KEY POINTS

- The Icelandic legislature has taken extraordinary measures in response to the collapse of its banks during the financial crisis.
- The measures taken by the Icelandic legislature do not fit easily into a clearly defined taxonomy of insolvency proceedings and have been treated with some suspicion by European judges.
- EC Directive 2001/24/EC may prove to be ineffective as a means of ensuring a unified approach to the reorganisation and winding-up of European Economic Area (EEA) credit institutions.

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Reorganisation with knobs on? The taxonomy of Europe's insolvency regime

Two recent decisions of the English High Court in *Rawlinson & Hunter v Kaupthing* [2011] EWHC 566 (Comm) (Rawlinson) and *Lornamead Acquisitions v Kaupthing* [2011] EWHC 2611 (Comm) (Lornamead) have considered applications by Kaupthing to stay proceedings brought in England in favour of the ongoing Icelandic insolvency proceedings. These cases have brought judicial focus upon the meaning of the difficult provisions of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (the Regulations) and EC Directive 2001/24/EC (the Directive), upon which the Regulations are based, with some unexpected results.

THE DIRECTIVE AND THE REGULATIONS

Like many pieces of European legislation, the Directive is loaded with opaque and complicated provisions. An indication of its objectives may be discerned from the grandiloquent recitals:

- Recital (1) cites the objective of promoting "harmonious and balanced development of economic activities throughout the Community".
- Recital (2) draws the reader's attention to "the situation which might arise if a credit institution runs into difficulties".
- Perhaps most striking of all is recital (7) which asserts that "[i]t is essential to guarantee that the reorganisation measures adopted by the administrative or judicial authorities of the home Member State and the measures adopted by persons or bodies appointed by those authorities to administer those reorganisation measures, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims and any other measure which could affect third parties' existing rights, are effective in all Member States."

"Reorganisation measures" is defined by Art 2 of the Directive as "measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims".

"Winding-up proceedings" is defined, also by Art 2, as "collective proceedings opened and monitored by the administrative or judicial authorities of a member state with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure".

To the uninitiated, the gist of the Directive seems clear: if a European bank becomes insolvent then its home member state must be allowed to manage the consequences of that insolvency free from interference by other member states so that there is a unified approach across all member states.

The Directive has been implemented in the UK in the form of the Regulations. For present purposes we will consider two of the relevant provisions of the Regulations: Reg 5(1) and Reg 32.

Regulation 5(1) provides that where there are reorganisation measures or winding-up proceedings taking place in another member state in respect of an insolvent credit institution then in so far as such measures affect: (a) any branch of that credit institution; (b) any property or other assets of that credit institution; or (c) any debt or liability of that credit institution, then those measures take effect as if they were part of UK law. That is to say, the foreign insolvency proceedings take precedence over any UK law that might otherwise have applied in so far as they relate to the matters listed in the Reg 5(1).

Crucially, Reg 32 provides that the effect of any reorganisation measures or winding-up proceedings in another member state upon "a relevant lawsuit pending" will be determined solely by English law. Thus, where proceedings are started in England against an EEA credit institution based in another member state prior to the commencement of any reorganisation measures or winding-up proceedings in that other member state, the foreign insolvency proceedings will not, without more, have any effect on the English proceedings.

The effect of Reg 32 is that the date of the commencement of reorganisation measures or winding-up proceedings in another member state is very important, for the impact of insolvency proceedings on claims by third parties against credit institutions may be markedly different depending upon whether the insolvency proceedings pre-date the making of the claim or vice-versa.

ICELAND'S REACTION TO THE COLLAPSE OF ITS BANKS

In the past few years the troubled times ahead for European banks which were euphemistically hinted at in recital (2) of the Directive have come to pass as European banks have been hit hard by the financial crisis which began to play out in the autumn of 2008.

Some of the most extreme effects on European banks have been felt in Iceland where its largest banks, Glitnir, Landsbanki and Kaupthing, faced enormous difficulties.

In October 2008, the Icelandic Parliament passed legislation granting emergency powers

to the Icelandic Financial Services Authority which enabled it to take control of Iceland's troubled banks.

In November 2008, a new law was passed enabling those banks to seek a court order granting each a moratorium to prevent any claims being brought against it. Kaupthing obtained a moratorium order from the District Court of Rekyavik on 24 November 2008 which was subsequently extended by the same court on 19 February 2009 with the court noting that in view of the low price of the bank's assets at that time, the bank's creditors would be best served by the liquidation of the bank's assets taking place over a longer period.

These measures were then adapted in the light of a domestic challenge to the use of the moratorium on the basis that the prohibition of proceedings against the banks, when the banks were not formally being wound up, nor was there any prospect that the banks could be rescued, was contrary to the Icelandic constitution. Consequently, in April 2009 the Icelandic legislation was amended again to allow the banks to apply to the Icelandic court for amended moratoriums with the effect that the banks would be treated as if they were subject to a winding-up order, and to automatically deem those banks to be in a winding-up procedure once the moratoriums came to an end, without the need for a further court order.

The amendments made in April 2009 allowed for the appointment of Winding-Up Committees by the Icelandic court and such committees were appointed by court order in May 2009. The Winding-Up Committees were then able to invite creditors to submit proofs of their debts to the committee appointed in respect of each bank, so overcoming the local constitutional difficulties.

Developments in France later unsettled the Icelandic constitutional compromise when the Paris Court of Appeal handed down its judgment in *Kepler Capital Markets SA v Landsbanki Islands hf* (Landsbanki) on 4 November 2010. The *Landsbanki* decision concerned an application by the failed Icelandic bank, Landsbanki, to stay proceedings brought by a creditor in France that had been started after the Icelandic court had made an order granting a moratorium to Landsbanki. Landsbanki argued that under the French law implementing the Directive, all proceedings against Landsbanki were subject to the moratorium, thus barring any proceedings brought in France. However, the Paris Court of Appeal held that the Icelandic moratorium was neither a "reorganisation measure" nor "winding up proceedings" within the meaning of the Directive. There was no "reorganisation measure", so the Paris Court of Appeal held, because the legislative amendments made in April 2009 were an attempt to place the banks into winding-up proceedings and this was inconsistent with there being any "reorganisation measure" in place. At the same time, there was no winding-up within the meaning of the Directive because there had been no judicial opening of winding-up proceedings, merely the enactment of a legislative provision which could not be appealed or subjected to judicial review. Thus, Landsbanki's application failed.

"The curious chain of events...has thrown up difficult questions with respect to proceedings brought by third parties against insolvent Icelandic banks."

The *Landsbanki* case prompted a rethink back in Iceland. A new amendment to the Icelandic insolvency legislation was passed in November 2010 requiring the banks that were subject to moratoriums to apply to the Icelandic court for a court order placing them into winding-up proceedings so as to overcome the objections of the Paris Court of Appeal to the measures that were already in place. Subsequently, on 22 November 2010, the Icelandic banks applied for and obtained winding-up orders from the Icelandic courts, each of which was stated to have retrospective effect to the date of the earlier amendments made to the Icelandic insolvency legislation which had been enacted in April 2009.

There can be little doubt that the winding-up orders made by the Icelandic court in respect of each of the failed banks now constitute "winding-up proceedings" within the meaning of Art 2 of the Directive so that any claims made against the Icelandic banks after 22 November 2010 will be subject to the Icelandic winding-up proceedings from which the courts of other member states are prohibited from interfering.

Nonetheless, the curious chain of events in Iceland and in France has thrown up difficult questions with respect to proceedings brought by third parties against insolvent Icelandic banks that were started before the Icelandic court order on 22 November 2010 but after 22 April 2009 (the date the moratoriums became compliant with the Icelandic constitution and purported date upon which the later winding-up orders came into effect retrospectively). This is the problem which the English courts have had to grapple with in the *Rawlinson* and *Lornamead* cases.

THE RAWLINSON DECISION

The first case in England to address the difficult problem outlined above was *Rawlinson*, in which Burton J was faced with an application by Kaupthing, similar to that faced by the Paris Court of Appeal in the *Landsbanki* case, to stay claims that had been issued against it during the course of July and October 2010 (ie after the moratorium affecting Kaupthing became constitutionally effective in Iceland in April 2009 but before a winding-up order was made by the Icelandic court in November 2010).

Kaupthing's application was based upon several grounds but the first and most important ground for present purposes was that at the time the claims had been issued against Kaupthing, Kaupthing had been subject either to "reorganisation measures" or "winding-up proceedings" within the meaning of the Directive so that the claims against it fell to be dealt with in the course of the Icelandic insolvency proceedings under Reg 5(1) of the Regulations.

The respondents argued that there had been no "reorganisation measures" or

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"winding-up proceedings" within the meaning of the Directive and the Regulations prior to November 2010 so that the claims they had brought were already pending at that time so that Reg 32 applied and the claims remained unaffected by the Icelandic insolvency proceedings.

Burton J set out in some detail (at paras 10 to 18) the progress of the Icelandic measures taken to deal with Kaupthing's collapse before considering whether those measures amounted to "reorganisation measures" (see paras 20 to 28) or "winding-up proceedings" (see paras 29 to 34) within the meaning of the Directive and the Regulations. If the Icelandic measures in place prior to November 2010 did not fall within either definition then the primary ground upon which Kaupthing's application was based would fail.

The judge went on to hold, after a careful textual analysis of the Directive and the Icelandic legislation, that the moratorium and other measures in place (termed "reorganisation with knobs on" by counsel for Kaupthing) between April 2009 and November 2010 was not "re-organisation measures" within the meaning of the Directive.

In reaching this conclusion the judge approved (at para 22) the analysis of the Paris Court of Appeal in the *Landsbanki* case that there is a sharp distinction between "reorganisation measures" and "winding-up proceedings" and that the presence of one was effectively mutually exclusive with the existence of the other. Since the language of the Icelandic legislative amendments made in April 2009 heavily suggested that what was taking place was in reality a winding-up, this provided a strong indication that there were no "reorganisation measures" in place after April 2009. Moreover, the judge was persuaded by the respondents' argument that "reorganisation measures" implied the possibility that the bank in question could be restored to viability but on the facts Kaupthing was clearly permanently insolvent so that whatever was taking place was not a "reorganisation measure".

Like the Paris Court of Appeal before him, Burton J also held that the Icelandic legislation in place between April 2009 and November 2010 did not amount to "Directive compliant winding-up" as he found that there was no judicial opening of the winding-up proceedings prior to November 2010 and he rejected an argument that the order of the Icelandic court made on 22 November 2010 could have retrospective effect for the purposes of the Directive and the Regulations.

As Kaupthing's other grounds for its stay application were also rejected, the application was dismissed.

THE *LORNAMEAD* DECISION: SECOND THOUGHTS?

The original hearing of the *Lornamead* case took place just three weeks after Burton J had heard argument in *Rawlinson* and after Burton J's judgment was handed down, a further oral hearing took place so that the court could hear argument on the implications of the earlier judgment.

The relief sought by the claimants in *Lornamead* was somewhat more complicated than the claim brought in *Rawlinson*. In substance however Gloster J, like Burton J before her, was faced with an application by Kaupthing to stay proceedings issued against Kaupthing between April 2009 and November 2010 on the basis of the Directive and Reg 5(1) of the Regulations.

After hearing full argument on the matter from counsel, Gloster J expressed doubts about the correctness of Burton J's decision but chose to follow his earlier decision in the interests of judicial comity (see para 56) as, despite her doubts, she was not "convinced" that Burton J's decision was clearly wrong but she did give Kaupthing leave to appeal.

At para 54 of her judgment, Gloster J set out the arguments which gave rise to her doubts about Burton J's analysis in *Rawlinson*. The main points were as follows:

- The Directive was clearly intended to achieve a "cross-border, unified and universal administration of the affairs of" insolvent credit institutions throughout the EEA. Applying a purposive approach to interpreting the Directive would be likely to lead to the conclusion that the Icelandic moratoriums in place prior to November 2010 did fall within the scope of the measures contemplated by the Directive.
- It may have been wrong in principle to assume that "reorganisation measures" and "winding-up proceedings" are mutually exclusive. There may well be situations in which it is difficult to distinguish between the two terms in practice but this difficulty of taxonomy should not be allowed to undermine the "mutual recognition in Member States of insolvency processes in respect of credit institutions".
- Looking closely at the text of the Directive and in particular at the definition of "reorganisation measures" in Art 2, there did not appear to be any reason why a reorganisation measure had to aim to restore a credit institution to viability rather than merely preserve its assets. Either one of these aims might suffice.
- The appointment of a Winding-Up Committee by the Icelandic court in May 2009 and the subsequent extension of the moratorium in November 2009 by the same court may well have amounted to a judicial opening of insolvency proceedings so that those events gave rise to a Directive compliant winding-up.

CONCLUSION

The Directive and the Regulations are difficult pieces of legislation which have self-evidently given rise to complex disputes. We would tentatively suggest, however, that the forceful criticisms of the decision in *Rawlinson* identified by Gloster J may well be correct and that in the interests of achieving a unified cross-border approach to the insolvency of EEA credit institutions in the future, the interpretation placed on those pieces of legislation by the Paris Court of Appeal and at first instance in England should be replaced with a more purposive approach.

It remains to be seen whether the Court of Appeal will overturn *Lornamead*. *Rawlinson* settled before reaching the appellate stage but *Lornamead* may yet provide a higher court with the opportunity to clarify these difficult issues. ■