



EUROPEAN COMMISSION

Brussels, 22 December 2016
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TO THE PRESIDENT AND MEMBERS OF THE LATVIAN SUPREME COURT

DEPARTMENT OF CIVIL CASES PROCEEDINGS

Observations

Lodged by the European Commission as non-disputing party (*amicus curiae*), represented by [REDACTED], members of its Legal Service, acting as Agents with an address of service at the offices BERL [REDACTED] Rue de la Loi 200, B-1049 Brussels, Belgium, who consent to service by e-mail to:

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in **Case no C04433312 (PAC-0158/2016)**

concerning the appeal submitted by **AS Reverta** before the Department of Civil Cases of the Latvian Supreme Court against the judgment of the Chamber of Civil Cases in the abovementioned case, the other party to the case being [REDACTED]

1. In order to ensure the coherent application of EU State aid rules, in particular Articles 107 and 108 of the Treaty on the Functioning of the European Union ("TFEU"), the European Commission (the "Commission") has the honour of submitting the following observations as *amicus curiae* in the case before your Supreme Court.

1. PROCEDURE

2. Article 29(2) of Regulation 2015/1589 provides the following:¹

“Where the coherent application of Article 107(1) or Article 108 TFEU so requires, the Commission, acting on its own initiative, may submit written observations to the courts of the Member States that are responsible for applying the State aid rules. It may, with the permission of the court in question, also make oral observations.

The Commission shall inform the Member State concerned of its intention to submit observations before formally doing so.

For the exclusive purpose of preparing its observations, the Commission may request the relevant court of the Member State to transmit documents at the disposal of the court, necessary for the Commission's assessment of the matter.”

3. In accordance with Article 36(2) of Regulation 2015/1589, that regulation is binding in its entirety and directly applicable in all Member States. Therefore, the direct effect of the aforementioned Article 29(2) enables the Commission to submit its written observations in the matter before your Supreme Court.
4. In that context, on 10 October 2016, the Commission's services sent to your Supreme Court a letter requesting the transmission for available documents of the case. By letter dated 11 November 2016, your Supreme Court kindly transmitted to the Commission the relevant documents of the case.
5. In light of the above, the Commission informed your Supreme Court by email and registered letter dated 18 November of its decision to intervene and to submit

¹ Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, Official Journal of the European Union ("OJ") L 248, 24.9.2015, p. 9.

written observations as *amicus curiae* in the present case, in order to ensure the coherent application of EU State aid rules, in particular Articles 107 and 108 TFEU, which constitute rules of public order in the European Union.²

2. FACTUAL BACKGROUND

6. The Commission has been informed of the appeal pending before the Department of Civil Cases of your Supreme Court on matters of law against a judgment of the Chamber of Civil Cases of the Latvian Supreme Court of 13 June 2016 in case C04433312 (PAC-0158/2016). The appeal has been submitted by AS Reverta [hereinafter "Reverta"], formerly known as AS Parex banka [hereinafter "Parex"], while the other party to the proceedings [REDACTED].
7. The Commission understands that the case concerns the repayment claims of one of the family members of former shareholders of Parex. The judgment under appeal held that Reverta must repay to [REDACTED] [hereinafter the "plaintiff"] an amount of EUR 15 million, corresponding to a term deposit which forms part of the subordinated capital of Parex.
8. Parex was the second largest bank in Latvia in 2008 but underwent a series of substantial rescue measures in the context of the global financial crisis. On 15 September 2010 the Commission approved the restructuring plan which led to the split of Parex into: (i) a newly established bank named AS Citadele bank [hereinafter "Citadele"], a "good bank", taking over all core assets and some non-core assets, and (ii) a "bad bank" Parex, later renamed Reverta, which kept the remaining non-core and non-performing assets. The Commission's approval took place through a decision³ [hereinafter the "first Commission Decision"] addressed to the Republic of Latvia and adopted on the basis of Article 108(2) TFEU and Article 7(3) of Regulation 659/1999.⁴

² Judgment of the Court of Justice of the EU in Case C-126/97 *Eco Swiss* ECLI:EU:C:1999:269.

³ Commission Decision 2011/364/EU, OJ L 163, 23.6.2011, p. 28. For the Court's facilitation, the decision is attached as **Annex 1** to the present observations. [attach LV version of decision (available in OJ)].

⁴ Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27.3.1999, p. 1–9. Regulation 659/1999, which set out the procedural framework for Commission decisions in State aid cases, has now been replaced by Regulation 2015/1589 (cited in footnote 1 of the present observations). Many of the articles of those

9. On 1 October 2013 Latvia notified a request for a further amendment to the first Commission Decision. In the course of the assessment of the amendment request the Commission became aware that Latvia had granted State aid to Parex and Citadele over and beyond the aid measures approved by the Commission.
10. In a second decision⁵ dated 9 July 2014 [hereinafter the "second Commission Decision"], the Commission approved the abovementioned aid measures on the basis of commitments offered by the Latvian Republic, which included the application of adequate "burden sharing" to the shareholders and subordinated creditors, in line with the requirements of the Restructuring Communication.⁶ The second Commission Decision was also addressed to the Republic of Latvia and adopted on the basis of Article 108(2) TFEU and Article 7(3) of Regulation 659/1999.⁷
11. The requirement of "burden sharing" is analysed in section 3.1 of the present observations. At this stage, it is important to note that the burden sharing requirement is a fundamental prerequisite for the Commission to be able to declare compatible an aid measure in favour of a given bank. In the first and second Commission Decisions, the commitments of the Latvian Republic include two main obligations in respect of burden sharing:
- First, Latvia committed that there would be no payment of any interest, dividends or coupons on existing capital instruments and no exercise of any call rights in relation to any subordinated debtholders or shareholders other than the Latvian State until the State aid to Reverta and Citadele bank would have been repaid.
 - Second, Latvia committed that there would be no repayment of any outstanding debt (principal) to former majority shareholders of Parex

two Regulations have remained the same. Article 7(3) of Regulation 659/1999 corresponds to the identical Article 9(3) of Regulation 2015/1589.

⁵ Commission Decision (EU) 2015/162, OJ L 27, 03.02.2015, p. 12. For the Court's facilitation, the decision is attached as **Annex 2** to the present observations. [attach LV version of decision (available in OJ)]

⁶ Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9-20.

⁷ See footnote 4 of the present observations.

banka, their affiliates, and other creditors that had granted subordinated loans, unless and until all State aid to Reverta/Citadele would have been fully repaid.

12. However, in one of the ensuing litigation cases before national courts in Latvia, [REDACTED] a family member of a former shareholder of Parex, brought an action against Reverta seeking reimbursement of his term deposit in the amount of EUR 15 million, which had been bailed-in. The term deposit in question had a status of subordinated debt and hence was subject to burden sharing requirements pursuant to the commitments by the Latvian Republic, on which the first and the second Commission Decisions were based.
13. The plaintiff brought the action before the Riga District Court on 21 November 2012. From the information at hand, the Commission understands that the plaintiff argued that the conclusion of the donation agreement between him and his mother on 19 June 2008 equates to a novation of the term deposit agreement, which had been concluded on 12 May 2008 between the plaintiff's mother and Parex. In addition the plaintiff claimed that, following the withdrawal of the licence of Parex, the term deposit agreement was terminated, notably in light of the fact that the successor entity Reverta did not hold a licence and hence did not qualify as a credit institution. The Commission understands that on that basis the plaintiff requested the repayment of the term deposit. It appears that on 29 May 2013 the Riga District Court decided that the plaintiff should be reimbursed the term deposit.
14. Reverta submitted before the Chamber of Civil Cases of the Supreme Court of Latvia an appeal complaint against the above judgment of the Riga District Court. However, opposite to a previous judgment of the Latvian Constitutional Court which considered the bail-in of such term deposits lawful,⁸ the Civil Chamber of the Supreme Court decided on 13 June 2016 that the plaintiff should be reimbursed the term deposit. As a final means of redress, Reverta filed an appeal with the Civil Department of your Supreme Court, registered on 6 September 2016. The

⁸ Judgment of 13 October 2015 of the Constitutional Court of the Republic of Latvia in case nr. 2014-36-01 regarding the conformity of Section 8, paragraph one, of the Law on the control of aid to commercial activity with Section 105 of the Constitution of the Republic of Latvia.

Commission understands that your Supreme Court is the last instance court in this case.

3. LEGAL ASSESSMENT

15. With the present observations, the Commission analyses: *first*, the purpose underpinning the burden sharing requirements in its decisions on Parex; *second*, the legal consequences of the Latvian Republic not adhering to those commitments; and *third*, the recent case-law of the Court of Justice of the European Union [hereinafter "CJEU"] in respect of such burden sharing requirements.

3.1. The purpose of the burden sharing requirements in the two Commission Decisions

16. Burden sharing, which is also sometimes referred to as bail-in, means in essence that companies facing financial difficulties can benefit from State aid only if they have financially contributed to overcoming those difficulties as much as possible with their own resources, which includes also the investments made in those companies by their shareholders and by their subordinated creditors. This principle has also been incorporated in recent EU legislation on banking resolution and restructuring.⁹

17. The principle of burden sharing is a fundamental requirement of EU State aid rules. This is also reflected in various Communications that have been adopted since the beginning of the financial crisis in 2008, including the Restructuring Communication.¹⁰ The latter formed the main basis for the Commission's assessment of the compatibility of restructuring aid with the internal market (including burden sharing) in the first and second Commission Decisions. In that context, the Commission assessed whether the restructuring plan of the bank would restore its long-term viability and whether the burden sharing was sufficient.

⁹ See e.g. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, OJ L 173 of 12.6.2014, p. 190-347, Article 43; see also Karl-Philipp Wojcik, *Bail-in and the Banking Union*, (2016) 53 Common Market Law Review, Issue 1, pp. 91-138.

¹⁰ Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9–20 [hereinafter "Restructuring Communication"]. For the Court's facilitation, the Restructuring Communication is attached as **Annex 3** to the present observations. [attach LV version of Restructuring Communication]

18. The burden sharing requirement is analysed in Section 3 and in points 22-27 of the Restructuring Communication. Of particular interest for the present case are points 22, 24 and 26 of the Restructuring Communication, which state the following (emphasis added):

*"22. In order to limit distortions of competition and address moral hazard, aid should be limited to the minimum necessary and an appropriate own contribution to restructuring costs should be provided by the aid beneficiary. The bank and its capital holders should contribute to the restructuring **as much as possible** with their own resources. This is necessary to ensure that rescued banks bear **adequate responsibility** for the consequences of their past behaviour and to create **appropriate incentives** for their future behaviour."*

*"24. In order to limit the aid amount to the minimum necessary, banks should first use their own resources to finance restructuring. This may involve, for instance, the sale of assets. State support should be granted on terms which represent an adequate burden-sharing of the costs. This means that the costs associated with the restructuring are not only borne by the State but **also by those who invested in the bank**, by absorbing losses with available capital and by paying an adequate remuneration for State interventions.[...]"*

*"26. Banks should be able to remunerate capital, including in the form of dividends and coupons on outstanding subordinated debt, out of profits generated by their activities. However, banks should not use State aid to remunerate own funds (equity and subordinated debt) when those activities do not generate sufficient profits. Therefore, in a restructuring context, the discretionary offset of losses (for example by releasing reserves or reducing equity) by beneficiary banks in order to guarantee the **payment of dividends and coupons on outstanding subordinated debt**, is in principle **not compatible** with the objective of burden sharing. This may need to be balanced with ensuring the refinancing capability of the bank and the exit incentives. In the interests of promoting refinancing by the beneficiary bank, the Commission may favourably regard the payment of coupons on newly issued hybrid capital instruments with greater seniority over existing*

subordinated debt. In any case, banks should not normally be allowed to purchase their own shares during the restructuring phase."

19. Moreover, the Commission's original Banking Communication of 2008,¹¹ the subsequent prolongations¹² and, finally, the 2013 Banking Communication¹³ applicable from August 2013 (which was one of the Communications on which the second Commission Decision was based),¹⁴ have further detailed and strengthened the burden sharing requirements. The burden sharing requirement, together with several other requirements of the Restructuring Communication (such as the restoration of the long-term viability of the bank,¹⁵ measures to limit the distortion of competition caused by the aid¹⁶ and effective monitoring¹⁷) form the basis that allows the Commission to approve an aid measure in favour of a given bank as compatible. In line with the principle of equal treatment of Member States, it is in observance of those requirements that the Commission declared compatible the aid measures proposed by the Latvian Republic in the two decisions regarding Parex bank.

20. Specifically, in the first Commission Decision, the Latvian Republic offered the following commitment in respect of burden sharing:¹⁸

"Dividend and Coupon ban. Citadele banka, Parex banka and their affiliated undertakings shall not pay investors any dividends or coupons on

¹¹ Commission Communication on the application of the State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (2008 Banking Communication), OJ C 270, 25.10.2008, p. 8.

¹² Commission Communication on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (2010 Prolongation Communication), OJ C 329, 7.12.2010, p. 7; Commission Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (2011 Prolongation Communication), OJ C 356, 6.12.2011, p. 7.

¹³ Commission Communication 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, OJ C 216, 30.7.2013, p. 1 [hereinafter "2013 Banking Communication"].

¹⁴ See recital 113 of the second Commission Decision.

¹⁵ See section 2 of the Restructuring Communication.

¹⁶ See section 4 of the Restructuring Communication.

¹⁷ See section 5 of the Restructuring Communication.

¹⁸ See recital 88 of the first Commission Decision (emphasis added).

existing capital instruments (including preference shares, B shares, and upper and lower tier-2 instruments) or exercise any call rights in relation to the same, unless there is a legal obligation to do so. This commitment, however, does not apply to the capital held directly or indirectly by Latvia and capital held by Citadele banka and Parex banka in their affiliated undertakings."

21. As explained in the first Commission Decision, if no State aid was granted to Parex, holders of subordinated debt would not have been reimbursed by the bank, because in such a case the bank would have to be liquidated and the proceeds of such liquidation would not have been sufficient to reimburse those holders.¹⁹ The State aid should serve solely towards restoring the viability of Parex for the sake of the stability of the financial system, and it should not reverse the outcome of investment decisions made by the holders of subordinated debts when they invested in those instruments.
22. In the second Commission Decision, the Latvian Republic further clarified and strengthened its commitments in respect of the burden sharing requirement. Those commitments are described in Section 5.5.3 of the second Commission decision, which is entitled "*Commitment to enhance burden-sharing measures by preventing any cash outflows to Reverta's Legacy Subordinated Creditors*". In particular, the following commitments are provided:²⁰

"(70) Latvia acknowledges that enhanced burden-sharing measures are necessary to ensure the compatibility of the First, Second and Third Measures with the internal market. Such measures would ensure, inter alia, that no third parties unduly benefit from the additional State aid provided to Reverta and Citadele.

¹⁹ Specifically, recital 148 of the first Commission Decision explained that: "*Additionally, subordinated loans by legacy shareholders will be junior liabilities in Parex banka. The liquidation of the assets of Parex banka in the base case scenario does not envisage that sufficient proceeds will be received to cover more than senior liabilities in the bank. As subordinated loans mature in the period 2015-2018 and the State would only support the capital of Parex banka [...], while at the same time it receives adequate remuneration for the State deposits, the subordinated debt holders are likely to bear losses on the capital they invested [...].*"

²⁰ See recitals 70-73 of the second Commission Decision (emphasis added).

(71) For that purpose Latvia commits to enhance previous burden-sharing commitments by bailing-in the former majority shareholders of Parex banka, their affiliates, and other creditors (the 'Legacy Subordinated Creditors') that had granted subordinated loans (the 'Legacy Subordinated Loans').

(72) Reverta has exceeded the liquidity amounts authorized by the Final Parex Decision in part due to the payment of interest on the Legacy Subordinated Loans. Had Reverta not paid such interest or had the Legacy Subordinated Loans been written down immediately following the Parex Final Decision, Latvia might not have had to implement the First, Second and Third Measures to the extent they were actually undertaken.

(73) In light of the foregoing, Latvia offers to clarify and strengthen its commitments as regards the principal and interest due in respect of the Legacy Subordinated Loans as follows:

(a) Citadele and Reverta (formerly Parex banka) as well as their affiliated undertakings shall not pay any interest, dividends or coupons on existing capital instruments (including preference shares, B shares, and upper and lower tier-2 instruments) (either due or accrued) or exercise any call rights in relation to the same, to any **subordinated debtholders or shareholders**, who are not strictly the Latvian State or the EBRD, until and unless the State aid to Reverta and/or Citadele has been fully repaid and unless there is a legal obligation to do so. To the extent such legal obligations exist, Latvia undertakes to remove them as soon as possible (and in any event by 30 April 2015 at the latest).

(b) Latvia also commits not to repay any outstanding debt (principal) of the Legacy **Subordinated Loans** (unless and until all State aid to Reverta/Citadele is fully repaid), which will be either:

- i. subject to a binding order that no payments under the Legacy Subordinated Loans shall become due and payable; or
- ii. converted into non-voting Tier 1 capital; or
- iii. written down;

to the extent necessary to cover the negative net asset value of Reverta, and provided a legal base is available.

c) Latvia will undertake all necessary measures to ensure that any legal provisions needed to comply with the commitments above are put in place by 30 April 2015 at the latest."

23. In recitals 163-167 of the second Commission Decision, the Commission was based on the above commitments by Latvia, in order to declare the aid measures compatible with the internal market. Specifically:

"(163) Section 3 of the Restructuring Communication provides that banks and their stakeholders should contribute to the restructuring costs as much as possible in order to limit the aid to the minimum, address distortions of competition and moral hazard issues.

(164) In that respect, the Commission takes note of the additional compensatory measures proposed by Latvia to ensure that third parties will not benefit from the additional aid amount received by Reverta, namely the commitment on strengthened burden-sharing arrangements described in recitals 70 to 73.

(165) Latvia commits that Citadele and Reverta (formerly Parex banka), as well as their affiliated undertakings, will not pay any interest, dividends or coupons on existing capital instruments (including preference shares, B shares, and upper and lower tier-2 instruments) (either due or accrued) or exercise any call rights in relation to the same, to any subordinated debtholders or shareholders other than the Latvian State or the EBRD, until and unless the State aid to Reverta and/or Citadele has been fully repaid and unless there is a legal obligation to do so. In that respect Latvia also commits to remove any such legal obligations as soon as possible and by 30 April 2015 at the latest. As a result, holders of existing capital instruments will not receive any payment, since those existing capital instruments do not carry a mandatory coupon and in the course of liquidation of Reverta (which will take place by the end of 2017) they rank after senior debt. Because Reverta has a negative capital, it will be impossible in practical

terms for the holders of those capital instruments to receive any payment or reimbursement.

(166) Moreover, in addition to the commitments referred to in recital 165, Latvia also commits not to repay any outstanding debt (principal) of the Legacy Subordinated Loans unless and until all State aid to Reverta/Citadele is fully repaid, to the extent necessary to cover the negative net asset value of Reverta and provided a legal base is available. For that purpose the outstanding debt (principal) of the Legacy Subordinated Loans will be either: (i) subject to a binding order that no payments under the Legacy Subordinated Loans shall become due and payable; or (ii) converted into non-voting Tier 1 capital; or (iii) written down. In that respect, considering that national law currently does not provide an appropriate legal base allowing for compliance with that commitment, Latvia further commits to undertake all necessary measures to ensure that any legal provisions needed to comply with that commitment are put in place by 30 April 2015 at the latest.

(167) The Commission welcomes the commitments of Latvia referred to in recitals 165 and 166 as, by aiming at limiting payments of principal and interest due in respect of the Legacy Subordinated Loans and capital instruments of Reverta and Citadele, they provide additional burden-sharing."

24. It follows from the above that the burden sharing obligations in the first and second Commission Decisions aim at ensuring that shareholders and subordinated creditors of Parex contribute to the restoration of the bank's viability. This is logical given that, without State aid, the bank would have been liquidated and those shareholders and subordinated creditors would not have received the value of their investments. In fact, those shareholders and subordinated creditors would not have received anything in case of liquidation, and thus their claims are not treated less favourably than if no aid had been granted. Hence the long held "no creditor worse off" principle was respected.²¹

²¹ According to the "no creditor worse off" principle, no creditor or shareholder shall incur greater losses than they would have incurred if the financial institution had been wound up under normal insolvency proceedings (i.e. without public support).

25. Moreover, if subordinated creditors were reimbursed, the difference still needed for the restoration of the bank's viability would have to be paid by additional State aid, i.e. additional money by the taxpayers. Accordingly, the reimbursement of those investors by the State takes away the commercial risk inherent to such investment decisions, and thus introduces "moral hazard". Moral hazard refers to the situation where an investor lacks the incentive to guard against risk because he/she is protected from its consequences. As a result, such investors would tend to assume increasingly excessive risks because they would eventually not have to bear the inherent commercial risk of their investment decisions. The lessons drawn from the 2008 global financial crisis have strengthened the case for reinforced burden sharing requirements on both the international and the EU level, hence these form a fundamental principle underpinning the Commission's approval decisions.

26. It is in accordance with the abovementioned considerations that, in the case at hand, the first and second Commission Decisions required that holders of subordinated debt (who would have received nothing in a liquidation scenario)²² should not be reimbursed. Since the plaintiff's term deposit had a status of subordinated debt, it follows that he has to fully bear the consequences of the commercial risk inherent in his decision to invest in such an instrument.

27. For the above reasons, the first and second Commission Decisions faithfully applied the Restructuring Communication and included the fundamental requirement that holders of subordinated debt, such as the plaintiff, should be neither reimbursed nor receive any other kind of remuneration (e.g. interest) on their term deposits.

3.2. The legal consequence of the Latvian Republic not adhering to the burden sharing requirements in the two Commission Decisions

28. Pursuant to Article 288 paragraph 4 TFEU, since the first and second Commission Decisions are addressed to the Republic of Latvia, they are binding in their entirety on the Republic of Latvia.

29. The CJEU has already ruled on the legal value of commitments by Member States in Commission decisions that conclude a State aid investigation on the basis of

²² See paragraph 24 of the present observations.

Article 7(3) of Regulation 659/1999, such as the first and second Commission Decisions in the case at hand.²³ In case *Iglesias Gutiérrez*, the CJEU has made clear that the Commission's "authorisation to put the aid into effect is valid only to the extent that proper regard is had to all the matters which the Commission has taken into consideration in its assessment of the compatibility of the measure concerned". In particular, "where the notified measure incorporates, upon a proposal from the Member State concerned, commitments to which that State has agreed, those commitments must be held also to form an integral part of the measure that has been authorised".²⁴

30. The CJEU also stressed that the "Member State concerned (which, under Article 25 of Regulation No 659/1999, is the addressee of the decision) must make sure that it will be able to fulfil the commitments included in the authorisation. In that respect, it is responsible, *inter alia*, for satisfying itself that those commitments are consistent with its national law and for determining, if need be, whether it is appropriate to initiate, in accordance with its constitutional procedures, a process for amending that law."²⁵

31. In the present case, the Commission understands from the evidence available that the Latvian Republic introduced the necessary legislation that would ensure fulfilment of the burden sharing requirements of the first and second Commission Decisions. That legislation appears to be Section 8, paragraph one, of the Law on the Control of Aid to Commercial Activity, which came into effect on 1 July 2014 and which would ensure that Reverta does neither reimburse nor remunerate any holders of subordinated debt, such as the plaintiff.

32. Nevertheless, implementation of the Civil Chamber's judgment currently under appeal would result in payments being made by Reverta to a subordinated creditor of Parex. This would breach the abovementioned burden sharing requirements on which the Commission's approval decisions were based in 2010 and 2014.

²³ See paragraphs 8 and 10 of the present observations.

²⁴ Judgment of the Court of Justice of the EU in Case C-352/14 *Iglesias Gutiérrez* ECLI:EU:C:2015:691, paras 27-28.

²⁵ Judgment of the Court of Justice of the EU in Case C-352/14 *Iglesias Gutiérrez* ECLI:EU:C:2015:691, para. 29.

33. As stipulated also in the case-law of the CJEU,²⁶ such a breach of the burden sharing commitments undertaken by the Latvian Republic would mean that the aid measures would no longer be covered by the authorisation of the first and second Commission Decisions. Therefore, in such a case, the amounts approved as compatible aid to the beneficiary banks would have to be recovered by Latvia. A non-remedied breach of the burden sharing requirements could eventually oblige the Commission to adopt a negative decision in respect of the aid measures that were previously considered compatible on the basis of the first and second Commission Decisions.

3.3. The recent case-law of the CJEU confirms the lawfulness of the burden sharing requirements

34. The lawfulness of burden sharing requirements such as those included in the first and second Commission Decisions has recently been confirmed by the CJEU in the *Kotnik* judgment.²⁷ In that judgment, the CJEU confirmed the validity of the, even tighter, burden sharing requirements of the 2013 Banking Communication,²⁸ and thus *a fortiori* the validity of those of the (2009) Restructuring Communication.

35. In its relevant findings the CJEU clearly identified that: "[w]hen reviewing the compatibility of State aid measures with the internal market, the Commission could take the view that [...] burden-sharing measures were essential in order that State aid in the banking sector should be limited to the minimum necessary and that any distortions of competition in the internal market should be limited."²⁹

36. The CJEU explained further that burden sharing measures prevent recourse to State aid merely as a tool to overcome the financial difficulties of the banks concerned.³⁰ Moreover, burden sharing measures ensure that banks with a capital shortfall take steps, with their investors, to reduce that shortfall, in particular by raising equity

²⁶ Judgment of the Court of Justice of the EU in Case C-667/13 *Banco Privado Português* ECLI:EU:C:2015:151, paras 71-72.

²⁷ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570.

²⁸ See points 40-46 of the Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), OJ C 216, 30.7.2013, p. 1-15.

²⁹ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, para. 54.

³⁰ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, para. 55.

capital and by obtaining a contribution from subordinated creditors, since such measures are likely to limit the amount of the State aid granted.³¹ To act otherwise would be liable to cause distortions of competition, since banks whose shareholders and subordinated creditors had not contributed to the reduction of the capital shortfall would receive State aid of an amount greater than that which would have been sufficient to overcome the residual capital shortfall. In those circumstances, such aid would not, as a general rule, be compatible with EU law.³²

37. The CJEU also stressed that burden sharing requirements are essential in overcoming the problem of ‘moral hazard’, which is linked to the fact that individuals are inclined to engage in risk-taking when the possible negative consequences of so doing are borne by the community as a whole. Therefore, banks must not be encouraged by the possibility of obtaining State aid to have recourse to financial instruments that carry greater risk and are more likely to cause significant losses, the effect of which would be to create serious distortions of competition and to jeopardise the integrity of the internal market.³³

38. Finally, the CJEU concluded that the inclusion of burden sharing requirements in the Commission's State aid decisions is in line both with the principle of legitimate expectations and with the right to property.³⁴

4. CONCLUSION

39. For the above reasons, the Commission respectfully submits that the burden sharing requirements included in the first and second Commission Decisions are fully in line with EU law and justified by imperative public policy considerations applied equally to all Member States. As a matter of EU law, the continued compatibility of the State aids granted to Parex depends on the fulfilment of the burden sharing requirements (as enacted into the two authorisation decisions) by the Republic of Latvia.

³¹ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, para. 56.

³² Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, para. 57.

³³ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, para. 58.

³⁴ Judgment of the Court of Justice of the EU in Case C-526/14 *Kotnik* ECLI:EU:C:2016:570, paras 61-80.

40. The Commission stands ready to provide any further clarification to your Supreme Court and to take part, if necessary, in an eventual oral hearing before your Supreme Court.

[REDACTED]

[REDACTED]

[REDACTED]

Agents for the Commission