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Case study

Litigating European Union Law

ADVANCED TRAINING FOR LAWYERS IN PRIVATE PRACTICE

By
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Banka Universia (“BU”) is a significant credit institution subject to the prudential supervision of the European Central Bank (“ECB”). BU is established in Coreliana, a Member State of the EU. BU’s Chief Executive Officer is J. Guppa, a renowned economist with more than thirty years of experience in the banking sector.

In the context of its supervisory activities, the ECB informed BU on December 2020, in a letter addressed to Mr. Guppa, of the decision of the supervisory board to undergo an onsite inspection to review the implementation and enforcement of cybersecurity measures in BU. As is known, BU is considered to be an essential infrastructure pursuant to Annex II of Directive (EU) 2016/1148 of the European Parliament and of the Council of 6 July 2016 concerning measures for a high common level of security of network and information systems across the Union. Furthermore, among the ECB’s supervisory priorities for 2021, cybersecurity risks are a main target of the ECB’s supervisory goals, in order to ensure that credit institutions are well shielded from potential attacks.

On 5 February 2021 a team of ECB staff, headed by the director of the on-site inspection, Mr. Collfu, arrived at Coreliana and met with BU staff in a kick-off meeting that took place in the premises of BU. Among other organizational matters, Mr. Collfu informed Mr. Guppa orally of the ECB’s concerns about cybersecurity risks, but also, more generally, IT systems, data management and data protection compliance. Mr. Guppa and the Director General of IT expressed their surprise to Mr. Collfu about the broad scope of the inspection, referring to the fact that the initial letter of the ECB informing of the inspection only referred to cybersecurity risks. Mr. Collfu replied that the notion of cybersecurity has to be interpreted in a broad sense and thus it should include any risks derived from IT management and potential derivative regulatory breaches. In the course of the kick-off meeting, BU accepted the time-line proposed by the ECB, which included on-site work by ECB staff in the course of the upcoming two months. ECB staff were to have access to all relevant information at their request.

That evening, BU received through its official email account for communications with the ECB a Decision, signed by Mr. Collfu, informing BU of the start of the on-site inspection on cybersecurity risks. The Decision also specified the time line, the scope of the investigations and added that the ECB “will take all the appropriate measures to ensure BU’s full compliance with regulatory standards and best practices”.

In the course of the on-site inspection, ECB staff accessed BU’s IT systems and underwent an intense analysis of past practice and systems management. While reviewing the functioning of email security, ECB staff had access to several emails in which the expression “ECB supervision – highly sensitive – security” was highlighted. When the ECB staff reviewed the content of these emails, they found eight messages in which the head of the legal service and secretary general of the Board of BU exchanged views with the director of risks, on the reappointment of Mr. Guppa as CEO of the bank. The subject of the correspondence was Mr. Guppa’s conviction for tax fraud and money laundering in February 2019 in a criminal court in Fraudalia, a neighboring country that is not a member of the EU. The emails confirm the bank’s concerns about Mr. Guppa’s ability to receive ECB authorization of his reappointment in 2020. As a result of the exchanges, both staff members decided that the best course of action was not to disclose this information when applying for authorization of Mr. Guppa’s reappointment. In one of the last emails in the exchange, the director of the legal service adds:

“We keep it secret, we don’t say a word to the bureaucrats in Frankfurt and the boss stays in his place. And so do we, my friend. If we lose him, you know that you and I are going out the door next”.

On 20 May 2021, the ECB forwarded to BU a draft inspection report. In its content, the report detailed the main findings of the inspection, enumerating an exhaustive list of areas of improvement on cybersecurity and IT systems. In its conclusions, the report adds that, in the course of the investigations, the on-site inspections team gathered other relevant information of concern in light of BU’s supervisory obligations.

On 28 May 2021 a closing meeting took place, this time in the premises of the ECB in Frankfurt. Once Mr. Collfu finished enumerating the cybersecurity concerns and heard BU staff’s observations on the matter, he pointed out to the email correspondence concerning Mr. Guppa’s conviction in Fraudalia. Considering the gravity of the findings, Mr Collfu informed BU that the emails had been forwarded to the Joint Supervisory Team in charge of BU, with the aim that it acted and, if necessary, report the facts to the ECB’s sanctions unit.

Mr. Guppa, visibly distressed, informed the ECB staff that the conviction had been quashed on appeal in late 2020, that he was innocent of any wrongdoing and that the investigations opened in Fraudalia were politically motivated by a prosecutor who was now ousted, following elections in that country in mid-2019. Mr. Collfu added that he was relieved to know that, but nevertheless the information had not been reported at the relevant time, in the course of Mr. Guppa’s reappointment. Mr. Collfu also pointed

out to the email in which BU staff decided to elude all reference to these facts to the ECB, showing inappropriate corporate conduct and a clear and obvious willingness to circumvent the supervisor's prudential tasks.

Shortly after the meeting, BU was informed by letter of 15 June 2021 of the Joint Supervisory Team's decision to forward the relevant information, including the email correspondence on Mr. Guppa's conviction, to the ECB's sanctions unit.

On 1 September 2021 the ECB's sanctions unit referred a statement of objections to BU, informing of its decision to open a sanctions procedure in light of relevant supervisory facts, as revealed in the course of the 2021 on-site inspection. According to the ECB's sanctions unit, the revealed facts amounted to a breach of Art. 94 of the Framework Regulation¹, with several aggravated circumstances, including the conscious and aware intention of high-ranking UB staff to hide relevant information from the supervisory authorities, as well as the seriousness of the criminal offences for which Mr. Guppa was trialed and convicted. The statement of objections makes no reference to Mr. Guppa's eventual acquittal in 2020.

On 5 September 2021, the ECB forwarded UB the final version of the inspection report, following the closing meeting that took place on 28 May 2021 and the written observations submitted by UB. The inspection report insists in its concluding section on the relevance of the correspondence disclosed and the serious gravity of the offences that such correspondence could entail. Once again, no reference is made to Mr. Guppa's acquittal in 2020, despite the fact that, in BU's written observations, the bank had provided the ECB all the relevant documents confirming Mr. Guppa's acquittal of all charges in Fraudalia's courts.

On 20 September 2021 BU was served a Decision of the ECB, enacted by the Supervisory Board and dated 18 September 2021, enumerating the supervisory measures that BU was to introduce following the on-site inspection on cybersecurity risks. On the same day, the ECB's Supervisory Board issued a Recommendation requesting BU to take all necessary measures to prevent corporate governance malpractice, including the introduction of robust reporting systems on criminal investigations of management. In point 23 of the Recommendation, the ECB states:

"It is requested of UB that it takes all necessary measures regarding the events of February 2019 in Fraudalia and UB's management of the situation. In particular, UB should implement all necessary measures, including termination of contracts with management, to ensure that precedents of serious supervisory breaches do not take place in the future."

On 27 September 2021 the Central Bank of Coreliana, entrusted with banking supervisory tasks, issued an order to BU instructing its Board to undertake all measures to withdraw its decision of reappointment of Mr. Guppa in 2020. According to the

¹ Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation)

Central Bank, in light of the information referred to it by the ECB following an on-site inspection, there is irrefutable evidence proving that BU committed serious unlawful acts with the aim of eluding reporting obligations in the course of the reappointment of Mr. Guppa's reappointment as CEO. The order has its legal base on Coreliana's Banking Law of 2016 and it is effective as of 1 January 2022, date in which BU shall have taken all the necessary corporate measures to undertake the removal of Mr. Guppa.

Questions

1. What is the challengeable act in case BU wishes to bring an action against the measures imposed resulting from the on-site inspection?
2. Could any of the measures of the ECB be challenged in national courts? If so, under what conditions?
3. In the case of the measures addressed to terminate the contract of staff, does BU have standing to bring such an action, or is it restricted to the employees only?
4. Can BU request interim measures?
5. In the case of the ECB's Decision and Recommendation, what grounds of annulment could BU invoke in its support?
6. Can the ECB make use of an on-site inspection with a specific subject-matter to investigate regulatory breaches of a different subject-matter? How does this issue affect BU's actions in court?

Answers

1. What is the challengeable act in case BU wishes to bring an action against the measures imposed resulting from the on-site inspection?

The issue of on-site inspections of the ECB is a novel area of practice, but it concerns the traditional notion of “preparatory acts”, which, in principle, cannot be challengeable in a direct action. An on-site inspection is an investigative measure which might ensue in binding decisions at an ulterior stage. Therefore, challenges should be brought directly against the final measures imposed on the undertaking. The only cases in which the Court of Justice has allowed exceptions to this principle, is when the preparatory measure raises an essential procedural issue that may not be remedied when challenging the final act.²

It will be up to the applicants to argue whether the on-site inspection, both at the preliminary stage when is notified to BU, but also when the inspection report is issued, is a preparatory act that raises an essential procedural issue. This matter is currently open to discussion because the Court of Justice has not ruled on the legal effects of ECB on-site inspections.

It will be difficult to argue that the letter informing BU of the on-site inspection, or the final inspection report, is a challengeable act. This can be clearly seen from the fact that, as a result of the on-site inspection, several ECB and national acts were introduced. Therefore, actions should be brought against these final acts and not the acts on which the on-site inspection was based.

However, it could be argued by the applicants that the question of the scope of the on-site inspection is an essential substantive issue that must be dealt prior to the inspection. Although Regulation 468/2014³ does not specify that on-site inspections must have a predefined scope, the case-law of the Court of Justice in field of competition has raised the importance of a clear scope in order to ensure the procedural guarantees of the undertaking. Therefore, it could be argued that for the specific purposes of challenging the scope of the on-site inspection, and thus to avoid ulterior errors of law in the final decisions that might ensue from the on-site inspection, these preparatory acts could be directly challengeable in an action of annulment.

Finally, in the case of the Recommendation, the Court of Justice has stated it is not sufficient that an institution adopts a recommendation which allegedly disregards certain principles or procedural rules in order for that recommendation to be amenable to an action for annulment, although it does not produce binding legal effects.

² Judgment in Joined Cases 23/63, 24/63 and 52/63 *Usines Emile Henricot and Others v High Authority* ([1963] ECR 217).

³ Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17).

“However, in exceptional cases, the impossibility of bringing an action for annulment against a recommendation does not apply if the contested act, by reason of its content, does not constitute a genuine recommendation.

In that regard, during the analysis of the content of the contested act with a view to determining whether that act produces binding legal effects, account must be taken of the fact that, as was noted in paragraph 25 above, recommendations are, in accordance with Article 263 TFEU, excluded from the scope of that provision and that, pursuant to the fifth paragraph of Article 288 TFEU, they have no binding force”.⁴

In other words, the Recommendation has to be a covert binding act, a matter that must be analysed in light of the wording and context of the act. In this particular case, the language is imperative and it leaves no doubt as to the aims of the measure: “it is requested”, “UB should implement”, a wording that leaves no margin of discretion to UB, particularly when the instruction is coming from its prudential supervisor. Therefore, the applicants can argue that the Recommendation, in light of the case-law of the Court, is in fact a binding act and therefore challengeable under Art. 263 TFEU.

2. Could any of the measures of the ECB be challenged in national courts? If so, under what conditions?

In principle, any EU act can be challenged in national courts by way of a preliminary reference of validity. However, it is necessary for these EU acts to be implemented in the Member State, therefore it will always be an indirect challenge of validity, channeled through an action against a national implementing act. In addition, an applicant must prove that it did not have standing to bring a direct action against the EU act in procedures before the Union courts. This is the result of the TWD case-law,⁵ which requires that an applicant makes use of the preliminary reference of validity only to indirectly challenge EU acts that he or she did not have standing to challenge within the prescribed time-limit.

The Court of Justice has recently confirmed this line of case law in the field of the Banking Union in the case of Iccrea Banca,⁶ in which it stated that EU acts that can be directly challenged before Union courts by applicants with standing to bring such action, are precluded from requesting review through a preliminary reference of validity.

3. In the case of the measures addressed to terminate the contract of staff, does BU have standing to bring such an action, or is it restricted to the employees only?

⁴ Judgment of 20 February 2018, Belgium/Commission (C-16/16 P, EU :C:2018:79, paragraphs 29 and 30).

⁵ Judgment of 9 March 1994, TWD Textilwerke Deggendorf (C-188/92, EU:C:1994:90).

⁶ Judgment of 3 December 2019 (Iccrea Banca, C-414/18, EU:C:2019:1036).

In the case the Recommendation instructing the termination of contracts of staff, the question of standing is only relevant if the Court decides that the Recommendation is a binding measure and therefore a challengeable act. Having resolved that point, the question of standing must be scrutinized in light of Article 263, paragraph four TFEU.

In the case of individual acts with an addressee, it is clear in the case-law that the addressee has standing to bring an action, as long as it has an interest to bring an action (its legal position will improve in case of a successful action). Therefore, BU will have standing to bring an action against the Recommendation. A different matter is whether the employees concerned have standing in this case, since they are not individualized in the Recommendation, although it is obvious that the act is referring to the head of the legal service and the director of risk. In this case, applicants should rely on the case-law that refers to standing against direct actions brought by applicants with an individual and direct concern. The second requirement (direct concern) is critical here, because the case-law requires that an applicant will lack direct concern if the challenged measure requires further implementing and discretionary acts. Although the Recommendation refers to "termination of contracts", it also mentions "all necessary measures" in a vague way, thus allowing for a broad variety of measures to be enacted by BU. Thus, the defendants will argue successfully that in the case of staff they will have to bring those actions in national courts, probably in national labor courts, a forum in which they will be able to request the court to make a preliminary reference of validity to the Court of Justice to question the Recommendation's legality.

When it comes to the termination of contract of Mr. Guppa, this is a measure that belongs to the national Central Bank and therefore the question of standing will pertain to national law. However, even though this is a matter of national law, all national procedural rules must abide with the EU principles of effectiveness and equivalence, so that the applicant has all the necessary courses of action at his disposal.

4. Can BU request interim measures?

BU can request interim measures from Union courts when lodging an action of annulment. This request has to be brought at the same time that the main application is lodged, and it must comply with several substantive requirements: a risk of an irreparable damage, an appearance of illegality and a balancing of interests.

BU can request suspensive interim measures so that the effects of the ECB's Decision and Recommendation are stayed during the time in which the action is heard by the General Court.

However, in the case of national courts, interim measures shall be enacted by the national courts in accordance with national law. However, in exceptional cases the national court will have the power to suspend EU acts, as long as the requirements

mentioned above are complied with, and the national court refers the issue of legality to the Court of Justice by way of a preliminary reference of validity.⁷

5. In the case of the ECB's Decision and Recommendation, what grounds of annulment could BU invoke in its support?

Article 263 TFEU provides a fixed list of grounds of review which the applicant has to rely on: lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers.

In this case, BU can invoke "essential procedural requirements" by alleging that the on-site inspection was essentially flawed from its start, when it authorized the inspection team to observe any other relevant regulatory breaches, not only those related to cybersecurity risks.

⁷ Judgments of 21 February 1991, *Zuckerfabrik Süderdithmarschen and Zuckerfabrik Soest* (C-143/88 and C-92/89, EU:C:1991:65, paragraph 16), and of 9 November 1995, *Atlanta Fruchthandelsgesellschaft and Others (I)* (C-465/93, EU:C:1995:369, paragraph 20).