

LANDSBANKI GUERNSEY LIMITED (IN COMPULSORY LIQUIDATION)

**SECOND INTERIM REPORT OF THE JOINT LIQUIDATORS TO CREDITORS AND
THE COMMISSIONER**

12 JANUARY 2012

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GLOSSARY

The following abbreviations are used in this report:

Butterfield BBGL	or	Butterfield Bank (Guernsey) Limited, which provides administration services to LGL
Court		The Royal Court of Guernsey (unless otherwise specified)
Deloitte		Deloitte LLP
Depositors		Depositors of LGL
E&Y		Ernst & Young LLP, London, who are the Administrators of Heritable.
Emergency Law		Icelandic Emergency Act no. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances
Heritable		Heritable Bank Plc, a fellow subsidiary of LGL
ICC		Informal Creditors Committee of LGL
Joint Liquidators		Mr Richard Anthony Garrard and Mr Lee Manning of Deloitte LLP
LGL		Landsbanki Guernsey Limited (in Compulsory Liquidation)
LIHF or Old Landsbanki		Landsbanki Islands hf, the 100% parent company of LGL
Liquidation		The Compulsory Liquidation of LGL
Loan Portfolio		The commercial loan portfolio assigned from Heritable to LGL in April 2008
New Landsbanki		Landsbankinn hf
Winding Up Board or WUB		The Winding Up Board of LIHF appointed to handle the winding up of LIHF

DISCLAIMER

1. This report has been prepared for the benefit of creditors. The information presented in this report has not been subject to independent audit verification by Deloitte LLP or by the Joint Liquidators.
2. The Joint Liquidators have formed the opinions expressed in this report on the basis of such information that has been made available to them at the date of this update. Should further information be made available, they reserve the right to revise or alter their opinions accordingly.
3. There are numerous references to legal advice received by the Joint Liquidators but they do not waive legal advice, litigation or any other privilege in respect of that advice.

STATEMENT OF AFFAIRS

4. The Joint Liquidators have prepared a statement of affairs as at 30 September 2011. A copy of the statement of affairs is attached at Appendix 1 to this Report. There are no significant developments since 30 September 2011 up to the date of this report other than as noted in paragraph 13.
5. The statement of affairs indicates that cash reserves (excluding ring-fenced amounts relating to the interim distribution made available to depositors) as at 30 September 2011 amounted to £4.15m.

PAYMENTS TO CREDITORS

6. As at 30 September 2011 the Joint Liquidators had made total payments of £102m to depositors and £0.6m to non-depositor creditors.
7. As at the date of this report, approximately 99% of proof of debt forms (both by reference to the number and value of accounts) have now been returned to the Joint Liquidators. The outstanding forms represent 13 depositors with amounts available for payment of £724k. Of these depositors, only 4 have yet to make any contact with the Joint Liquidators. The total balance available for payment (at 85p/£) for these 4 depositors amounts to approximately £322k out of the £724k.
8. Approximately £1.15m remains payable to depositors in respect of the interim distribution declared by the Joint Liquidators (this includes £724k in respect of depositors who have yet to provide proof of debt forms and £426k in respect of those depositors who have provided proof of debt forms but who have yet to provide their bank details to the Joint Liquidators). All priority creditors have been paid in full and payments of 85p/£ have been made to other ordinary creditors of LGL. **Any creditors who have returned their proof of debt forms but have yet to claim the interim distribution made available in February 2011 should return payment request forms to the Joint Liquidators as soon as possible.**
9. **The Joint Liquidators request that any depositors who have yet to provide their completed proof of debt forms or who have yet to contact the Joint Liquidators should do so as soon as possible.**

10. Further, given the Court and Commissioner's ruling that only those debts which have been proved in liquidation should be able to claim any distribution from LGL:
 - any depositors who received payments on account during the administration of LGL and who have not returned their proof of debt form will be pursued for return of those monies by the Joint Liquidators and those monies distributed among proved creditors should they not prove their debt via returning the proof of debt form; and
 - any deposits (in relation to depositors who have not made any contact with the Joint Liquidators) may, at the point of final dissolution of LGL, be distributed to other creditors proved in the liquidation.
11. In addition to seeking to communicate, at the last address provided, with those depositors who have not provided their proof of debt or otherwise not claimed their interim distribution, the Joint Liquidators have received approval from the Court that they can use tracing agency services in seeking to find the remaining depositors. The costs of these tracing services will be deducted, where practicable, from the respective depositors' entitlements on the basis that depositors are required, by the Terms and Conditions of their deposit, to notify LGL of changes of address details as soon as possible.

LOANS UPDATE

12. As at 30 September 2011, the Joint Liquidators had received total capital repayments of £40.5m (out of the original balance of £52.5m) and interest payments of £2.0m. As at 30 September 2011 the outstanding capital balance on the loan portfolio was approximately £8.2m, however the Joint Liquidators have made a provision of £4m against these loans.
13. Since 1 January 2011, £3.5m has been received in repayment of the outstanding loan amounts. Whilst not included in the 30 September 2011 statement of affairs figures, a further £1.15m has been received in capital and interest payments in the period from 30 September 2011 to 31 December 2011 resulting in cash available for distribution amounting to £5m at 31 December 2011 (30 September 2011: £4.15m).
14. The expected recoveries are dependent on the completion of the remaining residential property developments. The remaining loans are the more challenging loans which have suffered as a result of the stability of developers and current market conditions.
15. As previously advised, the resolution of the remaining loans has been made more difficult due to the economic environment and also to issues relating to the Master Transfer Agreement and cross collateral issues with Heritable Bank Plc whereby differences of interest continue with the Administrators of Heritable Bank plc who manage the remaining loans.

LEGAL ACTION IN ICELAND

Legal Proceedings

16. Further to the Joint Liquidators' update on the Icelandic Legal Proceedings provided to creditors in April and August 2011, the Icelandic Supreme Court has now handed down its verdict in relation to the various cases to which LGL has been party.
17. As previously advised, the Joint Liquidators had argued a case, on behalf of LGL and its creditors, in respect of the following matters:
 - *Wholesale deposits* – LGL, amongst a group of other ordinary unsecured creditors, challenged the decision of the Landsbanki Islands hf (“LIHF”) Winding Up Board to award these wholesale depositors priority on the basis that (1) the Emergency Law was invalid; (2) wholesale ‘deposits’ did not fall within the scope of the enhanced protection provided for deposits by the Emergency Law; and
 - *Icesave Cases* – Again, LGL amongst a group of other ordinary unsecured creditors of LIHF, had disputed the priority treatment accorded to this claim on the same basis as above.
 - *Notwithstanding*, any priority should in any event be limited to the maximum payable pursuant to the Icelandic Depositor Protection Scheme (i.e. €20,867).
18. As notified on the LGL website on 31 October 2011, the Joint Liquidators regret that the Supreme Court of Iceland has ruled that LGL (and other plaintiffs seeking to reduce the priority claimants) have been unsuccessful in their appeals following the rulings released on 28 October 2011.
19. A detailed summary of the rulings is attached to this report (in appendix 2) should creditors wish to understand the rulings in more detail.
20. One Supreme Court Justice had a dissenting view, concluding that Art. 6 of the Emergency Act no. 125/2008, cf. Art. 102 (3) of Act no. 161/2002 on Financial Undertakings, was a violation of the Icelandic Constitution, and therefore deposits should not be granted priority.
21. No legal fees were awarded, neither for the proceedings before the District Court of Reykjavik nor for the proceedings before the Supreme Court of Iceland.
22. Given how long it took the Supreme Court to come to its decision, the fact that there is a dissenting view in favour of LGL and other Plaintiffs and the fact that no legal fees are awarded does, in the Joint Liquidators' view, indicate that the ruling was in no way a foregone conclusion and thereby reflects the merit of appealing as the cost thereof is rather insignificant measured against the potential gain should LGL have prevailed.
23. It should be noted that, following the decision of the Supreme Court, LIHF has announced a first dividend distribution amounting to 27.5% to LIHF priority claimants. Whilst other creditors may seek to take their claim to the European Courts, this would not result in a delay in this distribution payment as any claim thereafter would be against the Icelandic Government rather than LIHF given the ruling by the Supreme Court.

24. As previously set out in the Joint Administrators' Report dated January 2010, the Joint Liquidators have been advised by their legal advisers that, as LGL is not an EU or EEA resident, it has no standing to make a claim against Iceland for a breach of EEA law. However EU and EEA resident depositors of LGL could possibly be able to make a claim although there remains some doubt as to whether there would be a sufficient causation between any discrimination giving rise to a breach of EEA Law and such depositors' losses as they are not direct depositor creditors of LIHF but potential creditors pursuant to LIHF's implicit guarantee of LGL's liabilities.
25. It should also be recognised that any remedy for a successful claim would likely consist of monetary compensation from the Icelandic Authorities for damages suffered and as such the claimants would be the only beneficiaries (i.e. there would not be expected to be a "creditor-wide" benefit as there would have been if the Emergency Laws were overturned).
26. It is, therefore, the Joint Liquidators' view (based on legal advice) that no further litigation should be taken in respect of the priority claims by LGL but the Joint Liquidators do expect to continue to consider the Alternative Claim (see below). The Joint Liquidators have sought the ICC's view and also that of the Guernsey Court as to whether they should continue with any further litigation in respect of the above matters. Both parties are in agreement that no further action should be taken in this respect.
27. Despite the Icelandic Supreme Court rulings, it is the Joint Liquidators' understanding that a market still exists for LIHF ordinary debt as the market had already discounted the prospects for success in the Icelandic courts and factored in the prospects for success in the European courts. Current prices in the market are approximately 3.5p-4p which, if the Joint Liquidators sold the LGL debt, would result approximately £500k being returned to LGL. Given the expected time frame for a European Court hearing, it is the Joint Liquidators' view that this market may exist for some time and as such a decision on the Alternative Claim is expected to have been made prior to a decision in the European Court thus allowing the Joint Liquidators to consider both courses of action.

Alternative Claim

28. Further to the Joint Administrators' fourth report to creditors, the "Alternative Claim" is also still being investigated and considered by the Joint Liquidators' Icelandic legal representatives. This claim, if successful, could result in LGL achieving a 100% return (subject to repatriation issues) on its claims as all deposits transferred to New Landsbanki were guaranteed by the Icelandic government.
29. The Joint Liquidators' Icelandic Counsel have advised that the Joint Liquidators should wait for a decision in respect of a similar claim brought in the administration of another of the failed Icelandic banks. This decision, together with those rulings already made, is expected to provide further guidance in relation to the criteria that would be used by the Icelandic courts in relation to the definition of "deposit" under the relevant Icelandic laws.
30. Icelandic Counsel advise that there is a four year statute of limitation period applicable to these types of claims in Iceland (running from October 2008), and that there is nothing that the Joint Liquidators need or should do to protect LGL's position at this stage. The

Court has approved that the Joint Liquidators can take the necessary steps to preserve LGL's claim without further reference to the Court.

31. It should be noted that, in the opinion of the Icelandic Counsel, the Alternative Claim should not be impacted by the verdicts noted above and the decision of the Winding Up Board to make a distribution to priority claimants in the winding up of LIHF as this claim would be made against New Landsbanki and the Icelandic Financial Supervisory Authority and/or the Icelandic State, and not LIHF.

Guarantee

32. As a result of the decisions made by the Icelandic Supreme Court noted above, the (unsigned) guarantee provided by LIHF to LGL depositors is expected to be valueless on the basis that there will be no assets available to pay out under the guarantee once all preferential creditors have been paid (assuming that the guarantee is first admitted as an ordinary creditor in by the Winding Up Board). As such depositors are not expected to have a viable recourse to LIHF. The Joint Liquidators also refer creditors back to sections 24 and 25 of this report in respect of potential recourse to the European Courts in this respect.

Icelandic Legal Costs Position

33. Currently, the Joint Liquidators have incurred costs in the amount of approximately £250,000 in respect of the Icelandic Proceedings. Broadly, these costs have been expended by the Joint Liquidators Icelandic Legal Counsel on:
 - Filing claims with the Winding Up Board of LIHF on behalf of LGL;
 - Corresponding with the Winding Up Board and its legal representatives in respect of LGL's claims; and
 - Drafting Court documents and attending and presenting oral arguments at Court hearings.The Joint Liquidators are satisfied that all expenditure to date is justified.

34. Creditors should refer to the August 2011 website update provided by the Joint Liquidators in respect of the reasons for the cost overruns to date.

COSTS OF THE LIQUIDATION/ADMINISTRATION

35. As at 30 September 2011 the costs of the liquidation/administration amounted to £5.6m which included Deloitte fees of £3.3m (of which £1.4m relates to the realisation of the Loan Portfolio), legal costs of £1.4m and £0.5m related to Butterfield Bank Guernsey Limited. The remaining balance comprises mainly ICC expenses and expenses in relation to the loan portfolio.
36. Total costs from 1 January 2011 to 30 September 2011 amount to £464k (which include Deloitte costs of £221k, £184k of legal fees and £77k of BBGL costs). The expected costs to the end of 2011 are expected to be over-budget by approximately £100k due to the increase in the Icelandic legal costs as previously advised to creditors in August 2011.

37. The Joint Liquidators expect that the liquidation costs for the last quarter of 2011 to be in the region of £0.1m (including foreseeable legal costs).
38. Liquidation costs for 2012 are budgeted to be approximately £310k assuming a final distribution is made and the liquidation closed which includes a Deloitte budget of £186k (of which £58k relates to the loan portfolio). This is assumed on the basis that the remaining two loans are realised and final Icelandic matters are resolved by this time albeit this may prove optimistic. The budget does not include any legal costs in relation to the Alternative Claim or any other litigation which may be undertaken.
39. The budget reflects a continuing volume of depositor enquiries, changes of details and other related legal matters which require attention while the liquidation continues. Whilst the Joint Liquidators have notified creditors that updates will be provided via the website in order to minimise costs, there remain a significant level of telephone enquiries regarding the progress of the liquidation which require attention and hence apply additional cost to the liquidation process.
40. The Joint Liquidators have considered the level of the budget for 2012 and the various options which may allow them to bring the liquidation to an earlier close and therefore minimise liquidation costs incurred. As a result of these considerations, the Joint Liquidators have identified a number of matters will require LGL to remain in liquidation at least to the middle of 2012. These include:
 - The realisation of the remaining two loans which are currently estimated to realise approximately £3.1m for LGL creditors (approximately 2.5p/£); and
 - The determination of the Alternative Claim, which given the potential value to LGL creditors, may have to be pursued by the Joint Liquidators subject to any decision by the Joint Liquidators to sell the LIHF debt. Given the timeframe for the current legal case referred to in 29 above this is unlikely to be resolved prior to mid 2012.

FUTURE DISTRIBUTIONS AND ULTIMATE RECOVERY

41. The Joint Liquidators continue to estimate the ultimate return to creditors of LGL to be between 87 to 91 pence in the pound and expect that there will only be one further distribution on dissolution of LGL.
42. However should the Alternative Claim in Iceland be successfully pursued then the recovery may increase (as the estimated recovery noted in 41 above assumes no return from LIHF). The Joint Liquidators remain very cautious about this eventuality. In addition EU depositors may also have recourse to the EU Courts (as described above) although this action is not available to LGL.

FURTHER UPDATES TO CREDITORS

43. The Joint Liquidators will continue to update creditors via the website in order to keep costs to a minimum. The Joint Liquidators will only provide updates when significant new information becomes available.

APPENDIX 1 – STATEMENT OF AFFAIRS AT 30 SEPTEMBER 2011

LANDSBANKI GUERNSEY LIMITED (IN COMPULSORY LIQUIDATION)

STATEMENT OF AFFAIRS

		06-Oct-08 Book value £'000s	Realised to date £'000s	30-Sep-11 Book value £'000s	Estimated Realisable Value/Actual realised value based on 6 October book values £'000s
Liquid Interbank Placements					
Ring fenced funds:					
Cash - POD forms received	1	-	-	695	-
Cash - POD forms not received	1	-	-	753	-
Other funds:					
Cash	3	41,266	41,266	4,153	41,266
Accrued interest		158	158	-	158
		<u>41,424</u>	<u>41,424</u>	<u>5,601</u>	<u>41,424</u>
Group Placements					
Heritable Bank (in Administration)	4	36,314	28,509	-	28,509
Landsbanki Islands hf (in Receivership)	5	12,753	-	-	-
		<u>49,067</u>	<u>28,509</u>	<u>-</u>	<u>28,509</u>
Loan Assets Supported by UK Property Security					
Loan Assets	6	52,449	40,525	4,217	43,533 - 44,743
Accrued interest on Loan Assets	7	183	183	-	183
Other Assets					
	8	238	-	-	-
Total Assets		<u>143,361</u>	<u>110,641</u>	<u>9,818</u>	<u>113,649 - 114,859</u>
Client Liabilities					
Ring fenced deposits:					
Interim distribution – POD forms received	9	-	-	695	-
Interim distribution - POD forms not received	9	-	-	753	-
Other deposits:					
Capital and accrued interest	10	120,651	-	18,329	-
		<u>120,651</u>		<u>19,777</u>	
Estimated Unsecured and Preferred Creditors					
EUSD retention tax payable to ITA	11	530	-	184	-
	2	-	-	-	-
Total Liabilities before costs of the Administration/Liquidation		<u>121,181</u>		<u>19,961</u>	
Accrued costs of the Liquidation					
	12	-	-	107	-
Total Liabilities including costs of the Administration/Liquidation		<u>121,181</u>		<u>20,068</u>	
Net Assets		<u>22,180</u>		<u>(10,250)</u>	
Share capital and reserves					
Share capital		10,000		10,000	
Reserves		12,180		(20,250)	
		<u>22,180</u>		<u>(10,250)</u>	

Notes

- The ring fenced cash represents the net amount left unpaid to depositors following the announcement of the interim distribution of 85p/£. This has been split between those amounts where proof of debt (POD) forms have been received and where POD has not been provided. 99% of POD forms (by number and value) have been received.
- EUSD payable is the amount due to the Income Tax Authority (for those depositors retaining retention tax status)/repayable to depositors following the decision to repay retention tax deducted to date following the agreement with the ITA that interest was not accrued until the adjudication of claims in January 2011 when Retention Tax went into its transitional phase.
- This is the remaining cash held with Lloyds after the transfer to the ring fenced account plus the receipt of non-ring fenced element of the £1.2m of returned funds from BACS and CHAPS payments that were stopped (these were not included in the 6 October 2008 cash balance) plus the interest and capital repayments received on the Loan Portfolio and distributions from Heritable Bank Plc, less any expenses paid.
- The Heritable debt was sold on 7 January 2011 at 83p/£, less distributions received to date.
- No interest is assumed to be accruing on the balance held with Landsbanki Islands hf. The principal balance is in fact approximately £15m having been increased by currency accounts originally thought to be held with Heritable Bank Plc. Full provision has been made against the balance.
- The movement in loan asset position is due to the capital repayments received during the period to 30 September 2011 and capital write offs and provisions amounting to £7.8m.
- This reflects accrued interest and arrears. No accrued interest remains receivable as it is expected that there will not be full recovery on the capital on the remaining loan balances.
- Other assets relate to fixed assets - capitalised costs in relation to the setting up of the online banking system and leasehold improvements along with some minor prepayments. Due to the nature of these assets there is no recoverable value and the balance has been written off.
- This represents amounts due to depositors in respect of the interim distribution. This is split between those who have provided their POD forms and those who have not.
- This represents the remaining balance of depositors funds excluding amounts made available in the interim distribution.
- Preferential creditors were paid in full and non-preferential creditors have been paid 85p in the pound as at 30 September 2011.
- Costs of the liquidation represents accrued fees payable to Deloitte LLP, Butterfield Bank (Guernsey) Limited, Hogan Lovells LLP (including leading counsel), Jonsson & Hall (Icelandic lawyers) and Collas Crill (formerly Collas Day). These fees will be paid during October/November 2011.

Landsbanki Guernsey Limited ("LGL") is in Compulsory Liquidation and the affairs, business and property of LGL are being managed by the Joint Liquidators, Mr Rick Garrard and Mr Lee Manning of Deloitte LLP.

RECONCILIATION OF MOVEMENT IN DEPOSITORS BALANCES FOR THE PERIOD FROM 6TH OCTOBER 2008 TO 30 SEPTEMBER 2011

	£'000s
Opening depositors balance (including accrued interest)	120,651
Payments to depositors (including ring fenced interest and charges)	(102,065)
Interest accrued on ring fenced balances to 19 January 2011	61
Net Retention tax deducted	(6)
Stopped payments - amounts recredited to depositor accounts	1,135
Closing depositors balance (including accrued interest)	<u>19,777</u>

RECEIPTS & PAYMENTS ACCOUNT FOR THE PERIOD FROM 6TH OCTOBER 2008 TO 30 SEPTEMBER 2011

		£'000s
OPENING CASH BALANCE		41,266
RECEIPTS		
Stopped payments - amounts recredited to depositor accounts	1	1,135
Tax refund		144
Interest credited - interbank placements (net of charges)	2	266
Interest credited - Loan Portfolio (net of Heritable administration fee)	3	2,071
Capital repayments on Loan Portfolio		40,525
Sale of Heritable debt		11,298
Distributions from Heritable Administration		<u>17,211</u>
		72,650
PAYMENTS		
Advance re Loan portfolio		(125)
Payments to depositors		(102,065)
EUSD retention tax payment		(6)
Payments to non-depositor creditors	4	(600)
Costs of the Administration/Liquidation	5	<u>(5,520)</u>
		(108,316)
NET PAYMENTS		<u>(35,665)</u>
CLOSING CASH BALANCE		5,601
Per Statement of Affairs		
Total Ring fenced funds at 30 September 2011		1,448
Non-ring fenced funds at 30 September 2011		<u>4,153</u>
		5,601

Notes

- Additional funds returned to LGL in the period as a result of payments being stopped in line with the Administrators instructions on appointment.
- Interest received on interbank placements during the period net of charges paid from breaking a fixed deposit held with a third party bank.
- Interest payments on the Loan Portfolio received from the Administrators of Heritable.
- Payments made to preferential (100p/£) and non-preferential (85p/£) non-depositor creditors.
- Amounts paid to Deloitte LLP, Butterfield Bank (Guernsey) Limited, Collas Crill, Hogan Lovells LLP, Jonsson & Hall and other suppliers during the Administration/Liquidation.

Landsbanki Guernsey Limited ("LGL") is in Compulsory Liquidation and the affairs, business and property of LGL are being managed by the Joint Liquidators, Mr Rick Garrard and Mr Lee Manning of Deloitte LLP.

LANDSBANKI GUERNSEY LIMITED (IN COMPULSORY LIQUIDATION)

PROFIT AND LOSS ACCOUNT FOR THE PERIOD FROM 6TH OCTOBER 2008 TO 30 SEPTEMBER 2011

		£'000s
Interest income - Interbank Placements		266
Interest income - Loan Portfolio	1	<u>1,888</u>
Net income		2,154
Loan portfolio write off and provisions	2	(7,832)
Heritable and LIHF provisions	3	(20,558)
Ring fenced interest due to depositors	4	(61)
Tax refund		144
Other expenses	5	<u>(650)</u>
Net loss for the period before costs of the Administration/Liquidation		(26,803)
Costs of the Administration/Liquidation		
Deloitte LLP		(3,259)
Butterfield Bank (Guernsey) Limited		(522)
Collas Day		(569)
Hogan Lovells LLP		(549)
Jonsson & Hall		(244)
ICC costs		(70)
Other costs (including loan book realisation costs)		(414)
Net loss for the period including costs of the Administration/Liquidation		<u>(32,430)</u>

Notes

- 1 Interest for the period on the Loan Portfolio.
- 2 Write off and provisions made against the Loan Portfolio for irrecoverable balances and estimated final recoveries on the remaining loans.
- 3 Provisions made LIHF balances (100%) and write off of 17% of the Heritable debt following the sale on 7 January 2011.
- 4 Ring fenced interest due to depositors.
- 5 Creditors of LGL as at the date of Administration identified after the initial statement of affairs as at 6 October 2008 was prepared, including employee claims, finalisation of tax returns and other third party claims together with write off of other assets.

Landsbanki Guernsey Limited ("LGL") is in Compulsory Liquidation and the affairs, business and property of LGL are being managed by the Joint Liquidators, Mr Rick Garrard and Mr Lee Manning of Deloitte LLP.

APPENDIX 2 – DETAILED RULINGS BY THE SUPREME COURT OF ICELAND

I. General

LGL and others (the “Plaintiffs”) appealed rulings of the District Court of Reykjavik, recognising for the most part the claims of Gemeente Alphen aan den Rijn, Gemeente Dordrecht, University of Oxford, Kent County Council, Wiltshire Council, Aylesbury Vale District Council, Norfolk County Council, the Financial Compensation Scheme and De Nederlandsche Bank N.V. (the “Defendants”, together with Landsbanki Islands hf (“LIHF”)), and accepting the claims as priority claims with reference to Art. 112 of the Icelandic Bankruptcy Act No. 21/1991, in LIHF’s winding up.

The Plaintiffs based their cases on various premises, among them that they had suffered losses resulting from the adoption of Act No. 125/2008, on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. (the so-called “Emergency Act”, the “Act”), and that provisions in this Act were in violation of Art. 65 (the principle of equality) and Art. 72 (the principle of free enjoyment of property rights) of the Icelandic Constitution and of specifically cited international conventions to which Iceland had acceded, including, but not limited to, Art. 14 (the principle of equality) and Art. 1 of Protocol 1 of the European Convention on Human Rights (ECHR) and Art. 4 and Art. 40 of the Agreement on the European Economic Area.

II. The Emergency Act No. 125/2008 (cases no. 300/2011, 301/2011, 310/2011, 311/2011, 312/2011, 313/2011, 314/2011, 340/2011, 341/2011).

The Supreme Court's verdict stated that it was undisputed that following rapid growth of the Icelandic economy for several years, which was not least related to the expansion of the country's largest commercial banks following their privatisation in the early years of this century, the situation had deteriorated in 2007, and the consequences had been felt suddenly and very severely at the end of September and the first days of October 2008. Furthermore, it was evident that the time available for the drafting of the main portion of the Bill which became Act No. 125/2008 had been extremely short, in being only a few days. The Supreme Court provided an account of the interpretative sources underlying the Act and pointed out that it was the responsibility of the courts to decide whether specific statutory provisions, which were disputed, violated the Constitution and there was no procedural necessity for the Icelandic State to be a party to the case. The Supreme Court described the circumstances which prevailed in Iceland in the autumn of 2008 and prompted the adoption of Act No. 125/2008. The verdict then stated that, considering the major and unprecedented difficulties which had to be dealt with, and the clear objectives which had been aimed at, in resolving the question of the legality of the legislature's decisions, it was necessary to grant it extensive scope in assessing what routes were to be taken to respond to the complex and perilous situation which had arisen.

The Supreme Court agrees with the Plaintiffs, including LGL, that their claims rights are considered to be property, in the meaning of the Icelandic Constitution and Protocol 1 of the ECHR. With regard to perspectives of legitimate expectations, the Court pointed out, however, that the legislature had in many previous instances assumed that it was authorised to alter the priority of claims in liquidation without constitutional provisions limiting its scope to do so. Next the Supreme Court gave examples of such legislation, and in its verdict stated that when these were taken into consideration the Plaintiffs' contention, that they could legitimately have expected the legislature not to take action in this respect to their disadvantage, could not be accepted; this applied in particular to those parties among the Plaintiffs who acquired their

claims after 6 October 2008, since the risk they were taking had been perfectly clear to them.

The Plaintiffs also maintained that Act No. 125/2008 had infringed their rights retroactively, which was unlawful in view of cited provisions of the Constitution and international agreements. In this regard the Supreme Court verdict stated that it had pointed out above a variety of amendments to the law on the ranking of claims by priority which were to apply henceforth. The adoption of Act No. 125/2008 had prescribed the ranking of claims against financial undertakings, which would be wound up after the enforcement of the Act. It did not provide for new arrangements in winding-up proceedings which had already commenced or had concluded. The Plaintiffs' contention in this regard was accordingly rejected. The verdict also stated that Act No. 125/2008 applied substantially to all financial undertakings; upon the adoption of the Act there was high probability of the insolvency of the three largest commercial banks. It had been demonstrated in this case that claims lodged in the winding-up of these banks totalled almost 50,000, 12,000 of them in the winding-up of the defendant LIHF, although no information was provided as to how large a portion of these claims would be ranked with reference to Art. 113 of the Icelandic Bankruptcy Act No. 21/1991. It had also been pointed out that there was a likelihood of greater payment for general claims in the winding-up of banks other than the defendant LIHF. The Act had not been adopted to apply temporarily but provided for new permanent arrangements. Accordingly, it had to be assumed that the Act had determined on a general basis how claims in the winding-up of financial undertakings were to be ranked, which could alter the rights of a great number of creditors of Icelandic financial undertakings and not merely those of the Plaintiffs. The verdict pointed out that prior to the adoption of Act No. 125/2008 a run had begun on the banks due to depositors' loss of confidence. New banks had been established in Iceland in direct continuation of the entry into force of the Act on the basis of the former banks and the old banks' deposits in Iceland had been transferred to the new banks. To achieve the objective of a functioning banking and payment system, the legislature had deemed it necessary to grant priority to deposits in the winding-up of financial undertakings and thereby instil in depositors confidence in the new banks and stop the run on the banks which had already begun. The Defendants had pointed out that in so doing, the run on the banks had been ended and had subsequently subsided over the course of the next two to three weeks. Their contention that the objective of Act No. 125/2008, of ensuring the functioning of banking activities and payment systems in Iceland and that deposits would be secure, was therefore unrefuted. Their argument that there were objective reasons underlying the legislature's decision to grant deposits priority was accepted, cf. Art. 6 of Act No. 125/2008.

The Supreme Court also rejected limiting the priority of deposit claims to EUR 20,887. The Court's verdict then stated that when consideration was given to statistical data cited, the contents of which had in this respect not been contested during the pleading of the case, it had to be deemed to have been demonstrated that, to achieve the legislature's objectives of preventing the run on and the collapse of the banks, it had been necessary to protect the deposits of domestic parties in excess of EUR 20,887, as the effect of limiting priority to this amount would likely have been contrary to the legislature's objectives of creating stability and confidence in the new banks in Iceland. On the basis of this conclusion, it had been the duty of the legislature to ensure, to the extent possible, that foreign depositors would enjoy a similar position. Bearing in mind the serious economic situation and the obligations of the state towards Icelandic society and international agreements, it could not be accepted that the principle of proportionality had been violated with the adoption of Act No. 125/2008.

The Supreme Court's verdict stated that in resolving the constitutionality of the Act, it had previously referred to the legislature's extensive scope in assessing the necessity of decisions

which were manifest in the Act, in circumstances where great risk had jeopardised the very existence of the society due to the chain reaction of the collapse of the largest commercial banks, which could have ended with the collapse of the country's entire economy. Under these circumstances, the legislature was not only entitled but obliged by its constitutional responsibility to ensure the welfare of the general public and the financial reckoning resulting from the banks' collapse had to be settled primarily between those parties who had direct interests at stake towards them. The contention of the Defendants, that no other option had been available which would in fact had provided a probability of achieving the objective of the Act and would have been more equitable than the one chosen, was unrefuted. The Plaintiffs' contention that Act No. 44/2009 had once more violated their rights was unsupported and ungrounded, as the wording of Art. 6 of Act No. 125/2008 had been amended slightly by the said Act without affecting its substance. In accordance with all of the above, it was evident that the legislature had not, in the actions which were concerned in the parties' dispute, exceeded its authority, having regard to the legal sources which have previously been mentioned. The Plaintiffs' contentions based on these premises were therefore rejected.

III. Wholesale deposits (cases no. 300/2011, 301/2011, 310/2011, 311/2011, 312/2011, 313/2011, 314/2011).

The Supreme Court's verdict stated that according to Art. 102 (3) of Act no. 161/2002 on Financial Undertakings the same rules applied to the winding-up of a financial undertaking as to the priority of claims against a bankrupt estate. However, claims for deposits according to Act No. 98/1999 should enjoy priority in accordance with Art. 112 (1&2) of the Icelandic Bankruptcy Act no. 21/1991. The term deposit according to Art. 9 (1) of Act No. 98/1999 meant, according to Art. 9 (3), a deposit originated from a deposit or credit transfer in normal and general banking and a commercial bank or a savings bank was obliged to pay back in accordance with the terms that applied according to laws or agreements. The Supreme Court traced the transactions between the creditors and LIHF and concluded, with respect to the transactions and otherwise to the conclusion of the verdicts of the District Court of Reykjavik (whose conclusion was based inter alia on the following arguments:

- a. The court did not consider the wording of the underlying documents, i.e. the confirmation or contract between Landsbanki and the creditor, to give any definite explanation of the nature of the transaction.
- b. The court accepted that these were in fact so-called wholesale deposits, and that LIHF did in fact pay fees to the Icelandic Deposit Guarantee Fund on the wholesale deposits.
- c. The court referred to a definition of wholesale deposits in an agreement regarding the supervision of LIHF's wholesale deposits between LIHF and Heritable Bank (the British wholesale deposit cases).
- d. The court denied that the following characteristics supported the Plaintiffs' arguments of the creditor's funds not being a "deposit" according to Act No. 98/1999:
 - i. The funds must have been kept in a separate account. (The court referred inter alia to the wording of Art. 1 (1) of EU Directive 94/19, and considered that the provision did not particularly support that a deposit must have been kept in a separate account in order to fall under the term "deposit" according to Act No. 98/1999).
 - ii. The funds were not accessible until the maturity date. (The court referred to fixed terms of traditional deposit accounts, including fixed terms of Landsbanki's so-called fixed-interest-account, stating that at the end of the term the deposit and accrued interest should be paid to a special disbursement account specified by the depositor).
 - iii. The place of payment was not at LIHF, but at the creditor's.

- iv. LIHF's fixed terms did not apply to those transactions, as the creditors were able to negotiate interest rates through an intermediate broker. (The court referred inter alia to the terms of the Icesave accounts, stating inter alia that the deposits were based on special agreements between the bank and the depositors – the court also referred to Art. 9 (3) of Act No. 98/1999, stating that a deposit could be based on an agreement – moreover, the court considered the approach of a broker to be meaningless).
- e. The court pointed out that no further explanation of the term “deposit” was found in the explanatory notes with Act 98/1999.
- f. The Plaintiffs maintained that the definition of “deposit” according to Art. 9 (3) of Act No. 98/1999 should be interpreted narrowly (i.e. in case of any doubt whether a transaction or funds should be considered “deposit” it should be excluded), as considering a transaction or funds to be a “deposit” has the legal effects of the transaction or funds being granted priority, which is an exception from the principle of equality of the creditors. This was, however, denied by the court. The court stated that Act 98/1999 must be interpreted in line with EU Directive 94/19, which does not state that such form of deposits (probably wholesale deposits) shall be exempted from the deposit guarantee. The court further referred to Art. 7 (2) of the Directive, which states that member states are able to exempt certain deposit forms or depositors, e.g. municipalities or larger investors, from the guarantee scheme. That had, however, not been done by the Icelandic State. The court also stated that even though the objective of protecting individuals and smaller investors had quite a substantial meaning when establishing the Deposit Guarantee Fund it was clear that the objective of a general financial stability and the strengthening of the financial system even had more meaning. Therefore, the court concluded that no arguments are in favour of an interpretation strictly in accordance with the wording of Art. 9 (3) of Act No. 98/1999.
- g. The court denied that the creditor's claim could be considered a security (which should not enjoy the deposit guarantee).
- h. The court considered LIHF's receipt of a wholesale deposit to be a part of a “normal banking transaction”, as such deposits fell under LIHF's operational licence (according to Art. 20 (1) of Act No. 161/2002 on Financial Undertakings), that the creditors had a claim with LIHF which should be considered to be a deposit according to Art. 9 (3) of Act No. 98/1999, and those deposits enjoyed guarantee under that Act. As a result, the creditors' claims enjoyed priority in accordance with Art. 112 of the Icelandic Bankruptcy Act No. 21/1991.