

Landsbanki Guernsey Limited (in Compulsory Liquidation)

APPENDIX TO WEBSITE UPDATE 31 OCTOBER 2011

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.