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IN THE EFTA COURT
Case E-16/11

ORIGINAL

Reykjavík, 8 March 2012

TO THE PRESIDENT AND MEMBERS OF THE EFTA COURT

DEFENCE

Submitted pursuant to Article 35 of the Rules of Procedure of the EFTA Court by

THE GOVERNMENT OF ICELAND

Represented by Mr. Kristján Andri Stefánsson, Ambassador, acting as Agent, Ms. Þóra M. Hjaltested, Director, as Co-Agent, and Mr. Tim Ward QC, Barrister, as Counsel[1]

seeking a declaration, that the application lodged by the EFTA Surveillance Authority in Case E-16/11 shall be dismissed.

The Government of Iceland has the honour of lodging the following defence with the Court.

[1] The Ministry wishes to acknowledge that this Defence is the product of a team of lawyers and external advisors both within Iceland (State Attorney General Einar Karl Hallvarðsson, Supreme Court Attorney Jóhannes Karl Sveinsson, Lecturer Kristín Haraldsdóttir and Supreme Court Attorney Reimar Pétursson) and outside (Professor Miguel Poiares Maduro).

INTRODUCTION

1. By this action, the EFTA Surveillance Authority ("the Authority") seeks a declaration that:

> "by failing to ensure payment of the minimum amount of compensation to Icesave depositors in the Netherlands and in the United Kingdom provided for in Article 7(1) of the Act referred to at point 19a of Annex IX to the Agreement on the European Economic Area (*Directive 94/19/EC of the European Parliament and of the Council laid of 30 May 1994 on deposit-guarantee schemes*) within the time limits laid down in Article 10 of the Act, Iceland has failed to comply with the obligations resulting from that Act, in particular its Articles 3, 4, 7 and 10, and/or Article 4 of the Agreement on the European Economic Area."

2. The Icelandic Government contends that the claim is entirely misconceived. The Authority has misunderstood the true nature and extent of the obligations imposed by the Directive. Its position is inconsistent with the case law of the Court of Justice of the European Union ("Court of Justice"), and the published views of the European Commission ("Commission").

3. The Authority's case is that Directive 94/19/EC ("the Directive") imposes an "obligation of result" upon the State that was not attained. It does not contend that Iceland failed to implement the Directive's requirement to establish and officially recognise a deposit-guarantee scheme. The relevant national provisions establishing the Icelandic deposit-guarantee scheme ("TIF") are set out at paragraphs 11 - 17 of the Application. They plainly satisfy the requirements on the face of the Directive.

4. Moreover, as shall be explained, the TIF was not a purely "formal" deposit-guarantee scheme, or a guarantee scheme that existed on paper only. It was pre-funded with substantial assets, in accordance with the manner in which the Directive has been implemented across the EU.

5. The TIF was nevertheless wholly unable to cope with the failure of 85% of the Icelandic banking system within a few days in October 2008. But this was not due to any <u>defect</u> in that scheme. The reality is that <u>no</u> deposit-guarantee scheme could have

withstood the shocks upon the Icelandic banking system at that time. It is not remotely practicable to pre-fund such a scheme up to anything like the full extent of potential exposure. To try to do so would freeze the banks' capital and render them unable to perform the lending activities that are essential to the wider economy.

6. The Commission has made clear that it does not anticipate that a deposit-guarantee scheme should or would be able to cope with a system-wide banking failure: in its latest proposals for reform of the Directive, it has suggested that the funding of deposit-guarantee schemes by credit institutions should be harmonised to ensure they are able to withstand a "mid-sized" bank failure – meaning a failure concerning 0.81% of eligible deposits.[2] The Icelandic crash was in the order of 100 times larger. The sums which were guaranteed by TIF were more than Iceland's annual tax revenues.

7. The question is whether the fact that TIF could not compensate the depositors in the Icesave account within the year allowed by the Directive gives rise to any breach by the Icelandic State of its obligations under the Directive. The Authority argues that the result required by the Directive is:[3]

> "1. To ensure that a deposit guarantee scheme, capable of guaranteeing the deposits of depositors up to the amount laid down in Article 7(1) of the Directive, is set up, and
>
> 2. To ensure that duly verified claims by depositors of unavailable deposits are paid within the deadline laid down in Article 10 of the Directive."

8. That raises a question as to what is meant by "ensure" in this context: what exactly are the obligations that Iceland is said to have failed to meet?

9. In substance, the Authority's argument is that the result required of the State is not just to establish a deposit guarantee scheme, but to guarantee its performance: that the Directive imposes an automatic State liability to pay the sums specified by the

[2] Impact Assessment accompanying a proposal for a recast directive on Deposit Guarantee Schemes SEC (2010) 834/2, pg 20 and fn 46.
[3] Application, para 71.

Directive in the event that a deposit-guarantee scheme fails. It explains that the obligations upon the State mean that:[4]

> "should all else fail, the state will ultimately be responsible for the compensation of depositors up to the amount provided for in Article 7, in order to discharge its duties under Directive 94/19/EC". (emphasis added)

10. Thus, the Authority's argument is that if "all else fails" then the State must pay the sums guaranteed. This is not, however a claim for damages brought by an individual for failure to implement the Directive. Such a claim must satisfy the criteria established in *Sveinbjörnsdóttir/Factortame.*[5] The Authority has not sought to argue that those conditions are satisfied.[6]

11. The Authority's argument must therefore be that the obligation upon the State to provide funding when "all else fails" is found in the Directive itself. There is plainly, however, no express obligation of this kind in the Directive. In truth, it simply does not address this situation at all.

12. The Authority appears to confuse:

    a) the obligation of result upon the Contracting States to fully implement the provisions that the Directive contains, and

    b) an obligation to guarantee that the general legislative objectives pursued by the legislator are actually achieved.

13. The Court of Justice has made clear that the "general result which the Directive seeks to achieve" is "a considerable improvement in the protection of consumers".[7] But it cannot be inferred that the State is under an obligation of result to guarantee that this objective is attained.

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[4] Application, para 133.

[5] Case E-9/97 *Erla María Sveinbjörnsdóttir v Iceland* [1998] EFTA Court Rep 95, para 66; Joined Cases C-46/93 and C-48/93 *Brasserie du pêcheur and Factortame* [1996] ECR I-1029, paragraph 51.

[6] For the avoidance of doubt, Iceland would strenuously resist any such argument.

[7] Case C-233/94 *Germany v Parliament and Council* [1997] ECR I-2405, para 48, quoted at paragraph 87 of the Application.

14. The Authority's argument simply assumes that the State itself becomes liable where a banking failure occurs on such a scale that a deposit-guarantee scheme cannot pay out.

15. Such a State guarantee would be a very different proposition to the explicit requirements of the Directive: it would impose a substantial burden on the public resources of the Contracting States arising out of the largely private activities of credit institutions. In the present case, the liability of TIF exceeded one year's revenue of the Icelandic State. The Icelandic Government contends that on the true analysis of the Directive, the legislature intended that the institutions that enjoy the rewards of deposit taking, were also intended to bear the costs of the Scheme. As shall be explained, it is clear that this is also the view of the Commission.

16. On the Authority's case, the financial obligation on the States is an exceptionally onerous one. Very substantial (and costly) contingency planning would be required to meet it throughout the Contracting States. Iceland's Institute of Economic Studies has calculated that the cost of funding the deposit-guarantee scheme in each Member State of the EU in the event of a system-wide banking crisis would average 83% of gross domestic product ("GDP").[8] The Authority's argument accordingly exposes the Contracting States to a vast liability, which would materialize at the worst given time, viz. in a systemic financial crisis. Given the financial difficulties currently experienced by some of those States, and the very real risk of a sovereign default that already exists, the consequences of such an argument may prove to be exceptionally serious. Iceland contends that it would require the clearest possible language to impose so onerous an obligation.

17. It does not follow, however, that in the event of a system-wide failure, Contracting States are powerless to help banks or their depositors.

18. As the Commission has recognised, the Member States may provide financial support where a financial collapse is of such a scale that a deposit-guarantee scheme is unable to cope. But any such State intervention has the ability to seriously distort competition. As a result, any such intervention must be in "strict obedience to the

[8] Report of the University of Iceland, Institute of Economic Studies, 6 March 2012, pages 9-10

State aid rules", and not as a result of a legal obligation under the Directive.[9] Thus, any such State funding takes place outside the Directive, and subject to the approval of the Authority, or the Commission.

19. The logic of the Authority's argument is, however, that the States are under a duty under the Directive to provide this support – which may involve a massive injection of State resources. The Authority's attempt to derive such an obligation from the wording of the Directive is contrary to the requirements of legal certainty, which requires that the rules of EEA law should be "clear and their application foreseeable for all those concerned", in order that parties are in a "position to know" what the law requires.[10]

20. Overall, the Authority's argument fails to recognise the true nature (and limitations) of deposit-guarantee schemes. The interpretation it proposes would be an obligation upon the Contracting States to achieve a result that no deposit-guarantee scheme itself could ever itself achieve: a guaranteed payout, even in the event of a collapse of the entire banking system.

21. The Icelandic Government contends that this approach is entirely misconceived. This is not to say that there is an "exception" from the Directive that applies in the case of systemic collapse of the banking system. The point is rather that when the Authority's analysis is tested against the facts that arose in Iceland in 2008, that analysis breaks down; it leads to results that the legislature cannot have intended.

22. Indeed it is the Authority that seeks to depart from the express language of the Directive in the exceptional case of a system-wide banking failure. It argues that in those circumstances, an obligation arises upon the State – even though the Directive does not say so. The effect is to turn a system-wide banking failure into an automatic breach of the Directive.

23. The reality is that a system-wide crisis such as occurred in 2008 could not be dealt with under the Directive. It is a partial harmonisation measure with the relatively narrow aim of putting in place a deposit-guarantee scheme. As shall be explained,

[9] Impact Assessment, section 3.2, pg 8 final para.
[10] Case C-390/98 *R v HM Treasury ex p University of Cambridge* [2000] ECR I-8035, paras 38 – 42.

during the crisis, a wide range of measures were put in place throughout the Contracting States, including, but not limited to the grant of extensive State aid Iceland sought to deal with the problems caused by the crisis in part through a restructuring of its banking system – a matter that is entirely outside the scope of the Directive.

24. The position now is that all Icesave depositors have received at least the €20,000 which is provided for by the Directive: whether from the assets of the collapsed banks or, in the case of most of the investors holding accounts in the Dutch or British branches of Landsbanki, from the Dutch or British Governments.

25. It is anticipated that 100% of the compensation advanced by the British and Dutch Governments to the individual depositors will be repaid from the proceeds of the winding up of Landsbanki, before the end of next year. Substantial sums have already been paid That winding up is being conducted by an independent Winding Up Committee.

26. In summary, the Icelandic Government contends that:

a) The Directive is a partial harmonisation measure which is concerned solely with deposit-guarantee schemes.

b) On its true construction, the Directive imposes obligations upon the Member State to ensure the proper establishment and recognition of a deposit-guarantee scheme. It also imposes certain duties of supervision upon the State.

c) There is however, no "obligation of result" that the State should use its own resources to guarantee the payout of a deposit-guarantee scheme in the event that "all else fails". In fact, the Directive is entirely silent as to the consequences of the failure of a deposit-guarantee scheme.

d) In its argument to the contrary, the Authority has read into the Directive strict obligations upon the State that cannot be found in its express provisions. If the Parliament and the Council had intended such consequences, they would have said so expressly.

e) Nor does the purpose of the Directive require that any such strict obligation should be imposed. In terms of consumer protection, it seeks to attain a "high level" of consumer protection: not absolute consumer protection. The Authority's approach would in any event impose substantial costs on consumers, as well as the potential benefit of a State guarantee. In reality, the Directive strikes a balance between those costs and benefits, which the Authority's argument seeks to override.

f) Moreover, the Authority's argument is fundamentally inconsistent with the case law of the Court of Justice.

g) In the alternative, even if, contrary to the Authority's case, the Directive did impose strict obligations upon the State to fund the guarantee scheme in the event of its collapse, Iceland was prevented from doing so by *force majeure:* the Icelandic Government simply lacked the resources to pay the sums in question.

27. The Authority also argues that the Icelandic Government breached the principle of non-discrimination.

28. There are three reasons why this claim fails.

29. First, the Authority has failed to identify the legal basis for the application of the rules on non-discrimination contained in the EEA Agreement to the specific facts of this case. The measures challenged essentially concerned the restructuring of Iceland's banks. They lie entirely outside the provisions of the Directive.

30. Secondly, and as a result, the Authority's argument amounts to an impermissible attempt to extend the specific requirements of the Directive.

31. Thirdly, if there was any *prima facie* discrimination, it was in any event objectively justified. The difference in treatment complained of was a consequence of a package of measures adopted by the Icelandic Government as part of a high stakes rescue mission in order to safeguard the functioning of the domestic banking system and the real overall economy in Iceland at that time. As the Authority itself has observed, in

dismissing certain complaints about the Icelandic measures: "[t]he existence of a banking system is of vital importance not only for the economy of the state but also for society as a whole, since payment systems of the country depend on it."[11] In the case of Iceland, that system had essentially collapsed. As the Icelandic Supreme Court found (also dismissing a challenge to certain aspects of Iceland's response to the crisis), Iceland faced a "complex and dangerous situation" that could "immediately or very quickly have led to great distress for the public and all economic operators in Iceland."[12] The measures adopted were not discriminatory treatment under the deposit-guarantee scheme, but in any event, in the exceptional circumstances that Iceland faced, were plainly objectively justified.

32. The Icelandic Government accordingly submits that this application is wholly without merit and should be dismissed.

THE BACKGROUND FACTS

33. The Authority has presented a narrow account of the background to this action in its Application. It has also served with its Application Chapters 17 and 18 of the Report of the Special Investigation Commission ("SIC") of April 2010. The Authority places very little express reliance upon the detailed contents of that Report in its application. The Icelandic Government would observe that the SIC was not seeking to determine the issues raised in this Application. It gave consideration to the Directive, but did not seek to determine the extent of the obligation placed upon the Icelandic State. Accordingly, the Icelandic Government does not consider that it would assist this Court to engage in a detailed commentary on the contents of the SIC Report.

34. The Icelandic Government wishes, however, to place this Application into context, and to emphasise the following factual matters.

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[11] Decision No. 501/10/COL of 15 December 2010 to close seven cases against Iceland commenced following the receipt of complaints against that State in the field of capital movements and financial services, para 89.

[12] http://www.lbi.is/home/news/news-item/2011/10/28/Supreme-Courts-Verdict-in-Disputes-concerning-Icesave-Deposits/

The Icelandic deposit-guarantee scheme

35. The legislation governing the Icelandic deposit-guarantee scheme ("the TIF") is set out at paragraphs 11 - 17 of the Authority's application.

36. The TIF was pre-funded to the level of a "minimum of 1% of the average amount of guaranteed deposits in commercial banks and savings banks during the previous year".[13] Should the assets of the fund prove insufficient, the Board of Directors of TIF also had power "if it sees compelling reasons to do so, [to] take out a loan in order to compensate losses suffered by claimants."[14]

37. As shall be explained, this scheme was entirely in accordance with norms within the EU. The Authority rightly does not seek to suggest that the TIF itself was flawed, or other than in accordance with the requirements of the Directive.

38. It is accordingly quite wrong for the Authority to argue that Iceland "in practice took no measures to achieve any result different from leaving those depositors without any guarantee at all".[15]

The worldwide financial crisis

39. The collapse of the Icelandic banks took place against the background of a worldwide financial crisis. A 2011 Commission Staff Working Paper on the effects of temporary State aid rules adopted in the context of the financial and economic crisis provided the following summary:[16]

> **"The size and extent of the financial crisis that hit the global economy since the summer of 2007 are without precedent in post-war economic history...**
>
> **In its early stages, between the summer of 2007 and summer of 2008, the crisis manifested itself as an acute liquidity shortage among financial institutions** as uncertainties around their exposures to subprime assets increased and creditors consequently showed more reluctance to roll-over

[13] Art 6 of Act 98/1999.
[14] Art 10 of Act 98/1999.
[15] Application, para 120.
[16] SEC(2011) 1126 final, section 3.1.1, p 19.

credit lines and short term bank debt. In that phase, concerns over the solvency of financial institutions were increasing, but a systemic collapse was deemed unlikely. This perception dramatically changed when a major US investment bank (Lehman Brothers) defaulted in September 2008.

In the ensuing second period, confidence collapsed, investors massively liquidated their positions and stockmarkets went into tailspin as the crisis revealed contagious solvability problems related to a significant number of large-scale interconnected institutions' holding of poorly performing assets. Those developments created a systemic risk of collapse ie of a chain bankruptcy of financial institutions. **From then onward the EU economy entered the steepest downturn since the 1930s...**" (original emphasis)

40. As part of this crisis, banks collapsed around the world: in the US, across the EU and in Iceland.

The EU policy response

41. The Paper also summarises the EU's policy response:[17]

"**Aware of the risk of financial and economic meltdown, central banks and governments in the European Union embarked on massive and coordinated policy action**, both on the supply side, through support packages to banks and adjusted monetary policy, and on the demand side through fiscal stimulus measures."

"On the supply side, financial rescue policies focused on restoring liquidity and capital of the banks and the provision of guarantees so as to get the financial system functioning again. Deposit guarantees were raised. Governments provided liquidity facilities to financial institutions in distress along with State guarantees on their liabilities, soon followed by asset injections and impaired asset relief measures. Those measures fell under the State control regime and are being assessed in this paper, with the exclusion of the increase in deposit guarantees." (bold emphasis original, underlined emphasis added).

42. The Paper goes on to list a wide range of measures taken to tackle the financial crisis, including the very widespread grants of State aid given to the banking sector.

43. On 29 January 2009, the Authority adopted specific guidance on State aid measures for banks in crisis, which noted that "in the context of a systemic crisis, general

[17] Section 3.1.2, p 20.

guarantees protecting retail deposits ... can be a legitimate component of the public policy response".[18]

44. Thus, the provision of State funds in the form of (lawfully granted) State aid was an integral element to the response to the banking crisis across the Member States. The Commission has in fact opened State aid investigations in respect of measures granted by 23 different Member States arising out of the crisis.[19]

The scale of the Icelandic banks

45. The banking sector in Iceland was privatised between 1997 and 2003. Following privatisation, the banking sector expanded rapidly and, taking advantage of the fundamental freedoms afforded by the EEA Agreement, expanded abroad.

46. In 2008, there were no foreign banks at all operating in Iceland. The three biggest banks, Landsbanki, Glitnir and Kaupthing were all privately owned and, as already noted, accounted for 85% of the Icelandic banking system.

47. By the time of the crash, the combined balance sheets of those banks amounted to ISK 16,000 billion. They had total deposits in their foreign branches of ISK 1,332 bn, of which ISK 1,169 bn were held in Landsbanki "Icesave" accounts in the UK or Netherlands.

48. When the banks failed in October 2008, the total sums guaranteed under the Directive in respect of the branches in the UK and Netherlands was ISK 659 bn. At that time TIF held liquid funds of approximately ISK 18 bn as well as guarantees from the Icelandic banks in total corresponding to 1% of "eligible" deposits in the Icelandic banks.

49. The scale of the collapse needs to be set against the resources of the Icelandic State. In 2008, the GDP of Iceland was ISK 1,482 bn. Central government revenue in that

[18] Guidelines from the Authority - The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (Dec. No 28/09/COL of 29 January 2009). Corresponding guidance was published by the European Commission on 25 October 2008 (2008/C 270/02).
[19] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/65&format=HTML&aged=0&language=EN&guiLanguage=en

year totalled ISK 477 bn. In October 2008, the Central Bank of Iceland had a foreign currency reserve of ISK 410 bn.[20] Thus, the depositor claims in the Landsbanki branches in the UK and the Netherlands amounted to 44% of GDP in 2008, 138% of government revenue in that year and 160% of the currency reserves held by the Central Bank of Iceland at the end of October 2008.

<u>The collapse of the Icelandic banks</u>

50. The worldwide financial turmoil put huge strains on the Icelandic banking system, and on the ability of the Icelandic Government to raise funds to deal with it.

51. On 15 September 2008, Lehman Brothers filed for Chapter 11 bankruptcy protection. This sparked a financial crisis that spread around the world. A run started on the non-Icelandic branches of Landsbanki and Kaupthing. Within a three day period from 7 – 9 October 2008, Landsbanki, Glitnir and Kaupthing collapsed. That collapse triggered a severe crisis in the remaining banks in the Icelandic system. As the Authority itself put it in October 2008:[21]

> "almost the entire banking sector in Iceland was on the brink of collapse".

52. In March 2009, a second wave of banks were taken over by the Icelandic Financial Supervisory Authority ("the FME") under the Emergency Act and subsequently wound up. By that stage 93% of the Icelandic commercial banking sector had failed. The FME estimates that since October 2008 in total banks representing 99% of the Icelandic banking market have become subject to either winding up or financial restructuring.

53. It would accordingly be difficult to exaggerate the extent of the Icelandic financial crisis at that time. This was not a case of an isolated banking collapse, but an overall failure of the financial system.

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[20] Report of the University of Iceland, Institute of Economic Studies, 6 March 2012, page 2.
[21] Decision No. 501/10/COL of 15 December 2010 to close seven cases against Iceland commenced following the receipt of complaints against that State in the field of capital movements and financial services, paras 96, 97.

54. The IMF observed that:[22]

> "Iceland's economy is in the midst of a banking crisis of extraordinary proportions that is expected to lead to a deep recession, a sharp rise in the fiscal deficit, and a dramatic surge in public sector debt, reflecting a very high fiscal cost of restructuring the banking system. The virtual collapse of the on-shore foreign exchange market poses a serious and immediate risk to the economy considering its very high import dependence."

55. It further noted that:[23]

> "As a result, key asset prices plummeted: the onshore foreign exchange market dried up, the króna depreciated by more than 70 percent in the off-shore market, and the equity market fell by 80 percent. Severe disruptions in the external payments system threatened to quickly spread to the real economy."

56. The IMF's Mission Chief for Iceland described the crisis as a "dramatic and unprecedented shock. It could be the most expensive bank restructuring that the world has ever seen relative to the size of the economy".[24]

57. The Authority's Application discloses a striking failure to acknowledge just how uniquely severe the crisis was in Iceland, arguing that "[t]he other Member States took measures to avoid deposits becoming unavailable by recapitalising the banks", and quoting the view of Commissioner Barnier that "we have no knowledge of any comparable situation in which depositors have not been compensated."[25]

58. The reality is that whilst the financial crisis was global, the risks to the Icelandic economy where of a wholly exceptional nature, and the public interest in seeking to rescue the Icelandic banking system was overwhelmingly strong.

Emergency action by the Icelandic State

59. On 6 October 2008, the Althingi passed Emergency Act No 125/2008 in response to the unfolding financial crisis. It provided the FME with powers to intervene in banks in "extreme and extraordinary circumstances on the financial markets" to disburse

[22] http://www.imf.org/external/pubs/ft/scr/2008/cr08362.pdf, p 3.
[23] IMF Executive Board Approves US$2.1 Billion Stand-By Arrangement for Iceland, Press Release No 08/296, November 19, 2008 (http://www.imf.org/external/np/sec/pr/2008/pr08296.htm).
[24] http://www.imf.org/external/pubs/ft/survey/2008/123108.pdf
[25] Application, paras 115, 116.

funds in order to establish a new financial undertaking, or to take over a financial undertaking or its bankrupt estate.[26] Where circumstances are "dire" the Act permits the FME to assume the powers of the shareholders' meeting or meeting of guarantee capital holders for the purpose of taking decisions on necessary measures, including limiting the decision-making power of the Board, dismissing the Board in whole or in part, taking over the operations of the financial undertaking in whole or in part, or disposing of such an undertaking in whole or in part, including merging it with another undertaking.[27] In parallel to a decision made dismissing the Board, the FME may decide to appoint a Resolution Committee to undertake the affairs of the financial undertaking, including supervising handling of all its assets and conducting its business operations.[28]

60. The Act also provided that in dividing the estate of a bankrupt financial undertaking, claims for deposits pursuant to the Act on Deposit Guarantees and an Investor Compensation Scheme were to have priority.[29] The practical effect was that claims in the Landsbanki estate by depositors, the UK and Dutch Government and TIF had priority, in unlimited amount.

61. The measure helped prevent a run on the banks from the depositors, and greatly improved the chances of those depositors making substantial recovery from the estate of Landsbanki, as has indeed proved to be the case. The Authority's suggestion that this also "improved the position of the Fund on capital markets should it need to raise a loan to cover its liabilities"[30] is entirely lacking in reality. The suggestion that the Fund had <u>any</u> ability to borrow on the capital markets is wholly unrealistic. It was effectively bankrupted.

62. It should not be thought that this grant of priority was without cost to the Icelandic State: the practical effect was to push down the ranking of priority of a number of claims of the State itself.

[26] Art 1 of Act No 125/2008.
[27] Art 5 of Act No 125/2008.
[28] Art 5 of Act No 125/2008.
[29] Art 6 of Act No 125/2008.
[30] Application, para 36.

63. The validity of the provision granting priority was challenged unsuccessfully before the Icelandic Supreme Court.[31] It was also the subject of a complaint to the Authority that was rejected, which is further explained below.[32]

Statements by the Icelandic Government

64. On 6 October 2008, the Prime Minister made the following statement:[33]

> "The Government of Iceland underlines that deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. "Deposit" refers to all deposits by general customers and companies which are covered by the Deposit Division of the Depositors' and Investors' Guarantee Fund."

65. Similar statements were made by Ministers on other occasions. In practice, what the Government actually did was to grant priority to deposit holders in the bankruptcy proceedings under the Emergency Act, and to transfer deposits to the new banks as shall be explained below. No legislation was ever passed to put in place a guarantee of those deposits.[34]

66. The Authority's Application sets out a number of further statements made by the Icelandic Government in August 2008 in which it made clear that it would seek to assist the Board of TIF in raising the necessary funds.[35]

67. The Icelandic Government wishes to emphasise that it gave these assurances entirely in good faith. As matters turned out, the sheer scale of the crisis made it wholly impracticable for TIF to raise the funds to discharge its liability, even with the assistance of the Icelandic State.

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[31] http://www.lbi.is/home/news/news-item/2011/10/28/Supreme-Courts-Verdict-in-Disputes-concerning-Icesave-Deposits/

[32] Decision No. 501/10/COL of 15 December 2010 to close seven cases against Iceland commenced following the receipt of complaints against that State in the field of capital movements and financial services: http://www.eftasurv.int/media/decisions/571071.pdf

[33] http://eng.forsaetisraduneyti.is/news-and-articles/nr/3033

[34] The Authority points to the fact that the bill for the Budget Act 2011 referred to this declaration by the Icelandic Government: Application para 118. In fact, the explanatory note to that bill makes it clear that the bill contains no such guarantee.

[35] Contrary to the Authority's suggestion at paragraph 29, the Icelandic Government did not make statements that it would itself provide the necessary funding.

68. The Icelandic Government's response had to match the circumstances that it found itself in by October 2008.

FME Action under the Emergency Act

69. Between 7 and 9 October 2008, Landsbanki, Glitnir and Kaupthing approached the FME and asked it to take over control. The FME duly exercised its powers under the Emergency Act and took control of those banks. The practical effect was that the FME obtained the powers of a shareholder meeting, and put in place Resolution Committees for each bank, each comprised of five experts drawn from independent accounting firms, law firms and the internal experts of the banks.

Freezing Order of the UK Treasury

70. Steps taken by the United Kingdom and Dutch authorities seriously impeded the Icelandic Government's ability to deal with the crisis. It considers that those steps were contrary to EU law, and in particular Directive 2001/24/EC on the reorganisation and winding up of credit institutions, although it accepts that is not an issue for this Court to decide. The practical impact of those measures, is however, highly material.

71. On 3 October 2008, the UK FSA issued a Supervisory Notice which required Landsbanki to take certain actions with regard to its London Branch. The practical effect was to freeze the assets of the Landsbanki branch in the UK and make the operation of the branch impossible.

72. On 8 October 2008, the UK Government took action under its Anti-Terrorism, Crime and Security Act of 2001 to formally freeze the assets of Landsbanki, and initially the FME and the CBI in the UK. Landsbanki was listed by HM Treasury as a "regime" in the "sanctions" section of its website, along with Al-Qaida & Taliban, North Korea and Iraq, among others. As described in the Financial Stability report of the Icelandic Central Bank of 2009, this had enormously damaging results.[36] A large number of

[36] Financial Stability Report of the Central Bank of Iceland 2009, page 28: http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=7357

banks outside the UK refused to fulfil and execute legitimate payment orders, irrespective of currency or origin of payment and:[37]

> "Numerous innocent Icelandic companies and individuals were thus turned into defaulters, with concomitant cost and damage to their reputation."[38]

73. Despite various attempts by the Icelandic Government and the Central Bank of Iceland to reverse it, the Freezing Order remained in force until 9 June 2009.[39] During this time the effects on the cross-border payment system were enormous and the bulk of flows had to be routed through the Central Bank's infrastructure. By means of the Freezing Order, the UK Government sought to press the Icelandic Government to pay compensation to Icesave retail depositors in the UK.[40] Moreover the continuation of the Freezing Order for several months impeded Landsbanki's orderly winding up.

74. On 7 October 2008 the Dutch Central Bank (DNB) submitted a petition to the District Court of Amsterdam asking for a ruling that certain emergency regulations of Dutch law were applicable. On 13 October 2008 the court declared that those regulations should apply and appointed administrators to handle the affairs of the branch, including all assets and dealings with customers of the branch.

75. The Icelandic Government and Landsbanki strenuously objected and the Dutch court finally lifted the restrictions in March 2010. During this period no assets in the Amsterdam branch could be sold or used for the purposes of repaying depositor claims. This very substantially delayed the winding-up of Landsbanki's estate.

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[37] Ibid

[38] Ibid, page 28.

[39] The Icesave Agreement (Loan Agreement between The Depositors' and Investors' Guarantee Fund of Iceland, Iceland and the UK and Dutch governments) is dated 5 June 2009. The Freezing Order was rescinded four days later. The funds of Landsbanki in the Bank of England were still frozen on basis of the Supervisory Order of theFSA at virtually no interest.

[40] See e.g: Lord Myners, House of Lords debate on 28 October 2008: "...The Treasury considers that the freezing order *should remain in place* until the Government have successfully agreed with the Icelandic authorities a mechanism whereby the Icelandic Government can honour their obligations to UK depositors [emphasis added]."

Emergency domestic bank restructuring

76. The FME exercised its powers under the Emergency Act to achieve a restructuring of the Icelandic banks. The Minister of Finance established the new banks (New Landsbanki, New Kaupthing and New Glitnir) between 6 and 9 October 2008, using powers granted to him under the Emergency Act .

77. Between 9 and 22 October 2008, the FME transferred all domestic deposits and loans to the new banks.

78. The essential reason for these steps was to safeguard the functioning of the Icelandic banking system. Almost every family and business in Iceland was a customer of the failed banks, holding not just savings accounts but also current accounts. A limitation in access to such accounts would have crippled the Icelandic economy overnight: production companies could not have paid for resources, workers could not have received wages, imported goods could not have been paid for. Any attempt to impose a limit upon access to such accounts would have risked a run on them. The result of failure, or of a restriction on access to the accounts, would have been very serious as the Central Bank has explained:[41]

> "If regular, normal operations of domestic payment intermediation and payment card use had not been ensured, **the situation could have deteriorated into turmoil** that would have defied all attempts to control it.
>
> Electronic payment intermediation (online banking and payment cards) constitute a very large share of payment intermediation in Iceland. For a number of years, banknotes and coin have accounted for only 1% of GDP, which is among the lowest levels known. Banknotes and coin in circulation totalled only 15 b.kr. before the crash. In addition to the banknotes and coin in circulation, the Central Bank had approximately 31 b.kr. in its vaults. [...]Demand for the largest denominations of banknotes was so strong that the Central Bank nearly exhausted its supply of 5,000 kr. notes during those first days, even though all electronic infrastructure for domestic payment intermediation infrastructure was open and operating normally. It is hard to imagine what the impact would have been if Iceland's domestic payment intermediation infrastructure had not been operable and a major run on the banks and savings banks had occurred. Such a situation would quickly have

[41] Payment intermediation during the financial crisis, Memorandum by the Central Bank of Iceland, 7 March 2012

resulted in a declared shortage of banknotes. The social ramifications would have been unimaginable." (emphasis added)

79. It was therefore essential in order to maintain the viability of the Icelandic economy to take urgent steps to ensure that confidence, to avoid a run on those banks and to maintain their continuing ability to function.

80. Moreover, the FME acted in order to minimise any harm to the remaining creditors of the old banks: those banks held a range of other valuable assets (which are now being realised through the winding up process). Those assets were not transferred to the new banks. The only assets transferred to the new banks were the domestic loans; this was essential to enable the banks and the Icelandic economy to function. The old banks held a range of other potentially valuable assets. Those assets were left within the old banks, thereby increasing the prospect that the creditors of those banks would be able to recover through the insolvency process, as has indeed proved to be the case. Thus, the measures taken did not involve a split into "good bank/bad bank".[42]

81. The Icelandic Government wishes to emphasise that the FME considered a wide range of options, but concluded that there were insuperable obstacles to the transfer of the overseas accounts to the new banks. The Authority has made clear that it does not challenge the failure to do so.[43] Nevertheless, in brief, any such move would have faced the following insuperable obstacles. First, it was not possible in practice to make transfers of funds into or out of Iceland: the international payment system between Iceland and the outside world had effectively broken down. Moreover, the UK and Dutch accounts and assets of Landsbanki had been frozen by actions of those Governments. The Icelandic State simply lacked the necessary access to foreign currency to operate such accounts. Prior to the crisis,[44] the overseas accounts contained the equivalent of ISK 1,332 bn in foreign currency. The Central Bank of Iceland had only ISK 410 bn in foreign currency reserves. It lacked the resources to render those accounts functional. There was no prospect of recourse to international capital markets at that time in order to do so. Matters were also made considerably worse by a sudden severe depreciation in the Icelandic Krona, causing a downgrade in

[42] A balance was sought between the assets and liabilities transferred to the new banks. As a result, only a small amount of additional capital was provided by the State to comply with regulatory requirements.
[43] Application, para 175.
[44] As explained, by this time a run had begun on the Kaupthing Edge and Icesave accounts.

Iceland's credit rating and posing severe difficulties to any attempt to obtain further foreign currency.

82. The practical effect was that any attempt to transfer the overseas accounts to the new banks would have been doomed to fail: an immediate default would have been the inevitable consequence. A bank run was already underway in respect of those branches. As a result, any attempt to do so would have risked undermining the entire bank rescue.

83. The steps taken by the FME to establish the new Icelandic banks was already risky: they depended critically upon maintaining the confidence of depositors and the markets. As already noted, a run had already taken place on the Dutch and British Icesave accounts. An unsuccessful attempt to transfer those accounts would have had catastrophic effects.

84. As it was, the rescue package adopted by the Icelandic Government succeeded in maintaining the viability of the Icelandic economy, but in October 2008, that was anything but a foregone conclusion.

85. In its Decision to open a formal State aid investigation in regard to the setting up of the new banks, the Authority concluded: [45]

> "The Authority accepts in principle the views of the Icelandic authorities that given the circumstances the approach taken of restoring the domestic operations of the banks was likely to be the only credible and effective means of safeguarding an Icelandic banking sector and the wider economy. Bank rescue measures of a kind adopted elsewhere in the EEA; recapitalisation, restructuring, relief for impaired assets, or a combination of each were unlikely to succeed. The scale of the problem and the sums of public money that would have been necessary to remedy it, the disproportionate size of the three main banks, and the realistic threat that the entire system could collapse meant that the state's options were limited." (emphasis added)[46]

[45] EFTA Surveillance Authority Decision No. 493/10/COL of 15 December 2010 opening the formal investigation procedure into state aid granted in the restoration of certain operations of (old) Landsbanki Íslands hf. and the establishment and capitalisation of New Landsbanki Íslands (NBI hf.), para 3.1.2. http://www.eftasurv.int/media/decisions/493-10-COL.pdf

[46] The Authority decided that the measure could finally be considered appropriate "if it can be demonstrated by means of a detailed restricting plan that the bank is viable in the medium to long term": para 3.1.2. The Authority's final decision is awaited.

86. The Authority's State aid decision contains the following footnote to this passage: "This decision does not relate to any aspect of the internal market rules of the EEA Agreement that may apply in so far as the division of foreign and domestic assets and liabilities is concerned." As shall be seen, the Authority has not, however, sought to argue that the fact that the Icelandic Government did not move the overseas accounts into the new banks was itself discriminatory or otherwise unlawful.

Imposition of capital controls

87. In October 2008 international foreign exchange market with the Icelandic króna almost came to a stop. The exchange rate of the króna fell in the international market by more than 70% and up to 200% from the year average without any sign of sustainable stability. This situation prompted the Icelandic Government to seek the assistance of the IMF.

88. Temporary capital account restrictions were imposed 28 November 2008 to prevent further depreciation of the króna, as an important part of the economic programme Iceland followed during its cooperation with the IMF. The capital controls restricted in general all transnational foreign currency movements except those that are for the purchase of goods and services. Certain very limited transactions, including related to emigration, are also exempted for the controls. The Icelandic Government presented the EFTA Standing Committee and the EEA Joint Committee with notifications of protective measures under Article 43 EEA. The EFTA Court has now ruled that the controls are compatible with those provisions.[47]

89. Whilst controls on capital inflows were removed in the autumn of 2009, the capital controls otherwise remain in place. A strategy for gradual capital account liberalisation is now in place, but it is anticipated they will remain until at least 2013.

[47] Case E-3/11 *Sigmarsson v Central Bank of Iceland*, 14 December 2011, para 56.

Declaration of non-availability of deposits.

90. On 27 October 2008, 30 October 2008 and 4 November 2008, the FME issued opinions stating that on 6 October 2008, the Icesave accounts of Landsbanki and certain overseas accounts of Kaupthing and Glitnir[48] had ceased to work.

91. The Icelandic Government accepts that this was declaration of unavailability for the purposes of Article 1(3) of the Directive, and that it served to trigger the obligations of the deposit-guarantee scheme under Article 10.

Payment of compensation to Glitnir and Kaupthing depositors

92. The Glitnir and Kaupthing retail depositors all recovered 100% of their deposits from the estates of those banks within one year of the deposits becoming unavailable. Depositors in those banks form no part of the Authority's claim: the declaration that it seeks is solely concerned with "Icesave depositors in the Netherlands and the United Kingdom".

Payment of compensation by the British and Dutch Governments

93. By late 2008, all UK retail account holders in the United Kingdom had received (or in a very small number of cases, declined[49]) compensation payments from the UK Government, to the full value of their deposits. In the Netherlands, the Government had paid all private and wholesale account holders up to €100,000 per account. That compensation was paid under the British and Dutch deposit-guarantee schemes.

94. The total payments to depositors were equivalent to ISK 1,150 bn, of which ISK 659 bn represented the €20,000 minimum guaranteed amount for each account.

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[48] Ie: the Kaupthing Edge accounts and certain wholesale deposits of Glitnir.
[49] A small number of account holders who had term deposits, due to mature on a later date, were offered immediate compensation but elected to defer payment, in order to continue to enjoy the (favourable) rates of interest that applied to those accounts.

95. The British and Dutch had good reasons of their own for acting as they did: they wished to maintain depositor confidence and stave off a run on their own banks, which were facing a severe crisis at that time.[50]

96. The practical result is that long before October 2009, when time to comply with the Directive expired, there were no retail depositors at all in the UK and Dutch branches of Icesave who remained entitled to compensation.

97. The only uncompensated depositors were a small number of institutional investors that held accounts with various Icelandic banks in the UK, including Landsbanki ("the Institutional Investors"). These investors were not covered by the UK deposit-guarantee scheme, and accordingly did not receive any form of compensation from the UK Government. Typically their deposits were very well in excess of €20,000 – in many cases running into millions of pounds.

98. On 4 October 2009, TIF published a notice in the Icelandic Legal Gazette calling for claims to be submitted within two months. The Dutch and UK Governments submitted claims, as did a small number of other depositors, including four institutional investors in Landsbanki.

99. In October 2009, the TIF pre-actively wrote to all Institutional Investors to inform them it was beginning to pay compensation under Act 98/1999, and seeking an assignment of any claim against the banks themselves. In fact, only one provided a completed application.

100. As already explained, all such depositors have now received a dividend of 31% from the Landsbanki estate, whether or not they notified TIF of a claim.

[50] See for example the UK Government's announcement of 8 October 2008 of a support package for UK banks: http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/press_100_08.htm, and its announcement of 29 September 2008 of its partial nationalisation of Bradford & Bingley, which had been found to be unable or likely to be unable to satisfy claims against it: http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/press_97_08.htm

The role of the IMF

101. On 19 November 2008, the IMF approved a two-year Stand-By Arrangement of US$ 2.1 billion.[51]

102. Under the Arrangement, US$ 827 million were made available immediately, with eight further instalments of US$ 155 million to follow. In fact, a second instalment of €105 bn was only approved in April 2010.

103. An important part of the IMF Arrangement was stringent capital controls put in place to prevent further devaluation of the Icelandic currency, as already explained. The IMF Arrangement was based upon certain projections as to the balance of payments and sustainability of debt. Funding an external liability in foreign currency as the Authority's argument would have been wholly inconsistent with this arrangement. The Authority has not sought to suggest otherwise.

The Icesave Agreements

104. The Authority makes reference to agreements that were entered into between the Dutch and UK Governments for repayment ("the Icesave Agreements"), although it accepts they are "not central" to its case.[52] In fact those agreements are of no bearing at all on the claim. Iceland accordingly does not propose to address this issue in any detail.

105. It is, however, important to clarify one point: the Icesave Agreements were not agreements to provide funds to the Icelandic Government or the TIF, as the Authority appears to suggest.[53]

106. The Agreements provided for the UK deposit-guarantee scheme and DNB to use that money to compensate depositors with Icesave accounts in the branches within those States. Even then, those depositors had very largely been compensated by the UK and

[51] http://www.imf.org/external/pubs/ft/scr/2008/cr08362.pdf
[52] Application, para 47.
[53] Ibid, para 153. Whilst the June 2009 versions of these Agreements provided for a "loan facility" from the UK/Dutch authorities, but to be drawn down by the UK FSCS, or the Dutch Central Bank ("DNB"), not the Icelandic Government.

Dutch authorities already. There was no suggestion then or at any stage that the Icelandic authorities would have access to those funds.

107. The essential purpose of the Icesave Agreements was to govern the terms on which the TIF would reimburse the compensation paid The Icesave Agreements of June 2009 provided for repayment in instalments over fifteen years, with a first instalment due after seven years. For the first seven years TIF was to pay every dividend from the Landsbanki estate to the Netherlands and the UK. Repayment was backed by guarantee of the Icelandic State. Interest ran at 5.5% per annum from January 1 2009 until the claims were paid in full.

108. Whilst Althingi, the Icelandic Parliament, authorised the entering into of revised agreements reached in October 2009, the President of Iceland declined to approve the necessary legislation. Under the Icelandic Constitution, this triggered a requirement to hold a referendum. In March 2010, the proposed law was rejected by 92.3% of the votes cast, rendering the law void. Despite this, the three Governments continued a dialogue on resolving the Icesave issue on more balanced terms than had previously been agreed. On 8 December 2010 new agreements on more favourable terms were reached with the British and Dutch authorities.[54] The Parliament again authorised the Minister of Finance to sign the agreements, but the President of Iceland rejected the bill. In April 2011, it was rejected in a referendum by close to 60% of the votes.

109. In the circumstances, it was deemed impossible to continue negotiations with the British and Dutch Governments.

The winding up of the Landsbanki estate

110. Landsbanki, together with the other two failed banks, entered a winding up procedure.

111. Payments from the Landsbanki estate were held up due to litigation by creditors and the freezing of assets by the UK and Dutch Governments as previously described. However, in December 2011, the estate paid a dividend of 31% in respect of all

[54] The revised agreements involved a lower interest rate, but earlier repayment of interest and a potentially longer overall repayment period.

accepted priority claims. Those claims included the claims of the Dutch and British Governments in respect of the compensation paid to Icesave investors.

112. In very broad terms, the level of recovery from the estate has increased over time, as the value of the estate's assets has recovered. It is now anticipated that it will be possible to pay back more than 100% of accepted priority claims – long before the timescale anticipated in the Icesave Agreements.

113. It is against that background that the Authority's case falls to be considered.

THE OPERATION OF THE DIRECTIVE IN PRACTICE

114. Before analysing the provisions of the Directive in detail, the Icelandic Government wishes to draw attention to the manner in which the Directive has operated in practice, and the nature of current proposals for its reform.

115. In 2010, the European Commission published an Impact Assessment, in which it reviewed the operation of the existing Directive, as it had been amended in 2009, and considered further proposals for change.[55] The analysis performed by the Commission provides important factual background material and serves to demonstrate the lack of practical reality in the Authority's submissions. Those submissions wholly fail to acknowledge the inherent limitations of deposit-guarantee schemes, and their place in a system of financial regulation.

116. Moreover, the Impact Assessment reveals that the Commission's analysis of the application of the Directive is fundamentally at odds with that of the Authority. Whilst the Commission's view is of course not binding authority in this regard, it at the very least calls into question whether the Authority's analysis is in accordance with the legislature's intention.

[55] SEC(2010) 834/2: IMPACT ASSESSMENT Accompanying document to the Proposal for a Directive on Deposit Guarantee Schemes and to the Report of the Commission on the Review of Directive 94/19/EC on Deposit Guarantee Schemes: http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_ia_en.pdf

117. Whilst the Authority has made certain references to this Impact Assessment,[56] it has not made clear the true nature, or implications, of the Commission's analysis.

118. The Icelandic Government wishes to emphasise six points arising out of that Impact Assessment. It has annexed the Impact Assessment to this Defence.

(1) **The funding of the Icelandic deposit-guarantee scheme was in accordance with EU norms**

119. The Commission noted that there were two means by which deposit-guarantee schemes were funded within the EU:[57]

> "DGS are principally funded by banks paying contributions into them. Currently, in 21 Member Sates such contributions are paid in advance on a regular basis (ex-ante) while in six Member States ... banks only contribute after failure (ex post). Other financing sources are loans taken by the DGS or direct State interventions."

120. It is to be noted that this paragraph is a description of how funding is provided in practice. The Commission later deals with the question of what is required by the Directive itself.[58]

121. The Icelandic scheme is funded "ex ante", a method which the Commission considered to be preferable, noting that "ex-post funding is pro-cyclical: it encourages risk taking in good times, but drains liquidity from banks in times of stress which might have implications on the level and conditions of credit supply by banks. Moreover, unlike in ex-ante schemes the failed bank does not contribute to payout (moral hazard)".[59]

122. The funding for the Icelandic scheme was well within the range of Community norms. As the Commission explained:[60]

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[56] Application, paras 130, 131.
[57] Impact Assessment, section 4.4.1, pg 19.
[58] Contrary to the implication in paragraphs 130 and 131 of the Application.
[59] Impact Assessment, section 4.4.1, pg 20.
[60] Ibid, section 4.4.1, pg 19. See also Report of the University of Iceland Institute for Economic Studies, 6 March 2012, pages 3 – 4.

> "In terms of the ratio between ex-ante funds and eligible deposits, there is a range between 0.01% and 2.3%."

123. As already noted, the Icelandic scheme is funded to the level of 1.0%.[61]

124. Thus, no States had funded their deposit-guarantee schemes to the kind of levels that would have been able to withstand a system-wide crash.

125. The Authority argues that a comparison with the manner in which other Contracting States have implemented the Directive is irrelevant. However, as this Court has explained:[62]

> "in the interpretation of EEA law, it may be a factor of some interest to ascertain how different Member States have demonstrated, through their implementation into national law of EEA provisions, how they perceived and interpreted those EEA legal provisions which the Member States have adopted and which the Court is called upon to interpret."

126. The research conducted by the Commission as to the implementation across the EU serves to demonstrate just how unrealistic the Authority's argument is.[63]

(2) The existing system of deposit-guarantee schemes across the EU proved insufficient to deal with the worldwide financial crisis

127. The Commission considers that the Directive is flawed:[64]

> "The events in 2007 and 2008 have shown that the existing fragmented system of DGS has not delivered on the objectives set by the Directive in terms of ensuring depositor confidence and maintaining financial stability in times of economic stress."

128. Thus, the difficulties of the TIF were not unique. The Commission went on to explain:[65]

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[61] As the Commission noted, at the time of the bank crash in 2008, the practical effect was that the ex ante funds available were 0.5%, due to the recent growth in size of the Icelandic banks.

[62] Case E-2/95 *Eilert Eidesund v Stavanger Catering A/S* [1995/1996] EFTA Court Report, p 1, para 15.

[63] This is not a case where there is a parallel to measures taken in one Member State in particular, as in Case E-1/03 *EFTA Surveillance Authority v Iceland* [2003] EFTA Court Report p 143, para 33.

[64] Impact Assessment, pg 5, 3rd para.

[65] Ibid, section 4.4.1, pg 20, 3rd para.

"The Commission's research has shown that DGS in 6 Member States would not be capable of being able to cope with a medium-sized bank failure ... Even if a single DGS might never be able to cope with a failure of a large cross-border banking group, they should at least be able to deal with medium-sized failures." (emphasis added)

129. The Commission defined "medium-sized bank failure" to mean "a failure concerning 0.81% of eligible deposits".[66] The bank failure in Iceland was of an altogether different magnitude.

(3) The Commission's proposals for reform would *still* not provide protection from system-wide bank failure

130. The Commission considered a range of policy options for the harmonisation of funding mechanisms and levels for deposit-guarantee schemes.[67] As regards the possibility of a harmonised approach to a target level for total funds, the Commission explained that:[68]

"the choice of a target level for the funds may be related to the capability of DGS to handle a bank failure of a specific size based on bank recapitalisations by Member States during the financial crisis (from a small failure to a big one – ranging from 0.36% and 7.25% of the amount of eligible deposits respectively)." (emphasis added)

131. The "big bank failure" scenario envisaged by the Commission was "failure of a big member bank" holding 7.25% of eligible deposits, which was "the simple average of the date from 32 DGS in 21 Member States."[69]

132. Thus, the Commission did not contemplate extending the funding of deposit-guarantee schemes to cover a system-wide crash of the kind experienced in Iceland. Its conclusion was that:[70]

"Setting a target level for DGS funds would ensure that schemes are credible and capable to deal with medium sized bank failures. The most cost efficient target level would be 1.96% (or simply 2%) of eligible deposits (to be

[66] Impact Assessment, pg 20 fn 46.
[67] Ibid, section 7.8, pgs 52-59.
[68] Ibid, pg 53, 2nd para.
[69] Ibid, pg 53, table 3 and fn 109.
[70] Ibid, pg 58, final para.

achieved within 10 years) because it would increase DGS funds to cope with a medium-sized bank failure; and despite quite substantial increase in contributions, it would, on average, only moderately affect bank profits at EU level (with a stronger impact in some Member States) and lead to very limited costs for depositors.... It would ensure a sound financing of the DGS but avoid unwanted side-effects if contributions were too high." (emphasis added).

133. The Commission accordingly proposed harmonisation at a level that would protect against mid-sized bank failure. It did not consider it appropriate to harmonise at a level that would protect against "large" failure – meaning 7.2% of deposits, still less at a level that would protect against system-wide failure.

134. The reason for this is apparent from the foregoing quoted passage: a deposit-guarantee scheme imposes costs. A balance must be struck between those costs and the benefits to consumers. As will be further explained below, the existing Directive also seeks to strike this balance.

(4) It falls to the banks to fund the deposit-guarantee schemes

135. The Commission made clear that it considered that the costs of the deposit-guarantee schemes fall upon the credit institutions, and that any State funding used in an emergency would fall outside the scope of the Directive:

> "The Commission has been tasked to assess retroactively whether [the increase in the level of the guarantee contained in Directive 2009/14/EC[71]] is appropriate and whether it is viable for Member States. In this context, it has to be borne in mind that DGS are financed by banks and the Commission intends to maintain that requirement. That means the budget of Member States is not directly concerned by the DGS Directive. The recent crisis has shown that in a systemic crisis, DGS may reach their limits. However, even if in such cases governments stepped in under strict obedience of state aid rules, this would not be triggered under a legal obligation in the DGS Directive and 'viability for Member States' is therefore not subject of this impact assessment." (emphasis added)

136. Thus, the Commission's understanding was that:

a) the obligation to fund the deposit-guarantee schemes fell upon the banks and not the State;

[71] Ie €50,000 by the end of June 2009, and €100,000 by the end of 2010.

b) the State might in practice step in if a deposit-guarantee scheme was unable to cope with the effects of a crisis, although such intervention would have to be in accordance with State aid rules; and

c) any such intervention would not be subject to a legal obligation under the Directive.

137. The Commission's reference to State aid rules is accordingly of fundamental importance. It is well–established that there can be no question of State aid where the State acts to implement the provisions of EU/EEA law: Case T-351/02 *Deutsche Bahn v Commission* [2006] ECR II-1047, paras 99 - 102.

138. In the present case, the Authority argues that the State had a duty to guarantee payment of compensation when "all else fails", derived from the Directive. If there is such a duty under the Directive, it does not engage the State aid rules: the States must simply provide the guarantee. There is no role for the Authority in seeking to assess its compatibility with the EEA Agreement.

139. What the Impact Assessment makes clear, however, is that the Commission has the opposite view: any such intervention would be State aid, and subject to its approval.

140. Thus, it is clear that the Commission's understanding was that there was no Directive obligation upon the State to "step in" where a deposit-guarantee scheme reaches its "limits" during a "systemic crisis". That view is completely at odds with the Authority's analysis.

(5) The use of State guarantees gave rise to concerns as to distortions of competition

141. In practice, as a result of the crash of 2008, a number of Member States had recourse to State funds to support the banks. The Commission explained:

> "The funds of a soundly financed DGS originate from the banks themselves. However, the current financial crisis has shown that when the banks threatened to fail, they were bailed out mainly with taxpayers' money amounting to almost €13 bn in the EU."

142. As already explained, it was plainly the Commission's view that this was not required under the terms of the Directive.

143. The Commission went on to express serious concerns about the impact of this development upon competition. Thus, it explained:[72]

> "The approach of minimum harmonisation, introduced by the Directive 94/19/EC, has resulted in significant differences between the coverage levels in the EU ... When the financial crisis aggravated in autumn 2008, most Member States either raised their coverage levels to €50,000 or €100,000 or issued unlimited guarantees, sometimes covering not only deposits but all liabilities of banks. First, on 20 September 2008, the Irish government announced its commitment to provide increased coverage of €100,000 for Irish banks for a few days excluding subsidiaries of foreign banks. Moreover, the government law of 30 September 2008 gave temporary unlimited state guarantees for major Irish banks. As a result, depositors quickly shifted money to banks covered by higher or unlimited guarantees, notably from UK to IE. This created heavy liquidity strains to the banks not covered by such guarantees. In this situation, the UK authorities were forced to raise the coverage level from £35 000 to £50 000. In order to avoid competitive disadvantages and prevent the outflow of deposits, other Member States were also forced to increase radically their coverage (for example, in early October 2008, AT adopted law on temporary unlimited coverage for individuals, and the governments of GR and DE also declared unlimited deposit guarantees but they were not followed by any legislative action). Those actions were undertaken unilaterally and in an uncoordinated way and – as they were followed by other Member States – contributed to serious competitive distortion between Member States, undermining depositor confidence and threatening the overall stability of the EU. In order to maintain depositor confidence and prevent runs on banks, the ECOFIN Council had to intervene urgently[73]."

144. This passage makes clear that in the view of the Commission, the provision of a State guarantee was not an automatic, or anticipated consequence of the Directive. Rather, it was a source of concern, as it gave rise to significant distortions of competition and risked undermining the stability of the EU.

[72] Impact Assessment, section 4.1.1, pg 9.
[73] The Commission included a footnote in the following terms: "The ECOFIN Council agreed on 7 October 2008 that all Member States would, for an initial period of at least one year, provide deposit protection for individuals for at least €50 000, acknowledging that many Member States had already determined to raise their minimum to at least €100 000. The ECOFIN Council also welcomed the intention of the Commission to bring forward urgently an appropriate proposal to promote convergence of DGS".

(6) System-wide banking failure requires a wide range of policy tools

145. Finally, as the foregoing points illustrate, the mechanism established under the Directive does not provide the means to tackle system-wide banking failure. Even under the strengthened scheme proposed by the Commission, it would never be able to do so. The Commission explained that it was developing a range of other tools "necessary for an EU crisis management framework", ranging from "'early intervention' actions by banking supervisors aimed at correcting irregularities at banks, to bank resolution measures which involve the reorganisation of ailing banks, to insolvency frameworks under which failed banks are wound up."[74] As the Commission observed "[t]he better the crisis management tools are, the lower the probability that DGS are triggered."[75]

146. Thus, a systemic crisis requires comprehensive intervention to avert failures and support the financial system.

147. In the crisis that began in 2008, the grant of State aid was an essential component. The Commission has described the ability of State aid rules to regulate such interventions in a timely and flexible way:[76]

> "From October 2008 the Commission assessed the State aid to financial institutions notified by the Member States from the perspective that they could be declared compatible with the internal market if they remedy a serious disturbance in the economy of the notifying Member State. In the presence of a systemic risk of collapse of the financial system, the Commission State aid policy pursued the twin objective of restoring financial stability and returning to functioning financial markets, whilst at the same time keeping to the minimum any competition distortions between aided and non-aided banks, between banks from different Member States and between aided banks.
>
> Those overarching objectives of the temporary rules for State aid to financial institutions were outlined by the Commission in four Communications adopted between October 2008 and July 2009. As regards financial stability, State aid was approved to restore confidence in the banking sector, ensure inter-bank lending, limit the systemic risk of insolvency and avoid contagion between Member States. State aid was also deemed compatible in order for the

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[74] Impact Assessment, section 3.1, pg 7 bottom para.
[75] Ibid, section 3.1, pg 8 first para.
[76] Staff working paper on the effects of temporary State aid rules adopted in the context of the financial and economic crisis, Brussels, 5.10.2011, SEC(2011) 1126 final, page 20.

financial markets to continue lending to the real economy and in order to ensure the long-term viability of the EU banking sector through improved solvency and restored profitability of financial institutions. State aid had to include strict conditions to mitigate distortions of competition and to ensure burden sharing to remedy moral hazard." [77]

148. These measures lie far beyond the scope of the present Directive.

THE COMMISSION'S ORIGINAL PROPOSAL FOR THE DIRECTIVE

149. The Commission's 1992 proposal for the Directive also proceeded on the basis that funding would be provided by the credit institutions.[78] It contemplated the possibility that the Member States might be called upon to provide funding in an emergency:

> "The question of whether the public sector would be able to provide assistance for guarantee schemes in emergency situations of exceptional gravity and when the schemes' resources have been exhausted, has been raised in order to enable them to respect their commitments to depositors.
>
> It did not seem appropriate, in the proposal for a Directive, to prohibit such assistance, which could prove necessary in practice, although it is not desirable as a general rule and could not be allowed to contravene the rules of the Treaty concerning State aid."

150. Thus, just like the Commission's 2010 Impact Assessment, the proposal anticipated that State assistance might be required where the resources of a deposit-guarantee scheme were exhausted. It made clear that this was not desirable "as a general rule", and that any such assistance would have to comply with the State aid rules. As already noted, this is wholly inconsistent with the Authority's case that an automatic obligation arises by virtue of the Directive itself.

151. This approach reflects the practical limitations of deposit-guarantee schemes. Such a scheme can <u>never</u> deal with the consequences of a system-wide banking failure. Any attempt to fund a scheme to the level at which it would be able to do so would be to render the business of banking practically impossible. The Icelandic SIC Report contains the following quotation from a report of 2001 of the French Commission

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[77] These temporary state aid rules were adapted by the Authority in four sets of guidelines regarding the financial crisis, issued between January and November 2009, based on the Commission Communications

[78] COM(92) 188 final – SYN 415, pgs 5 and 8.

Bancaire, presided over by Mr Jean-Claude Trichet, then the Director of the Central Bank of France, which observed:[79]

> "It is accepted that deposit guarantee schemes are neither meant nor able to deal with systemic banking crises, which fall within the remit of other parts of the 'safety net', eg supervisors, central bank, government."

152. The Authority's analysis fails to recognise this inherent limitation of deposit-guarantee schemes.

THE PROVISIONS OF THE DIRECTIVE

153. Iceland accepts that the Directive imposes certain obligations upon the State: to set up, recognise and supervise a deposit-guarantee scheme. But nothing in either the wording or the purpose of the Directive supports the Authority's contention that any duty attached to the Icelandic State to make good the guaranteed sums where it is not possible for the deposit-guarantee scheme to do so.

Recitals 1 -3 : the purposes of the Directive

154. The purposes of the Directive are identified in its first three recitals:

a) The harmonious development of the activities of credit institutions through elimination of restrictions on the right of establishment and freedom to provide services (recital 1).

b) The need for a harmonised minimum level of deposit protection (recital 2).

c) To ensure that the depositors in a branch situated in a Member State other than that in which the credit institution has its head office are protected by the same guarantee scheme as the institutions other depositors (recital 3).

[79] SIC Report Chapter 17, pg 93.

155. Thus, the Directive pursues linked objectives of eliminating obstacles to the right of establishment and freedom to provide services by means of a consumer protection measure.

156. The objective of promoting the exercise of the fundamental freedoms does not require the State to step in when "all else fails". Plainly, the provisions of the Directive achieve this aim irrespective of the existence of such a duty: through the introduction of a harmonised regime for deposit-guarantee schemes that applies wherever deposits are located, and wherever a credit institution has its head office: recitals 2 and 3. The very fact of harmonisation itself promotes the fundamental freedoms.

157. The objective of "consumer protection" is not "all or nothing" consideration. What is required, as the Authority acknowledges, is a "high level" of consumer protection, not an absolute level of consumer protection. In Case C-233/94 *Germany v Parliament and Council* [1997] ECR I-2405, para 48, the Court of Justice held in the context of Directive 94/19/EC:

> Admittedly, there must be a high level of consumer protection concomitantly with those freedoms however, no provision of the Treaty obliges the Community legislature to adopt the highest level of protection which can be found in a particular Member State. The reduction in the level of protection which may thereby result in certain cases … does not call into question the general result which the Directive seeks to achieve, namely a considerable improvement in the protection of depositors within the Community." (emphasis added)

158. It is plainly unrealistic to aim for absolute consumer protection by reserving all the assets necessary to cover the deposit-guarantee scheme. Commercial banks operate on "fractional reserves": they take deposits and lend them onwards, keeping only a small fraction of the deposits (known as a reserve ratio) at hand as either cash or deposits. This enables banks to perform vital functions in supplying capital. If necessary in order to meet demands for deposits, they borrow liquid funds either in the interbank market or from central banks.

159. As the Icelandic Institute of Economic Studies has explained, it is not possible for a deposit guarantee scheme to borrow sufficient funds to meet a substantial bank crisis, or for the surviving banks to provide such funds.[80]

160. Moreover, not even a State guarantee would provide absolute consumer protection from bank default, as the Authority appears to suggest.[81] As current circumstances across the EU demonstrate, even a State guarantee may carry some degree of credit risk, particularly so in the absence of any kind of cross-border fund to provide support for the deposit-guarantee scheme of a particular State.

161. The reality is that any deposit-guarantee scheme must recognise that increasing consumer protection will come at increased cost. A balance must be struck if the banking system is to be able to function in the interests of consumers and the economy. A less onerous scheme may serve consumers better.

162. The Directive strikes such a balance between the cost of funding a deposit-guarantee scheme and the benefits of consumer protection. Recital 16 provides:

> "Whereas, on the one hand, the minimum guaranteed level prescribed in this Directive should not leave too great a proportion of deposits without protection in the interests both of consumer protection and of the stability of the financial system whereas, on the other hand, <u>it would not be appropriate to impose throughout the Community a level of protection which might in certain cases have the effect of encouraging unsound management of credit institutions whereas the cost of funding schemes should be taken into account</u> whereas it would appear reasonable to set the harmonized minimum guarantee level at ECU 20,000 whereas limited transitional arrangements might be necessary to enable schemes to comply with that figure." (emphasis added)

163. This recital also recognises the potential moral hazard that might arise if deposit-guarantee schemes were too generous: it would lead to a risk of "unsound management" on the part of credit institutions. That risk would evidently be all the greater if the deposit-guarantee scheme were to be underwritten by the State.

164. The 23rd recital recognises the need for proportionate funding, but again cautions against the risk that might arise if the requirements of the scheme are too onerous:

[80] Report of the University of Iceland, Institute for Economic Studies, 6 March 2012, pages 3 – 7.
[81] See eg paragraph 93 of the Application.

"… the financing capacity of such schemes must be in proportion to their liabilities whereas this must not, however, jeopardize the stability of the banking system of the Member State concerned."

165. Such a threat to stability could materialise if deposit taking institutions were required to put aside such large sums by way of financing for the scheme as to threaten their viability. As already noted, the Commission recognised in its Impact Assessment the scope for the costs of a deposit-guarantee scheme to give rise to "unwanted side-effects".[82]

166. Nothing in these objectives justifies the conclusion that the State must bear financial responsibility for the functioning of the deposit-guarantee scheme.

Recitals 4, 23, 24 and 25: the funding of the deposit-guarantee

167. The Directive imposes no requirement of State funding. The 23rd recital explains:

> "Whereas it is not indispensable, in this Directive, to harmonize the methods of financing schemes guaranteeing deposits or credit institutions themselves, given, on the one hand, the cost of financing such schemes must be borne in principle by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be borne, in principle, by credit institutions themselves, and on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities whereas this must not, however, jeopardize the stability of the banking system of the Member State concerned". (emphasis added)

168. Thus, the Directive proceeds on this basis that the cost of such schemes will fall on the credit institutions. Similarly, the fourth recital provides:

> "Whereas the cost to credit institutions of participating in a guarantee scheme bears no relation to the cost that would result from a massive withdrawal of bank deposits not only from a credit institution in difficulties but also from healthy institutions following a loss of depositor confidence in the soundness of the banking system" (emphasis added)

169. The 25th recital provides:

> "Whereas deposit protection is an essential element in the completion of the internal market and an indispensable supplement to the system of supervision

[82] Impact Assessment, pg 58, final para.

> of credit institutions <u>on account of the solidarity it creates among all the institutions</u> in a given financial market in the event of the failure of any of them." (emphasis added)

170. The reference to "solidarity" again indicates that funding should be provided by the credit institutions themselves.

171. The Directive contains no express provision at all imposing funding obligations on the State, even where "all else fails".

172. The reality is that the Directive does not deal at all with the circumstances in which a deposit-guarantee scheme is unable to pay compensation.

173. The only hint in the Directive that such a widespread failure is contemplated is the fourth recital:

> "Whereas the cost to credit institutions of participating in a guarantee scheme bears no relation to the cost that would result from a massive withdrawal of bank deposits not only from a credit institution in difficulties but also from healthy institutions following a loss of depositor confidence in the soundness of the banking system."

174. This recital does not, however, indicate how such a widespread failure should be dealt with under the Directive. Rather, it points to the value of the deposit-guarantee scheme in providing a <u>deterrent</u> to such a loss of confidence.

175. There is only one paragraph within the operative provisions of the Directive which addresses the possibility that the deposit-guarantee scheme might prove unable to pay duly qualified claims: Article 7(6). It provides:

> "Member States shall ensure that the depositor's rights to compensation may be the subject of an action by the depositor against the deposit-guarantee scheme."

176. Thus, the solution contemplated by the Directive to non-payment is action against the <u>deposit-guarantee scheme</u> itself, not action against the State.

177. As shall be explained, the case law of the Court of Justice makes clear that there can be no automatic liability of the State in those circumstances: liability of the State to

depositors could only ever arise on *Factortame/Sveinbjörnsdóttir* conditions, and even then, is subject to an important exception.

Recital 24: exclusion of State liability

178. Recital 24 of the Directive also addresses the question of State liability. It provides:

> "Whereas this Directive may not result in the Member State or their competent authorities being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this Directive have been introduced and officially recognised."

179. The Authority argues that recital 24 demonstrates that:[83]

> "a Member State may be liable if it has not ensured that one or more schemes capable of ensuring the compensation or protection of depositors under the conditions prescribed by the directive".

180. The recital says nothing of the sort: it simply serves to exclude liability in one particular instance.

The judgment in *Paul*

181. This proposition was confirmed by the Court of Justice in Case C-222/02 *Paul v Germany* [2004] ECR I-9425.

182. In that case, the applicants were customers of a bank that applied unsuccessfully to become a member of a German deposit-guarantee scheme.[84] They suffered losses when the Germany authority revoked its authorisation to engage in banking transactions and the bank became insolvent.[85] They claimed they would not have suffered those losses if the Directive had been transposed within the period allowed, and that the authority would have then taken supervisory measures against the bank

[83] Application, para 123.
[84] Para 11.
[85] Para 12.

before the applicants had made their deposits.[86] The German authority had denied liability on the basis that it exercised its functions only in the public interest.[87]

183. The first question asked by the Referring Court was whether Community law precluded a national rule which precluded individuals from claiming damages against the national authority responsible for supervising credit institutions resulting from defective supervision by that authority.[88]

184. The Court began by observing:

> 26. In that regard, it should be borne in mind that Directive 94/19 seeks to introduce cover for depositors, wherever deposits are located in the Community, in the event of the unavailability of deposits made with a credit institution which is a member of a deposit guarantee-scheme.
>
> 27. The depositor's right to compensation in such a situation is governed by Article 7(1) and (6) of that directive. Article 7(1) determines the maximum amount of compensation which a depositor may claim on the basis of the directive, whilst Article 7(3) specifies that Member States may under their national law provide for rules offering depositors a higher or more comprehensive cover for deposits. Article 7(6) of Directive 94/19 requires Member States to ensure that the depositor's rights to compensation, as defined in particular in Article 7(1) and (3), may be the subject of an action by the depositor against the deposit-guarantee scheme." (emphasis added)

185. Thus, the Court explained that the Directive "seeks to introduce cover for depositors", not that the State must guarantee such cover, and that any action lay against the deposit-guarantee scheme, not the State itself.

186. The Court then explained the purpose of Article 3 of the Directive:

> "29. The purpose of Article 3(2) to (5) of Directive 94/19 is to guarantee to depositors that the credit institution in which they make their deposits belongs to a deposit-guarantee scheme, in order to ensure protection of their right to compensation in the event that their deposits are unavailable, in accordance with the rules laid down in that directive and more specifically in Article 7 thereof. Those provisions thus relate only to the introduction and proper functioning of the deposit-guarantee scheme as provided for by Directive 94/19." (emphasis added)

[86] Para 13.
[87] Para 19.
[88] Para 25.

187. The Court did not rule that the State had an automatic obligation to pay the sum guaranteed under Article 3; on the contrary, it explained that the State's obligations extended only to the "introduction" and "proper functioning" of the deposit-guarantee scheme. The Court went on, however, to consider the circumstances in which State liability to a depositor might arise, for failure to properly implement these provisions:

> "30. Under those conditions, as pointed out by the governments which submitted observations to the Court and by the Commission, if the compensation of depositors is ensured in the event that their deposits are unavailable, as prescribed by Directive 94/19, Article 3(2) to (5) thereof does not confer on depositors a right to have the competent authorities take supervisory measures in their interest.
>
> 31. That interpretation of Directive 94/19 is supported by the 24th recital in the preamble thereto, which states that the directive may not result in the Member States' or their competent authorities' being made liable in respect of depositors if they have ensured the compensation or protection of depositors under the conditions prescribed in the directive.
>
> 32. The answer to the first question must therefore be that, if the compensation of depositors prescribed by Directive 94/19 is ensured, Article 3(2) to (5) thereof cannot be interpreted as precluding a national rule to the effect that the functions of the national authority responsible for supervising credit institutions are to be fulfilled only in the public interest, which under national law precludes individuals from claiming compensation for damage resulting from defective supervision on the part of that authority." (emphasis added)

188. The Authority argues that the *Paul* case establishes that "if the compensation of depositors described by the Directive is not ensured in the event that deposits become unavailable (which is the case in Iceland), the State should be held liable."[89] But as can be seen, in reality, the Court dealt explicitly with the circumstances in which liability is excluded, not the circumstances in which liability is incurred.

189. The Authority also states that in paragraph 30 of *Paul*:[90]

> "... the Court of Justice held that Directive 94/19:
>
> > "[prescribes that] compensation of depositors is ensured in the event that their deposits are unavailable"."

[89] Application, para 127.
[90] Ibid, para 78.

190. But read in context, these words provide no support at all to the Authority's case. Paragraph 30 of the Court's judgment simply affirms the content of recital 24: if the compensation of depositors is ensured, then there can be no question of State liability.

German version of the Directive

191. Moreover, the German version of recital 24 is inconsistent with the Authority's analysis. It provides that:

> "Die Mitgliedstaaten oder ihre zuständigen Behörden können aufgrund dieser Richtlinie den Einlegern gegnüber nicht haftbar gemacht warden, wenn sie für die Einrichtung bzw. die amtliche Anerkennung eines oder mehrerer Systeme Sorge getragen haben, die die Einlagen oder die Kreditinstitute selbst absichern und die Zahlung von Entschädigung oder den Schutz der Einleger nach Maβgabe dieser Richtlinie gewährleisten."

192. The effect in English is:

> "The Member States or their competent authorities cannot on the basis of this Directive in respect of depositors be made liable, if they have provided for the introduction and official recognition of one or more schemes, which guarantee deposits or credit institutions themselves and ensure the compensation or protection of depositors under the conditions prescribed in this Directive." (emphasis added)

193. Thus, the German version of the Directive makes clear that is for the schemes to ensure the compensation of depositors. The State cannot be held liable if it has provided for the introduction and recognition of the scheme.

194. It is settled case law that where the different language versions of a measure are not consistent, the most liberal interpretation must prevail, provided that it is sufficient to achieve the objectives pursued. That it because the legislator cannot have intended to impose stricter obligations on some Member States than on others.[91]

195. Here, for reasons already given, the German version is entirely sufficient to achieve the Directive's aims.

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[91] Case 29/69 *Stauder v Ulm*[1969] ECR 419, para 4.

State liability under *Paul*

196. In *Paul* the Court also went on to consider "the possibility of a State incurring liability in accordance with the principles of Community law in the event of defective supervision on the part of the competent national authorities".[92] The Court explained:

> "49. It follows from the case-law that a State incurs liability for breach of a rule of Community law only where, in particular, the rule of law infringed is intended to confer rights on individuals (see Joined Cases C-46/93 and C-48/93 *Brasserie du pêcheur and Factortame* [1996] ECR I-1029, paragraph 51; Joined Cases C-178/94, C-179/94 and C-188/94 to C-190/94 *Dillenkofer and Others* [1996] ECR I-4845, paragraph 21; and Case C-63/01 *Evans* [2003] ECR I-0000, paragraph 83).
>
> 50. However, it is clear from the answers given to the first two questions that Directives 94/19, 77/80, 89/299 and 89/646 do not confer rights on depositors in the event that their deposits are unavailable as a result of defective supervision on the part of the competent national authorities, if the compensation of depositors prescribed by Directive 94/19 is ensured.
>
> 51. Under those conditions, and for the same reasons as those underlying the answers given above, the directives cannot be regarded as conferring on individuals, in the event that their deposits are unavailable as a result of defective supervision on the part of the competent national authorities, rights capable of giving rise to liability on the part of the State on the basis of Community law."

197. Paragraph 49 of this judgment accordingly makes clear that State liability for defective supervision arises <u>only</u> where the three conditions specified in *Factortame,*[93] and which apply in EEA law,[94] are satisfied, namely:

> "the rule of law infringed must be intended to confer rights on individuals; the breach must be sufficiently serious; and there must be a direct causal link between the breach of the obligation resting on the State and the damage sustained by the injured parties."

198. Paragraph 50 of the judgment in *Paul* then goes on to explain that this first condition is not satisfied in circumstances where the compensation of depositors is ensured, as

[92] Para 48, as formulated by the Court of Justice.
[93] Joined Cases C-46/93 and C-48/93 *Brasserie du pêcheur and Factortame* [1996] ECR I-1029, paragraph 51.
[94] Case E-9/97 *Sveinbjörnsdóttir v Iceland* [1998] EFTA Court Rep 95, para 66.

recital 24 makes clear. Thus, recital 24 establishes an exception to the general rule of liability on *Factortame* grounds.

199. The present case is not a claim for damages against the Icelandic State. The question whether the *Factortame/Sveinbjörnsdóttir* conditions are satisfied accordingly does not arise: the Authority has (rightly) not sought to argue that those conditions are satisfied. [95]

200. There is no suggestion in the judgment of the Court in *Paul* that the State is under an automatic duty under the Directive to pay depositors in the event of defective implementation of the Directive.

Article 3(1): the obligation to establish a deposit-guarantee scheme

201. The Directive imposes obligations upon the Contracting States to ensure that one or more deposit-guarantee schemes are introduced and officially recognised. Article 3(1) provides:

> "Each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognised..." (emphasis added)

202. Thus, the duty on the Member State is to ensure such a scheme is introduced – not for the State itself to provide such a guarantee.

203. Moreover, Article 3(1) goes on to give a further indication that such a scheme should not involve a State guarantee. It provides that no credit institution authorised within the Member State may take deposits unless it is a member of such a scheme. That is subject to an exception where the credit institution:

> "belongs to a deposit-guarantee scheme which protects the credit institution itself and in particular ensures its liquidity and solvency, thus guaranteeing protection for depositors at least equivalent to that provided by a deposit-guarantee scheme, and which, in the opinion of the authorities, fulfils the following conditions:

[95] For the avoidance of doubt, Iceland would strenuously resist any suggestion that those conditions are satisfied in this case.

- the system must be in existence and have been officially recognised when this Directive is adopted,

- the system must be designed to prevent deposits with credit institutions belonging to the system from becoming unavailable and have the resources necessary for that purpose at its disposal,

- <u>the system must not consist of a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities</u>,

- the system must ensure that depositors are informed in accordance with the terms and conditions laid down in Article 9." (emphasis added)

204. The prohibition upon the use of a State guarantee reflects the potential for such guarantees to distort competition, as is recognised in the Commission's analysis quoted at paragraph 143 above.

205. The Authority's argument is that in the circumstances of the present case, where "all else" has failed, the Directive requires the State to use its resources to provide compensation. The implication is that such a use of State resources is removed from the scope of State aid supervision by the Authority, and the Commission. As already seen, this is clearly at odds with the Commission's understanding, expressed both in the proposal for the Directive, and the more recent Impact Assessment, that where a deposit guarantee scheme is unable to meet its obligations, the Member State has the <u>option</u> to intervene, subject to compliance with State aid rules, see paragraphs 135 to 140 above.

206. It is also at odds with the reality of the position, which is that in a systemic crisis the the Contracting States will employ a wide range of measures to support their financial systems. The optimal way to regulate these is under State aid rules, which allow for examination of the question whether the measures are compatible with the functioning of the EEA Agreement pursuant to Article 61, see paragraphs 145 to 148 above.

207. The recitals to the Directive show a clear concern on the part of the Parliament and Council that the deposit-guarantee scheme should not lead to distortions of

competition.[96] As already noted, recital 16 points to the moral hazard that might arise where a level of protection offered is so high as to encourage "the unsound management of credit institutions". That moral hazard would also arise in the case of a State guarantee, serving to immunise the deposit-guarantee scheme from the consequences of default.

208. It is of course open to the EU legislature/EEA Joint Committee to introduce legislation imposing an ex ante requirement for a State guarantee, outside the scope of the State aid legislation. But Iceland respectfully submits that in the absence of express wording, the Court should be very slow to conclude that obligations with such potentially adverse consequences arise. The Icelandic Government contends that on the true construction of the Directive, there is no such "obligation of result".

Article 3(2) the obligation of supervision upon the State

209. The Directive does not only place the State under an obligation to ensure that a deposit-guarantee scheme is established: it is also placed under certain limited obligations of supervision.

210. Article 3(2) of the Directive provides:

> "If a credit institution does not comply with the obligations incumbent on a member of a deposit-guarantee scheme, the competent authorities which issued its authorisation shall be notified and, in collaboration with the guarantee scheme, shall take all appropriate measures including the imposition of sanctions to ensure that the credit institution complies with its obligations."

211. Article 3(3) then deals with the possibility that a non-compliant institution may be excluded from membership of the scheme, and ultimately, have its authorization revoked: Art 3(5).

212. The Directive does not provide that in the event of default by a credit institution, or the scheme itself, the Member State should make up any shortfall.

[96] Recitals 13 and 14 point to the potential for distortions of competition or "market disturbances" where there are disparities within a Member State between institutions authorised in the host state and branches of institutions authorised in another State.

213. In any event, the Authority does not allege any breach of this duty by the Icelandic State.

Article 7: the substance of the deposit-guarantee scheme

214. The rules governing the substance of the deposit-guarantee scheme are set out in Article 7 of the Directive. Article 7(1) provides:

> "Deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to ECU 20,000 in the event of deposits being unavailable." (emphasis added).

215. Thus, Article 7 is addressed to the rules of the deposit-guarantee scheme. The Directive does not provide that the Member State should itself provide such cover, or that the State should guarantee that such cover would be available "if all else fails".

216. It is not however, the Icelandic Government's case that the Directive required only the setting up of a purely formal deposit-guarantee scheme – an empty shell, without assets.[97] Such a scheme would plainly frustrate the objectives of the Directive: it would not provide the necessary assurance to both Member States and consumers, envisaged in its first three recitals.[98] It would not attain a "high level" of consumer protection.

217. In this case, as already explained, the Icelandic Government ensured that a deposit-guarantee scheme was established that was able to offer a guarantee of substance, pre-funded by the credit institutions to a level that was entirely in accordance with international norms. In the end, that scheme was quite unable to cope with the scale of the demands placed upon it, but no scheme could have done so.

218. The essential question is whether the Directive nevertheless placed an obligation upon the State to ensure that it could. The Icelandic Government submits that the answer is "no". The Community legislature was careful to place a much more limited obligation upon the State.

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[97] Contrast paragraph 93 of the Application.
[98] See paragraphs 154 - 166 above.

219. The Authority's argument is that the huge costs of a deposit guarantee, applicable even in the case of a total failure of the banking system, are in fact placed upon the State (and ultimately, the taxpayer). It would require the clearest possible language to entail such a result. Instead, the Directive says nothing of the kind.

Article 10: the procedure by which claims are paid

220. Article 10 imposes certain procedural requirements upon deposit-guarantee schemes. It provides, materially:

> "(1) Deposit-guarantee schemes shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits within three months of the date on which the competent authorities make the determination described in Article 1(3)(i) or the judicial authority makes the ruling described in Article 1(3)(ii).
>
> (2) In wholly exceptional circumstances and in special cases a guarantee scheme may apply to the competent authorities for an extension of the time limit. No such extension shall exceed three months."

221. This provision accordingly imposes procedural obligations upon the deposit-guarantee institutions, to which it is addressed. It is a wholly unwarranted leap to derive from this an obligation that the State must provide the funds to guarantee deposits in the event that the guarantee scheme is unable to pay.

222. The Icelandic Government further notes that the German version of the Directive refers only to deposit-guarantee schemes "taking precautions" in order to make such payments within the three month period allowed by the Directive:

> Die Einlagensicherungssysteme treffen Vorkehrungen, um ordnungsgemäß geprüfte Forderungen der Einleger in bezug auf nicht verfügbare Einlagen binnen drei Monaten ab dem Zeitpunkt zahlen zu können, zu dem die zuständigen Behörden die Feststellung nach Artikel 1 Nummer 3 Ziffer i) getroffen haben oder das Gericht die Entscheidung nach Artikel 1 Nummer 3 Ziffer ii) getroffen hat." (emphasis added)

223. That is very far from a strict obligation upon the State to do so. Once again, the most liberal interpretation must prevail.[99]

224. On the correct analysis of the Directive the State itself must establish and supervise the deposit-guarantee scheme, but no more.

Emanation of the State

225. The Authority argues that the TIF itself forms part of the Icelandic State.[100] This argument is of no assistance. The Authority does not dispute that it was impossible for the TIF to honour the deposit guarantee out of its own resources, given the scale of the Icelandic bank collapse. The issue is whether there was nevertheless an obligation upon the State to fund the guarantee thereafter. It makes no difference to that argument whether the TIF was an emanation of the State or not.

226. That issue arises where an individual is seeking to demonstrate that a Directive gives rise to directly effective rights as against a particular entity. The Court of Justice has explained that: [101]

> "A directive cannot be relied on against individuals, whereas it may be relied on as against a State, regardless of the capacity in which the latter is acting, that is to say, whether as employer or as public authority. The entities against which the provisions of a directive that are capable of having direct effect may be relied upon include a body, whatever its legal form, which has been made responsible, pursuant to a measure adopted by the State, for providing a public service under the control of the State and has for that purpose special powers beyond those which result from the normal rules applicable in relations between individuals (Case C-188/89 *Foster and Others* [1990] ECR I-3313, paragraph 20; Case C-343/98 *Collino and Chiappero* [2000] ECR I-6659, paragraph 23; and Case C-157/02 *Rieser Internationale Transporte* [2004] ECR I-1477, paragraph 24)." (emphasis added)

227. The Authority's case is of course not concerned with direct effect.[102] In any event, the Authority has failed to make out its case on the facts: the test for "emanation of the State" is not satisfied.

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[99] Case 29/69 *Stauder v Ulm*[1969] ECR 419, para 4.
[100] Application, para 97.
[101] Case C-356/05 *Farrell and Whitty v MIBI* [2007] ECR I-3067, para 40.

228. The TIF was established by Act No 98/1999. Article 2 provides:

> "Guarantees under this Act are entrusted to a special institute named the Depositors' and Investors' Guarantee Fund, hereinafter referred to as the 'Fund'. The Fund is a private foundation, operating in two independent departments, the Deposit Department and the Securities Department, with separate financing and accounting...." (emphasis added)

229. The TIF is a private and non-profit fund. In accordance with Article 4 of Act No 98/1999, private institutions nominate four out of six members of the board and the Minister of Commerce nominates two members. Accordingly, the State does not have the required majority to exercise control over the board.

230. This contention is accordingly of no assistance to the Authority.

Comparison with Directive 80/987/EEC

231. The provisions of the Directive may be compared with those of Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer. That Directive has now been repealed and replaced,[103] but the case law of the Court of Justice interpreting this Directive further demonstrates that the Authority's argument in the present case cannot be right.

232. Directive 80/987/EEC was a harmonising measure adopted under Article 100 EC (now Article 114 TFEU). Its first recital explained:

> "it is necessary to provide for the protection of employees in the event of the insolvency of their employer, in particular in order to guarantee payment of their outstanding claims, while taking account of the need for balanced economic and social development in the Community". (emphasis added)

233. Article 1 of Directive 80/987/EEC explained that it applied to employees' claims arising from contracts of employment or employment relationships and existing against employers who are in a state of insolvency, as defined in the Directive.

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[102] EEA Agreement, Protocol No 35.
[103] Directive 2008/94/EC, Art 16. That replacement Directive is materially unaltered for present purposes.

234. The Directive envisaged that the required guarantee would be provided through a "guarantee institution". Article 3 provided:

> "Member States shall take the measures necessary to ensure that guarantee institutions guarantee, subject to Article 4,[104] payment of employees' outstanding claims resulting from contracts of employment or employment relationships and relating to pay for the period prior to a given date." (emphasis added).

235. This language imposes an explicit obligation on the Member State to "ensure that institutions guarantee", unlike the language of Article 3 of Directive 94/19/EC, which requires only that Member States ensure that guarantee schemes are "introduced and officially recognised".

236. Article 5 of Directive 80/987/EEC concerned the funding and organisation of guarantee institutions. It provided that:

> "(b) employers shall contribute to financing, unless it is fully covered by the public authorities ..."

237. Thus, Directive 80/987/EEC specifically provided for the option that guarantee institutions should be funded by public authorities, although it contained no requirement. In the present case, as already noted, Directive 94/19/EC does not harmonise the rules for funding the deposit-guarantee scheme, although plainly proceeds on the expectation that the deposit-guarantee scheme will be funded by the credit institutions.

238. In Cases C-6/90 and C-9/90 *Francovich and Bonifaci v Italy* [1991] ECR I-5357, the Court was asked to consider questions arising out of the Italian Government's failure to implement Directive 80/987/EEC. The Court considered "the direct effect of the provisions of the directive which determine the rights of employees".[105] The Court held that:

[104] Article 4 provided the Member States with certain options to limit the liability of guarantee institutions.
[105] Para 9.

"the result required by the directive in question is a guarantee that the outstanding claims of employees will be paid in the event of the insolvency of their employer."[106]

239. That was the "result to be achieved". The Court nevertheless rejected an argument that this provision could lead to liability on the part of the State to provide the guarantee. The difficulty was that the Directive did not identify the person liable to provide the guarantee:

"25 ... It follows from the terms of the directive that the Member State is required to organize an appropriate institutional guarantee system. Under Article 5, the Member State has a broad discretion with regard to the organization, operation and financing of the guarantee institutions. The fact, referred to by the Commission, that the directive envisages as one possibility among others that such a system may be financed entirely by the public authorities cannot mean that the State can be identified as the person liable for unpaid claims. The payment obligation lies with the guarantee institutions, and it is only in exercising its power to organize the guarantee system that the State may provide that the guarantee institutions are to be financed entirely by the public authorities. In those circumstances the State takes on an obligation which in principle is not its own.

26 Accordingly, even though the provisions of the directive in question are sufficiently precise and unconditional as regards the determination of the persons entitled to the guarantee and as regards the content of that guarantee, those elements are not sufficient to enable individuals to rely on those provisions before the national courts. Those provisions do not identify the person liable to provide the guarantee, and the State cannot be considered liable on the sole ground that it has failed to take transposition measures within the prescribed period." (emphasis added)

240. A similar finding was made in Case C-278/05 *Robins v Secretary of State for Work and Pensions* [2007] ECR I-1053 in which the Court stated: [107]

"The wording of Article 8 of [Directive 80/987/EEC], inasumuch as it states in a general manner that the Member States 'shall ensure that the necessary measures are taken', does not oblige those States themselves to fund the rights to benefits that must be protected by virtue of [Directive 80/987/EEC]."

[106] Para 18.

[107] Para 35. In Case C-441/99 *Soghra* [2001] ECR I-7687, the Court of Justice held that Article 3 of Directive 80/987/EEC did have direct effect, but in a case where – and explicitly on the grounds that – the Member State had exercised its discretion and chosen to provide direct funding for the guarantee from public funds (para 41). In the present case, the position is precisely the opposite: the Icelandic Government chose to fund the deposit-guarantee scheme through the contributions of credit institutions.

241. Therefore, the Court found that Directive 80/987/EEC defined no rights which individuals were able to assert against the State, capable of being held directly effective. Instead it found that the State was able to choose who should be liable for employee claims, and rights against the State were only created if the State chose to undertake the liability itself.

242. Such a finding is wholly incompatible with the existence of an implicit requirement on the State to compensate employees where the scheme did not.

243. The Icelandic Government contends that it is even harder to imply such a requirement into 94/19/EC than 80/987/EEC:

a) Directive 94/19/EC places no explicit obligation of guarantee upon the State: the only express Directive requirements are to set up and supervise a guarantee scheme.

b) Moreover, Directive 94/19/EC does not even provide an explicit option of State funding.

244. Whilst the question of direct effect does not arise in these proceedings, the foregoing cases serve to demonstrate that it is not possible to identify any obligation under the Directive upon the State to fund the deposit-guarantee scheme in the present case, even where "all else fails."

245. Indeed the *Francovich* case helped to establish the general principle of EU law that Member States should only be liable to individuals under directives where these (i) can be shown to have direct effect[108] or (ii) where the conditions articulated in *Francovich* for the award of damages, including the requirement for a manifest and grave breach of European law, have been met. Seeking to imply an obligation on the State to fund the guarantee scheme, where no such obligation appears on the face of

[108] By contrast, it follows from Article 7 EEA and Protocol 35 that the EEA Agreement does not require that individuals and economic operators can rely directly on non-implemented EEA rules before national courts (See Case E-1/07, *Criminal proceeding against A*, [2007] EFTA Court Report p. 246, para 40 and E-4/01 *Karlsson*, [2002] EFTA Court Report p. 240, para 28). Pursuant to EEA law there can only be question of State liability if the directive in question is intended to confer rights on individuals, the content of which must be identifiable on the basis of the provisions of the directive (see *Sveinbjörnsdóttir*, para 66).

the Directive, is an attempt to circumvent this system and undermine the clear principles repeatedly applied by the European Courts.

FORCE MAJEURE

246. For the reasons already given, the Icelandic State was under no Directive obligation to compensate depositors in light of the failure of the deposit-guarantee scheme to do so. But even if there was such an obligation, it was defeated by virtue of *force majeure.*

247. The Authority argues:[109]

> "It is only when there is a total physical impossibility, for reasons beyond all control of the EEA State, that the Court of Justice has accepted that a Member State is not in breach of its obligation under secondary law." (emphasis added)

248. In fact, the case law of the Court of Justice makes clear that the doctrine is far broader and more flexible than the Authority seeks to suggest. As Advocate General Jacobs has observed:[110]

> "[*f*]*orce majeure* is by its very nature a flexible doctrine, which is more concerned with equitable outcomes than with precisely defined conditions."

249. Whilst the circumstances of this case are wholly exceptional, it nevertheless falls squarely within the established case law of the Court of Justice. The Court of Justice has summarised the effect of its case law in the following terms:[111]

> "According to settled case-law established in various contexts, for example agricultural regulations or the rules on time-limits for bringing an action laid down by Article 45 of the Statute of the Court of Justice, force majeure is not limited to absolute impossibility but must be understood in the sense of

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[109] Application, para 149. The Authority relies, in support of this argument, upon the judgment of the Court of Justice in Case 101/84 *Commission v Italy* [1986] 2629. That was a case of physical impossibility: information required to compile certain transport statistics had been destroyed in a bomb attack. The Court accepted that this created "insurmountable difficulties", albeit that this lasted only for a certain period of time: para 16. The Court did not rule that "physical impossibility" was a pre-requisite for the application of the doctrine of *force majeure.*

[110] Case C-236/99 *Commission v Belgium* [2000] ECR I-5657, para 17.

[111] Case C-314/06 *Société Pipeline Méditerranée et Rhône (SPMR) v Administration des douanes et droits indirects,Direction nationale du renseignement et des enquêtes douanières (DNRED)* [2007] ECR I-12273.

> abnormal and unforeseeable circumstances, extraneous to the operator concerned, the consequences of which, in spite of the exercise of all due care, could not have been avoided (see, to that effect, Case C-195/91 P *Bayer v Commission* [1994] ECR I-5619, paragraph 31, and Case C-208/01 *Parras Medina* [2002] ECR I-8955, paragraph 19 and the case-law cited).
>
> 24 It follows from this that, as the Court has already noted, 'force majeure' contains both an objective element relating to abnormal circumstances extraneous to the trader and a subjective element involving the obligation, on that person's part, to guard against the consequences of the abnormal event by taking appropriate steps without making unreasonable sacrifices (see, to that effect, Bayer, paragraph 32, and the order in Case C-325/03 P *Zuazaga Meabe v OHIM* [2005] ECR I-403, paragraph 25).

250. Thus, *force majeure* does not require "physical impossibility", but rather "abnormal and unforeseeable" events, which could not have been avoided if all due care had been taken. Nor does it require that the State ought to have acted as if with perfect hindsight. "All due care" is not equivalent to "strict liability": it means "appropriate steps" that can be taken "without making unreasonable sacrifices".

251. The worldwide financial turmoil in 2008 and the collapse of the Icelandic banking system plainly satisfies the objective element.

252. As to the subjective element, the Authority has not sought to argue that the Icelandic State should or could have prevented the Icelandic bank crash. Nor could any deposit-guarantee scheme have been devised that was capable of withstanding such a collapse, at least without making unreasonable sacrifices in terms of the banks' ability to conduct their business.

253. The Authority does not argue that it was possible for Iceland to comply with the requirements of the Directive in October 2008. Rather, its argument is that by 23 October 2009:

> "the Icelandic Government could not argue that it could not have access to the funds necessary to fulfil its obligations under the Directive. This is evidence by the conclusion, in June 2009, of an agreement with the Governments of the United Kingdom and the Netherlands, who were ready to provide the necessary funds to Iceland. Had this agreement been ratified, it would have allowed the Icelandic State to fulfil its obligations according to the Directive,

within the time limits provided for in Article 10 of the Directive."[112] (emphasis added)

254. This entirely mischaracterises the nature of the Icesave Agreements. As already explained,[113] they were not agreements to provide funds to Iceland at all. They were simply agreements to govern repayment to those states for the compensation that they were providing.[114] They provided for repayment to take place long after the period of one year allowed by the Directive.

255. There were no "appropriate steps" that the Icelandic Government could have taken to pay the depositors, without making unreasonable sacrifices: Iceland did not have ISK 659 billion to pay to depositors. That represented approximately one and a half years' tax revenue of the Icelandic State. Nor could it have raised that money on the capital markets.

256. At the end of October 2009, the gross size of the foreign reserves of the Central Bank amounted to ISK 451 bn. When taking into account the Central Bank's external liabilities, the net foreign assets amounted to ISK 169 billion. In addition, the central government's foreign debt amounted to ISK 356 bn at the end of 2009.

257. As already explained, it is now anticipated that 100% of all outstanding claims will paid out of the assets of Landsbanki itself. Those are not the assets of the Icelandic State, as the Authority seems to think.[115] They are to be paid out to creditors (including the United Kingdom and Dutch Governments) as soon as the Winding Up Board judges the time right to ensure a 100% return. No other option is realistically open.

[112] Application, para 153.
[113] See paragraphs 104 - 107 above.
[114] For the avoidance of doubt, Iceland entirely reserves its position as to whether any duty arose under the Directive itself to those States.
[115] Application, para 154.

<u>The context of the plea of *force majeure*</u>

258. The Court of Justice has made clear that the meaning of the doctrine of *force majeure* "must be determined by reference to the legal context in which it is to operate".[116]

259. The Authority argues that its operation is precluded in this case by the language of Article 10(3) of the Directive, which permits a deposit-guarantee scheme to apply to the competent authorities for an extension of time of up to nine months in which to pay verified claims "in wholly exceptional circumstances."

260. Article 10(3) is, however, addressed to deposit-guarantee schemes, not the Contracting States.

261. If, as the Authority contends, the Directive places an obligation on the State to provide compensation "if all else fails", then it cannot be found in the express provisions of the Directive. Those provisions do not address this situation at all.

262. As a result, the words of Article 10(3) cannot serve to exclude the State from reliance upon *force majeure* when it is unable to meet such an obligation.

<u>Interpretation</u>

263. In any event, it is submitted that the foregoing considerations are relevant in considering the true extent of the obligations under the Directive. The Authority's argument is that the Icelandic Government is obliged by the Directive to make a payment which is to all practical purposes impossible. This consequence strongly suggests that the proposed interpretation is simply wrong.

[116] Case C-314/06 *Société Pipeline Méditerranée et Rhône (SPMR) v Administration des douanes et droits indirects,Direction nationale du renseignement et des enquêtes douanières (DNRED)* [2007] ECR I-12273, para 25.

NON-DISCRIMINATION

Introduction

264. The Authority's case is that Iceland breached the principle of non-discrimination by "failing to ensure payment of the minimum amount of compensation to Icesave depositors in the Netherlands and the United Kingdom" (emphasis added).[117] This claim is entirely misconceived.

265. It is well-established that the duty of non-discrimination requires that:[118]

> "comparable situations must not be treated differently and ... different situations must not be treated in the same way, unless such treatment is objectively justified."

266. Here, the Authority seeks to draw a comparison between "depositors in domestic branches and depositors in foreign branches" of Landsbanki.[119] It argues that "both groups were in a comparable situation".[120] Thus, to make good its claim of discrimination, it must argue that they "must not be treated differently".

267. The starting point, however, is that there has been no discrimination at all in the manner in which the deposit guarantee fund itself has been operated. No depositors in Landsbanki, or the other failed banks, have received any payments under that scheme. In this respect, the two groups have been treated equally.

268. The Authority asserts:[121]

> "The breach is constituted by the failure of the Icelandic Government to ensure that Icesave depositors in the Netherlands and the United Kingdom receive payment of the *minimum amount of compensation provided for in the Directive* within the time limits laid down in the Directive, *like it did for domestic depositors.*" (original emphasis)

[117] Declaration sought by the Authority.
[118] See e.g. Case T-216/06 *Lucite International v Commission*, 15 September 2011, para 59.
[119] Application, para 157.
[120] Ibid, para 164.
[121] Ibid, para 175.

269. If that is the basis for the claimed discrimination, then it is simply wrong on the facts. No depositors in the failed banks received such payments.

270. The Authority is not arguing for equal treatment on the basis that the depositors in the overseas branches should have been moved to the new banks: in fact it explicitly disavows any such argument.[122]

271. Instead, the Authority is arguing for different treatment: it argues that because the domestic depositors were "covered" by virtue of a transfer of their deposits to the new banks, then it was discriminatory to fail to provide the "minimum guarantee" afforded by the Directive to the overseas depositors.[123]

272. It is clear, not least from the form of declaration sought by the Authority[124] that the "minimum guarantee" means in substance the payment of €20,000 per depositor.[125]

273. Thus, the Authority's case is that because one type of measure was adopted that applied to the domestic depositors (transfer of deposits to a newly established bank), a different type of measure should have been adopted for overseas depositors (cash payment by the State of €20,000). That is not to argue for equal treatment. The reality is that these are two very different things. As a basis for a discrimination claim, it is incoherent.

274. What the Authority seeks to present as discrimination is in reality simply the different consequences that have flowed as a result of the fact that the domestic branches of Landsbanki were essential to the rescue of the domestic financial system and have formed part of the restructuring of the domestic banks. It was not possible to extend this rescue to the overseas branches: the Authority does not argue that to the contrary.

275. In any event, it is far from clear that the depositors in the Icelandic branches were better off overall. Whilst their accounts were transferred to the new banks, the account holders were made subject to strict capital controls, and were unable to

[122] Application, para 175.
[123] Ibid, para 165.
[124] The declaration sought is that by "failing to ensure payment" of the sums guaranteed, Iceland breached EEA law. See also para 175 of the Application.
[125] See eg the Declaration sought by the Authority and para 175 of the Application.

convert their (severely depreciating) Icelandic Krona into any other currency. By contrast, the priority claimants in the Landsbanki winding up now stand to be fully reimbursed the amounts in their accounts in a fully convertible currency. It is accordingly unclear that they have been subjected to any detriment overall.

276. The Authority has two legal bases for its discrimination argument.

277. First, it argues that the Directive itself imposes such a requirement, at least when "read in light of Article 4 EEA."[126]

278. It must be recalled, however, that the Authority's first head of claim is that the Directive itself requires such payments to be made, irrespective of its second argument based upon discrimination. The Icelandic Government of course disagrees. But if the Authority's first argument is accepted, the question of discrimination never arises.

279. If the Authority's first argument is not accepted, then the only way a claim to discrimination could arise would be if the operation of the deposit-guarantee scheme itself was itself somehow discriminatory. But that is clearly not the case. Either way, the argument on discrimination adds nothing.

280. Thus, if the argument on discrimination is not to be redundant, the Authority must argue that the duty of non-discrimination somehow gives rise to an additional obligation to ensure such payments are made – an obligation that cannot be found in the Directive itself.

281. That is reflected in the second way in which the Authority puts its argument. It argues that the Icelandic Government's actions constituted a stand-alone breach of Article 4 EEA.[127]

282. The argument is that this general duty of equal treatment somehow extends to the State the duty that the Directive imposed upon the deposit-guarantee scheme to make payment to depositors.

[126] Application, para 158.
[127] Ibid, para 183.

283. Thus, the Authority is driven to the argument that:

a) even though no domestic depositors received payments under the deposit-guarantee scheme, and

b) even though (ex hypothesi[128]) the language of the Directive itself does not require Iceland to ensure payment of €20,000 to each depositor,

the application of the principle of equal treatment <u>nevertheless</u> required Iceland to ensure that those payments were made to the overseas depositor.

284. The Icelandic Government submits that this argument is plainly unsustainable. At its heart is a confusion between the requirements of the Directive on the one hand, and the effects of a restructuring of the domestic banking system on the other.

285. If, however, there was any form of discrimination in this case, it was objectively justified. The difference in treatment complained of was a consequence of a package of measures adopted by the Icelandic Government in order to safeguard the functioning of the domestic banking system and real overall economy in Iceland, and the orderly functioning of Icelandic society in its entirety.

286. In what follows, the Icelandic Government pleads in detail to the Authority's case.

(1) <u>The Authority's complaint lies outside the Directive</u>

287. Iceland accepts the statement of legal principle advanced by the Authority at paragraph 160 of its Application:

> "all secondary legislation must be interpreted in accordance with primary law as a whole, including the principle of equal treatment".

288. As shall be explained, however, the matters complained of by the Authority lie entirely outside the scope of the Directive.

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[128] Ie: on the assumption that the Authority did not succeed in the first part of its Application, in which it argues that the Directive imposes such an obligation on Iceland, without recourse to anti-discrimination law.

289. The Authority formulates its complaint of discrimination as follows:[129]

> "By moving over the domestic depositors only, thereby covering domestic deposits at least at the level prescribed by Directive 94/19/EC and within the time limits foreseen by the Directive, without providing foreign depositors with at least that minimum guarantee, Iceland has indirectly discriminated against foreign depositors on the basis of nationality, which is prohibited by Directive 94/19/EC read in the light of Article 4 EEA." (emphasis added)

290. As already noted the "minimum guarantee" it seeks for depositors is payment of €20,000.

291. The Authority's case confuses two very different things:

a) the restructuring of the Icelandic banks, and

b) the payment of compensation by TIF under the Directive.

292. The restructuring of the Icelandic banks had nothing to do with the Directive. No compensation was paid to the domestic depositors; TIF was not involved at all.

293. The point can be made clear by considering the time line. The new banks were established between 6 and 9 October 2008. The domestic deposits and loans were transferred to the new banks between 9 and 22 October 2008. Between 27 October and 4 November 2008, the FME issued its opinions triggering the obligations of TIF.[130] The mechanism of the Directive is as follows:

a) Article 1(3) defines "unavailable deposit" to mean a deposit that is due and payable, but has not been paid by a credit institution, and where either the relevant competent authorities have made a declaration that the credit institution is unable to repay the deposit and/or a judicial authority has made a ruling suspending the depositors' ability to make claims against it.

[129] Application, para 165.
[130] Ibid, para 38.

b) Article 7(1) provides that deposit guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to €20,000 in the event of deposits being unavailable.

c) Article 10(1) requires that deposit guarantee schemes must be in a position to pay duly verified claims by depositors in respect of unavailable deposits within three months.

294. There was no declaration of inability to pay, or relevant judicial ruling within the meaning of Article 1(3) of the Directive in respect of the domestic accounts of any of the collapsed banks. Those accounts were never "unavailable" within the meaning of the Directive. In respect of those depositors, the Icelandic Government did not "pay duly verified claims by depositors in respect of unavailable deposits" the sum of €20,000 pursuant to Article 10(1) of the Directive. TIF was not involved. What did happen was the restructuring of the Icelandic banking system by a series of measures, including moving deposits from the old banks to the new banks.

295. The Authority seeks to avoid this difficulty through the following submission:[131]

> "The purpose of the Directive being to improve consumer protection by ensuring minimum payment of compensation, nothing in the Directive suggests that any distinction may be made based on the location of the deposits and indeed such a distinction would run counter to the entire concept underlying the internal market. Consequently, it is a breach of the Directive to differentiate between depositors protected under the Directive by providing protection for some depositors while leaving others without any or any comparable protection."

296. This argument is flawed: the Directive is indeed a consumer protection measure, but it aims to achieve consumer protection by means of limited harmonisation of the protection of bank deposits by a guarantee scheme in the event of a bank failure. It does not address in any way the regulation of bank insolvencies or restructuring. Those activities – and the steps taken by Iceland in respect of the restructuring of the domestic banks – are entirely outside its scope.

[131] Application, para 172.

297. It is accepted that the principle of equality entails that a deposit-guarantee scheme must be set up, and must function, in a non-discriminatory way. Thus, by way of example, a Contracting State may breach this principle if, in the course of implementing the Directive, it were to introduce more stringent time limits for lodging a claim against a deposit-guarantee scheme for non-nationals than apply to nationals of that State, or if the funds held by the guarantee scheme were made available in a manner that discriminated on grounds of nationality. The Authority does not suggest any unequal treatment of this kind has taken place in the present case.

298. This approach to the interpretation of the Directive does not, however, prevent other forms of different treatment of bank deposits, arising from measures which are taken entirely outside the Directive's scope. The argument that the Icelandic State was obliged to provide the same treatment to all branches of the failed banks leads to startling consequences: for example, given that the United Kingdom and Netherlands granted compensation to the Icesave depositors – beyond the requirements of the Directive - are they now to be obliged to pay similar compensation to depositors in any failed bank in their territory?

299. The Authority has accordingly failed to establish any legal basis under the Directive for its claim of discrimination.

(2) No duty to ensure payment of €20,000 per depositor under Article 4 EEA

300. The Authority makes very brief reference to a freestanding claim that Iceland has breached Article 4 EEA, irrespective of the provisions of the Directive. At the end of its application, it contends: [132]

> "It follows from the above that even if the provisions of Directive 94/19/EC were interpreted, contrary to the reasoning set out above, as not imposing obligations of result, by treating deposits located in Icelandic branches differently from deposits in other EEA States, Iceland is in breach of Articles 4(1) and 7(1) of the Directive and/or Article 4 EEA."

[132] Application, paras 182, 183.

> Moreover, to the extent this differentiation in treatment of depositors protected by the Directive is not considered a breach of that Directive, it constitutes discrimination on the basis of residency prohibited by Article 4 of the EEA Agreement". (emphasis added)

301. It is settled case law that:[133]

> "Article 4 EEA applies independently only to situations governed by EEA law in regard to which the EEA Agreement lays down no specific rules prohibiting discrimination".

302. The Authority has not, however, pleaded to this requirement at all. It has simply asserted that Article 4 is applicable without seeking to demonstrate that the legal conditions for its application are made out.

303. The claim is, moreover plainly unsustainable. It amounts to the argument that Article 4 EEA creates obligation upon the State to ensure payment of €20,000 per depositor, in circumstances in which the partially harmonised regime created by the Directive does not require it. If the Directive does not apply, it is hard to understand how such a specific obligation might arise.

304. In reality, the Authority has not begun to make good such a claim.

(3) Any difference in treatment is objectively justified

305. In any event, it is clear that any difference in treatment between the two groups of depositors was objectively justified.

306. The EFTA Court has explained that:[134]

> "a national rule ... which discriminates indirectly between EEA nationals may be justified on the basis of public interest objectives. This is the case where the national rule is suitable for attaining the public interest objective pursued, is necessary to achieve that objective and not excessive in its discriminatory effects having regard to the objective sought".

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[133] Eg: Case E-5/98 *Fagtún ehf v Byggingarnefnd Borgarholtsskóla* [1999] EFTA Court Report p. 51, para 42.
[134] Case E-5/10 *Kottke v Präsidial Anstalt and Sweetyle Stiftung* [2009/2010] EFTA Court Report p.320, para 40.

307. Whilst "economic aims" cannot constitute a sufficient justification, as the Authority itself rightly observed in its decision to dismiss certain complaints in respect of Iceland's emergency law "that does not mean that restrictions, which are partly economically motivated are always impermissible."[135] The Authority went on to quote from the Opinion of Advocate General Tesauro in Case C-158/96 *Kholl* [1998] ECR I-1831, para 53, where he observed:

> "economic aims are indeed justifiable, where far from being an end in themselves, they are crucial to the operation of the system in question ... or affect interests of vital importance to the State."

308. The EFTA Court has similarly found that clear public interest objectives may constitute a legitimate aim even where that public interest has economic ends, such as "ensuring the functioning and good reputation of the financial market",[136] or ensuring that "the management of banks is able to react quickly to a crisis".[137]

309. As to the nature of the objective in this case, in dismissing the complaint about the Emergency Act, the Authority found:[138]

> "the Authority considers that the objective of the emergency measures was not merely economic but rather to <u>safeguard the functioning of the domestic banking system and the real overall economy in Iceland. The functioning of a country's banking system is of systemic significance for the proper functioning of the state's real overall economy and that of society</u>. The existence of a banking system is of vital importance not only for the economy of the state but also for society as a whole, since payment systems of the country depend thereon. Therefore, the objective of the emergency measures is an overriding requirement in the general interest capable of justifying restrictions to the free movement of capital, provided that the measures taken can be regarded as proportionate to the attainment of the objective pursued." (emphasis added)

310. The Icelandic Government respectfully agrees. Whilst the issue that arose in those complaints was not precisely the same as that in issue in the proceedings, the same

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[135] Decision No. 501/10/COL of 15 December 2010 to close seven cases against Iceland commenced following the receipt of complaints against that State in the field of capital movements and financial services, para 88, http://www.eftasurv.int/media/decisions/571071.pdf

[136] Case E-1/09 *EFTA Surveillance Authority v Liechtenstein* [2009/2010] EFTA Court Report p.46, para 36.

[137] Ibid, para 38.

[138] Decision No. 501/10/COL of 15 December 2010, para 89.

objective was at stake. It was plainly legitimate, and the measures adopted were suitable to its attainment.

311. As already explained, the rescue was carried out through a package of measures: the creation of the new banks, and the granting of priority in the bankruptcy to depositors with claims upon TIF. The practical effect of this distinction was to save the domestic branches of the failed banks, but not the Icesave branches in the UK and Netherlands.

312. In essence, the reason for this difference in treatment was that for the reasons already explained, the failure of the domestic branches posed a systemic risk to the Icelandic economy, as the Supreme Court identified, through the collapse of the banking system. The collapse of the banks' overseas branches did not carry any such risk.

313. In substance, the Authority's complaint is an attack on the judgment of the State as to what was necessary to safeguard its banking system. It is clear that in this context, the Icelandic Government enjoys an exceptionally wide margin of appreciation. As this Court explained in Case E-3/11 *Sigmarsson v Central Bank of Iceland*, 14 December 2011 para 50:

> "The substantive conditions laid down in Article 43(2) and (4) call for complex assessment various macroeconomic factors. EFTA States must therefore enjoy a wide margin of discretion, both in determining whether the conditions are fulfilled, and the choice of measures taken, as those measures in many cases concern fundamental choices of economic policy."

314. Similarly, in rejecting the challenge brought by depositors to the Emergency Act, the Icelandic Supreme Court ruled:[139]

> "Considering the great and unprecedented problems being faced, and the clear objectives aimed at, the legislator must be granted a wide margin of appreciation when assessing what ways to go to respond to the complex and dangerous situation at hand."

315. The matters challenged by the Authority also involve fundamental economic judgments about the approach of the Icelandic State to an exceptionally grave economic crisis.

[139] http://www.lbi.is/home/news/news-item/2011/10/28/Supreme-Courts-Verdict-in-Disputes-concerning-Icesave-Deposits/

316. As to the question of proportionality, in rejecting the aforementioned complaint, the Authority found that the emergency measures were suitable for the attainment of the aim of safeguarding the functioning of the Icelandic banking system,[140] and no more than necessary to attain the legitimate aim. It observed:[141]

> "The Authority notes that confidence, in particular that of depositors, is of systemic importance for the functioning of any banking system. This justifies measures to protect depositors beyond the protection offered to other unsecured creditors."

317. In reaching that conclusion, the Authority made clear that the context of the financial crisis was of fundamental importance:[142]

> "The proportionality of the emergency measures, both of the Emergency Act and the FME measures, has to be considered against the background that, at the time these measures were taken, almost the entire banking sector in Iceland was on the brink of collapse ... the IMF found that Iceland's economy was in the midst of a banking crisis of extraordinary proportions.
>
> Consequently, the measures taken by the Icelandic authorities were aimed at remedying a real and imminent danger of total collapse of the domestic banking system. Similarly the Icelandic measures were designed to safeguard the functioning of the economy as such rather than the interests of individual depositors." (emphasis added)

318. In its Decision to open a formal State aid investigation in regard to the setting up of the new banks, the Authority concluded: [143]

> "The Authority accepts in principle the views of the Icelandic authorities that given the circumstances the approach taken of restoring the domestic operations of the banks was likely to be the only credible and effective means of safeguarding an Icelandic banking sector and the wider economy." (emphasis added)

319. Essentially the same considerations apply in this case.

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[140] EFTA Surveillance Authority Decision No. 501/10/COL, para 94.
[141] Ibid, para 95.
[142] Ibid, paras 96, 97.
[143] EFTA Surveillance Authority Decision No. 493/10/COL of 15 December 2010 opening the formal investigation procedure into state aid granted in the restoration of certain operations of (old) Landsbanki Íslands hf. and the establishment and capitalisation of New Landsbanki Íslands (NBI hf.), para 3.1.2. http://www.eftasurv.int/media/decisions/493-10-COL.pdf

320. In rejecting a challenge to the Emergency Act, the Icelandic Supreme Court described the situation that the Icelandic Government faced as follows:[144]

> "It is clear that the government and the parliament believed it impossible to refinance the banks with funds from the state treasury and thus enable them to continue operations. The situation on financial markets moreover lead to that the state's options to borrow funds from abroad evaporated over a short period of time. According to the above the court agrees with the respondents that <u>without immediate actions of the legislator and the government a collapse of the banking system was imminent and the payment systems in the country would become inactive. It is also beyond any doubt that such circumstances would have immediately or very quickly have lead to great distress for the public and all economic operations in Iceland</u>. Thus Act no. 125/2008 was adopted under very dire circumstances for the Icelandic society as a whole when it was clear that the banks, including Landsbanki Íslands hf., would in all probability not be saved and there was no escaping great losses due to their collapse." (emphasis added)

321. What the Icelandic Government did was to carry out a wholly exceptional form of intervention designed to secure the functioning of the Icelandic banking system. Viewed in the context of the factual situation that faced Iceland, it is submitted that its plain that its approach satisfied the requirements of proportionality. The stakes for Icelandic society in the rescue were enormously high. The Icelandic Government had very few resources. It was in no position to pay out the sums guaranteed by TIF. It was simply not possible to move the overseas accounts to the new banks for the reasons already given. Any attempt to do so would have undermined the rescue of the domestic branches. As already noted, the Authority has expressly stated that it does not argue that this gives rise to any discrimination.[145]

322. In assessing the proportionality of this approach it is also necessary to have regard to the facts that the Emergency Act granted the depositors, and the United Kingdom and Dutch Governments priority claims. The practical effect is that they will recover far more than the sums guaranteed by the Directive, albeit rather later than the Directive requires.

323. It is accordingly contended that the measures challenged were both necessary and proportionate to the aim pursued.

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[144] http://www.lbi.is/home/news/news-item/2011/10/28/Supreme-Courts-Verdict-in-Disputes-concerning-Icesave-Deposits/

[145] Application, para 175.

324. The logic of the Authority's argument is that the Icelandic Government did not go far enough, as it did not extend additional measures to the overseas branches. As already explained, such exceptional measures of state intervention in the banking system have the potential to distort competition, and must conform to EEA law, and in particular, the State aid rules. As a result, such measures must not exceed what is strictly necessary to achieve its legitimate purpose. Thus, the Authority's guidance on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", explains: [146]

> "in line with the general principles underlying the state aid rules of the EEA Agreement, which require that the aid granted does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible, and taking due account of the current circumstances, all general support measures have to be:
>
> - well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy,
>
> - proportionate to the challenge faced, not going beyond what is required to attain this effect, and
>
> - designed in such a way as to minimize negative spill over effects on competitors, other sectors and other EEA States." (emphasis added).

325. Thus, it is simply mistaken to suggest that Iceland needs to justify its failure to go further, and to extend the scope of its intervention.

326. Iceland contends that such an approach is entirely misconceived.

(4) Authority's arguments on objective justification

327. The Authority argues that a state cannot rely on any mandatory requirements as a reason for "deviating from the harmonisation laid down in a directive in the absence of any express provision which permits the state to do so".[147] But this argument proceeds on the basis that the Directive requires the payments under its harmonised

[146] http://www.eftasurv.int/?1=1&showLinkID=16604&1=1, para 15.
[147] Application, para 174.

framework. But as already explained, the discrimination argument only arises for consideration if that assumption is wrong.

328. The Authority also argues it was not "impossible to comply with the requirements of the Directive", as Iceland could have access to the necessary funds, as evidenced by the Icesave Agreement, even if this would have come at a "high cost".[148] But:

a) The question of compliance with the Directive does not arise: if the Directive required the Icelandic Government to pay the overseas depositors, then the discrimination claim is immaterial.

b) The test is not "impossibility" but "proportionality". This is not a question of *force majeure.*

c) The Icesave Agreements would not have provided the Icelandic State with funds in any event: they were essentially agreements for repayment, as already explained.

329. Thirdly, the Authority observes that it "fails to understand how Iceland can simultaneously argue that it was financially impossible to comply with the Directive and refer to" recovery from the estate of Landsbanki.[149] But here the Authority misses a fundamental point: the assets of the estate of Landsbanki are not State assets at all: they are private assets, now being distributed by a wholly independent Winding Up Committee. The requirement of equal treatment does not require the Icelandic State to appropriate those assets in order to speed up their distribution.

330. Fourthly, the Authority argues that "the fact that the United Kingdom and Dutch authorities have compensated the majority of deposit holders under their respective national deposit guarantee schemes is irrelevant with regard to whether Iceland has complied with its obligations under the Directive. The issue is how Iceland has

[148] Ibid, paras 176, 177, 178.
[149] Ibid, para 179.

treated different groups of depositors, not whether as a matter of fact they are worse off."[150]

331. This fact is, however, plainly relevant to the proportionality of a failure by Iceland to pay compensation to such depositors if it was not obliged to do so by the Directive.

CONCLUSION

332. The Icelandic Government accordingly contends that this application should be dismissed.

333. It further seeks an order that the Authority should pay its costs.

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[150] Application, para 181.

LIST OF ANNEXES