the agency." "The Comptroller, incident to his responsibilities, must make innumerable subtle judgments in describing the content of safe and sound bank practices – judgments that draw upon a mix of law, accounting, bank custom, and policy". Sometimes, as here, those determinations must be made under grave pressure and expeditiously.

No action for damages: The court held that an action for damages against the OCC for closing the bank was not available because the OCC's actions fell within the discretionary function exception to the FTCA. The government is not liable in damages merely because in a particular case the Comptroller's conclusion or some aspect of it turns out to be legally vulnerable.

Evidence Required by Court: The district court limited review to the administrative record before the OCC at the time the decision was made. The government refused to file certain documents turned over to examiners by bank officers, pending a criminal investigation. The government sought and obtained stays of Golden Pacific's discovery. On appeal, the District of Columbia Circuit expressed concern with the procedure because it could result in litigation of the merits of the OCC's actions on an incomplete record. The District of Columbia Circuit did not reach the issue because it did not need a complete record to rule on the damages claim.[58]

Burden of Proof and Economic Assessment: The district court reviewed the valuation on which the decision to put the bank into resolution was based to determine whether it was reasonable. The original challenge to the closing in the district court was considered under the APA arbitrary and capricious standard. On appeal the case was limited to the legal question of whether damages were available for negligent or wrongful acts of the government in closing the bank and whether a tort claim for money damages was available under the FTCA.

[55] Id. at 510
[56] 28 U.S. Code 2680(a).
[57] Id. at 512.
[58] Id. at 511 n.1.

2.5 Golden Pacific Bancorp v. United States[59]

Summary: The claims court held that the actions of the Comptroller in declaring the Golden Pacific National Bank insolvent and placing it in FDIC receivership did not constitute a compensable taking under constitutionally protected property rights. The court found that the bank owners could not have reasonably expected that the government „would fail to enforce the applicable statutes and regulations" and that their "expectations could only have been that the FDIC would exert control over the Bank's assets if the Comptroller became satisfied that the Bank was insolvent and chose to place it in receivership."

Background: This case arises out of the same bank failure discussed above (see 2.4). On June 21, 1991, Golden Pacific and Miles P. Jennings, Jr., who owned 6,400 shares of stock of Golden Pacific, subsequently brought this separate action in the U.S. Court of Federal Claims (claims court) alleging that the actions of the OCC in declaring the bank insolvent and appointing FDIC receiver constituted a taking for which they were entitled to compensation under the Fifth Amendment of the United States Constitution. The takings claim could not have been litigated in the earlier district court action because the district court lacked subject matter jurisdiction over non-tort claims exceeding $10,000.[60] Thus, when the district court granted the OCC's motion for summary judgment, Golden Pacific was no longer asserting any monetary claims under the Fifth Amendment.

Limits on Right to Challenge Resolution: At the time this case was filed there was no specific statute addressing a failed national bank's right to challenge OCC decisions appointing FDIC as receiver. As noted above, the challenge to the closing was first litigated in the U.S. District Court for the District of Columbia. The district court rejected the challenge and its decision was affirmed by the U.S. Court of Appeals for the District of Columbia Circuit. The second action in the claims court was a non-tort monetary claim for damages arising under the Fifth Amendment of the U.S. Constitution for an alleged unconstitutional taking of property when the bank was closed. The claims court has special jurisdiction to hear claims for non-tort monetary damages that arise from the U.S. Constitution, federal statutes, executive regulations, and contracts with the U.S.[61]

MAIN PLEAS

Interference with property rights and impingement of personal freedom: The claim was based on the Fifth Amendment of the U.S. Constitution, which states that "private property [shall not] be taken for public use without just compensation." Golden Pacific argued that, "the shareholders maintain that the government's action deprived them of the value of their stock."

JUDGMENT AND COURT REASONING

No violation of property rights: The claims court held that the actions of the OCC in declaring the bank insolvent and placing it into receivership did not constitute a compensable taking under the Fifth Amendment because the holding company "lacked one of the most essential sticks in the bundle of rights that are commonly characterized as property – the right to exclude others."[62] Without the right

[59] 15 F.3d 1066 (Fed. Cir.), cert. denied, 513 U.S. 961 (1994) (Constitutional Claim)
[60] 28 U.S.C. 1346(a).
[61] 28 U.S. Code 1491 (the Tucker Act).
[62] Golden Pacific Bancorp v. United States, 25 Cl. Ct. 768, 771 (1992).

to exclude others, Golden Pacific did "not have the 'historically rooted expectation of compensation' necessary to establish a fifth amendment taking."[63] The court also stated that Golden Pacific's "reasonable investment-backed expectations could not possibly have been interfered with given the highly regulated nature of the banking industry."[64] On appeal, the Court of Appeals for the Federal Circuit affirmed. It noted that a regulatory action may result in a compensable taking in either of two ways: (1) a property owner may suffer a physical invasion or permanent occupation of property; or (2) a regulatory action may go too far and impinge on personal freedom. In rejecting the physical invasion, the court found that Golden Pacific voluntarily entered into the highly regulated banking industry by choosing to invest in the bank. The actions of the OCC simply enforced portions of an extensive regulatory scheme designed to promote the public interest in a sound banking system. "At those times when the Comptroller could legally inspect the bank or place it in receivership, the bank – which Golden Pacific owned – was unable to exclude the government from its property."[65] "Consequently, neither the bank nor Golden Pacific 'could have developed a historically rooted expectation of compensation' for the seizure which resulted from the Comptroller's actions."[66] The second ground for a taking based on impingement of personal freedom was also denied. Given the highly regulated nature of the banking industry, the OCC's actions could not have interfered with a reasonable investment-backed expectation on the part of Golden Pacific. "Golden Pacific could not have reasonably expected that the government 'would fail to enforce the applicable statutes and regulations.' . . . Indeed, Golden Pacific's expectations could only have been that the FDIC would exert control over the bank's assets if the Comptroller became satisfied that the bank was insolvent and chose to place it in receivership."

Burden of Proof: The issue presented was whether the OCC's actions constituted a taking under the Fifth Amendment. The government sought summary judgment, which the court granted after determining that there were no issues of material fact, and the government was entitled to judgment as a matter of law. The original challenge to the closing in the district court was considered under the APA arbitrary and capricious standard.

2.6 Fahey v. Mallonee[67]

Summary: The action before the district court sought an order removing the conservator, restoring the institution to its former management. The Supreme Court reversed the district court view that the appointment of a conservator before a hearing violated the Due Process Clause stressing that "the impossibility of preserving credit during an investigation has made it an almost invariable custom to apply supervisory authority in this summary manner" and that "in the light of the history and customs of banking we cannot say it is unconstitutional."

Background: On May 20, 1946, the Federal Home Loan Bank Board, which regulated savings and loan associations, appointed a conservator to take possession of Long Beach Federal Savings and Loan Association (bank). Section 5(d) of the Home Owners' Loan Act of 1933, gave the Board "full power to provide in the rules and regulations herein authorized for the reorganization, consolidation, merger, or liquidation of such associations, including the power to appoint a conservator or a receiver to take charge of the affairs of any such association."[68] Pursuant to regulations, the Board appointed a conservator after finding that the bank was conducting its affairs in an unlawful, unauthorized, and unsafe manner, that its management was unfit and unsafe, that it was pursuing a course injurious to, and

[63] Id. At 770-71
[64] Id. At 771.
[65] Golden Pacific Bancorp, 15 F.3d at 1074
[66] Id
[67] 332 U.S. 245 (1947) (Civil Action-- Constitutional Claim).
[68] 48 Stat. 133, 12 U.S. Code 1464(d).

jeopardizing the interests of, its members, creditors, and the public. A three-judge district court held that section 5(d) violated the Due Process Clause of the U.S. Constitution because it allowed for the appointment of a conservator before a hearing. The district court ordered removal of the conservator, restored the institution to its former management, ordered the conservator to account, and enjoined the authorities from asserting any claims, rights, title, or interest in or to the bank's property. An appeal was taken to the United States Supreme Court.

Limits on Right to Challenge Resolution: This case was filed in 1946 at a time when there was no statute addressing what, if any, judicial review was available when a conservator or receiver was appointed. Indeed, the Supreme Court noted, "We do not now decide whether the determination of the Board in such proceeding is subject to any manner of judicial review."[69] The sole question on review was whether the seizure of the institution before a hearing violated the Due Process Clause of the U.S. Constitution. The action was a stockholder derivative action in which the plaintiffs sued only in the right of the association. The court did not address the rights of the stockholders to bring the action.

MAIN PLEAS

- **Right to Due Process:** The challenge to the bank's closing was based on the Due Process Clause of the Fifth Amendment of the U.S. Constitution, which states that no person shall "be deprived of life, liberty, or property, without due process of law."

- **Requests to Stay Resolution:** The action before the district court sought an order removing the conservator, restoring the institution to its former management, and enjoining the authorities from taking any action with respect to the association's property. The district court granted those requests. On review, the Supreme Court reversed the district court judgment.

JUDGMENT AND COURT REASONING

Non violation of due process: The district court held that the appointment of a conservator without a prior hearing violated the Due Process Clause. On review the Supreme Court reversed, noting: "This is a drastic procedure. But the delicate nature of the institution and the impossibility of preserving credit during an investigation has made it an almost invariable custom to apply supervisory authority in this summary manner. It is a heavy responsibility to be exercised with disinterestedness and restraint, but in the light of the history and customs of banking we cannot say it is unconstitutional."[70]

Evidence Required by Court: The issue ruled on by the district court and reviewed by the Supreme Court on appeal was whether the Federal Home Loan Bank Board's actions in appointing a conservator without a hearing violated the Due Process clause of the Fifth Amendment. A post-deprivation hearing process had begun by the time the action was filed in district court. The bank obtained an injunction to prevent the administrative hearing and cut off the making of a record before the case was considered by the courts. The constitutional argument was primarily a legal one.

[69] Id. at 256
[70] Id. at 253-54

2.7 Washington Mutual Receivership[71]

Summary: The lawsuit by Deutsche Bank National Trust Co (Deutsche Bank) against the FDIC and JPMorgan Chase Bank, N.A. (JPMC) over losses stemming from alleged defects in WAMU mortgage underwriting was settled after a partial summary judgment decision. The court found that under the terms of the P&A the FDIC as receiver (FDIC-R) retained liability for Deutsche Bank's claims to the extent that such claims were not reflected at a stated book value in the financial accounting records of WAMU as of the failure date (FDIC-R asserted that the JPMorgan Chase Bank, N.A. (JPMC) had assumed the liabilities for repurchase of the loans while JPMC asserted that the liabilities remained with FDIC-R).

Background: On September 25, 2008 WAMU was closed by OTS which appointed FDIC as receiver. OTS found that WAMU was likely to be unable to pay its obligations or meet its depositors' demands in the normal course of business. WAMU had suffered significant cash outflows, exceeding $22 billion since July 2008, had limited and diminishing liquidity sources available to it, and the current rate of outflow would deplete the bank's cash resources and liquidity in a short period of time. In addition, OTS found that the bank was in an unsafe or unsound condition to transact business "as a result of its severe liquidity strain, deteriorating asset quality, and continuing significant negative operating earnings with no realistic prospects for raising capital to ensure that it can repay all of its liabilities, including deposits".[72] WAMU was the largest failure of an insured depository institution in U.S. history with $307 billion in assets, $188 billion deposits, and over 2,200 branches in 15 states. FDIC-R transferred substantially all of WAMU's assets and liabilities to JPMC for $1.9 billion and assumed all of the deposits and "substantially all other liabilities" of WAMU pursuant to a P&A agreement. The resolution of WAMU through the P&A agreement was completed at no cost to the Deposit Insurance Fund but precipitated a number of major litigation matters.

MAIN PLEAS

Bankruptcy litigations: The holding company for WAMU, Washington Mutual Inc. (WMI), filed for Chapter 11 bankruptcy protection the day after the bank failed. Thereafter, WMI, JPMC, the FDIC in its corporate capacity (FDIC-C) and the FDIC-R became involved in several lawsuits contesting the ownership of over $20 billion in assets, including capital contributions, tax refunds, deposits, and trust preferred securities. WMI claimed that the JPMC purchase price was insufficient and that it owned or otherwise held interest in certain WAMU assets acquired by JPMC from FDIC-R under the P&A agreement. After several years of litigation, the bankruptcy settlement became effective on March 19, 2012. Pursuant to the settlement, FDIC-R received an additional $843.9 million into the WAMU receivership.

Action for damages by Deutsche Bank and JPMC: a significant part of WAMU's business focused on the sale and servicing of securitized residential mortgage loans through large-scale financial transactions. Soon after WAMU failed, Deutsche Bank, which served as trustee for a large group of securitized loans, sued FDIC-R and JPMC claiming $6 billion to $10 billion in damages arising out of WAMU's alleged breach of representations and warranties made in connection with mortgages sold to securitized trusts. Deutsche Bank sought to enforce WAMU's contractual obligation to repurchase hundreds of faulty mortgage-backed securities that had collapsed. FDIC-R asserted that JPMC had assumed

[71] Washington Mutual Inc. v. FDIC, No. 09-00533 (District Court for the District of Columbia March 20, 2009); In re Washington Mutual. Inc., No. 08-12229 (Bankr. D.Del. Feb. 23, 2012); Deutsche Bank National Trust Company v. FDIC, 109 F. Supp. 3d 179 (District Court for the District of Columbia 2015) (Civil Actions)

[72] OTS Order No. 2008-36 (September 25, 2008)

the liabilities for repurchase of the loans, JPMC asserted that the liabilities remained with FDIC-R. In June 2015, the U.S. District Court for the District of Columbia issued a partial summary judgment decision finding that under the terms of the P&A agreement, FDIC-R retained liability for Deutsche Bank's claims to the extent that such claims were not reflected at a stated book value in the financial accounting records of WAMU as of the failure date. FDIC-R sought appellate review of the decision. JPMC also filed lawsuits and cross-claims seeking indemnification against FDIC-R and FDIC-C and submitted over 100 notices for indemnity. Subsequently, FDIC-R, FDIC-C, Deutsche Bank, and JPMC settled the lawsuit filed by Deutsche Bank, the indemnification lawsuit filed by JPMC, and all claims for indemnification made by JPMC against the Receiver. Pursuant to that agreement, on September 8, 2017, the Receiver paid JPMC $645 million and issued Deutsche Bank an allowed unsecured receivership claim for $3,006,929,660.

As of June 30, 2017, the Receiver had approximately $2.76 billion to distribute to holders of claims allowed by the receivership pursuant to priorities established in 12 U.S. Code 1821(d)(11). After paying JPMC in full, the Receiver made an interim distribution on September 26, 2017 on all approved senior unsecured claims of the receivership, including the claims by Deutsche Bank, general trade creditors, and WAMU senior bondholders. A final distribution will be made consistent with 12 U.S.C. 1821(d)(11).[73]

Litigation and Settlements: There were several actions filed. One involved the bankruptcy proceeding initiated by WMI, which was filed the day after WAMU was put into receivership. In addition, WMI filed a related action in federal district court seeking damages for the transfer of assets WMI alleged it owned. These cases were settled by the parties, with WMI receiving a large part of a tax refund and an additional $843.9 million being paid to FDIC-R. A separate action involving liabilities related to mortgage backed securities originated by WAMU was litigated between Deutsche Bank, JPMC, and FDIC. After a ruling on the issues by the district court and while the case was pending on appeal, the matter was settled with FDIC-R paying JPMC $645 million to indemnify it on claims relating to the WAMU purchase, in which it also assumed some of the thrift's liabilities and issuing Deutsche Bank an allowed receivership claim for $3,006,929.660.

Evidence Required by Court: The litigation filed by WMI in both the bankruptcy court and district court sought damages. WMI alleged that damages were owed because JPMC did not pay fair value for the bank and it owned certain assets of the failed bank. The cases were litigated by the parties before the bankruptcy and district courts. Ultimately, the parties settled the matters. The Deutsche Bank action was a contractual claim that WAMU repurchase hundreds of faulty mortgage-backed securities.

Burden of Proof: The cases did not challenge the bank closing, but instead sought damages for the alleged transfer of assets which were not the property of the failed bank, or a determination as to who assumed certain liabilities under the P&A agreement between the parties. The plaintiffs had the burden of proof on their claims and the issues were reviewed de novo by the courts.

[73] See fdic.gov/resources/resolutions/bank-failures/failed-bank-list/wamu-settlement.html

2.8 Meritor Receivership[74]

Summary: The court determined that the government was liable for breach of contract by the FDIC by closing the bank and failing to recognize goodwill as part of Bank's capital in accordance with the memorandum of understanding (MOU) FDIC entered under a prior merger agreement. The damage was based on the bank's market valuation immediately before the closing of the bank i.e. the breach of contract.

Background: In 1981, Meritor was a healthy thrift with $7.5 billion in assets. In 1982 the FDIC sought to save a failing Pennsylvania bank, the Western Savings Society of Philadelphia, through merger with Meritor. In 1982, FDIC and Meritor entered into a MOU under which it was agreed that Meritor would merge with Western; Meritor could treat as "goodwill" the excess of Western's liabilities over the value of its assets that Meritor assumed and could use this goodwill as a capital asset for purposes of meeting the bank's capital requirements. If Western had been closed, the estimated cost to the FDIC insurance fund was at least $696 million.

By late 1985, Meritor had grown to $17 billion in assets and had $19 million in assets at its peak in 1987. In 1988, the financial markets had deteriorated significantly. This deterioration caused the FDIC to become concerned with Meritor's underperforming assets and Western goodwill, and their possible threat to the insurance fund. The FDIC and Meritor entered into a new MOU requiring Meritor to increase its minimum capital requirement to 6.5% of primary capital. Although Meritor was allowed to continue to count goodwill as capital, Meritor's new 6.5% capital requirement exceeded the existing regulatory minimum of 5.5% for other banks. The 1988 MOU also provided that if Meritor failed to achieve the higher capital levels by the end of 1988 it would have to infuse $200 million in tangible capital by March 31, 1989. To comply with the new requirements, Meritor sold 54 of its most profitable branches and other assets. The remaining assets continued to trouble the FDIC as a large percentage were nonperforming loans and other assets that produced large losses for the bank. FDIC continued to focus on the Western goodwill because it would provide no protection for the insurance fund. As a result, the FDIC again increased the capital requirements on the bank in a 1991 Written Agreement to 8.5% of primary capital. Meritor's total capital ratio was 7.5% including goodwill, but was only 0.66% if goodwill was excluded. Meritor could not meet the new 1991 capital requirements and was closed by the Secretary of the Pennsylvania Department of Banking on December 11, 1992.

MAIN PLEAS

Breach of contract by FDIC: Frank Slattery, an owner of Meritor stock, and other shareholders filed suit in the Court of Federal Claims, asserting FDIC breached its contract to honor the goodwill as capital. This action sought damages for the breach of contract. The U.S. Court of Federal Claims has special jurisdiction to hear claims for non-tort monetary damages that arise from the Constitution, federal statutes, executive regulations, and contracts with the U.S.[75]

[74] Slattery v. United States, 53 Fed. Cl. 258 (Fed. Cl. 2002) (liability); Slattery v. United States, 69 Fed. Cl. 573 (Fed. Cl. 2006) (damages) modified, 73 Fed. Cl. 527 (Fed. Cl. 2006), aff'd in part, rev'd in part, 583 F.3d 800 (Fed. Cir. 2009), reinstated after rehearing en banc, 635 F.3d 1298 (2011) (Civil Action – Breach of Contract)

[75] 28 U.S.Code 1491 (the Tucker Act).

JUDGMENT AND COURT REASONING

Breach of contractual obligation by the FDIC and award of damages: The claim was based on an alleged breach of contract by the FDIC in not honoring the 1982 MOU which allowed Meritor to count "goodwill" as part of its capital. The Court of Federal Claims found that FDIC had breached the 1982 MOU and awarded damages. On appeal, the Federal Circuit affirmed the damages award allowing $276 million in "lost value" damages based on Meritor's market valuation immediately before the FDIC's breach on the theory that the breach initiated a change of events leading to the bank's seizure and the loss of all shareholder value.

Burden of Proof and Economic Assessment: The plaintiffs in the case, former shareholders of the institution, had the burden of proof to demonstrate that the FDIC had breached the 1982 MOU which allowed Meritor to continue to count "goodwill" as part of its capital. They also had the burden to prove their damages. The trial as to liability lasted five months with extensive testimonial and documentary evidence. The issue presented was whether the closing of the bank was a breach of contract. The court then, after expert testimony, determined damages based on Meritor's market valuation immediately before the government's 1988 breach on the theory that all of this value was lost by the chain of consequences initiated by that breach.

3. EUROPEAN UNION[76]

3.1 Cyprus / Ledra Advertising and Others v European Commission and European Central Bank

Summary: The European Court of Justice (ECJ) ruled that the bail-in and restructuring measures the Central Bank of Cyprus imposed on Bank of Cyprus and Popular Bank (Laiki) – based on the MoU agreed with European institutions in order to receive financial assistance - did not constitute a disproportionate and intolerable interference impairing the very substance of the applicants' right to property under Article (17) 1 of the Charter of Fundamental Rights of the EU and dismissed the actions for compensation against the European Central Bank (ECB) and the European Commission.

Background: The Court examined, among other matters in relation to the relationship of European institutions (European Commission, ECB, and European Stability Mechanism), whether the European Commission and ECB contributed to a serious breach of the applicants' right to property within the meaning of Article (17)1 of the Charter of Fundamental Rights of the EU when negotiating and signing the macroeconomic adjustment program with Cyprus. The European Commission, ECB, and the International Monetary Fund agreed a macroeconomic adjustment program with the Cypriot government and signed a MoU for the granting of financial assistance to Cyprus, in March 2013. The conditions for European Stability Mechanism financial assistance included the restructuring of the Bank of Cyprus and Popular Bank (Laiki). The Central Bank of Cyprus imposed resolution measures on both banks which resulted in a substantial reduction in the value of the deposits. The exact level of the bail-in ("haircut") of the uninsured deposits was set finally at 47.5%. A number of Cypriot individuals and a company established in Cyprus with funds deposited at Bank of Cyprus or Laiki brought actions before the Cypriot courts, in particular for an order requiring the European Commission and the European Central Bank to pay them compensation equivalent to the reduction in value of their deposits caused allegedly by the adoption of the MoU and asked for the annulment of the relevant paragraphs of that MoU. Additionally, other Cypriot individuals brought actions before the General Court for annulment of the ESM statement concerning the restructuring of the Cypriot banking sector.

The General Court of Cyprus dismissed the actions. The individuals and the company then appealed to the European Court of Justice (ECJ) seeking to have the orders of the General Court set aside.

MAIN PLEAS

Breach of property rights and request for compensation: The appellants argued that the European Commission should ensure that the conditionality attached to the financial assistance is consistent with EU law. The application of a bail-in scheme such as the one applied in Cyprus constituted a breach of the right to property, contrary to Article 17(1) of the Charter of Fundamental Rights of the EU and Article 1 of Protocol 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms. Thus, the appellants requested compensation from the European Commission and the European Central Bank equivalent to the reduction value of their respective deposits.

[76] Judgment of 20 September 2016, joined cases Ledra Advertising v Commission and ECB, C-8/15 P to C-10/15 P.

JUDGMENT AND COURT REASONING

Non-contractual liability by EU institutions: The ECJ reiterated the conditions under which the EU may incur non-contractual liability, namely the unlawfulness of the conduct alleged against the EU institution, the fact of damage, and the existence of a causal link between the conduct of the institution and the damage complained of. As regards the first condition, there must be established a serious breach of a rule of law which confers rights on individuals. In this case the applicants evoked Article 17(1) of the Charter of Fundamental Rights of the EU, which states that everyone has the right to own his or her lawfully acquired possessions. However, the exercise of the right to property is not absolute and may be subject to restrictions justified by objectives of general interests pursued by the EU, provided that the restrictions do not constitute, in relation to the aim pursued, a disproportionate and intolerable interference, impairing the substance of the right guaranteed.

No interference with property rights: The ECJ examined, among other matters in respect of the role of the European institutions (European Commission, ECB and European Stability Mechanism), whether the European Commission and ECB contributed to a serious breach of the applicants' right to property within the meaning of Article (17)1 of the Charter of Fundamental Rights of the European Union, when negotiating and signing the macroeconomic adjustment program with Cyprus. The European Commission is bound to ensure that such a MoU is consistent with the fundamental rights guaranteed by the Charter. However, the objective of ensuring the stability of the banking system while avoiding excessive public spending and minimizing distortions of competition does constitute an objective of public interest which may justify certain restrictions to the right to property. The ECJ ruled that the adoption of the MoU corresponded to an objective of general interest pursued by the EU, namely of ensuring the stability of the banking system of the Euro area as a whole. In view of that objective, and having regard to the imminent risk of financial losses to which depositors would have been exposed if the two banks concerned had failed, those measures could not be regarded as unjustified restrictions of that right. The ECJ ruled that such measures did not constitute a disproportionate and intolerable interference impairing the very substance of the applicants' right to property and dismissed the actions for compensation.

3.2 Cyprus / Council of the European Union v K. Chrysostomides & Co. LLC and others[77]

Summary: This case concerns an action seeking compensation from European institutions for damage allegedly suffered by the applicants as a result of the restructuring measures taken by the Central Bank of Cyprus (CBC) imposed on two banks. The General Court of the European Union (General Court), ruled that the bail-in and other restructuring measures which the CBC imposed on Bank of Cyprus (BoC) and Popular Bank (Laiki), such as the conversion of bonds of BoC into shares and the reduction of the nominal value of BoC shares did not constitute a disproportionate and intolerable interference contrary to the right to property given that the restructuring measures were intended to ensure the stability of the Cypriot financial system. Additionally, the General Court ruled that the applicants' right to rely on the principle of legitimate expectation and the principle of the equal treatment were not infringed. Both the applicants and the Council of the European Union filled appeals before the Court of Justice (ECJ) and the ECJ confirmed the judgments of the General Court in so far as they dismissed the actions for damages brought by the applicants.

[77] Joined Cases C 597/18 P and C 598/18 P, C 603/18 P and C 604/18 P; K. Chrysostomides & Co. LLC and the other v Council and others and b) Bourdouvali and others v Council and others

Background: Under the circumstances described above in the Ledra case (see section 3.1) several individuals and companies depositors in Laiki and BoC and/or shareholders or bondholders of those banks considered that the implementation of the restructuring measures taken by the CBC in relation to the banks BoC and Laiki resulted in a substantial reduction in the value of their deposits, their shares or their bonds. The applicants brought actions for non-contractual liability before the General Court in order to be compensated for losses they claim to have suffered as a result of those measures.

MAIN PLEAS

The applicants considered that the restructuring measures:

- were not proportionate to the objective pursued and thus the applicants were unlawfully deprived of their right to property over the deposits held in the banks or over the shares or bonds of those banks held by them;
- infringed the principles of legitimate expectations and equal treatment.

JUDGMENT AND COURT REASONING

The General Court reiterated the conclusions held in the previous case Ledra (section 3.1) that the adopted measures, i.e. the bail-in of the depositors, the conversion of bonds into shares and the reduction of the nominal value shares were not considered to constitute a disproportionate and intolerable interference which infringes the right to property.

Regarding the principle of protection of legitimate expectations, the General Court noted that the right to rely on that principle assumes that precise, unconditional and consistent assurances were provided to the interested parties by the EU authorities which was not the case and concluded that there was no infringement of this principle.

The General Court examined the existence of a possible infringement of the principle of equal treatment and concluded that there was no difference in treatment between the depositors of the two banks, the deposits of Laiki which were transferred to BoC (in the context of the restructuring) were subject to the uniform ceiling of EUR 100 000 per depositor. The difference in treatment between uninsured depositors and insured depositors in no way constituted unequal treatment, in so far as the uninsured depositors were in a legally distinct situation from that of depositors whose deposits did not exceed the €100 000 insurance limit.

Regarding the applicants' argument that they were discriminated against vis-à-vis the depositors, shareholders and bondholders of banks established in other Member States which benefited from financial assistance, in so far as the deposits, shares and bonds of those Member States were not affected and against vis-à-vis companies in the cooperative banking sector, since the latter were not subject to a bail-in, the General Court held that the cases concerned different not comparable situations and thus no unlawful discrimination was found

3.3 Ireland / Gerard Dowling and Others v Minister for Finance[78]

Summary: The European Court of Justice (ECJ) examined the crisis circumstances which led to a "forced" public capital increase in the bank Irish Permanent and Life (ILP) and the fact that the Irish court adopted an Order to impose the recapitalisation of a financial institution against the will of its private shareholders. It concluded that, given that the extraordinary general meeting of the shareholders rejected the Minister's proposed capital support, a public recapitalisation based on an ad-hoc Court order, as requested by the government/Minister for Finance, was necessary to prevent the failure of the bank, which would have posed a serious threat to the financial stability of Ireland and the EU. The Court was satisfied that the Irish court's decision was made on the basis of a balanced evaluation of competing interests.

Background: In 2011 Ireland took steps to recapitalize the national banks, including Irish Life and Permanent (ILP). The Minister for Finance submitted to the shareholders of ILPGH (Irish Life and Permanent Group Holdings, the parent company of the ILP group) a proposal in order to achieve the recapitalization of ILP. That proposal was rejected by the general meeting of ILPGH on 20 July 2011. In order to recapitalize ILP notwithstanding that refusal, the Minister obtained from the Irish courts an Order for a share capital increase of €2.7 billion in ILPGH by issuing new shares to the Minister. Following the capital injection, the Minister obtained 99.2% of the shares of the company, without any general meeting decision to this effect.

MAIN PLEAS

Non-compliance with EU law: Members and shareholders of ILPGH brought an application before the High Court, arguing that the share capital increase was incompatible with the EU Second Company Directive[79] since it was effected without the approval of the general meeting of the ILPGH's shareholders. Article 25 of that directive provides that "1. Any increase in capital must be decided upon by the general meeting….".

Request for Preliminary Ruling by the ECJ: The High Court asked the ECJ whether the Second Directive precludes the adoption of administrative measures which have the effect of (i) increasing a company's capital, (ii) allotting new shares without offering to existing shareholders a pre-emptive right, and (iii) altering the nominal value of the company's shares and of the statute without the consent of the general meeting.

JUDGMENT AND COURT REASONING

Ordinary company law does not preclude the adoption of "exceptional crisis measures": The ECJ stated that the aim of the Second Directive is to achieve minimum equivalent protection for both shareholders and creditors of public limited liability companies and that the measures provided by that Directive concerning the formation, maintenance, increase, or reduction of the share capital provide such protection against acts taken by the governing bodies of those companies during their normal operation. However, the adopted measure constitutes an exceptional measure that is adopted "where

[78] Joined Cases C 597/18 P and C 598/18 P, C 603/18 P and C 604/18 P; K. Chrysostomides & Co. LLC and the other v Council and others and b) Bourdouvali and others v Council and others

[79] Second Council Directive 77/91/EEC of 13 December 1976 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 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 1977 L 26, p. 1)

there is a serious disturbance of the economy and financial system of a Member State [...], with the objective of preventing a systemic risk and ensuring the financial stability of the European Union". It held that the provisions of the Second Directive do not preclude an exceptional measure affecting the share capital of a public limited liability company, taken by the national authorities acting under exceptional circumstances. Additionally, the ECJ stated that, although there is a clear public interest in ensuring a strong and consistent protection of shareholders and creditors, that interest cannot be held to prevail in all circumstances over the public interest in ensuring the financial stability established by the EU Treaties. Therefore, the ECJ concluded that the Second Directive does not preclude national authorities from adopting an exceptional measure relating to the increase of the share capital of a company without the approval of the general meeting, where there is a serious disturbance of the economy and financial system of a Member State, with the objective of preventing a systemic risk and ensuring the financial stability of the EU.

The ECJ added that the above interpretation is not irreconcilable with the interpretation adopted by the Court in the judgment of 12 March 1996, Pafitis and Others[80] because (i) the factors distinguish the Dowling case from Pafitis given that the latter concerned the insolvency of a single bank and the ECJ held that the Second Directive continues to apply in the case of 'ordinary reorganization measures' and (ii) the ECJ did not give a ruling on extraordinary reorganization measures, which are designed to avoid the failure of a bank and prevent a serious disturbance of the national economy and of the financial system and thereby to maintain the financial stability of the Member State and the EU.

3.4 Slovenia / Tadej Kotnik and Others v Državni zbor Republike Slovenije[81]

Summary: The European Court of Justice (ECJ) upheld the burden sharing requirements under the EU Banking Communication[82] – i.e. the obligation to write down subordinated creditors' claims (as required, equally, under the BRRD bail-in rules) – to be compliant with regard to EU primary law in particular the protection of property rights and the principles of legitimate expectations, stressing that investor cannot rely on the assumption they would not face losses even if in the past creditors of the same rank were not included in burden sharing requirements.

Background: On 18 December 2013, the European Commission authorized the provision of state aid from the Slovenian state to certain banks which were facing capital shortfall after the results of a comprehensive asset quality review, compatible with the state aid framework and in line with the EU Banking Communication.[83] That Banking Communication was adopted in the wake of the global financial crisis in order to provide guidelines regarding the criteria and the conditions of state aid granted to the financial sector when in crisis and included burden-sharing measures by shareholders and holders of subordinated debt. The Bank of Slovenia adopted decisions putting in place exceptional measures in order to effect a recapitalization, or resolution, of these banks. The adopted measures, in line with the provisions of the Banking Communication, included writing off equity capital, as well as hybrid capital and subordinated debt (but no conversion of creditors).

[80] Judgment of 12 March 1996, Pafitis and Others, C-441/93, (para 57)

[81] Judgement of 19 July 2016, Kotnik and Others, Case C 526/14

[82] 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 (2013/C 216/01).

[83] Communication from the Commission on the application, from 1 August 2013, of state aid rules to support measures in favor of banks in the context of the financial crisis (2013/C 216/01).

MAIN PLEAS

Constitutionality of burden sharing requirements and interference with EU property rights: A number of applications were brought before the Constitutional Court of Slovenia by private individuals, the National Council, and the Slovenian Ombudsman for review of constitutionality of the Slovenian law on the basis of which the measures for the recapitalization and the resolution of the banks were adopted. The applicants argued that the adopted measures were incompatible in particular with the principle of non-retroactivity, the principles of protection of legitimate expectations and proportionality, and the right to property as it is enshrined not only in the Slovenian Constitution, but also in Article 17 of the Charter of Fundamental Rights of the European Union ('the Charter').

The national Court asked the ECJ for a preliminary ruling on the interpretation of EU law with regard to the EU Banking Communication.

JUDGMENT AND COURT REASONING

On the question whether the Banking Communication should be considered as de jure or de facto binding on the Member States, the ECJ ruled that the Banking Communication is not binding on the Member States.[84]

Non violation of the principle of protection of legitimate expectations: Regarding the applicants' argument that burden-sharing measures infringe principles of protection of legitimate expectations the Court stressed that the principle presupposes that precise, unconditional, and consistent assurances have been given to the person concerned. In that particular case, shareholders and subordinated creditors of banks subject to burden-sharing measures were given no guarantee from the Commission regarding the conditions for the approval of the state aid or that some of the measures required for the approval would not be prejudicial to their investments. While the principle of protection of legitimate expectations is one of the fundamental principles of the EU, "the objective of ensuring the stability of the financial system while avoiding excessive public spending and minimizing distortions of competition constitutes an overriding public interest of that kind".[85] The ECJ further held that the fact that decisions by the EU Institutions not to call upon subordinated creditors to contribute to the rescue of credit institutions during the first phases of the international financial crisis, did not put these creditors in a position to rely on the principle of protection of legitimate expectations against a subsequent, less favourable application of the law. The ECJ reiterated that "economic operators are not justified in having a legitimate expectation that an existing situation which is capable of being altered by EU institutions in the exercise of their discretion will be maintained" in the future; particularly in a field such as State Aid in the banking sector, whose subject matter involves constant adjustment to reflect changes in the economic situation.[86]

Burden sharing does not interfere with right of property: The ECJ stated that burden-sharing measures "cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within insolvency proceedings that followed such aid not being granted" and thus they don't "constitute interference in the right to property of the shareholders and the subordinated creditors".[87] The ECJ added that the shareholders of the banks must fully bear the risk

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[84] dvocate General Wahl in his opinion of 18 February 2016 (C-526/14) pointed out that the Banking Communication is considered as an act of 'soft law' (such as guidelines, notices, or communications) which the Commission adopted "for reasons of transparency, and in order to ensure equal treatment and legal certainty" and "with a view to announcing how it intends to make use, in certain situations" (above opinion, paras 25, 38). In adopting such guidelines, the Commission imposes a limit on the exercise of its discretion while assessing the compatibility of state aid measures with the internal market and cannot, as a general rule, depart from those guidelines.

[85] Para 69

[86] Para 66

[87] Paras 78 and 79

of their investments and given that they are liable for the debts of the bank up to the amount of its share capital, the fact that burden sharing is required in order to overcome a bank's capital shortfall, prior to the grant of state aid cannot be regarded as adversely affecting their right to property because 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. In any event, the losses would have been the same in case of insolvency of the banks. Advocate General Wahl, in his opinion dated February 18, 2016 on this case, added "Article 17 of the Charter states that the right to property is not absolute but must be viewed in relation to its function in society. Consequently, the exercise of the right to property may be restricted, provided that those restrictions in fact correspond to objectives of public interest pursued by the Union and do not constitute, in relation to the aim pursued, a disproportionate and intolerable interference, impairing the very substance of the right so guaranteed".[88]

Burden sharing measures constitute exceptional measures that do not follow ordinary company law: The ECJ addressed the question of whether the administrative measure which resulted in increasing the bank's capital without the consent of the general meeting was compatible with the EU Company Law Directive.[89] This 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 ECJ indicated that the aim of the Directive is to guarantee investors' rights, particularly when a company is formed and when its share capital is increased or reduced during the normal operation of the companies. It stressed that burden-sharing measures constitute exceptional measures which 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".[90] The ECJ departed from its ruling in the case Pafitis and Others (see also 2.1 Dowling Case above) and stressed that in the Kotnik case the interest in ensuring protection of investors, cannot "prevail in all circumstances over the public interest in ensuring the stability of the financial system" adding that the circumstances after the introduction of the euro and the establishment of the Eurosystem were very different from those in the Pafitis case.

[88] Para 87

[89] Directive 2012/30 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.

[90] Para 88

4. ICELAND / NETHERLANDS / UNITED KINGDOM - EFTA SURVEILLANCE AUTHORITY V ICELAND ('ICESAVE')[91]

Summary: In its interpretation of the EU Deposit Guarantee Directive[92] (DGSD, as applicable prior to its 2009 re-casting), the EFTA Court rejected a subsidiary responsibility of the Republic of Iceland to compensate customers of overseas branches of an Icelandic bank, 'Landsbanki', after the national Deposit Guarantee Scheme became unable to meet its obligations. The EFTA Court found that the DGSD (pre-2009) imposed onto the 'home state' various obligations as to the establishment and supervision of deposit guarantee schemes (DGS) and confirmed the coverage of the minimum amount by home Member States' (DGS, but held that it did not require the 'home state' to guarantee the DGS's obligations to depositors at branches in another Member State in the same way as to domestic depositors. In this case, domestic deposits were ich were transferred to a bridge bank, New Landsbanki, as part of a broader restructuring of the Icelandic banking sector. Unlike deposits in overseas branches domestic branches therefore did not become unavailable for the purposes of the DGSD.

Background: As part of its legal obligations as a member state of the European Economic Area (EEA), Iceland implemented the EU DGSD through the enactment of Act No. 98/1999 on a Deposit Guarantee and Investor Compensation Scheme on January 01, 2000. This established the Depositors' and Investors' Guarantee Fund.

In October 2006, Landsbanki, the country's second-largest private bank at the time, launched a branch in the United Kingdom which provided online savings accounts under the brand name 'Icesave'. A similar Icesave online deposit branch was launched in the Netherlands and began accepting deposits there in May 2008. Deposits at the British and Netherlands branches of Landsbanki were under the responsibility of the Icelandic DGS, which offered a minimum guarantee of ISK 1,700,000 (about 14.500 EUR)[93] per depositor. From May 2008, Landsbanki opted to take part in the Netherlands deposit guarantee scheme to supplement its home scheme. At that time, the minimum amount guaranteed under the Netherlands scheme was €40,000 per depositor which was later raised to €100,000 per depositor. Similarly, the Landsbanki branch in the United Kingdom joined the UK Financial Services Compensation Scheme for additional coverage up to a maximum of GBP 50,000 for each retail depositor.

On 07 October 2008, Landsbanki collapsed and the Icelandic Financial Supervisory Authority appointed a winding-up committee which, with immediate effect, assumed the full authority of the board. Customers of Landsbanki with deposits held at its branches in the Netherlands and the United Kingdom, including the so-called Icesave-on-line savings accounts, lost access to their deposits when the UK and Netherlands froze the bank's assets in their respective jurisdictions. On 27 October 2008, FME issued a statement that obliged the TIF to make payments to the bank's depositors in the Netherlands and the United Kingdom up to the maximum insured amount in accordance with Art. 10 of Act No 98/1999. The resources of TIF were, however, insufficient to cope with the simultaneous failure of the country's three largest banks and, as a result, no such payments were made to those depositors. The UK and Netherlands authorities arranged for a pay-out of retail depositors from their own deposit guarantee schemes. 120,000 depositors in the Netherlands and 230,000 depositors in the UK were reimbursed for total amounts of €1.6 billion and GBP 4.5 billion, respectively. Domestic deposits in

[91] EFTA Court, Case E-16/11

[92] Directive 94/19/EC on deposit-guarantee schemes

[93] Avg. FX rate over the course of May 2008

Landsbanki were guaranteed in full and had been transferred by FME to a bridge bank, 'New Landsbanki', which was established by the Icelandic Government.

Against this background the EFTA Surveillance Authority (ESA)[94] lodged an application with the EFTA Court. ESA sought a determination that Iceland had failed to comply with its obligations resulting from the DGSD, since it did not ensure payment of the minimum amount of compensation (€20,000) to Icesave depositors in the Netherlands and the United Kingdom within the given time limits. The applicant argued that Iceland was responsible by virtue of its obligations under the EEA Agreement and in accordance with settled case law of the ECJ (e.g. C-222/02 Paul and others. [2004] ECR I-9425) not only to transpose the DGSD into national law but to ensure that the DGS so established (TIF) was capable of covering depositors' claims in all circumstances.

DECISION

The application was dismissed on the grounds that

a. Art. 3 DGSD, as applicable at the time, obliged EEA states to introduce and officially recognize a DGS and to fulfil certain supervisory tasks in order to ensure the proper functioning of the DGS. However, it was not envisaged in that provision that EEA states had to ensure the payment of aggregate deposits in all circumstances. It did not therefore establish a subsidiary liability of the home state or its institutions to provide compensation to depositors in the event that the home state DGS were unable to meet its obligations, e.g. in a systemic crisis.

b. The fact that home state depositors' claims were treated differently than UK/NL branch depositors and transferred to a government-funded bridge bank did not constitute a breach of the principle of non-discrimination (Art. 4 EEA Agreement). The transfer of deposits took place before FME issued its instruction to TIF to pay out compensation to depositors in the Netherlands and the UK. As a consequence of the transfer, Icelandic customers' deposits never became unavailable within the meaning of Art. 1 (3) DGSD and therefore were not entitled to compensation by TIF, unlike customers in the Netherlands and the UK.

NOTES

Directive 94/19/EC on Deposit-Guarantee Schemes has since been amended by Directive 2009/14/EC of the European Parliament and of the Council of March 11, 2009. The amendments include, among others, a re-wording of Art. 7 DGSD which, in the opinion of the EFTA Court, now seems to impose a legal obligation upon EEA states 'to ensure a certain level of coverage', which did not exist under the original provision.

The UK Financial Services Compensation Scheme and De Nederlandsche Bank subsequently pursued their claims against the Landsbanki estate through the Icelandic courts. By January 2016, all pay-outs to depositors in the Netherlands and UK were recovered in full.[95]

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[94] The application was supported by the European Commission and written observations were submitted by the Principality of Liechtenstein, the Kingdom of the Netherlands, the Kingdom of Norway, and the United Kingdom. The EEA states limited their observations to the first plea only.

[95] De Nederlandsche Bank, DNB sells remaining claim on old Landsbanki, Press Release, 27 August 2014; https://www.dnb.nl/en/news/news-and-archive/nieuws-2014/dnb310933.jsp Dunkley, Emma, Treasury recoups last Landsbanki payment, Financial Times, 15 January 2016; https://www.ft.com/content/3ec13e4c-bbaa-11e5-b151-8e15c9a029fb

5. UNITED KINGDOM

5.1 European Court of Human Rights: Grainger and others. v United Kingdom[96]

Summary: In accordance with established case law, the European Court of Human Rights (ECHR) rejected the applicant's claim that nationalization without compensation of their shares in Northern Rock plc (Northern Rock), a distressed and failing UK bank, was a violation of their right to property under Article 1 Protocol No. 1 ECHR. The ECHR reiterated that interference by the state was explicitly provided for in Article 1 if deemed necessary and in the public interest and that it was justifiably in the public interest to prevent 'moral hazard' by imposing upon shareholders the financial losses caused by poor commercial decisions of the bank's management.

Background: Northern Rock was originally a building society. In 1997 it was converted into a public limited company, listed on the London Stock Exchange and authorized to carry on business as a bank. On its demutualization, shares were issued to its existing depositors. Its core business remained residential mortgage lending. It grew to become the fifth-largest mortgage lender and eighth-largest bank in the United Kingdom.

On August 13, 2007 Northern Rock alerted the Financial Services Authority to its liquidity problems and its doubts over the sustainability of its situation. On September 3, 2007 the Treasury, the Bank of England, and the Financial Services Authority (together the tripartite authorities) agreed in principle to provide financial support, as a lender of last resort (LOLR), to allow Northern Rock to maintain liquidity. On January 21, 2008 the Treasury announced that the preference of the tripartite authorities was to find a private sector solution for Northern Rock. However, if no suitable private sector solution could be found, the government would bring forward legislation which would empower the Treasury to take Northern Rock into temporary public ownership, since it was not considered that it would be in the public interest to allow the bank to go into administration. By February 17, 2008 there were two private sector proposals for the future of Northern Rock. However, both involved the continuation of public financial support to the company, and the government did not consider that either would deliver sufficient value for money for the taxpayer. The Chancellor of the Exchequer therefore announced that legislation would be brought forward to take Northern Rock into a period of temporary public ownership.
The power to nationalize Northern Rock was conferred on the government by the Banking (Special Provisions) Act 2008, which was passed into law on February 21, 2008. The nationalization of the company was effected by the Northern Rock plc Transfer Order 2008, which was made on the same date and came into force on February 22, 2008. It transferred the shares in the company to the Treasury Solicitor as nominee of the Treasury on February 22, 2008.

Immediately before nationalization, the market price of Northern Rock shares was GBP 0.9, giving it a market capitalization of approximately GBP 379 million. The statutory instrument making provision for the determination of the compensation payable to former shareholders was the Northern Rock plc Compensation Scheme Order 2008, made on March 12, 2008. It required the independent valuer, when calculating the amount of compensation to be paid by the Treasury, to assume that Northern Rock was unable to continue as a going concern and was in administration.

[96] Case reference: 34940/10

On December 7, 2009 the independent valuer wrote to former shareholders informing them that his provisional view was that, applying the statutory assumptions, there would be no residual value in the company and therefore no compensation would be payable.

MAIN PLEAS

Interference with property rights: The applicants complained that the statutory assumptions imposed on the independent valuer, and the resultant lack of compensation for shareholders following the nationalization, were a breach of the government's obligations under Article 1 Protocol No. 1 ECHR.

JUDGMENT AND COURT REASONING

Justification of Interference with property rights: Article 1 Protocol No. 1 ECHR contains three distinct rules: the first rule (first paragraph) is of a general nature and enunciates the principle of the peaceful enjoyment of property; the second rule (first paragraph, second sentence) covers deprivation of possessions and subjects it to certain conditions; the third rule (second paragraph), recognizes that the Contracting States are entitled, amongst other things, to control the use of property in accordance with the general interest. These rules are not "distinct" in the sense of being unconnected: the second and third rules, which are concerned with particular instances of interference with the right to the peaceful enjoyment of property, are to be construed in the light of the principle laid down in the first rule. According to its settled case law[97] any interference with the right to the peaceful enjoyment of possessions has to strike a 'fair balance' between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. Because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is in the public interest on social or economic grounds, and the Court will generally respect the legislature's policy choice unless it is 'manifestly without reasonable foundation.[98]

No general right to compensation: Article 1 Protocol No. 1 does not guarantee a right to full compensation in all circumstances.[99] There was no obligation under domestic law for the tripartite authorities to provide LOLR support, and no duty owed by the state to the shareholders to protect their investments in Northern Rock. Nor does Article 1 Protocol No. 1 impose such a positive obligation on the state. This provision cannot be interpreted as imposing any general obligation on the Contracting States to cover the debts of private entities.[100] The decision taken in the legislation that the former shareholders of Northern Rock should not be entitled to take the value which had been created by the Bank of England's emergency loan was far from being 'manifestly without reasonable foundation'. Instead, it was clearly founded on the policy of avoiding 'moral hazard', which is at the heart of the principles which regulate the provision of LOLR. It was entirely legitimate for the authorities to decide that, had the Northern Rock shareholders been permitted to benefit from the value which had been created and maintained only through the provision of state support, this would encourage the managers and shareholders of other banks to seek and rely on similar support, to the detriment of the UK economy.

[97] E.g. Scordino v. Italy (No. 1) [GC], No. 36813/97, § 78, ECHR 2006-V, with further references

[98] E.g. James et al. vs. the United Kingdom, 21 February 1986, Series A No. 98, § 46; and National & Provincial Building Society, Leeds Permanent Building Society and Yorkshire Building Society vs. the United Kingdom, October 23, 1997, § 80, Reports 1997 VII

[99] see James et al., cited above, § 54; and Scordino, cited above, § 94

[100] E.g. Kotov vs. Russia [GC], No. 54522/00, § 111, 03 April 2012

5.2 United Kingdom/Portugal / Goldman Sachs International v Novo Banco[101]

Summary: The UK Supreme Court rejected an appeal by holders of a financial contract that was agreed under English law and subject to a clause stipulating the exclusive jurisdiction of the English courts against a decision taken by the Portuguese resolution authority in the course of the reorganization of Banco Espírito Santo S.A. (BES). The UK Supreme Court established that the transfer of assets and liabilities to a 'bridge institution' by the Portuguese authorities qualifies as a 'reorganization measure' and jurisdiction regarding any financial contracts affected by such measure is determined by Article 3 Winding-up Directive, irrespective of any contractual jurisdiction clauses contained in such contracts, and pertains to the 'home state'.

Background: The appellants were the assignees of the rights of Oak Finance Luxembourg SA (Oak). In June 2014, Oak entered into a facility agreement with BES, under which it agreed to lend BES approximately $835 million ('the Oak liability'). The facility agreement was governed by English law and provided for the English courts to have exclusive jurisdiction over any dispute. The entire loan was advanced on July 3, 2014. BES made one scheduled payment of approximately $53 million, but it soon became clear that BES was in serious financial difficulties.

The Central Bank of Portugal decided to invoke the bridge institution tool to protect depositors' funds in BES.[102] By a decision dated August 3, 2014 ('the August decision'), it incorporated the Respondent (Novo Banco) to serve as the bridge institution and transferred specified assets and liabilities of BES to it, leaving behind "bad" assets and some creditors in the "bad bank" (BES).[103] Transferred assets purportedly included the Oak liability. Under Article 145H(2) of the Portuguese Banking Law, however, no liability could be transferred to a bridge institution if it was owed to an entity holding more than 2% of the original credit institution's share capital. By a decision dated December 22, 2014 ('the December decision'), the Central Bank determined that the Oak liability had never been transferred to Novo Banco, as it fell within the Article 145H(2) prohibition.[104]

MAIN PLEAS

UK jurisdiction and alleged Transfer of the Oak Loan to Novo Banco: In February 2015, the appellants commenced legal action in the High Court in England for sums due in respect of the Oak loan, arguing that the Oak liability had been transferred to Novo Banco (and not left behind in BES to be liquidated) by the decision, and that Novo Banco was bound by the jurisdiction clause in the facility agreement.

JUDGMENT AND COURT REASONING

Court of first instance

Invocation of the jurisdiction clause and Transfer of the Oak liability: A court of first instance held that due to the (alleged) transfer of the Oak liability in the August decision, Novo Banco became party to the jurisdiction clause in the facility agreement and was therefore bound to submit to the English court "any dispute arising out of or in connection with this Agreement".

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[101] Supreme Court of the United Kingdom, Case [2018] UKSC 34

[102] In August 2014, the BRRD had entered into force but had yet to be enacted in national legislation. However, the Portuguese resolution regime then in force, introduced in 2012, already took into account to a large extent the ongoing international debate on bank resolution.

[103] Garcia, Ana Rita, Banco Espirito Santo S.A.: Resolution via a Bridge Bank Including a Retransfer, in: Lintner, Pamela / Lincoln, Johanna (eds.), Bank Resolution and 'Bail-in' in the EU: Selected Case Studies pre- and post-BRRD, World Bank (FinSAC): Washington/Vienna (2016), pgs. 52 60.

[104] ibid

The Supreme Court

Recognition of the Portuguese resolution authority's (December) decision that the liability in question had not been transferred. The Supreme Court rejected the proposition of the High Court, that the effect of the August decision could be recognized without regard to the December decision. It held that an English court is required by Article 3 Winding-up Directive to recognize the December decision, and must therefore treat the Oak liability as never having been transferred to Novo Banco which was therefore never party to the jurisdiction clause in the facility agreement. The provision which is primarily relevant to this appeal is Article 3 Winding-up Directive, which determines the applicable law to be applied to a reorganization measure in England.[105] The purpose of Article 3 Winding-up Directive is to ensure that all assets and liabilities of the institution, regardless of the country in which they are situated, are dealt with in a single process in the home Member State. This can be achieved only by taking the process as a whole and applying the legal effects attaching to it under the law of the home state in every other Member State. It is not consistent with the language or the purpose of Article 3 Winding-up Directive that an administrative act such as the December decision, which affects the operation of a reorganization measure under the law of the home state, should have legal consequences as regards a credit institution's debts which are recognized in the home state but not in other Member States. Article 66 BRRD is a supplementary recognition provision dealing with (among other things) dispositions of assets and liabilities in the course of a reorganization of a credit institution in its home state. Article 3 Winding Up Directive, unlike Article 66 BRRD, is not limited to requiring the mutual recognition of 'transfers' but requires recognition of the entire process of reorganization under the BRRD.

With regard to the correct analysis of the December decision, it was held that this is up to the Portuguese administrative court to decide (See below Section 8.2).

[105] Credit Institutions (Reorganisation and Winding-up) Regulations 2004 (SI 2004/1045)

6. GREECE

6.1 Agricultural Bank of Greece[106]

Summary: The Council of State ("the court") dismissed applications relating to the annulment of the decisions of the Bank of Greece for the revocation of the banking license of the failing bank and the transfer of certain assets and liabilities to a viable bank arguing that the decisions in relation to the resolution of the bank were fully substantiated and adequately justified.

Background: The Agricultural Bank of Greece ("the bank"), by the time of the resolution, had a considerable presence in the Greek market. It had been undercapitalized and unprofitable (despite capital injections by its shareholder, the Greek State), and had failed repeatedly to fulfil its capital adequacy requirements. In 2011, following a viability diagnostic assessment of Greek banks conducted by an independent advisor, the Agricultural Bank of Greece was assessed as non-viable and thus public money could not be used for its recapitalization according to the existing framework. The Bank of Greece proceeded to resolve the bank applying the sales of business tool, in the context of which it carried out an informal and confidential bidding process which ultimately resulted in the transfer of the defined bank's assets and liabilities to a viable bank. The resolved bank went under liquidation and its shareholders were wiped out.

MAIN PLEAS

Annulment of the resolution decision and discretionary exercise of Bank of Greece powers. The employees' association and certain individuals filed applications before the court for the annulment of the decisions pertaining to the resolution of the bank, on the grounds that these decisions were contrary to constitutional provisions that safeguard the value of equality, economic freedom, and free competition and to the principle of transparency. In particular the questions raised before the court related to:

- the nature and extent of the Bank of Greece's powers;
- the validity and the reasoning of the Bank of Greece decisions, arguing it lacked adequate justification;
- the resolution process, arguing it lacked transparency because the sale of business was completed via an informal and confidential bidding process, thus not complying with the principle of transparency of the administration's action;
- the extent of the judicial review of the resolution decisions;
- the employment contracts, arguing that these should not have been terminated (as provided in the resolution legislation) but they should have been transferred to the acquirer bank, claiming that a transfer of assets and liabilities in the context of bank resolution was in fact a transfer of business in the meaning of the European Directive relating to the safeguarding of employees' rights in the event of transfers of undertakings and businesses.[107]

[106] Three decisions of the plenary session of the Council of State (Supreme Administrative Court) were issued in relation to the resolution of the Agricultural Bank of Greece: Council of State decisions 3013/2014, 3014/2014, and 3616/2014

[107] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (Official Journal L 082 , 22/03/2001 p. 0016 – 0020)

JUDGMENT AND COURT REASONING

Jurisdiction of administrative courts: Administrative courts have the competence to rule on applications for the annulment of resolution decisions. The court reiterated that the acts of the Bank of Greece when exercising its powers that fall within the remit of public authority to protect financial stability and to enhance public confidence in the financial system are regarded as administrative acts, irrespective of the nature of the legal relations these acts regulate, whether they are public or private relations. Consequently, the acts adopted by the Bank of Greece in the exercise of its supervision or resolution powers are enforceable administrative acts and as such are challenged before the administrative courts.

Justification of the Bank of Greece resolution decision: The Court made extensive reference to the facts of the case and the evidence produced and held that the decisions in relation to the resolution of the bank were fully substantiated and justified. The Bank of Greece had reasonably assessed the bank as non-viable on the basis of the independent viability report carried out to this effect by independent auditor and the comprehensive study of the case which had examined the alternative scenarios as well as the cost of each solution. The Court relied on the evidence advanced by the parties noting that the applicants did not invoke substantive convincing evidence submitted to support their arguments or elements to refute the allegations of the Bank of Greece and substantiate their claims. The Court concluded that the conditions for the application of the resolution measures were fulfilled and that the contested decisions of the Bank of Greece concerning the non-viability of the resolved bank, the implementation of the resolution measure of transfer order, and the withdrawal of the license were legally and adequately justified. The Bank of Greece respected the conditions set by the law and took the decisions within the discretionary powers conferred on it by the law.

Confined judicial review: With regard to the extent of judicial review of the decisions pertaining to financial and economic matters, the Court reiterated that substantive decisions of the resolution authority do not fall under judicial review as they are based on estimates and assessments of the facts. The judicial review was confined to verifying whether the rules on procedure have been followed and the reasons for adopting the resolution measures substantiated. The court did not proceed to its own economic assessment but relied on the assessments carried out by the Bank of Greece which was – by that time - the resolution authority, which were based on the reports of the independent advisors. It is worth noting that one member of the court was of the opinion that the court should postpone the deliberation and, prior to taking any decision, have independent experts obtain a complete picture of the case and thus form an informed opinion as to whether or not the resolution measures adopted by the Bank of Greece were justified.

Legitimate restrictions on transparency requirements: The court ruled that the Bank of Greece acted within the framework laid down by the law and the closed, informal bidding process was a choice made by the legislator who set the terms and conditions under which this process should be conducted. The legislator while defining the terms and conditions of the resolution process had evaluated the conflicted principles, namely the transparency on one hand and the need for effectiveness of the administrative action on the other, for the purpose of ensuring the stability of the financial system. The legislator's choice in favor of the partial restriction of transparency was in the interest of the national economy and protection of public confidence in the banking system, since the withdrawal of the license of a functioning credit institution and subsequent special liquidation would be likely to cause considerable disruption to the financial system, especially in light of the serious financial crisis. Under the circumstances, the legislator decided that the closed tender process and confidential bidding procedure which resulted to the swift completion of the implementation of the resolution measure of the transfer of the assets of the resolved bank a viable credit institution best protected financial system stability, addressed depositors' concerns that they would suffer losses and limited the possibility of massive withdrawal of deposits which would have unjustified negative impacts on viable banks. More generally the court noted that, from the point of view of EU law, the principle of transparency is neither unconditional nor without restrictions. In particular, restrictions on fundamental freedoms, such as on the right of access to documents or the transparency of EU institutions' actions, are admissible if they are justified for the protection of public interest and according to the principle of proportionality, especially restrictions under these conditions may applied in matters related to economic activities, competition cases and safeguarding the financial stability.

Overriding public interest justifying restrictions on economic freedom: The court ruled that the principle of economic freedom or equal treatment may be subject to restrictions by general and objective legislation if justified by overriding reasons of public interest in which case they are not regarded as unjustified. The protection of the national economy, safeguarding of financial system stability, and protecting depositors' confidence may justify the adoption of measures imposing certain restrictions, provided that these do not constitute disproportionate interference making it impossible or excessively difficult to continue the legitimate business activity on which the survival of the business as a business unit depends. The legislator has a wide margin of discretion in determining the arrangements considered appropriate and necessary to achieve the objective pursued. In this connection, the court confirmed that judicial review of the necessity and the adequacy of such measures with the principle of proportionality is limited to determining whether the legislation adopted is manifestly inappropriate or manifestly goes beyond what is necessary to attain the objective pursued. Additionally, the restrictions must be in line with the principle of equality and ensure a level playing field.

Non application of the protection of employment contracts: The court held that the European Directive relating to the safeguarding of employees' rights in the event of transfers of undertakings[108] may not apply in bank resolution cases if the national law provides for an exception in cases of bankruptcy or of any other similar insolvency proceedings initiated for the purpose of liquidating the assets of a business. In such cases the employees' contracts may be terminated following the withdrawal of the banking license and not transferred to the acquirer bank.

6.2 Proton Bank s.a[109]

Summary: The court dismissed the applicant's (main shareholder of the resolved bank) argument that the his shareholding rights (voting rights, right to dividend) and property rights were infringed by the decision of the Bank of Greece to resolve the bank and that the Bank of Greece should have used a different resolution tool from the one used in this case which was the creation of a bridge bank, namely to resolve the bank using the transfer of business tool . It held that the value of the equity held by the applicant (shareholder) no longer corresponded to the real value and that, in any case, the shareholder retained the right to any liquidation proceeds.

[108] The Transfers of Undertakings Directive 2001/23/EC is a European Union law that protects the contracts of employment of people working in businesses that are transferred between owners.

[109] Council of State 419/2014

Background: The case relates to the resolution of a small private bank, which at the time the measure was taken was undercapitalized and had repeatedly failed to address serious organizational and governance issues identified by the supervisor, the Bank of Greece. The Bank of Greece appointed a commissioner with the specific duty to submit a report on the bank's capital adequacy requirements, its financial situation, and its governance. Following the commissioner's findings, the Bank of Greece, as the resolution authority, asked the bank to increase its capital within a specified time limit. The bank failed to raise private funds and thus the Bank of Greece took resolution measures which in this case was the creation of the bridge bank. The Court decision of the plenary of the Council of State was issued following an application for annulment of a resolution decision submitted by the main bank shareholder.

MAIN PLEAS

Request for annulment: application for annulment of the resolution decision submitted by the main bank shareholder on the basis of:

- lack of justification of the decision of Bank of Greece with regards to the choice of the implementation of the specific resolution tool of creation of the bridge bank;
- infringement of the right to a fair trial and the right to be heard as enshrined in article 6 of the European Convention of Human Rights arguing that the resolution decision was an administrative penalty;
- unconstitutionality of the law on the basis of which the decision for the resolution of the bank was taken because the decisions taken by the Bank of Greece infringed the applicant's shareholding and property rights given that the restriction and/or deprivation of such rights were not compensated as it is provided in the Constitution.

Request for application of a different resolution tool under the principle of proportionality: The applicant argued that the Bank of Greece should have used a transfer of business (instead of creating a bridge bank) as a less burdensome for the shareholder solution, providing for consideration to be paid by the acquirer of the balance sheet items. By adopting the bridge bank solution, the Bank of Greece as the resolution authority violated the principle of proportionality because the administration could have achieved the same result by adopting a solution more favorable to the shareholder's property interests. The applicant added that the decision of the Bank of Greece was not adequately justified.

The resolution decision affected the applicant: The applicant argued it should have been heard before resolution measures were taken.

Interference in property rights: The applicant argued that the implementation of the resolution measures violated shareholder's rights on dividend payment and property rights since no adequate compensation was provided for the deprivation of rights as it is provided in the Constitution where it is stipulated that "no one shall be deprived of his property except for public benefit, ... and always following full compensation corresponding to the value of the expropriated property....".

JUDGMENT AND COURT REASONING

Administrative measures are not administrative penalties. The court ruled that resolution measures are administrative measures adopted by the Bank of Greece, as the resolution authority, with the aim of safeguarding financial stability, minimizing resolution costs, and protecting depositors' and investors' interests. The law makes a clear distinction between administrative penalties, imposed on the bank for breaches of its obligations as prescribed by law or in the banking license, and resolution measures. Administrative penalties are intended to punish the bank for violations of the law or of the supervisor's instructions whereas resolution measures are designed to prevent the collapse of a bank, prevent any systemic risk or contagion, as well as to protect public confidence and the smooth operation of the financial system.

Principle of proportionality, discretionary exercise and justification of exercising resolution power. The court ruled that resolution measures aim to address the inability of a bank to recover or to take alternative measures and prevent any systemic risk taking into consideration the expected impact on the financial system. These measures do not constitute penalties which step up according to the severity of the non-compliance with the obligations imposed by the law or the supervisor, but they are the means which enable the competent bodies to deal with the problems of the failing credit institutions. Depending on the specificities of each case and the financial conditions, the Bank of Greece as the resolution authority may adopt at its sole discretion the adequate resolution measure. In this particular case, the court noted that the decisions related to the resolution were adequately justified and substantiated, evidence was produced including the Bank of Greece explanatory note with regards to the reasons for adopting the specific resolution measure.

Given the above as to the nature of the resolution measure the court resolved that article 6 of the European Convention of Human Rights is not applicable in the case because the resolution measure was not addressed to bank or the shareholder as an administrative penalty.

Property rights: The Court reiterated that the resolution measure was taken for the protection of public interest, pointing out that:

- the resolution law didn't provide for the participation of the shareholder of the resolved bank to any decision-making process of the newly created bank (bridge bank) following the resolution,
- the property rights of the applicant were not violated given that, at the time of the resolution, the resolved bank was not profitable, the bank's liabilities exceeded the assets, and all the relevant figures of the bank were negative, thus the value of the equity held by the applicant no longer corresponded to the real value.
- in case the proceeds of the liquidation of the resolved bank, after the satisfaction of the creditors, turn out to be positive, the applicant has a right to the proceeds of the liquidation, depending on the shares held.

7. GERMANY

7.1 Abt and others v Hypo Real Estate Holding[110]

Summary: The compulsory purchase of minority shareholders' interests ('squeeze-out') in a systemically important financial institution, whose disorderly collapse into insolvency could cause a serious disturbance in the economy of the home state, is permissible and in the public interest of preserving financial stability. A squeeze-out under these circumstances does not constitute expropriation within constitutionally guaranteed property rights provided that the principle of proportionality is maintained in its application.

Background: Hypo Real Estate Holding AG (HRE) was formed in the autumn of 2002, by way of a de merger of the real estate financing and mortgage banking activities of HypoVereinsBank, a German subsidiary of the Italian banking group, UniCredit. In 2007, HRE took over Dublin-based Depfa Bank plc (Depfa) and extended its business to public sector and infrastructure finance. That transaction more than doubled HRE group's balance sheet, which by the end of 2008 grew to approximately €420 billion. In 2008 HRE joined the DAX index of the 30 largest listed German companies.

At the end of September 2008, after Lehman Brothers applied for creditor protection, HRE faced an acute liquidity shortage which put the bank on the brink of collapse. HRE was no longer able to obtain short-term financing on the markets and did not have sufficient liquidity reserves to bridge the funding gap. In addition, HRE faced a potential capital shortfall attributable to non-performing legacy assets. Finally, information technology and risk systems at the group level were inadequate and made the efficient management of operations difficult.

On September 29, 2008, the German Ministry of Finance announced an emergency credit line of approximately €35 billion, backed by a German government guarantee and arranged in co operation with a consortium of German banks, in order to alleviate the bank's liquidity constraints and to prevent its collapse. On October 17, 2008, the German Parliament approved the Law on Measures to Accelerate the Stabilization of Financial Markets which includes provision for the compulsory acquisition of minority interests in distressed financial institutions by government agencies, specifically SoFFin. Between October 2008 and April 2009 several tranches of emergency liquidity support failed to stabilize the bank as HRE continued to report heavy losses and could no longer raise funding on the capital markets. On March 23, 2009, the German government, through SoFFin, acquired a 8.7% stake in the bank by way of a rights issue at a price of €3.00 per share. Existing shareholders' preemptive rights were disapplied. In view of the continuing deterioration of the bank's condition the German Parliament approved, on April 7, 2009, an emergency takeover law to facilitate a takeover offer by SoFFin as a first step towards the nationalization of HRE. On April 9, 2009, SoFFin announced a public tender offer to acquire all remaining outstanding shares of HRE at a price of €1.39 per share. At the end of the offer period, on May 4, 2009, SoFFin held 47.3% of the issued and outstanding capital of HRE. On June 2, 2009, the bank's general assembly approved another capital increase by SoFFin, again at a price of €3.00 per share, which increased the German government's holding in HRE to 90%. On June 8, 2009, SoFFin issued a written request to the executive board of HRE to convene an extraordinary general meeting of shareholders for the purpose of approving the compulsory purchase ('squeeze-out') of all

[110] Case January 20, 2011 (5HK O 18800/09) Landgericht München I

remaining minority interests in accordance with § 12 (4) FMStBG. The Extraordinary General Meeting was held on October 5, 2009, and approved the requested 'squeeze out'.

MAIN PLEAS

The applicants argued that the compulsory acquisition of their shares in HRE by SoFFin amounted to an expropriation and was in breach of the constitutional right to property as guaranteed by Article 14 (1) Grundgesetz.

JUDGMENT AND COURT REASONING

Constraints on shareholders property rights are proportional. § 12 (4) FMStBG, which provides for the possibility of a 'squeeze out' where the (public) majority shareholder holds at least 90 % of the issued and outstanding share capital of the institution, does not constitute expropriation within the meaning of Article 14 (3) Grundgesetz but qualifies as a qualification and restriction of the right to property in accordance with Article 14 (1). It does not violate the principle of proportionality. In view of the potential damage of the disorderly collapse of a systemically important financial institution to the economy of its home state it is justifiable and proportionate for the German legislator to impose constraints on shareholders' rights to property, in general, and to allow for the compulsory purchase by the government's SoFFin of a minority interest of up to 10% of the distressed institution's outstanding capital . This provision is therefore not in breach of Article 14 (1) Grundgesetz.

No violation of EU treaty principles or state aid: From the perspective of EU law, § 12 (4) FMStBG does not infringe upon the free movement of capital (Article 56 (1) Treaty on the EU (TEU) and/or Article 63 (1) Treaty on the Functioning of the EU (TFEU), which may be restricted, if necessary, by measures which are justified on grounds of public policy or public security (Article 65 (1) (b) TFEU). A squeeze-out in accordance with § 12 (4) FMStBG does not constitute 'state aid' within the meaning of Article 87 TEU and/or Article 107 TFEU.

[111] Buder, Matthäus / Lienemeyer, Max / Margnus, Marcel / Smits, Bert / Soukup, Karl, The Rescue and Restructuring of Hypo Real Estate, European Commission: Competition Policy Newsletter No. 3/2011; http://ec.europa.eu/competition/publications/cpn/2011_3_9_en.pdf

[112] in contrast to §§327a–327f AktG where a majority of 95% is required to initiate a squeeze-out.

8. SPAIN

8.1 Bankia

Background: In 2010, seven independent savings banks (Caja Madrid, Bancaja, Caja Insular, Caixa Laietana, Caja de Ávila, Caja Segovia and Caja Rioja) were consolidated through a form of institutional protection scheme (IPS). This was a common strategy in the sector and one strongly encouraged by the Spanish authorities at the start of the financial crisis to address problems in regional saving banks like political influence from their regions of origin, negligent acts by their managers, or difficulty generating own funds, etc. This form of IPS differed from the current concept of IPS under the EU Capital Requirements Regulation. They were a central vehicle acting as consolidating entity that made decisions for the other members of the IPS, but each maintained their individual solvency and liquidity requirements. There was also a mutualization undertaking, that implied sharing or mutualizing all the profits and risks of each of the members. Banco Financiero y de Ahorro, S.A. (BFA) was established as the central vehicle of the IPS to manage and "download" the required funds in order to allow the other members of the IPS to comply with individual solvency and liquidity needs. The Spanish Fund for Orderly Bank Restructuring (FROB) had a recapitalization scheme pre-approved by the European Commission in January 2010 to provide public support for the consolidation of the Spanish banking sector.[113] On June 29, 2010, Spain informed the Commission under EU state aid rules that the FROB had decided to subscribe €4,465 million in BFA convertible preference shares, under the recapitalization scheme, to support the consolidation and fund the restructuring costs. In 2011, all assets and liabilities of the seven savings banks were hived-down to BFA which, in turn, hived-down 95% of the same (mainly its banking business) to its wholly-owned subsidiary, Bankia (not part of the IPS). BFA continued to be the holding company, not carrying out regular banking operations but rather holding equity stakes in Bankia and other industrial holdings. Bankia was a commercial bank. In July 2011, Bankia was listed through an initial public offering in which private investors acquired 47.6%, while BFA retained the remainder.

In December 2011, the EBA identified a capital shortfall of €1,329 million in BFA. In 2012, the Spanish authorities increased the mandatory level of provisioning and capital buffers for real estate assets (the new rules entailed additional capital needs of €2,767 million and €1,452 million in additional provisioning). On May 25, 2012, Bankia published a revised version of its 2011 annual accounts recording €2,979 million in losses, and BFA announced that it would be requesting a further €19 billion from the FROB, of which Bankia would need €12-14 billion. Trading was suspended. The BFA/Bankia group was put into "restructuring" according to the Spanish law then in force (although the effects were similar to the current concept of resolution). The convertible preference shares subscribed by the FROB in 2010 were then converted into share capital.[114] The FROB became the owner of 100% of BFA and the seven savings banks lost all control over BFA i.e. they were written down. FROB also granted a €19 billion guarantee on the issuance of liabilities to cover Bankia/BFA's liquidity needs.

An MOU of July 2012 between Spain and euro area heads of state and government established that public capital would be provided once relevant restructuring plans, based on the results of stress tests published in September 2012,[115] were approved by the European Commission. The FROB communicated BFA's restructuring plan[116] and the Commission approved it in November 2012. According to the

[113] Case N 28/2010, OJ C 57, 09.03.2010

[114] Also considered state aid – Case SA34820, OJ C 220, 25.07.2012

[115] The stress tests revealed that the BFA group had a capital shortfall of €24,743 million in the worst-case scenario (€13,230 million in the best-case scenario). The expected aggregate losses were €42,756 million and the loss absorbing capacity of €18,012 million in the worst-case scenario.

[116] According to the Spanish law then in force, as a systemic bank BFA/Bankia was formally considered to be undergoing a "restructuring" process and was not "in liquidation".

valuation reports issued by three independent experts, the BFA Group was valued at -€10.44 billion and Bankia at -€4.15 billion (and BFA's liquidation was valued at -€13.27 billion and Bankia's at -€49.64 billion). These valuations were the basis for implementing public financial support established in the restructuring plan. However, in September 2012, before the restructuring/resolution decision was made the FROB injected a further €4.5 billion through a share capital increase in BFA that was paid-in with Spanish treasury bonds due to the group's critical and extraordinary situation. Subsequently, BFA granted a subordinated loan (Tier 2) for the same amount to Bankia.

The restructuring plan included a burden sharing agreement and the obligation to transfer a specific (undisclosed) amount of impaired assets and real estate loans to a public bad bank (the SAREB). Burden sharing affected all the outstanding preference shares and subordinated securities[117] (amounting to €6.9 billion) of BFA and Bankia; creditor hierarchy was observed by applying different haircuts to the securities. Holders of preference shares and perpetual subordinated debt were forced to reinvest the residual value of their securities (if any) in Bankia's shares, but holders of non-perpetual subordinated debt were able to choose between senior debt[118] or Bankia shares. A further injection of capital of €13.5 billion into BFA by the FROB was also approved. Subsequently, BFA transferred the funds to Bankia via contingent convertible capital securities and they were then converted into capital when the 2012 annual accounts were approved.

MAIN PLEAS

In the administrative jurisdiction

Wrongful supervision: claims were brought against the Bank of Spain (and the Spanish Market Securities Commission as co-defendant) based on wrongful supervision of the bank and of the Bankia public listing. No claims have been filed against the intervention/restructuring measures adopted by the Bank of Spain or the FROB in Bankia or BFA.

In the civil jurisdiction

Misselling and error of consent: claims against Bankia from shareholders (a) mainly for annullability of the transactions based on the error in the consent of the parties to the acquisition of the shares in Bankia's listing, since its annual accounts were "materially inaccurate or incorrect" and, hence, covered up Bankia's actual situation of insolvency, and (b) liability for the materially inaccurate or incorrect information contained in the listing prospectus. Furthermore, there were claims against BFA/Bankia from investors in hybrid securities formerly issued by the savings banks or BFA/Bankia. Most of the claims were for the annullability of the transactions based on the error in the consent of the parties to the acquisition of the securities.

In the criminal jurisdiction

Wrong (accounting) information. There were claims against BFA, Bankia, the former board of directors of both BFA and Bankia, the auditor (Deloitte), and the chief accounting officer of Bankia based on false accounting from which false information was derived to provide to investors in the context of the Bankia public listing.

[117] That is, all Tier 1 and Tier 2 instruments. Former shareholders (i.e. the original seven savings banks had already been written off).

[118] Deposits for retail investors and senior securities for non-retail investors.

JUDGMENT AND COURT REASONING

In the administrative jurisdiction

No wrongful supervision. Claims based on wrongful supervision of the bank have been rejected by the National Court. The National Court[119] follows the doctrine of the Supreme Court that declares that the liability of the supervisory body (i.e., the Bank of Spain) would be determined when the damage can be attributed to it based on a causal link caused by omissions of those actions that should reasonably be adopted by the supervisory body in the exercise of its legal functions, or an inadequate exercise of those functions taking into account the circumstances and the spirit of the law. This necessarily involves a technical evaluation by the supervisory body under the lawful exercise of discretionary powers, unless such actions or omissions were due to an arbitrary or unjustified exercise thereof, wrongful in their factual considerations, or against the law. In the view of the National Court, in the case at hand none of those circumstances applied and the authorities (Bank of Spain) action was not considered unlawful. In addition, the National Court quoted Directive 1997/9/CE to highlight that no supervisory system can offer a complete guarantee for investors, especially in those situations where fraud is committed.

In the civil jurisdiction

Error in consent in the acquisition of shares/ investment products: Most of the actions for annullability brought by retail customers and professional non-institutional investors were upheld. Particularly, after the Spanish Supreme Court held in favor of the claimant in two of these claims.[120] Annullability actions on the acquisition of shares are mainly based on error in the consent of the parties to the acquisition of the shares in Bankia's listing, on the alleged ground that its annual accounts were "materially inaccurate or incorrect" and, hence, covered up Bankia's actual situation of insolvency. Regarding institutional investors, only two of them filed claims and they have been rejected by the Court.

There was also significant litigation against Bankia/BFA based on misselling and error in the consent related to transactions in preference shares and subordinated debt affected by the burden sharing. However, Bankia and BFA made an offer to all retail investors to review their cases under consumer arbitration proceedings where, generally speaking, all retail investors have been reimbursed for their investment. This mechanism has minimized judicial claims on this matter.

In connection with preference shares and subordinated debt, a Spanish Association of Consumers and Users has brought various collective actions against Bankia/BFA which a myriad of investors have been party to. There were three main collective claims: two collective actions relating to the sale of preference shares and one regarding the sale of subordinated debt; two of them have been upheld at second instance court and the outcome[121] has been similar: the court rejects the nullity of the sales although appreciates the nullity of certain supplemental clauses with no monetary effect.

In the criminal jurisdiction

Note: The hearings have been completed (after 5 years of investigation and 72 sessions) but are still waiting for the court sentence publication.

Burden of proof and evidence required (in civil law): Once the court finds that there is a breach in the entity's compliance with its legal obligations, there is a rebuttable presumption of error in the consent by retail investors. For the purposes of determining if there was an error in the consent of the parties

[119] Case numbers 66 / 2014 and 160/2014 at the National Court.

[120] Rulings of the Supreme Court number 23/2016, of 3 February (Case number 541/2015) and number 24/2016, of 3 February (Case number 1990/2015).

[121] Case numbers 389/2017 and 326/2017.

to the transactions, or misselling, Spanish jurisprudence in financial products has traditionally imposed the burden of proof on the entity. The entity needs to prove that it duly complied with all applicable legal (capital markets and MiFID)[122] obligations or, otherwise, the court considers that there is a rebuttable presumption of an error in the consent of the parties. To that end, three aspects are generally assessed by the court (i) financial knowledge of the client and suitability of the product for the client's profile (based on the MiFid test executed, documentation of previous investments made, etc.), (ii) clarity and transparency of the contractual documentation (i.e., whether the prospectus and the summary of the prospectus were clear enough to identify the real risks) and whether it was provided with time enough in advance, (iii) accuracy of the explanations provided by the branches' employees in the sale of the securities. Regarding the annullability actions for the acquisition of Bankia's shares in the listing process, independent experts' reports have often been requested to support the allegation that the annual accounts were "materially inaccurate or incorrect".

8.2 Banco Popular

Summary: After the SRB concluded that Banco Popular Español, S.A. (Banco Popular) was failing or likely to fail (FOLTF), the SRB adopted a resolution decision on June 7, 2017 applying the write-down and conversion of capital instruments power combined with the transfer to the acquiring Banco Santander. It was the first resolution decision taken by the SRB and executed within the legal framework of the BRRD/ Single Resolution Mechanism Regulation (SRMR) since this regulation came into force. Affected bonds and/or shareholders filed numerous claims before Spanish and European courts challenging the SRB's resolution decision. In addition to procedural aspects, the claimants mainly argued that the bank was actually not FOLTF (including challenge of the underlying valuation reports) and sought a declaration of liability of Banco Popular for providing false information in the prospectus, as well as compensation for the damages. At this stage, many of the pleas and arguments raised by the claimants are still unknown. More than 250 claimants have filed their appeals against the FROB and SRB decisions and the Spanish High Court has suspended the proceedings until the EU General Court rules on the SRB resolution decision, which may include referral to the European Court of Justice (ECJ) for a preliminary ruling on the interpretation of EU law. One interesting procedural aspect already clarified by the General Court is that the SRB was not obliged to conduct a final Valuation 2 (under the sale of business tool), stressing that the affected shareholders and creditors could only be entitled to compensation under Valuation 3 if they had lost more than under the hypothetical liquidation counterfactual. While rulings on substance are still ongoing, a Spanish High Court clarified that Santander would not inherit any criminal liability (which is without prejudice on the question whether Santander remains liable on the civil side for any potential misselling committed by Popular).

Background: On June 6, 2017, the ECB concluded that Banco Popular was FOLTF on the basis of Article 18(4)(c) SRMR. The ECB endorsed this decision on the basis of Banco Popular's rapidly deteriorating liquidity situation,[123] concluding that it would, in the near future, be unable to pay its debts as they became due. Once the FOLTF condition was satisfied, the SRB considered that the other two conditions for taking resolution action had also been met.[124] Within the framework of the resolution regime,[125] the SRB decided to exercise the write-down and conversion of capital instruments power prior to the transfer under the sale of business tool in order to address the shortfall in Banco Popular's value. In particular, all the existing shares (common equity tier¬–CET–1) (overall amount of €2,098,429,046)

[122] Markets in Financial Instruments Directive 2004/39/EC

[123] Although figures were not officially published, it is publicly known that emergency liquidity assistance was granted to Banco Popular on June 5, 2017, and that it was partially disposed by Banco Popular.

[124] In accordance with article 18(1) Regulation (EU) No 806/2014, three conditions need to be satisfied for the resolution of an entity: (1) FOLTF analysis; (2) no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure of the entity within a reasonable timeframe; and (3) public interest, all of which were satisfied in the Banco Popular case. The lack of alternatives from the private sector was justified by the negative outcome of the private sale process initiated by Banco Popular and the difficulties the institution had in mobilizing sufficient additional liquidity within the given timeframe. Public interest was supported by the critical functions carried out by Banco Popular.

[125] I.e. Regulation (EU) No 806/2014 and Spanish Law 11/2015 on the recovery and resolution of credit institutions.

were written down and all the additional tier (AT) 1 instruments (overall amount of €1,346,542,000) were first converted into new shares and then written down, while the Tier 2 instruments (overall amount of €684,024,000) were converted into 684,024,000 new shares. All the new shares were immediately sold to Banco Santander, S.A. for €1, received by the FROB on behalf of the holders of the new shares (former holders of the Tier 2 instruments). Banco Santander, S.A. became the sole shareholder of Banco Popular. The resolution measures were based on a so called Valuation 1, deciding if the bank was FOLTF, and a provisional Valuation 2 undertaken by an independent valuer (Deloitte), to inform the SRBs resolution decision i.e. the amount of write down and conversion and the transfer price as well as an estimate of the treatment that shareholders and creditors would have received if Banco Popular had entered into normal insolvency proceedings.[126]

The SRBs internal review process and right to be heard In accordance with the SRMR and BRRD obligation to undertake an ex-post NCWOL valuation the SRB published a notice in August 2018 after receiving the so called "Valuation 3" (NCWOL valuation) from Deloitte regarding its preliminary decision that no compensation needed to be granted to shareholders and creditors under the NCWOL principle and launched the right to be heard process.[127] In March 2020 The Single Board (SRB) decided that no compensation is due to shareholders and creditors affected by the resolution of Banco Popular Espanol, and stressed that the resolution decision was justified by the fact that shareholders and creditors of the ailing bank would not have been better off under the hypothetical application of normal insolvency proceedings compared to their actual treatment in resolution. The SRBs decision was based on the post resolution Valuation 3 undertaken by the independent valuer as well as on the analysis of comments received in the context of the 'right to be heard' process.[128]

On October 16, 2018 the SRB published a statement on its website that 'After careful assessment of the legal framework, the SRB considers that, in the light of the circumstances of the resolution of Banco Popular, it is not necessary for an ex post definitive Valuation 2 as referred to in Article 20(11) of Regulation No 806/2014 to be prepared, in particular, since carrying out such valuation could not have an impact on the concluded sale of Banco Popular to Banco Santander that determined the market price of Banco Popular as an entity in an open, fair, and transparent process.'

MAIN PLEAS

The court responsibility has been addressed at both the European level (before the EU Court of Justice / General Court), and at the national level.

(i) The EU Court of Justice / General Court

There are three main types of claims that have been filed (a) annullability of the SRB resolution decision, (b) damages (as a separate claim or together with the annullability claim), and (c) pleas of illegality over the SRMR and, indirectly, over the BRRD (most of these pleas are based on the Meroni judgment with regard to the limits of delegation of discretionary exercise of delegated powers to an EU agency i.e. the SRB). In addition to procedural aspects, most claims before the General Court argue that the Bank was not FOLTF. On procedural aspects, litigations include the request for the annulment of the SRB's decision not to carry out an ex post definitive valuation (Valuations 1 and 2) of Banco Popular arguing that "the preparation of an ex post definitive valuation will directly affect the legal

[126] Both valuations are annexed to the resolution decision. Valuation 1, dated 5 June 2017, was compiled by the SRB pursuant to Article 20(5)(a) of Regulation No 806/2014 and Valuation 2, dated 6 June 2017, was compiled by an independent expert, Deloitte, pursuant to Article 20(10) of Regulation No 806/2014.

[127] SRB/EES/2018/132)' (OJ 2018 C 277 I).

[128] https://srb.europa.eu/en/node/958

situation of the funds represented by the applicants, as it requires the SRB to consider the write back of AT 1 and Tier 2 instruments that were expropriated from the funds as a result of the resolution decision or to increase the consideration paid by Banco Santander."[129]

(ii) At the domestic level in Spain

At a domestic level, administrative, civil, commercial, and criminal actions have been filed. No claim has yet been filed before the Spanish Constitutional Court but given the Bankia case (see example 6.1 above) this possibility cannot be disregarded.

In the administrative jurisdiction

Request to stay resolution and error in declaring the bank FOLTF: These claims have been filed by former shareholders and holders of AT1 and Tier 2 instruments, i.e. those affected by the write-down conversion mechanism (not only qualified investors but also natural persons), against the FROB for the execution of the SRB resolution decision.

Liability for wrong prospectus and annulment of transactions: Most of the claims to date against Banco Popular in the civil jurisdiction are from (i) shareholders who subscribed their shares in the 2016 share capital increase or those who acquired them in the secondary market after such share capital increase, and (ii) investors in subordinated debt that were written-down by the resolution scheme (mainly retail investors who in July and October 2011 acquired subordinated debt issuances that Banco Popular had placed through its branches). Regarding litigation linked to the 2016 share capital increase, some claims relate to liability for allegedly inaccurate or incorrect information contained in the listing prospectus, but most seek the annulment of transactions based on errors in the consent of the parties.[130]

Several of the claims filed at the General Court and others filed before the administrative jurisdiction at national level seem to be exclusively focused on gaining access to documentation and information related to the resolution and the (financial) situation of Banco Popular prior to its resolution.

In the civil jurisdiction

Misselling and error in consent: These claims have been filed by former shareholders and holders of AT1 and Tier 2 instruments (i.e. those affected by the write-down conversion mechanism) (particularly natural persons) against Santander as acquirer and legal successor of Banco Popular mainly based on misselling and error in the consent related to the Banco Popular share capital increase approved by the end of 2016 and shares acquired in the secondary market in the last year.

Banco Santander as acquirer of Banco Popular post-resolution, launched a campaign to try to reduce litigations. Former shareholders and holders of subordinated bonds who acquired the securities through the Banco Popular branches during the respective subscription period were offered so-called fidelity bonds at no cost, but with the condition that they would waive any potential claims they may have against Banco Popular.

In the criminal jurisdiction

Wrongful (accounting) information: Spain's national court [Audiencia Nacional] started investigations based on many different grounds (false accounting, unfair administration, etc.) to establish whether

[129] Case T 2/19 para 36.

[130] Legally speaking, annulment based on error in consent should not be a remedy available for investors in shares acquired in a share capital increase listed on Spanish stock exchange markets since the Spanish Securities Act establishes a specific protection regime for this type of transaction and the eventual remedy should be exclusively based on materially inaccurate or incorrect information contained in the listing prospectus.

Banco Popular's board of directors or the financial auditor PwC committed any wrongdoing under criminal law procedures on possible false financial statements. These claims have also been filed by former shareholders and holders of AT1 and Tier 2 instruments, both qualified investors and natural persons.

In the commercial jurisdiction

A petition for mandatory insolvency proceedings has been already rejected by the court.[131] In addition, both the Del Valle family (former shareholder of Banco Popular) and Pimco (as former holder of hybrid securities) initiated discovery proceedings in the U.S. to obtain access to Popular's documentation. The discovery was rejected by the U.S. courts.[132]

JUDGMENTS AND COURT REASONING

(i) The EU Court of Justice / General Court

Regarding the obligation for the SRB to undertake a final resolution Valuation 2 – the resolution decision taken on June 7 was based on an "preliminary valuation" undertaken by Deloitte (see above) - the General Court held[133] that there was no obligation for the SRB to undertake a final Valuation 2 in this case. The court held the sale of business tool applied to Banco Popular is not one of the situations referred to in Article 20(12) of Regulation No 806/2014 in which compensation may be paid following an ex post definitive valuation[134] and that it was "for Banco Santander to ensure that any losses incurred were reflected in the accounts when consolidating Banco Popular's assets and liabilities".[135] It was therefore held that the applicants err in submitting that the SRBs decision to conduct a final Valuation 2 was capable of affecting the situation of the funds they represent. The Court further highlighted the distinction that must be made between Valuation 3 and the ex post definitive valuation and that the applicants would potentially be entitled to compensation as a result of Valuation 3 and not the ex-post definitive valuation. [Note that according to the SRBs final decision on Valuation 3, affected shareholders and creditors are not entitled to any compensation under the NCWOL principle (see above); an issue not decided (yet) by the Courts.]

Note: Other rulings of the European Courts were not published at the time of writing

Burden of proof: It is for the applicant in the proceedings before the Court of Justice and the General Court to prove that the FOLTF or the valuation was not correct. In addition, the burden of proof requires that the applicant can successfully argue that the SRB incurred a "manifest breach", despite the fact that the agency in accordance with the SRMS/BRRD holds a "wide discretion" in deciding whether a bank is FOLTF/ what resolution action to take. Therefore, it is a highly demanding standard of evidence that is required from the applicant. The same applies to applicants in damages actions before the Court of Justice and the General Court, in which they must also prove a "manifest breach", as well as a real and actual harm and a causal link.

Administrative claims (national level)

Request to stay the resolution decision: All applications to suspend the Banco Popular resolution decision have been rejected. The arguments provided by the National Court were that suspending the effects of enforcing the resolution decision issued by the FROB would entail suspending the effects of

[131] Pursuant to the Spanish regulations transposing Article 86 of BRRD, once an institution is under resolution, judges must reject any petition for ordinary insolvency proceedings filed in respect of such institution.

[132] It must be noted that those proceedings, that are still open, have been initiated against Banco Santander and not Banco Popular (Banco Popular does not have any links to the U.S. that may justify the opening of a discovery).

[133] Case T-2/19

[134] See Case T-2/19 para 47: That provision expressly refers to situations in which compensation (by an increase in the value of the claims or the payment of additional consideration) may be granted following an ex post definitive valuation. Such compensation applies only where the resolution scheme applied to the entity is either the bail-in tool under Article 27 of Regulation No 806/2014, the bridge institution tool under Article 25 of Regulation No 806/2014 or the asset separation tool under Article 26 of Regulation No 806/2014.

[135] Case T-2/19 para

the resolution decision itself, something which it has no authority to do (as this would be a European decision). From the reasons offered by the High Court for rejecting the requests to stay that had been filed, it appears to limit the right to challenge the Banco Popular resolution decision before the Spanish courts to the procedural/formal aspects of the resolution decision as the substantive aspects of the resolution decision are regulated by the European jurisdiction. Even though interim measures exist under EU law and were in principle available also in the case of Banco Popular, surprisingly, no single request to suspend the resolution was filed before the Court of Justice of the EU/General Court.

Civil claims (national level)

Rulings regarding the annulment of transactions based on errors in the consent of the parties and liability for allegedly inaccurate or incorrect information contained in the listing prospectus were not published at the time of writing.

Burden of proof: For the purposes of determining whether there was an error in the parties' consent when acquiring complex finance products, Spanish case law imposes the burden of proof on the entity. The entity needs to prove that it duly complied with applicable legal obligations, otherwise the court could consider that there is a rebuttable presumption of an error in the consent of the parties. To that end, several aspects are generally assessed by the court: (i) suitability of the product for the client's profile (based on documentation of previous investments made, the MiFid test executed,[136] etc.), (ii) information provided during the commercialization, (iii) specific documentation signed by the investors, and (iv) information available after the contracting process.

Liability of the acquirer: It should be noted that the civil liability of the acquirer of Banco Popular is being reviewed in the EU courts (Case C-410/20), as a result of a preliminary reference of interpretation raised by a Spanish court. In these proceedings the Court of Justice will have to determine if civil liability incurred by the resolved entity is entirely assumed by the acquirer under the EU resolution regime. This matter will not be resolved until late in the year 2022

Criminal claims (national level)

Criminal proceedings are still at a preliminary phase. The National Court has opened two separate "streams": (i) to investigate the share capital increase approved by Banco Popular in 2016 and, in particular crime related to false information in the financial statements used for the purposes of the share capital increase, and, (ii) a potential market abuse crime related to the share market price of Banco Popular's shares on the dates previous to the resolution date.

The acquirer is not liable for criminal liabilities: While rulings on substance are still ongoing, a higher Court clarified that Santander did not inherit any criminal liabilities[137] (which however has no effect on the question whether Santander remains liable on the civil side for any misselling committed by Popular; see above civil claims.)

[136] Markets in Financial Instruments Directive 2004/39/EC

[137] Ruling of 30 April 2019 of the Section 4 of the Criminal Room of the National Court (Case number 246/19).

9. PORTUGAL

9.1 Banco Internacional do Funchal (Banif)

Summary: As part of the resolution action taken in 2015, Banco International do Funchal, S.A. (Banif) was partly transferred to an asset management vehicle owned by the national resolution fund, part was transferred to a private acquirer (Santander) and the part left behind ("bad bank") was finally liquidated in 2018. Creditors and shareholders left behind ("indirect bail-in") started several litigations which are still ongoing. Regarding requests to give suspensive effect to claims against the resolution decision, the Court made reference to an overriding public interest expressed by the legislator's intention not to question the execution of resolution decisions (unless in exceptional cases). Based on an independent valuation assessing whether shareholders and creditors were treated differently under resolution than under the hypothetical liquidation counterfactual (NCWOL) which was undertaken in 2017, Bank of Portugal concluded in July 2020 that ordinary creditors might have been better off under liquidation and could have a right to compensation. At the time of writing this process was still ongoing.

Background: Banif had received state aid in 2013. After attempts to restructure or sell the bank without further state aid failed, the Bank of Portugal concluded that Banif was failing or likely to fail[138] and initiated the application of resolution measures on December 19, 2015.[139] The next day, December 20, 2015, the Bank of Portugal decided to apply two resolution measures: the asset separation tool combined with a partial sale of business.[140] The resolution resulted in: (i) the transfer of certain assets, liabilities, off-balance sheet items, and assets under management from Banif to the Oitante, an asset management vehicle initially known as Naviget, S.A. owned by the Portuguese Resolution Fund (at a transfer price of €746 million),[141] (ii) the transfer of certain assets, liabilities, off-balance sheet items, and assets under management from Banif to Banco Santander Totta, S.A. (Santander),[142] and (iii) the appointment of members of the board of directors and audit board of Banif (the part left behind - "Bad Bank") which continued operating until May 2018, when it was put into liquidation after the ECB withdrew the banking license.[143] Since then, Oitante has sold several assets to domestic and international investors.[144] Baker Tilly was appointed in November 2017 as an independent valuer to conduct the NCWOL assessment with the final report received in July 2020.[145] According to this valuation there was no difference in treatment for shareholders and subordinated creditors as they would have received zero under the hypothetical liquidation counterfactual. For ordinary creditors the recovery rate was estimated to be around 12.7% under hypothetical immediate liquidation (of the whole bank) while for the same common creditors that were left behind in Banif the estimated recovery resulting from the resolution (and following liquidation of the remaining part of Banif) is 0%.[146] As stated by Banco de Portugal in its notice, these creditors may have a right to compensation from the Portuguese Resolution Fund. It further stressed that for defining the exact amount of possible compensation, these creditors need to be formally recognized as part of Banif's liquidation process (which was still ongoing at the time of writing).

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[138] In basic terms, the grounds were the following: i) Imminence of having to return €1.1 billion of state aid granted by the Portuguese State in 2013 to recapitalize Banif, which would lead to a very serious violation of the own funds requirements (the European Commission raised many concerns regarding the several versions of the recapitalization plan and initiated an in-depth investigation to the aid measures at stake in July 2015). ii) Lack of liquidity and resorting to emergency liquidity assistance no longer an option and suspension of Banif as counterparty for eurosystem monetary policy operations. iii) No immediate and viable solutions to transfer the business of Banif to other credit institution (through private sale and without state aid) or to recapitalize Banif.

[139] I.e., before the bail-in tool under BRRD came into force and the SRB assumed its faculties.

[140] The resolution was subject to some adjustments and clarifications through the decision of the Bank of Portugal dated 4 January 2017.

[141] State aid case SA.43977 (2015/N) – Portugal Decision on the impaired asset measure in the resolution of Banif

[142] See State aid case SA.43977

[143] Shareholders and subordinated creditors were left in Banif, that became the "bad bank". On 22 May 2018, the European Central Bank notified Banif of its decision to withdraw Banif's license. On 4 July 2018, the Lisbon Commercial Court opened the liquidation proceedings of Banif. case no. 13511/18.2T8LSB, pending before «Juízo de Comércio de Lisboa – Juiz 5

[144] e.g. Açoreana Seguros was acquired by Apollo, Oitante's servicing platform was acquired by Altamira, etc.

[145] https://www.bportugal.pt/comunicado/comunicado-do-banco-de-portugal-sobre-conclusao-dos-trabalhos-de-avaliacao-independente-1

[146] ibid

MAIN PLEAS

Administrative, civil, and criminal actions have been filed. No claim has yet been assessed before the Portuguese Constitutional Court but several constitutional issues have been raised in judicial actions, thus the Portuguese Constitutional Court may have to decide on some aspects of the resolution.

In the administrative jurisdiction

Annulment of the resolution decision or damages: shareholders and subordinated creditors left in Banif sought annulment of the Bank of Portugal's resolution decision, and damages (as a separate claim or together with the annulment claim).

In the criminal jurisdiction

Actions were brought against former members of Banifs corporate bodies based on different grounds (fraud, embezzlement, breach of trust, etc.), mostly by the shareholders and subordinated creditors that were left in Banif.

In the civil jurisdiction

Misselling and errors in consent: Civil law action are mainly based on misselling and errors in consent in the purchasing contracts of several financial instruments (e.g. shares, bonds, etc.).

Media reporting leading to outflows: actions were taken against a Portuguese broadcasting channel that reported on December 13, 2015 that Banif was about to be resolved (ie 5 days before adoption of the formal FOLTF decision), which led to massive outflows of deposits (about €980 million) in the following days. These actions were mostly initiated by the shareholders and subordinated creditors left in Banif.

Santander engaged with some retail and subordinated creditors of Banif in order to find a solution for the partial recovery of their credits. Some creditors sought a solution similar to the one reached for some retail creditors of Banco Espírito Santo, S.A. following the latter's resolution, i.e. setting up a recovery fund (see below).

JUDGMENT AND COURT REASONING

In the administrative jurisdiction

No suspensive effect of the resolution decision: the administrative courts have not admitted the suspension of the effects of the challenged decision. For that purpose and in general terms, the courts argued that the public interest must prevail over the relevant private interests in the specific case at stake and that the latter will not suffer irreparable damages as a result of that prevalence.

In the criminal jurisdiction

[No ruling has been published at the time of writing].

In the civil jurisdiction

The part of Banif not transferred under resolution was finally put into liquidation in 2018. All claims (including those of the plaintiffs) had therefore to be lodged, and will be decided, in the liquidation proceedings. The individual civil lawsuits became "useless" and were closed without any decision being taken in their regard.

9.2 Banco Espirito Santo (BES)

Summary: Banco Espírito Santo, S.A. (BES) was split into a „good bridge bank" Novo Banco and a remaining "bad bank" by resolution decision of the Bank of Portugal in 2014. In November 2015, the Bank of Portugal approved the recapitalization of Novo Banco by transferring €1.9 billion senior debt back to BES which is under liquidation. Around 450 court cases were filed relating to the non-transferal of liabilities from BES to Novo Banco ("indirect bail-in") as well as regarding the transfer back to BES. Litigations are still ongoing at the time of writing. Regarding the retransfer decision, the Court justified the taking of resolution measures and the non-application of suspensive effect, arguing it was the appropriate means for the pursuit of the stability and security of the financial system, to prevent systemic risk and a run on deposits, and to protect values and constitutionally protected principles. The Court further stressed that the resolution action complied with the NCWOL principle and that affected creditors could not count on any other alternative: either resolution or liquidation.

Background: Early implementation of the BRRD was crucial to address issues arising in the Portuguese banking sector. The BRRD was fully implemented in Portugal by means of Decree-Laws which amended the Portuguese Banking Law by December 2015. Portugal had already implemented very similar mechanisms and principles in 2012 as an outcome of previous winding-up processes in the Portuguese banking sector, discussions with the Troika (EU, ECB, and International Monetary Fund), and assessment of the preliminary BRRD drafts. On August 3, 2014, the Bank of Portugal concluded that BES was FOLTF.[147] For the first time in Portugal, it was decided to apply a resolution measure to BES: the bridge bank resolution measure. This was one of the first cases of resolution after the enactment of the BRRD and under its terms. However, at that time, BRRD (which provided for four types of resolution measures) was only partially implemented in Portugal and the only resolution tools available were the transfer of business and the bridge bank (bail-in was not in force).

The resolution resulted in: (i) the incorporation of a bridge bank denominated Novo Banco, S.A. (Novo Banco);[148] (ii) the transfer of certain assets, liabilities, off-balance sheet items and assets under management from BES to Novo Banco with funding by the resolution fund plus public support;[149] and (iii) the appointment of members of the board of directors and audit board of the "bad bank" BES. No creditors were bailed-in although some creditors were left in BES ("indirect bail-in"). The parameters initially outlined in the resolution decision were subject to several adjustments and clarifications, namely through the decisions of the Bank of Portugal dated August 11, 2014, August 14, 2014, February 17, 2015, and December 29, 2015. The adjustment dated December 29, 2015 (the retransfer decision) resulted in the transfer of five senior bonds from Novo Banco back to BES and was the subject of wide media coverage and dozens of judicial proceedings.

On July 14, 2016, the Bank of Portugal announced that the European Central Bank had decided to withdraw BES' banking authorization, which triggered the liquidation process of the remaining part of BES. On July 21, 2016, the Commercial Court of Lisbon declared the commencement of BES' winding-up proceeding.

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[147] The grounds were the following: Serious violation of own funds requirements. At the time of resolution, BES' consolidated CET1 ratio was 5.1% and the individual CET1 ratio was 6.9%, thus below the 7% threshold set out by the Bank of Portugal for the CET1 ratio. Additionally, BES' consolidated T1 ratio was 5.1% and the individual T1 ratio was 6.9%, thus below the 7% threshold set out by the Bank of Portugal for the T1 ratio. The consolidated total capital ratio was 6.5% and the individual was 8.3%, thus the consolidated was below the 8% ratio set out by the Bank of Portugal for the total capital ratio.

- Lack of liquidity, resorting to emergency liquidity assistance was no longer an option and BES suspended as counterparty for eurosystem monetary policy operations.
- No immediate and viable solutions to transfer the business of BES to another credit institution (through private sale and without state aid) or to recapitalize BES.

[148] The grounds were the following: Serious violation of own funds requirements. At the time of resolution, BES' consolidated CET1 ratio was 5.1% and the individual CET1 ratio was 6.9%, thus below the 7% threshold set out by the Bank of Portugal for the CET1 ratio. Additionally, BES' consolidated T1 ratio was 5.1% and the individual T1 ratio was 6.9%, thus below the 7% threshold set out by the Bank of Portugal for the T1 ratio. The consolidated total capital ratio was 6.5% and the individual was 8.3%, thus the consolidated was below the 8% ratio set out by the Bank of Portugal for the total capital ratio.

[149] Novo Banco was recapitalized with €4.9 billion from the Resolution Fund with a €4.4 billion loan from the state; plus government guarantee for bonds issued by Novo Banco.

MAIN PLEAS

Civil and criminal actions have also been filed that are associated with the resolution but are mainly related to BES' practices, notably as a financial intermediary (e.g. misselling), and potential negligent or fraudulent management practices by directors of BES. These were mainly addressed at the domestic level as the resolution was applied by national authorities (the Single Resolution Mechanism had not entered into force at the time) and pursuant to the terms of the Portuguese Banking Law although there is litigation before the European General Court (not related to the resolution) seeking to annul the European Commission's decision to approve Portugal's state aid application. No claim has yet been assessed before the Portuguese Constitutional Court but several constitutional issues have been raised in the judicial actions, thus the Portuguese Constitutional Court may have to assess some aspects of the resolution.

In the administrative jurisdiction

Annulment of the resolution decision as well as with regard to the (December) retransfer decision have been filed against the Bank of Portugal, as have requests for damages (as a separate claim or together with the annulment claim).

In the civil jurisdiction

Misselling and errors in consent in the context of the commercialization of several financial instruments (e.g. shares, bonds, commercial paper, etc.).

Claims based on the retransfer decision from large international investors (e.g. PIMCO and Blackrock), which reacted both judicially and extra-judicially.

In the criminal jurisdiction

Based on different grounds (including fraud, embezzlement, corruption, breach of trust, forgery, etc.) litigations against some of the members of the corporate bodies of BES (not only former board members, but also former members of the management team).

JUDGMENT AND COURT REASONING

In the administrative jurisdiction

Requests to stay the resolution decision: Even though this mechanism has been used by the creditors of BES in relation to both the resolution and the retransfer decision, the administrative courts have not admitted the suspension of the effects of the challenged decision. For that purpose, and in general terms, the courts argued that the public interest must prevail over the relevant private interests in the specific case at stake and that the latter will not suffer irreparable damages as a result of that prevalence. It is worth noting that one creditor managed to briefly suspend the effects of the retransfer decision by requesting the preliminary declaration of a stay, but the court reversed its preliminary decision after a more detailed analysis of the stay request.[150]

Regarding the supremacy of public over private interest in the resolution measure, the reasoning followed by the Administrative Court was that the measure applied by the Bank of Portugal safe-

[150] Case number 959/16.6 BELSB of the Administrative Court of Lisbon ("Tribunal Administrativo de Círculo de Lisboa").

guarded the public interest – in particular, as regards the protection of the financial system – in the following aspects:

(i) it ensured the continuity of provision of essential financial services, which are understood as vital to citizens, businesses and to the economy in general, whose interruption would have a huge impact on the normal functioning of the economy and the overall well-being of society, since it would limit citizens and businesses access to their savings, preventing them from meeting their needs and complying with their contractual obligations;

(ii) it prevented a systemic risk, which was likely to have massive consequences for the internal market and the real economy;

(iii) additionally, it was able to safeguard the interests of taxpayers and protect the public purse, by avoiding the use of public funds to cover bank losses, bearing in mind that this is an entity operating "outside" the scope of public management; and

(iv) safeguarding depositors' confidence, which is a key condition for ensuring the proper functioning of the financial system, since the breakdown of such relationship of confidence can lead to serious financial imbalances and may affect other institutions operating in the financial system, for instance as a result of a potential "domino effect".

Therefore, and as a result of a proportionality assessment between the possible effects triggered by the different measures potentially applicable to BES, in particular the resolution measure and the liquidation measure, it was the Administrative Court's understanding that the private interest - embodied in the principle of private property protection - would have to be compressed in the face of the public interest as described above, which is ultimately supported by the argument that the resolution measure allowed for the centralization of losses mainly on stakeholders rather than citizens.

In the retransfer proceedings, the Court took into consideration the stability of the Portuguese financial and banking system, which would be gravely damaged by the suspension of the retransfer decision, as well as the need to comply with the deadline to sell Novo Banco, in order to reimburse the public money that had already been injected. The Court presented these facts as notorious and public (factos notório e do conhecimento público): "In view of the conflicting interests and the damages arising from the decision to provisionally decree the measure or its survey, as presented by the parties, it is understood that, in light of the criterion imposed by paragraph 2 of Article 120 of the Portuguese Administrative Courts Code, the weighting judgment is on the side of the interests invoked by the receiving entity Banco de Portugal, since the stability of the Portuguese financial and banking system is clearly superior, for the reasons explained above, to the eventual losses that the applicant may have, being the lifting of the provisional decree of the measure necessary in order to avoid the damages / losses stated to the interests pursued by Banco de Portugal, damages / losses which prove to be substantially superior to those that are expected to possibly exist with the lifting of the provisional decree in the applicant's sphere".

The Court further held that the resolution measure was carried out without compromising compliance with the NCWOL principle, i.e. the affected creditors did not suffer higher losses than they would have in a liquidation situation, which means there was no scenario of a possible breach of trust, because, in a banking crisis such as the one in question, they could not count on any other alternative: either resolution or liquidation.

Interference with pari passu treatment: Some investors have considered that the retransfer decision entailed discrimination between unsecured creditors (and in particular senior bondholders), since the Bank of Portugal transferred back to BES five series of senior bonds (amounting in aggregate to €2.1 billion) out of an universe of more than 50 in the overall amount of 13.4 billion that were transferred to Novo Banco and has not touched any other type of unsecured credit. According to the Bank of Portugal such discrimination occurred because "these are bonds (notes) which were originally issued by BES directly to qualified investors, under article 30.° of the Portuguese Securities Act, and not to retail investors, in addition to having been issued with denominations of 100,000 euros and therefore typically not targeting small investors, even in the secondary market" and justified the selective retransfer on the basis of public interest and financial stability. [No ruling has been published at the time of writing.][151]

In the civil jurisdiction

The Portuguese Government, the Bank of Portugal, Novo Banco, and BES entered into a memorandum of understanding aimed at creating a structure (a recovery fund) that would enable some retail creditors (claiming mis-selling of commercial paper) to recover part or the whole amount of their investments. In the meantime, the legal framework of the so-called recovery funds was discussed and approved in Portugal, facilitating this type of solution.[152] [No ruling has been published at the time of writing].

In the criminal jurisdiction

[No ruling has been published at the time of writing]

Cross border aspects: For the recognition of bank resolution decisions including bail-in decisions regarding the transfer of a loan granted by a Goldman Sachs-formed vehicle ("Oak") see above under UK case 2.2.

[151] To the best of our knowledge there was no assessment undertaken by the court on the NCWOL Valuation as this valuation was not challenged. On December 3, 2014, the Bank of Portugal issued a press release disclosing the results of the resolution valuation undertaken by an independent valuation. https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/combp20141204.pdf On July 6, 2016, the Bank of Portugal disclosed the executive summary of the assessment conducted by Deloitte on the treatment creditors would have received if BES had entered into normal liquidation on August 3, 2014 (rather than being resolved) so as to ensure compliance with the NCWOL principle . According to Deloitte, the hypothetical recovery rate for each class of claims would have been: (a) 100% for secured claims, (b) 100% for privileged claims, (c) 31.7% for unsecured/common claims, and (d) 0% for subordinated claims and also for capital holders.

[152] Law no. 69/2017, of August 11

10. ITALY

10.1 Crediveneto Bank[153]

Summary: The conduct of the Ministry of Economy and Finance (MEF) making a decision of liquidation or resolution based solely on the recommendation of the Bank of Italy (as resolution authority) without itself assessing the merits of the case was considered compliant with the law. There is no requirement for the authorities to request an independent valuation nor a need for prior notification before deciding to put a bank into liquidation as the default option, contrary to resolution (Note that under Italian liquidation procedure the failing bank was transferred to an acquiring bank out of the liquidation estate). The burden of proof that resolution would be "necessary and proportionate" and able to achieve public interest objectives to a greater degree than liquidation lies upon the claimants.

Background: Crediveneto was placed under liquidation due to serious losses. The Institutional Guarantee Fund of the Cooperative Banks had been keeping open a financing line to guarantee liquidity. After the bank was declared insolvent it was put into liquidation by decision of the MEF based on the Bank of Italy's proposal. The bank's assets and liabilities were then transferred out of the liquidation estate (managed by the Bank of Italy) to the acquirer Banca Sviluppo at €1. The Cooperative Credit Institutional Guarantee Fund intervened by purchasing non-performing loans and some other Crediveneto assets. The intervention ensured the protection of all creditors of the bank, including subordinated bondholders.[154]

MAIN PLEAS

Annulment of the liquidation decision: Claimants (all former administrators of Crediveneto) with the support of the Committee for the Protection of the Rights and Interest of Members of the BCC (cooperative credit bank)[155] requested annulment of Decree May 6, 2016, ordering liquidation of Crediveneto, against MEF and the Bank of Italy. The request for annulment was based on the following arguments:

- **Lack of autonomous motivation by MEF as the deciding authority:** According to the claimants the mere recall of the motivation of Bank of Italy by MEF represents a lack of proper verification of the Bank of Italy's proposal. Claimants' requested to ascertain whether MEF has a mere confirmative power of the Bank of Italy's proposal or if it can verify the merits and eventually invalidate the decision.
- **Misuse of power:** With the acquisition of Crediveneto by a transferee (Banca Sviluppo) the overall operation resembles more a resolution scheme than a liquidation procedure. Hence the liquidation would have been preventable. The claimant argue that the strategy used by liquidators is analogous to the restructuring measures planned by the Crediveneto administration board, namely the transfer to an acquirer according to a contract scheme already existent before the placement in liquidation.
- **Lack of an independent evaluation** justifying liquidation measures.

[153] Ruling TAR Lazio, May 31, 2017

[154] https://www.bancaditalia.it/compiti/risoluzione-gestione-crisi/fondi-risol-crisi/2016/comunicazione-130516/index.html

[155] See for example: https://www.europarl.europa.eu/doceo/document/PETI-CM-619059_EN.pdfl

- **Lack of due process/right of defense:** Since the decision of liquidation had not been promptly notified to the concerned parties, the latter could not effectively exercise their right to defense.

- **Misuse of state aid:** the transfer to Banca Sviluppo features state aid contrary to EU state aid rules.

JUDGMENT AND COURT'S ARGUMENTS

No lack of motivation by the MEF as the deciding authority: If the authority issuing the measure (MEF) is different from the technical evaluation authority (Bank of Italy), it is fully legitimate that MEF motivation shall make reference to the technical authority proposal, (even) without further elaborating on it. A screening of the motivation by MEF can also be expressed by merely invoking and aligning to the arguments of the Bank of Italy in its motivation.

No misuse of power opting for liquidation without verifying feasibility of resolution: Given the seriously deteriorated situation of Crediveneto,[156] which was also acknowledged by the bank administration board, there was no time to proceed with the resolution regime. Moreover, the claimants failed to demonstrate that resolution would be "necessary and proportionate" and able to achieve public interest objectives to a greater degree than liquidation.

No violation of due process rights: There is no duty of prior notification to the parties of a decision of liquidation. On the contrary, the discipline states that because of the peculiar nature of the banking activity and the objective of safeguarding savings, bypassing the principle of participation to the administrative proceedings is justified.[157]

No requirement for independent valuation: The assessment of an independent expertise is required for other crisis management procedures with the exclusion of liquidation. While the adoption of a resolution regime should evaluate the most proper strategies given the specific crisis circumstances as well as quantifying the contribution imposed on shareholders and creditors, thus requiring an independent assessment, liquidation is aimed at liquidating the assets of the insolvent entity and eventually dividing them among creditors according to insolvency schemes. This latter requires only an assessment by the Bank of Italy of the bank's state of insolvency.

No breach of EU state aid rules: The transfer of assets and liabilities to Banca Sviluppo can be seen as a transaction among private stakeholders. The transfer price was proportionate to the level of insolvency of Crediveneto, which was not only zero but likely negative thus requiring the intervention of the Institutional Guarantee Fund to absorb losses, the only circumstances in which Banca Sviluppo would agree to the transfer.

The application was therefore dismissed, and the conduct of the Bank of Italy has been ascertained to be fully legitimate.

[156] In advance of a planned meeting of the Crediveneto Administration Board meeting on May 8, 2016 the local media reported serious budgetary deterioration and that a 40% bank personnel cut would be announced.

[157] Article 7 Law 241/1990

10.2 Banca Popolare Valle d'Itria e Magna Grecia[158]

Summary: Bank shareholders challenged the decision of the Bank of Italy to put the bank into liquidation and transfer assets and liabilities to Bancapulia, arguing that the creation of a joint stock company would have allowed the preservation of shares' value. In its reasoning, the court stressed that the primary duty of the Bank of Italy is safeguarding financial stability not preserving the value of an investment. It further held that the Bank of Italy's acts [as supervisory and resolution authority] are subjected to sanctions only if affected by a manifest irrationality or a manifest error on the facts.

Background: Banca Popolare Valle d'Itria e Magna Grecia S.C. was founded in 2006. After only 3 years, in 2009, it had halved its assets due to bad management allowing lending to some local private companies without the necessary guarantees. The managers of the bank were held accountable for their wrongdoing and summoned at the end of 2017. The bank, already in extraordinary administration, had its bank license revoked by the MEF at the proposal of the Bank of Italy, placing it in liquidation per decree of October 26, 2010. The bank's assets and liabilities were transferred to BancApulia for the symbolic price of €1.

MAIN PLEAS

Annulment of the liquidation decision and the transfer decision: The claimants, all members of the bank's stock cooperative company, with the support of the Consumer Rights Protection Committee requested annulment of the liquidation order and questioned the legality of the transfer to BancApulia.

- **Lack of transparency:** The liquidation decision was challenged, arguing there was a lack of information about the Bank of Italy intervention that had led to the extraordinary administration;
- **Request for transformation into a joint stock company instead of liquidation:** Claimants argued that instead of liquidation, authorities should have opted for transformation to a joint stock company, thus preserving the nominal value of the shares.

JUDGMENT AND COURT'S REASONING

No violation of procedural rules/transparency: As to the lack of information on the extraordinary administration, the court judged that the related discipline was correctly interpreted and applied by the Bank of Italy. The discipline provides discretionary power to the commissioner, upon preliminary authorization by the Bank of Italy, to convene or not the assemblies of the bank's governing bodies and eventually notify the parties about possible determinations.

No obligation to apply alternative measures: The court affirmed that the claimants did not provide any concrete evidence that the transformation of the bank into a joint stock company would have been a viable alternative to the liquidation. Ultimately, as per the related discipline of preserving the

[158] Ruling TAR Lazio, May 7, 2014

value of the investment of bank members, this is not a task required of the Bank of Italy, its primary duty is safeguarding financial stability. Moreover, the claimants did not dispute the existence of circumstances that brought the bank to liquidation (irregularities, violations of law, serious losses). The final report of the extraordinary commissioners showed that attempts were made to find alternative solutions to liquidation but these did not prove successful. Assessment of the transfer of assets and liabilities by the Bank of Italy is one of the measures expressly provided by the law in case of forced liquidation of a bank, subject to sanction only if affected by a manifest irrationality or a manifest error on the facts. The complaint was therefore dismissed as ungrounded.

10.3 Banca Marche[159]

Summary: The court confirmed that actions by the Bank of Italy (as resolution authority) in the exercise of powers that involve a degree of discretion, can be sanctioned by the administrative judge only if affected by incompetence, violation of law, manifest irrationality, and/or abuse of power (so called "extrinsic" judicial review) and that it cannot replace the Bank of Italy technical assessment. The court also held that differences in the provisional and the final valuation are not unreasonable and that both share the conclusion that shareholders and subordinated creditors are not made worse-off by taking resolution action, while the claimant failed to prove that he would have been better-off under liquidation.

Background: Banca Marche was placed in interim management by the Bank of Italy on August 2013, then in extraordinary administration from October 2013 until October 2015 due to a state of serious distress. From 2011, shortcomings in the bank governance and excessive credit risks had been pointed out following Bank of Italy inspections which found that they were widely ignoring the principle of sound and prudent management. An urgent need for capital increase was addressed by a bond issuance subscribed by the claimant and other banks. During the extraordinary administration several actions (all inconclusive) were undertaken to face the lack of liquidity affecting the bank (recapitalization). In November 2015, after the BRRD had been transposed into Italian legislation, the Bank of Italy imposed a resolution regime for Banca Marche Bank (and 3 other banks, see below 8.3) via a transfer to a bridge bank (Nuova Banca Marche)[160] and subsequent transfer of non-performing assets to an asset management vehicle, both owned by the resolution fund. Apart from losses suffered by remaining equity and subordinated debt holders (being left behind in the entity to be liquidated), the operations have been financed through the intervention of the national resolution fund.[161]

MAIN PLEAS

Request for suspension and annulment of the resolution decision: The claimant (Fondazione Cassa di Risparmio di Jesi who had contributed to a capital injection of Banca Marche in 2013), requested the immediate suspension and annulment of all preliminary and subsequent acts and measures issued by the Bank of Italy in the framework of the resolution regime of Banca Marche. Annulment of the following acts, among others, was requested: Bank of Italy decision to dispose of the reserves and share capital reduction with extinction of administrative and creditor rights; bank sale to a bridge bank; adoption of Nuova Banca Marche statute by Bank of Italy; MEF liquidation decree of Banca Marche;

[159] Ruling TAR Lazi, October 4, 2016

[160] For details see: Merler, Silvia, Four Small Banks: Resolution via Bridge Bank and Asset Management Vehicle Tools to Avoid Full Bail-in in Lintner, Pamela / Lincoln, Johanna (eds.), Bank Resolution and 'Bail-in' in the EU: Selected Case Studies pre- and post-BRRD, World Bank (FinSAC), 2016, pgs.38-44. Degree of November 21, 2015 and confirmed by MEF decree on November 22, 2015.

[161] The resolution fund provided 1) a capital injection to (a) cover the negative equity of the bridge bank of €1,005 million and (b) recapitalize the bridge bank with a further amount of € 1,041 million resulting in a total capital contribution of €2,046 million; 2) a guarantee to support the transfer of impaired assets from the bridge bank to the asset management vehicle up to the amount of €916 million. The European Commission declared the resolution program compatible and compliant with EU state aid regime, C(2015) 8371 final: https://ec.europa.eu/competition/state_aid/cases/261428/261428_1951636_241_2.pdf

appointment of liquidators; independent expert's evaluation. The claimant challenged all the decisions and requested compensation for damages based on the following pleas:

- **Misapplication of law and abuse of power and erroneous proceeding,** in particular violation of proportionality principle; manifest irrationality; lack of preliminary inquiry; manifest injustice.
- **Constitutional illegitimacy of the resolution regime** as transposed in Italian legislation for violation of constitutional principles related to the interference with right of property as well as violation of BRRD.
- **Independent valuation on substance and process:** Upon receipt by the court of the independent assessment of the bank's assets and liabilities (valuation), the claimant presented further arguments against the assessment and the tendering process for the selection and appointment of the independent expert.

JUDGMENT AND COURT'S ARGUMENT

No unlawful exercise of discretionary powers: Though the matter under scrutiny relates to the application of a new normative discipline, the jurisprudence on the exercise of the Bank of Italy's powers has been to reaffirm the specific technical competence embedded in its supervisory actions and decisions which imply a degree of discretion that can be sanctioned by the administrative judge only if affected by incompetence, violation of law, manifest irrationality, and/or abuse of power. The administrative judge cannot overturn the Bank of Italy in its technical assessment.

As with other independent authorities, the scrutiny of the administrative judge is essentially aimed at affirming the reasonability and coherence of the administrative decision, facing a limit in the specific technical competence and the independence of the authority. In this case, the Bank of Italy operates as resolution authority with public interest goals that include the continuity of a bank's critical functions; safeguarding systemic stability; and minimizing the collective impact of bank failure. The Court did not challenge the Bank of Italy's assessment that liquidation of the bank would achieve these public interest objectives to the same degree. As indicated in the resolution decision, the Bank of Italy's actions ensured the continuity of the bank's critical functions, emissions of loans and mortgages, and the safeguarding of 3,000 jobs. It was also noted that attempts at recapitalization during the period of extraordinary administration were all inconclusive and that an envisaged intervention of the deposit guarantee fund was unsuccessful, as the European Commission declared this would not be compatible with state aid discipline.[162]

No errors in conducting the independent valuation: The Bank of Italy decision to take resolution action, was found to have been taken after having ascertained the bank's serious situation of deterioration. The claimants did not challenge this conclusion but argued that the losses were the consequence of the excessive devaluation of non-performing loans. However, the heavy losses had already been ascertained by the extraordinary commissioners prior to the provisional valuation in September 2015 carried out by the Bank of Italy, as resolution authority, which found that losses amounted to €923 million. The definitive assessment conducted by the independent expert brought this amount to

[162] See EC communication on Banca Tercas case of February 2015, followed by December 2015 decision, 2016/1208.

about €1,032 million and was not challenged by the Court. Nor was it judged unreasonable to impose resolution rather than liquidation that would have destroyed the bank's value. As to the provisional assessment carried out by the Bank of Italy, this was required for an early and urgent intervention. Both the provisional and definitive valuations found that shareholders and subordinated creditors were not made worse-off by taking resolution action, while the claimants failed to prove that they would have been better-off under liquidation. Furthermore, the state of insolvency of Banca Marche had also been acknowledged by sentence of an ordinary tribunal in March 2016.[163] The Court therefore considered the resolution decision taken by the Bank of Italy was not unreasonable and therefore not illegitimate.

No violation of constitutionally protected (property) rights: The court held that the resolution regime cannot be judged as violating constitutionally guaranteed principles, like protecting savings and property protection, as no expropriation has taken place. Shares and bonds have the prescribed function to cover bank losses and losses were not greater than they would have been under liquidation.

No violation of due process by having ex-post judicial control: As to the objection of constitutional illegitimacy of the resolution discipline in relation to an alleged lack of effective judicial protection, the Court recalled that according to the BRRD it is left to the national legislation to adopt an ex-ante and/or ex-post judicial check provided that, if ex-ante, the judicial screening has to be expeditious. Moreover, the intervention of an ordinary court ascertaining the bank state of insolvency constitutes another means of judicial safeguard.

The court dismissed all the claims as unfounded but, given the relative novelty of the matter, the expenses were compensated.

10.4 Banca Marche, Cassa di Risparmio Ferrara, Cassa di Risparmio Chieti, Popolare Etruria[164]

Summary: The Court dismissed all the claims from shareholders and bail-in junior bondholders and upheld the resolution action for the four banks. It found that the attribution of the resolution function to the same authority responsible for supervision does not undermine the independence of the authority and was in line with legal provisions. It further upheld the combination of resolution action for four banks and found the retroactive application of the resolution law (with regard to bail-in of instruments already in place before), to be justified by prevailing considerations of public interest.

Background: Successive inspections, carried-out by Bank of Italy between 2009 and 2012, found irregularities in the management of four small regional banks: Banca Marche, Cassa di Risparmio Ferrara, Cassa di Risparmio Chieti, and Popolare Etruria. The banks were all put under special administration; management replacement was requested in most cases and pecuniary sanctions totaling about €8.5 million were imposed on the banks' managers. The mismanagement of the four banks had repercussions on around 140,000 share and bondholders that saw the value of their investment drastically reduced. In 2015 – after entry into force of the BRRD but prior to the obligatory 8% bail-in for the use of the resolution fund - the four banks were put into resolution. For each of the banks a bridge bank was created while the "bad" assets were transferred into a joint asset management vehicle with support from the national resolution fund and loss absorption by shareholders and junior bondholders.[165]

[163] Ruling No. 22/2016 Tribunale di Ancona, second civil section.

[164] Ruling TAR Lazio October 4 and 18, 2016

[165] See for details: Merler, Silvia, Four Small Banks: Resolution via Bridge Bank and Asset Management Vehicle Tools to Avoid Full Bail-in; Lintner, Pamela / Lincoln, Johanna (eds.), Bank Resolution and 'Bail-in' in the EU: Selected Case Studies pre- and post-BRRD, World Bank (FinSAC): Washington/Vienna (2016), pgs.38-44.

MAIN PLEAS

Request for annulment of the resolution decision and compensation: Complaints were made by the Association of Consumers' Rights Safeguard and 249 individual complainants against the MEF, Bank of Italy, Ministry of Justice, Ministry of Economic Development, Council of Ministers Presidency/ Chairmanship, and the National Authority for Stock Exchange Market Vigilance (Consob), in order to obtain annulment of all preliminary and subsequent acts and measures issued by Bank of Italy in the framework of the resolution regime for these banks.

Request for compensation due to supervisory failures: Compensation is sought for damages due to wrongful or inefficient oversight carried out by Bank of Italy and Consob on the banks under resolution.

In addition to the objections already formulated for the previous case (Banca Marche, see above under 8.3), further objections were raised in relation to:

- **Illegitimate retroactive application** of resolution provisions as per Italian legislation transposing the BRRD.
- **Integration of the supervisory and the resolution function within one authority** (Bank of Italy); The merger of the above two functions in one entity would, according to the claimant, conflict with the principle of impartiality and sound management of the public administration as constitutionally expressed (Art. 97 Constitution).
- **Legitimacy of assuming a "one-size fits all" solution,** adopted by the Bank of Italy for all four banks; reflected in the absence of a specific evaluation and inquiry of the situation of each individual bank.

JUDGMENT AND COURT'S ARGUMENT

The court essentially confirmed the legal arguments already used for the previous ruling on Banca Marche (see case 8.3 above). As to the further objections raised by the complainants the court held:
No illegitimate empowering of the Bank of Italy with the supervisory and the resolution function: the court affirmed that the merging of supervision and resolution competences within the Bank of Italy was stipulated for (and allowed) by the national legislation transposing the BRRD as the functional and organizational separation of both functions is guaranteed in the internal institutional set-up by respective reporting lines ensuring the resolution authority's independence.

No procedural irregularities in partly combining resolution measures for all four banks: The inquiry aimed at assessing the state of instability and financial risk of the four banks was conducted by the Bank of Italy based on the concrete and specific situation of each bank as well as on the financial data and supervisory parameters of each bank.

No illegitimate retroactive application: The claim of retroactive application of the resolution law transposing the BRRD (with regard to bail-in of instruments already in place before), does not constitute a breach of the principle tempus regit actum since considerations of public interest prevail.
The complaint was dismissed as unfounded on the merits and the request for damages/ compensation declared null. Expenses would be compensated.