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EFTA SURVEILLANCE
AUTHORITY

REASONED OPINION

delivered in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, concerning Iceland's failure to correctly implement and apply Articles 23, 25 and 30(1) of Directive 2001/24/EC of the European Parliament and the Council of 4 April 2001 on the reorganisation and winding-up of credit institutions

1 Introduction

By a letter dated 12 March 2015, the EFTA Surveillance Authority (“the Authority”) informed the Icelandic Government that it had opened an own initiative case regarding the implementation of Articles 23, 25 and 30(1) of Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the *reorganisation and winding-up of credit institutions* (“Directive 2001/24” or “the Directive”) into Icelandic legislation. The letter was sent following the judgment of the EFTA Court in Case E-28/13 *LBI hf. v. Merrill Lynch International Ltd* and in light of the interpretation of the Supreme Court of Iceland (“the Supreme Court”) in judgments No. 552/2013 and 120/2014.

Iceland replied by letter dated 15 April 2015¹ that Article 30(1) of the Directive was implemented into the Icelandic legal order by Act No. 161/2002 on Financial Undertakings. It stated that, following communications with the Authority in 2010-2011 on the implementation of Directive 2001/24/EC, further amendments had been made to Article 99(2)(n) of the Act on Financial Undertakings, to fully implement Article 30(1) of the Directive. Additionally, the Government stated that in its view, the EFTA Court did not fully conclude in its judgment in Case E-28/13 that Article 99(2)(n) of the Act limited the scope of application of Article 30(1) of the Directive. Lastly, regarding Articles 23 and 25 of the Directive, the Government considered that the way in which they were applied by the Icelandic courts sufficiently achieved the result of the Directive in disputed winding-up proceedings.

The case was further discussed at a package meeting in Reykjavik in May 2015.

By letter of 25 February 2016², the Authority received follow-up observations from Iceland. Therein, the Government informed the Authority that the implementation of Article 30(1) of the Directive was being considered in ongoing court proceedings in Iceland related to the winding-up of Icelandic credit institutions. The Government further stated that Articles 23 and 25 were inconsistent with Article 10 of the Directive, making room for different interpretations of their meaning. Lastly, the Government informed the Authority of the future revision of the Chapter XII of Act No. 161/2002, once the winding-up proceedings of certain Icelandic credit institutions were completed.

By a letter dated 4 May 2016³, the Authority set out its preliminary assessment that Iceland had not correctly implemented Articles 23, 25 and 30(1) of the Directive.

On 1 June 2016, at a package meeting in Iceland, the Government’s representatives stated that the intention was to review Chapter XII of Act No. 161/2002, where Article 99(2) as a whole would be amended. In addition, detailed explanatory notes on its application were to be provided for in the *travaux préparatoires*. The resulting bill was to be submitted to the Parliament in November 2016 (“the Bill”).

The Authority sent a letter of formal notice to the Government dated 6 July 2016.⁴ Therein, the Authority stated that Government had failed to fulfil its obligations arising from Article 30(1) of the Act referred to at point 16c of Annex IX to the EEA Agreement (i.e. Directive 2001/24), and that by not ensuring a derogation from the general principle that the law of the home EEA State shall apply, the Government had failed to fulfil its

¹ Your reference FJR15030070/17.4.2.

² Your reference FJR15030070/17.4.2.

³ Document No. 803362.

⁴ Document No. 789678.

obligations arising from Articles 23 and 25 of Directive 2001/24 and Protocol 35 to the EEA Agreement.

The Government did not formally reply to the letter of formal notice. However, through informal correspondence dated 6 December 2016⁵, 31 January 2017⁶ and 7 March 2017⁷, the Government informed the Authority that there were delays in the adoption of the Bill. Despite this, the Government stated that the Bill, ensuring the correct implementation of Articles 23, 25 and 30(1) of the Directive was nearly finalized.

On 8 June 2017, at a package meeting in Iceland, the Government presented and explained the finalized Bill amending Chapter XII of Act No. 161/2002 and further informed the Authority that it planned to submit the Bill to the Parliament when it had resumed its sessions.

According to an email from the Government dated 19 September 2017⁸ and 11 December 2017⁹, the Bill has not been submitted to the Parliament for discussion and a date for the Bill's discussion has not been set.

The Authority notes that in its previous correspondence with the Government, it stated its view that the Supreme Court's interpretation of Article 99(2)(j) of the Act also constituted a breach of Protocol 35 to the EEA Agreement, as the Supreme Court failed to give full effect to the principle set out in the Protocol. The Authority has opened an own initiative case against Iceland concerning Protocol 35 (case No. 71655), and has removed the matter from its assessment in the current case.

2 Relevant national law

Article 104(1) of Act No.161/2002 reads as follows:

Winding up of a credit institution with head offices in Iceland and branches in another EEA state

Should an Icelandic court decide on the winding up of a credit institution which is established and licensed to operate in Iceland, this authorisation shall automatically apply to any branches operated by the credit institution in other member states. The legal effect, procedure and implementation of the decision shall be governed by Iceland law, with those exceptions listed in the second paragraph of article 99.

According to Iceland's legislative table of correspondence from September 2011,¹⁰ Articles 25 and 30(1) of the Directive were incorporated into the Icelandic legal order by Act No. 161/2002 on Financial Undertakings, namely by Article 99(2)(n)-(j) of that Act.

Article 99(1) and Article 99(2)(n), which implement Article 30(1) of the Directive, read as follows:

“1. If a court of law in Iceland grants to a credit institution permission for suspension of payment or composition with creditors such permission shall automatically extend to all branches operated by the credit institution in another member state.

⁵ Document No 835659.

⁶ Document No. 839659.

⁷ Document No. 872812.

⁸ Document No. 874201.

⁹ Document No. 892081.

¹⁰ Document No. 607751, your ref. EVR09100340/3.5.1.

2. Icelandic law shall apply concerning the legal effect, procedure and implementation of the decision, with the following exceptions:

(n)... the provision of Chapter III of the Act on conclusion of contracts, power of attorney and invalid legal instruments, No 7/1936, on invalid legal instruments, may be applied unless the law of the host State does not allow this. A legal instrument may not, however, be invalidated if the party benefiting from the continuing validity of such a legal instrument provides satisfactory evidence that the law of another State should apply to the legal instrument and that the respective law does not include an invalidating rule which applies to the instance in question.”¹¹

Further, Article 99(2)(j), which according to the correspondence table of the Government implements Article 25 of the Directive, reads as follows:

“An agreement concerning set-off shall be governed by the law of the state which applies to the agreement”.¹²

According to the said table of correspondence,¹³ Article 23 of the Directive is implemented by Articles 100-106 and 118(3) of Act No. 21/1991 on Bankruptcy etc. These provisions contain general requirements for filing claims against a bankrupt estate and for the set-off of such claims.

3 Relevant EEA law

The purpose of Directive 2001/24 is to ensure that a credit institution and its branches in other EEA States are reorganised or wound up according to the principles of unity and universality, ensuring that there is only one set of insolvency proceedings, in which the credit institutions are treated as one entity.¹⁴

The Directive does not attempt to harmonise the insolvency laws of the EEA States. Instead, it sets out conflict-of-law rules, identifying which EEA State(s) law shall apply to the winding up of a credit institution.

Articles 3(1)-(2) and 10(1) of the Directive provide that reorganisation measures and winding-up proceedings respectively shall be applied in accordance with the laws, regulations and procedures applicable in the home State of the credit institution, unless otherwise provided in the Directive. Subject to this proviso, Article 10(2) provides a list of matters that are to be determined by the law of the home State.

The provisions of Title IV of the Directive set out various exceptions to the rule that the law of the home State shall apply to reorganisation measures and winding-up proceedings.

¹¹ Translation by the EFTA Court in Case 28/13, para 14. Original wording in Icelandic: “Þrátt fyrir ákvæði d- og e-liðar er heimilt að beita ákvæðum III. kafla laga um samningsgerð, umboð og ógilda gerninga, nr. 7/1936, um ógilda löggerninga, nema lög gistiríkis heimili ekki slíkt. Löggerningur verður þó ekki ógiltur ef sá sem hag hefur af því að slíkur löggerningur haldi gildi sínu leggur fram fullnægjandi sönnun um að um löggerninginn eigi að gilda lög annars ríkis og að þar sé ekki að finna ógildingarreglu sem tekur til þess tilviks sem um ræðir.”

¹² Unofficial translation. Original wording in Icelandic: “Samningur um skuldajöfnuð fer eftir lögum þess ríkis sem um samninginn gilda.”

¹³ Document No. 607751, your ref. EVR09100340/3.5.1.

¹⁴ See Recitals 4 to 6 and 16 of the Directive.

The exceptions relevant for the case at hand are provided in Articles 23, 25 and 30(1) of the Directive.

Article 3 of the Directive provides:

“1. The administrative or judicial authorities of the home Member State shall alone be empowered to decide on the implementation of one or more reorganisation measures in a credit institution, including branches established in other Member States.

*2. The reorganisation measures shall be applied in accordance with the laws, regulations and procedures applicable in the home Member State, **unless otherwise provided in this Directive** [our emphasis].”¹⁵*

Article 10 of the Directive provides:

*“1. A credit institution shall be wound up in accordance with the laws, regulations and procedures applicable in its home Member State, **insofar as this Directive does not provide otherwise** [our emphasis].*

2. The law of the home Member State shall determine in particular:

[(a)-(k)]

(l) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors.”

Article 30(1) of the Directive expressly limits the scope of Article 10. It reads as follows:

“Article 10 shall not apply as regards the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the creditors as a whole, where the beneficiary of these acts provides proof that:

- the act detrimental to the creditors as a whole is subject to the law of a Member State other than the home Member State, and*
- that law does not allow any means of challenging that act in the case in point.”*

Recital 28 of the Directive explains the rationale for this limitation (which is also relevant to Article 23, below):

“(28) Creditors who have entered into contracts with a credit institution before a reorganisation measure is adopted or winding-up proceedings are opened should be protected against provisions relating to voidness, voidability or unenforceability laid down in the law of the home Member State, where the beneficiary of the transaction produces evidence that in the law applicable to that transaction there is no available means of contesting the act concerned in the case in point.”

Article 23 of the Directive reads as follows:

¹⁵ Recital 16 to the Directive records the legislative intention to provide exceptions to the principle of home State law: *“(16) Equal treatment of creditors requires that the credit institution is wound up according to the principles of unity and universality, which require the administrative or judicial authorities of the home Member State to have sole jurisdiction and their decisions to be recognised and to be capable of producing in all the other Member States, without any formality, the effects ascribed to them by the law of the home Member State, **except where this Directive provides otherwise**” (emphasis added).*

- “1. The adoption of reorganisation measures or the opening of winding-up proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the credit institution, where such a set-off is permitted by the law applicable to the credit institution's claim.*
- 2. Paragraph 1 shall not preclude the actions for voidness, voidability or unenforceability laid down in Article 10(2)(l).”*

It follows from this Article, together with Articles 10 and 30(1), that where the law applicable¹⁶ to the credit institution's claim permits set-off, such set-off may be demanded by creditors. Such a set-off is subject to home State rules on voidability etc (Article 10), unless the act which it is sought to avoid etc. is subject to the law of another EEA State than the home State, and under the law of that State, that act cannot be/can no longer be challenged (Article 30(1)).

Article 25 of the Directive states:

“Netting agreements shall be governed solely by the law of the contract which governs such agreements.”

4 The Authority's Assessment

4.1 Introduction

As noted above and by the Authority in the letter of formal notice dated 6 July 2016, despite the general principle of Articles 3(1) and 10(1) of the Directive, which provides for the law of the home EEA State to be applied to a credit institution's reorganisation or winding-up, Articles 23, 25 and 30(1) contain exceptions to that principle.

Article 23(1) of the Directive protects a creditor's right to set-off its claim(s) against a credit institution under the same law as is applicable to the credit institution's claim, while Article 25 of the Directive states that choice-of-law provisions in netting agreements should be respected. The law of the credit institution's home State is therefore not necessarily the governing law.

The exception provided for in Article 30(1) of the Directive, on the application of another law than the home EEA State of the credit institution, applies where a beneficiary proves that the relevant act (which is detrimental to creditors) is subject to the law of another EEA State and that under that governing law, there is no possibility (or no longer any possibility) to challenge the act in question.

As stated below, the Authority is *firstly* of the view that Article 30(1) of the Directive was not correctly implemented into Icelandic law, as the wording of Article 99(2)(n) of Act No. 161/2002 on Financial Undertakings limits the non-application of Icelandic law, where the act in question is governed by the law of another EEA State, to rescission in accordance with Chapter III of the Act on Invalid Legal Instruments, as was confirmed by the EFTA Court in its judgment in Case E-28/13. *Second*, the Authority finds that Article 23 of the Directive cannot be considered as correctly implemented by the provisions of the Bankruptcy Act cited in the table of correspondence. *Finally*, the Authority considers that Article 99(2)(j) of Act No. 161/2002 on Financial Undertakings, as interpreted and applied

¹⁶ Whether home State law or another law.

by the Supreme Court of Iceland, fails to ensure the implementation of either Articles 23 or Article 25 of the Directive.

4.2 Article 30(1) of Directive 2001/24/EC

According to the Government, the provisions of Article 30(1) of the Directive are implemented into Icelandic law by Article 99(2)(n) of Act No. 161/2002, as amended by Act No. 78/2011.¹⁷ The text of the provision as implemented states that certain Icelandic rules on avoidance/unenforceability of legal acts shall apply to reorganisational procedures of a credit institution, namely the provisions of Chapter III of the Act No 7/1936 on Contracts, Mandates and Invalid Legal Instruments, unless the law of the “host State” does not permit this, or under the law of the other State which applies to the act, that act cannot be invalidated.

Chapter III of Act No. 7/1936 contains the general rules on the invalidity of legal acts in contract law, for example in cases where they have been executed under coercion, through deception, the abuse of position or by unfair means. However, the Act contains no rules on the rescission of measures taken – for example - by a bankrupt party within the meaning of Chapter XX of Act No. 21/1991 on Bankruptcy etc.¹⁸

In its judgment in Case E-28/13 *LBI hf. v Merrill Lynch International Ltd.*, the EFTA Court states that the text of Article 30(1) of the Directive refers to “voidness, voidability or unenforceability” of a legal act, based on whether the act could affect creditors as a whole in a detrimental manner. According to the Court, Article 30(1) does not limit the basis on which to invoke voidness, voidability or unenforceability of a legal act. It does not therefore limit the basis to rescission under contract law, as the wording of Article 99(2)(n) of Act No. 161/2002 seemed to do.¹⁹

The Government acknowledged, by letter dated 15 April 2015, that Act No. 7/1936 did not contain rules on the rescission of measures taken by a bankrupt party, i.e. based on avoidance rules under Chapter XX of Act No. 21/1991. However, at a package meeting in Iceland in May 2015, the representatives of the Government suggested that the Icelandic Supreme Court might be able to interpret and apply Article 99(2)(n) of Act No. 161/2002 in conformity with Article 30(1) of the Directive, so that e.g. the rescission rules on the basis of avoidance under Chapter XX of Act No. 21/1991 would also apply to demands for rescission made by financial undertakings under Chapter XII of Act No 161/2002. In this respect, the Government’s representatives referred to judgments of the Supreme Court²⁰, where the wording of Article 99(2)(n) of Act No. 161/2002 was interpreted in line with the Directive in relation to procedural issues in rescission proceedings of Icelandic financial undertakings under Chapter XX of Act No. 21/1991.²¹

By letter dated 25 February 2016, the Government stated that the aforementioned cases had not yet been tried on the merits. The Government has not reported on more recent judgments of the Supreme Court on the interpretation and application of Article 99(2)(n).

¹⁷ Iceland’s table of correspondence from September 2011 (Document No. 607751, your ref. EVR09100340/3.5.1), cf. also the preparatory works for Act No. 78/2011, which state that this provision was specifically intended to implement Article 30(1) of the Directive into Icelandic law.

¹⁸ Case E-28/13 *LBI hf. v Merrill Lynch International Ltd.*, judgment of 17 October 2014, [2014] EFTA Ct. Rep. 970, paragraphs 15-16.

¹⁹ *Ibid.*, paragraphs 37-39.

²⁰ Cf. Supreme Court cases No. 228/2015, 231/2015, 250/2015 and 251/2015.

²¹ The cases concerned the appointment of an expert assessor to determine whether English law permitted rescission in circumstances such as those at hand.

Based on the above, the Authority considers that the wording of Article 99(2)(n) of Act No. 161/2002 does not reflect the provisions of Article 30(1) of the Directive, as interpreted by the EFTA Court in Case E-28/13 *LBI hf. v Merrill Lynch International Ltd.*

The Authority recognises that when implementing a directive into the national legal order, it is not required that the provisions are enacted in precisely the same wording. A general legal context may be sufficient, provided in practice it ensures full application of the directive. Due to requirements of legal certainty, provisions of directives must nevertheless be implemented with unquestionable binding force and the necessary specificity, precision and clarity. EEA States must therefore ensure the full application of directives not only in fact, but also in law.²²

In that regard, it is essential that the implementing measure is sufficiently precise and clear and that interested parties are made fully aware of their rights according to EEA law, so that, where appropriate, they may rely on them before the national courts.²³ That principle is to be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them.²⁴

At a package meeting in Iceland on 8 June 2017, the Bill amending the Act was presented. To date, it has not however been submitted to the Parliament or incorporated into national law. Therefore, despite the intention to introduce legislative changes to national law, as recorded in Section 1 of the present reasoned opinion, the necessary measures have yet not been adopted by the Government.

In light of the above, it is the Authority's view that, as Article 99(2)(n) of Act No. 161/2002 refers solely to Chapter III of Act No. 7/1936, the exception contained in that Article does not include invalidity on grounds other than contract law, such as, but not limited to, the grounds for rescission included in Chapter XX of Act No. 21/1991. Article 99(2)(n) of Act No. 161/2002 does not therefore correctly implement the substantive elements of the exception in Article 30(1) of the Directive on the application of another law than of the home State (*lex loci concursus*) of a financial credit institution.

4.3 Article 23 and 25 of Directive 2001/24/EC

4.3.1 Introduction and preparatory works to the Directive

By letter dated 25 February 2016, the Government stated that the provisions of Article 10 of the Directive, containing a general principle, and the exceptions in Articles 23 and 25 of the Directive, are inconsistent with each other and are therefore unclear and ambiguous, making room for different interpretations of their meaning.

²² Case E-15/12 *Jan Anfinn Wahl* [2013] EFTA Ct. Rep. 534, paragraphs 50-51 og 56; Case E-12/13 *EFTA Surveillance Authority v Iceland* [2014] EFTA Ct. Rep. 58, paragraphs 69-70 and Case C-159/99 *Commission v Italy* [2001] ECR I-4007, paragraph 32.

²³ Case E-15/12 *Jan Anfinn Wahl*, cited above, paragraph 52, Case C-478/01 *Commission v Luxemburg* [2003] ECR I-2351, paragraph 19 and Joined cases E-10/11 and E-11/11 *Hurtigruten ASA* [2012] EFTA Ct. Rep. 758, paragraphs 280-281.

²⁴ Case C-325/85 *Ireland v Commission* [1987] ECR 5041, paragraph 18; Case 32/79 *Commission v United Kingdom* [1980] ECR 2403.

The Authority concluded in its letter of formal notice, dated 6 July 2016, that Article 99(2)(j) of Act No. 161/2002, as interpreted by the Supreme Court of Iceland, did not comply with Article 23 or 25 of the Directive.

Further, the Authority recorded that Article 10 of the Directive prescribed the general principle that credit institutions should be wound up subject to the laws, regulations and procedures applicable in their home EEA State, “[...] *insofar as the Directive does not provide otherwise*”.²⁵

As a result, and as also noted further above, Article 10 of the Directive specifically allows for exceptions to be made to the general principle. Such exceptions are provided for in Articles 23 and 25 of the Directive. Article 10 is a conflict of law rule.

Pursuant to the wording of Article 23(1) of the Directive, the adoption of reorganisation measures or the opening of winding-up procedures of a credit institution “[...] *shall not affect the right of creditors to demand the set-off of their claims against the claims of the credit institution, where such a set-off is permitted by the law applicable to the credit institution's claim*”²⁶ and where the set-off is not avoided or unenforceable.²⁷

This means that if the credit institution's claim is regulated by another law than Icelandic law, the creditor of that institution shall have a right to demand set-off, even if set-off is not permitted under Icelandic law, provided it is permitted by the law applicable to the claim (and not otherwise voided etc. under the provisions foreseen in Articles 10(2)(1), subject always to the limitation in Article 30(1): see paragraph 2 of Article 23).

The Authority also noted in the letter of formal notice, that the text of Article 25 of the Directive was clear, in that netting agreements were governed solely by the law of the governing contract.

It therefore follows from Article 25 of the Directive that, if the law chosen by the parties to the netting agreement as the governing law grants a broad right of netting, this right should be enforceable against a credit institution (and/or its liquidator), even though the credit institution undergoing winding-up proceedings is situated in a jurisdiction which provides for a more limited right of netting.²⁸ Thus, the law of the contract applies, to the exclusion of any other potentially applicable legal system. This also follows from the use of “*solely*” in the text of Article 25 of the Directive.²⁹

The Authority observes that the above interpretation is supported by the Statement of the Council, when it established a common position on the Directive on 17 July 2000.³⁰

In stating its reasons for the introduction of a group of exceptions to the applicability of Home State laws (which included, *inter alia*, the first draft of the current Articles 23 and

²⁵ See section 5.3. of the Authority's letter of formal notice, dated 6 July 2016.

²⁶ Article 23(1) of the Directive.

²⁷ Article 10(2)(1) of the Directive, subject always to Article 30(1).

²⁸ See also Recital 28 of the Directive.

²⁹ See also Report by European Financial Market Lawyers Group: *Protection for Bilateral Insolvency Set-Off and Netting Agreements under EC Law*, October 2004, pg. 115.

³⁰ Common Position (EC) No 43/2000 of 17 July 2000 adopted by the Council, acting in accordance with the procedure referred to in Article 251 of the Treaty establishing the European Community, with a view to adopting a Directive of the European Parliament and of the Council on the reorganisation and winding up of credit institutions, OJ C 300, 20.10.2000. The document is available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2000.300.01.0013.01.ENG.

25), the Council stated that these provisions derogate “*from the basic principle of the application of the law of the Home Member States set out in Articles 3 and 10. The overall objective of this [...] [is] to ensure legal certainty in particular cases where it is thought that the importance or the special nature of the contract justifies the derogation from the principle of universality.*”³¹

Furthermore, the Council stated that Articles 25-27 of the Directive “*concern contractual netting agreements (agreements to set off positive and negative balances) between a credit institution and its counterparty and repurchase agreements (an agreement between a seller and a buyer of securities where the seller agrees to repurchase the securities at an agreed price) respectively. In both cases the law of the Member State applicable to the agreement applies. Such agreements are commonly used on the financial markets and the Council considers that the special function of such contracts requires a derogation from the principle of universal application of home Member State law in order to protect the functioning of the financial markets and to ensure legal certainty for the contracting parties.*”³²

The Council further stated that: “*Paragraph 2 [which became Article 23 of the Directive] concerning set-off stipulates, in line with Article 6 of the Insolvency Regulation, that the right of a creditor to set off a claim is not affected by the reorganisation measure or the insolvency proceedings when such set-off is permitted by the law of the Member State applicable to the credit institutions claim, regardless of whether such set-off is permitted by the home Member State law or not.*”³³

According to the Government, Article 23 of the Directive is implemented into Icelandic law by Articles 100-106 and Article 118(3) of Act No. 21/1991, while Article 25 of the Directive is implemented into Icelandic law by Article 99(2)(j) of Act No. 161/2002.³⁴

The Authority, however, notes that Articles 100-106 and 118(3) of Act No. 21/1991 are general provisions on claims against a bankrupt estate and the set-off of such claims. In the Authority’s view, those provisions do not secure the right of creditors to demand set-off of their claims in accordance with Article 23(1) of the Directive. Furthermore, the provisions of the Bankruptcy Act do not implement Article 23(2) of the Directive.

Article 99(2)(j) of Act No. 161/2002, which according to the table of correspondence implements Article 25 of the Directive, reads as follows:

*“An agreement concerning set-off shall be governed by the law of the state which applies to the agreement.”*³⁵

³¹ *Ibid.*, Section E, Title IV. The principle of universality is expressed inter alia in Recital 16 (home State authorities have sole jurisdiction, except where the Directive provides otherwise).

³² *Ibid.* Note that Recital 16 of the Directive reflects this: “*Although it is important to follow the principle that the law of the home Member State determines all the effects of reorganisation measures or winding-up proceedings, both procedural and substantive, it is also necessary to bear in mind that those effects may conflict with the rules normally applicable in the context of the economic and financial activity of the credit institution in question and its branches in other Member States. In some cases reference to the law of another Member State represents an unavoidable qualification of the principle that the law of the home member State is to apply.*”

³³ *Ibid.*

³⁴ Iceland’s table of correspondence from September 2011.

³⁵ Unofficial translation. Original wording in Icelandic: „*Samningur um skuldajöfnuð fer eftir lögum þess ríkis sem um samninginn gilda.*”

The Authority observes that, while Article 25 of the Directive refers to “netting agreements”, and Article 99(2)(j) (as translated) refers to “an agreement concerning set-off”, the Icelandic term used in that provision could be considered, on the face of it, sufficiently broad to be construed as including both netting and set-off. However, as demonstrated by the judgments of the Icelandic Supreme Court below, Article 99(j) of Act No. 161/2002 is not applied at all, as in the Supreme Court’s view, it is contrary to the provisions of Icelandic law, namely Article 102 of the same Act and Article 100 of the Bankruptcy Act No. 21/1991. Therefore, the wording of the Article 99(2)(j) cannot be considered as implementing Article 25 of the Directive, or, similarly, Article 23(1) of the Directive, where the EEA rule is not made to prevail in a such a situation.

4.3.2 *Judgments of the Icelandic Supreme Court*

The Authority stated in its letter of formal notice that the relevant provisions of Act No. 161/2002, as interpreted and applied by the Supreme Court of Iceland in its recent judgments in the cases of *Commerzbank AG v Kaupthing hf.* (Case No. 552/2013, judgment delivered on 28 October 2013)³⁶ and *De Nederlandsche Bank N.V. v LBI hf.* (Case No. 120/2014, judgment delivered on 8 May 2014), were not consistent with the provisions of Directive 2001/24. Accordingly to those judgments, a provision in a set-off agreement between parties stating that the agreement shall be governed by the law of another EEA State does not prevail over Icelandic insolvency rules.

The circumstances of *Commerzbank AG v Kaupthing hf.*³⁷ were as follows: In 2003, Commerzbank and Kaupthing entered into a financial agreement, which ended on 9 October 2008, when a resolution committee was appointed to replace the board of directors of Kaupthing.³⁸ When the agreement was settled, it became clear that Kaupthing’s claim amounted to over 86 million EUR. In November 2008, Commerzbank’s subsidiary subrogated its claim against Kaupthing, worth 20.000.000 USD, to Commerzbank.

In December 2009, Commerzbank submitted its claim to the winding-up committee, and sought to settle part of Kaupthing’s claim by means of a set off against its counterclaims against Kaupthing. The winding-up committee rejected the claim, holding that the conditions for set-off had not been met.

Commerzbank claimed that the bank’s right to set-off was prescribed by the original agreement, which stated that it should be governed and interpreted in accordance with English law. In this respect, Commerzbank referred to Article 99(2)(j) of Act No. 161/2002 which states that an agreement concerning set-off shall be governed by the law of the state which applies to the agreement. Commerzbank maintained that English law permits set-off, even though the counterclaimant acquired the claim subsequent to the commencement of the winding-up proceedings.

³⁶ See also the procedural decisions during trial in Case No. 723/2012 and Case No. 166/2013.

³⁷ Case No. 552/2013.

³⁸ On 9 October 2008, the Icelandic Financial Supervisory Authority exercised its special powers due to unusual financial market circumstances, and took over the power of the shareholders’ meeting of Kaupthing, dismissed its board of directors and appointed a resolution committee which immediately assumed control of the bank. On 25 May 2009, the Reykjavík District Court, upon a request from the resolution committee, appointed a winding-up committee for the estate. The winding-up committee’s main task was to invite creditors to lodge their claims and to examine these claims.

Kaupthing maintained that since Commerzbank did not acquire the claim at a juncture when at least three months remained to the reference date (one of the criteria required by Article 100 of Act No. 21/1991), the bank was not allowed to set off its claim.³⁹

Commerzbank requested that an expert assessor be appointed to determine whether English law permits set-off in circumstances such as those of its case. The Supreme Court rejected the request, on the basis that rights regarding setting off shall be governed solely by Icelandic rules.⁴⁰ The Court acknowledged that Article 99(2)(j) of Act No. 161/2002 states that an agreement concerning set-off shall be governed by the domestic legal system that is applicable to the agreement. However, the Supreme Court stated that this did not change the fact that, according to Article 102 of Act No. 161/2002, reorganisation measures are governed by Article 100 of Act No. 21/1991, and therefore the latter should be applied.

Following this judgment, Commerzbank requested the Supreme Court to seek an advisory opinion from the EFTA Court,⁴¹ concerning, *inter alia*, the interpretation of Articles 23 and 25 of the Directive, regarding exceptions to governing law in the case of claims for setting off and netting.

The Supreme Court found the interpretation of Directive 2001/24 to be of no relevance for the resolution of the case, since it had already been decided by the Supreme Court⁴² that Commerzbank's right to set-off was governed by Icelandic law. By referring to its own previous judgment, the Supreme Court rejected Commerzbank's request for an advisory opinion from the EFTA Court.

This reasoning was reiterated in the Supreme Court's decision of 28 October 2013, when the case was tried on the merits and Commerzbank's demand for set-off was denied, as the conditions for conducting set off had not been met under Act No 21/1991, cf. Case No. 552/2013.

The same issue arose in Supreme Court Case No. 120/2014, *De Nederlandsche Bank N.V. v LBI hf.* *De Nederlandsche Bank N.V.* argued that Article 99(2)(j) of Act No. 161/2002 provides that an agreement concerning any set-off shall be governed by the applicable domestic law governing the agreement, which in this case was the Dutch Bankruptcy Act. Although the Supreme Court acknowledged that Dutch law was applicable to the agreement, the Court found that this did not change the fact that the winding up of LBI hf. was governed by Icelandic law, i.e. by the aforementioned Article 100 of Act No. 21/1991. The Court's judgment of 8 May 2014 *inter alia* states that:

“Dutch law shall apply to the plaintiff's right to demand set-off of its claims against the defendant's deposit on the plaintiff's account. Even so, that does not change the fact that Icelandic law applies to the winding-up of the defendant and therefore a set-off cannot be accepted when winding-up proceedings have been initiated, unless the requirements of Article 100(1) of the Bankruptcy Act No 21/1991 are met.

³⁹ Article 100(1) of Act No. 21/1991 reads as follows: “Any person indebted to a bankruptcy estate may subtract from his debt what the estate may owe him, whatever the nature of the debt or the counterclaim, provided that the creditor acquired the claim before three months remained to the reference date, that he neither knew nor should have known that the bankrupt was insolvent, that he did not acquire the claim in order to set it off against another claim, and provided that the bankruptcy estate's claim against him came into being before the reference date.” (Unofficial translation provided by the Ministry of the Interior).

⁴⁰ See Case No. 723/2012.

⁴¹ See Case No. 166/2013, which turned upon the motion for a request for an advisory opinion.

⁴² Case No. 723/2012 regarding the appointment of an examiner.

Article 104(1) of Act No 21/1991 and Article 99(2)(j) of Act No 161/2002 do not seem to depart from these general rules. If the intention was indeed to depart from these general rules, it should have been stated in an unequivocal manner since it could lead to discrimination of creditors in winding-up proceedings on the basis of which rules are applicable to set-off, but equality among creditors is a general principle in both winding-up of credit institutions and bankruptcy proceedings. It can by no means be deduced from the preparatory works that this was the intention when Article 99(2)(j) of Act No. 161/2002 was implemented by Act No. 130/2004.”⁴³

By its letter of 25 February 2016, the Government stated that in its opinion, the Supreme Court's findings on the lack of clarity of the applicable rules on set-off, after winding-up proceedings have opened, were most likely due to the ambiguous wording in the Directive. For the reasons mentioned in Section 4.3.1, the Authority disagrees.

As stated in its letter of formal notice,⁴⁴ the Authority considers that Article 99(2)(j) of Act No. 161/2002, as interpreted by the Supreme Court in the light of Article 102 of Act No. 161/2002 and Article 100 of Act No. 21/1991 (i.e. to the effect that a provision in an agreement between parties stating that the agreement shall be governed by the law of another EEA State does not prevail over Icelandic insolvency rules), does not comply with Article 25 of the Directive (which requires that netting agreements are governed solely by the law of the contract that governs such agreements) or Article 23 of the Directive (containing a protection for set-off claims, subject to the relevant rules on voidability).

The Authority notes that the Court of Justice of the European Union has consistently held that the scope of national laws, regulations or administrative provisions must be assessed in the light of the interpretation given to them by national courts.⁴⁵ These Supreme Court judgments must therefore be regarded as relevant legal authority in Iceland on the issue at hand.

Consequently, it is the opinion of the Authority that Article 99(2)(j) of Act No. 161/2002, as interpreted by the Supreme Court of Iceland, does not adequately implement Article 23 or 25 of the Directive, since it does not ensure a derogation from the general principle that the law of the home EEA State shall apply, in order to secure that the creditors' rights to set-off and netting are not undermined.

The Government of Iceland has not put forth counter-arguments to the position adopted by the Authority in its letter of formal notice. As noted above, while at a package meeting in

⁴³ Translation provided in the Government's letter of 25 February 2016 with the Authority's amendments. The original text reads as follows: “*Að því leyti sem hér hefur verið rakið fer um heimild sóknaraðila til að skuldajafna gagnvart innstæðu varnaraðila hjá honum eftir hollenskum lögum. Það breytir því þó ekki að slit varnaraðila fara eftir íslenskum lögum og því verður skuldajöfnuði gagnvart honum ekki lýst yfir við slitin nema fullnægt sé skilyrðum 1. mgr. 100. gr. laga nr. 21/1991, enda verður ekki talið að vikið hafi verið frá þeim reglum með 1. mgr. 104. gr., sbr. j. lið 2. mgr. 99. gr., laga nr. 161/2002. Ef víkja átti frá þeim reglum hefði þurft að koma ótvírætt fram þar sem slíkt hefði getað valdið því að kröfuhöfum væri mismunað við slitin eftir því hvaða reglur giltu um skuldajöfnuð, en jafnræði kröfuhafa er grundvallarregla við slit fjármálafyrirtækja á sama veg og við gjaldþrotaskipti. Verður með engu móti ráðið af lögskýringagögnum að slíkt hafi staðið til þegar j. liður 2. mgr. 99. gr. laga nr. 161/2002 var lögfestur með lögum nr. 130/2004.”*

⁴⁴ See section 5.3.2 of the letter of formal notice, dated 6 July 2016.

⁴⁵ Joined Cases C-132/91, C-138/91 and C-139/91 *Katsikas and Others* [1992] ECR I-6577, paragraph 39; Case C-382/92 *Commission v United Kingdom* [1994] ECR I-2435, paragraph 36; Case C-300/95 *Commission v United Kingdom* [1997] ECR U-2649, paragraph 37; Case C-129/00 *Commission v Italy* [2003] ECR I-14637, paragraph 30; and Case C-418/04 *Commission v Ireland*, [2007] ECR I-10947, paragraph 166.

Iceland on 8 June 2017, the representatives of the Icelandic Government presented a Bill which would amend Chapter XII of Act No. 161/2002, namely the wording of Article 99 of the Act, according to an email from the Icelandic Government dated 19 September 2017, the Bill had not been submitted to the Parliament for discussion.

5 Conclusion

FOR THESE REASONS,

THE EFTA SURVEILLANCE AUTHORITY,

pursuant to the first paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, and after having given Iceland the opportunity of submitting its observations,

HEREBY DELIVERS THE FOLLOWING REASONED OPINION

that by

- failing to extend the rule in Article 99(2)(n) of Act No. 161/2002 on Financial Undertakings to rescission on the basis of avoidance rules other than those contained in Chapter III of Act No. 7/1936, Iceland has failed to fulfil its obligations arising from Article 30(1) of the Act referred to at point 16c of Annex IX to the Agreement on the European Economic Area (*Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions*) as adapted to the EEA Agreement by Protocol 1 thereto (“Directive 2001/24/EC”);
- failing to ensure a derogation from the general principle of Article 10 of the Directive that the law of the home EEA State shall apply, in order to secure that the creditors’ rights of set-off and netting are not undermined in circumstances such as those described above, Iceland has failed to fulfil its obligations arising from Articles 23 and 25 of Directive 2001/24/EC.

Pursuant to the second paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, the EFTA Surveillance Authority requires Iceland to take the measures necessary to comply with this reasoned opinion within *two months* of its receipt.

Done at Brussels, 7 February 2018

For the EFTA Surveillance Authority

Bente Angell-Hansen
President

Frank J. Büchel
Responsible College Member

Högni Kristjánsson
College Member

Carsten Zatschler
Countersigning as Director,
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This document has been electronically authenticated by Bente Angell-Hansen, Carsten Zatschler.