SHEARMAN & STERLING LLP

FINANCIAL RESTRUCTURING & INSOLVENCY | CLIENT PUBLICATION

August 20, 2015

Bank Resolution: English and German Courts Place Limits on Obligations to Give Effect to Actions of Resolution Authorities in Other Member States

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Solomon J. Noh
London
+44.20.7655.5795
solomon.noh@shearman.com

Fredric Sosnick
New York
+1.212.848.8571
fsosnick@shearman.com

Barney Reynolds
London
+44.20.7655.5528
barney.reynolds@shearman.com

Thomas Donegan
London
+44.20.7655.5566
thomas.donegan@shearman.com

Reena Agrawal Sahni
New York
+1.212.848.7324
reena.sahni@shearman.com

Susanna Charlwood
London
+44.20.7655.5907
susanna.charlwood@shearman.com

Kolja Stehl
London
+44.20.7655.5864
kolja.stehl@shearman.com

Alastair Goldrein
London
+44.20.7655.5756
alastair.goldrein@shearman.com

SHEARMAN.COM

In two recent decisions, European national courts have taken a narrow view of their obligations under the Bank Recovery and Resolution Directive (BRRD)—the new European framework for dealing with distressed banks. The message from both the English and the German courts was that resolution authorities must adhere strictly to the terms of the BRRD; otherwise, measures that they take in relation to distressed banks may not be given effect in other Member States.

Goldman Sachs International v Novo Banco SA

In August 2014, the Bank of Portugal announced the resolution of Banco Espírito Santo (BES), what at the time was Portugal's second largest bank. That announcement followed the July disclosure of massive losses at BES, which compounded a picture of serious irregularities within the bank that had been developing for several months. As part of the resolution, BES's healthy assets and most of its liabilities were transferred to a new bridge bank, Novo Banco (the so-called "good bank"), which received €4.9 billion of rescue funds—while troubled assets and "Excluded Liabilities," categories specifically identified in the BRRD, remained at BES (the "bad bank"). Amongst those liabilities initially deemed to have transferred to Novo Banco in August was a USD $835 million loan made to BES via a Goldman Sachs-formed vehicle, Oak Finance.

In December 2014, the Bank of Portugal issued a further decision stating that the loan had not in fact been transferred to Novo Banco, but rather remained at BES. In response, Goldman Sachs, together with a group of funds that had participated in the loan,

commenced proceedings in the English court (the loan being subject to English law and jurisdiction) claiming repayment of the debt from Novo Banco.[1]

Novo Banco, in turn, asked the court to dismiss the Goldman Sachs proceedings for lack of jurisdiction (or alternatively for a stay pending a decision of the Portuguese court in related proceedings). Novo Banco argued that the English court had no right to continue the proceedings because the effect of the December decision had been to transfer the loan back to BES, such that Novo Banco ceased being a party to the Oak Finance loan at all.

On August 7, 2015, the English High Court denied Novo Banco's preliminary application. In confirming its right to continue the proceedings, the English court made several interesting findings, including:

- The Goldman Sachs proceedings are a claim on a debt and not a challenge to the decision of a resolution authority of another Member State. The fact that the proceedings may represent, in effect, a challenge to a decision by the Portuguese resolution authority does not mean that the English court should refuse to hear them.
- The BRRD explicitly requires that "transfers" made in the context of bank resolutions administered in any Member State are given effect in all other Member States, including any re-transfer of assets and/or liabilities from the bridge institution back to the original bank. The December decision, however, did not claim to be a "re-transfer" of the loan to BES. Instead, it stated that "the liability…was not transferred to Novo Banco" and that the decision was effective as of August 3, 2014. In addition, the Bank of Portugal did not definitively state that the loan is an Excluded Liability, but only that there are serious and well-grounded reasons to so conclude. The court's view was that the December decision, therefore, was not one to which the English court was obliged to give effect within the terms of the BRRD, as, among other things, it technically failed to provide for a transfer or a re-transfer. Novo Banco's submission that the December decision involved the exercise of powers implicitly provided for in the BRRD was rejected on the basis that the BRRD explicitly lists the resolution authorities' powers, and the December decision (seeking to clarify that certain transfers that initially had been made had not in fact been made) was not an exercise of one of those powers.
- The court also rejected the submission that it was obliged to give effect to the December decision on the basis of common law authority on universal succession.
- The judge expressed a preliminary view that the loan is not an Excluded Liability and, therefore, is a liability of Novo Banco. He recognized, however, that Novo Banco had not sought, in the context of its preliminary application, to address this issue.

These proceedings are now set to continue in parallel with the challenge to the December decision commenced by Goldman Sachs and the other loan participants before the Portuguese courts.

Bayerische Landesbank v Heta Asset Resolution

Three months earlier, a similar approach was taken by the regional Court of Munich in the case between Bayerische Landesbank (Bayern LB) and Heta Asset Resolution AG (Heta).

Heta is the "bad bank" that was established as a wind-down vehicle to assume and manage large parts of the failed Austrian bank, Hypo Alpe Adria. Heta is 100% owned by the Republic of Austria. In March 2015, the Austrian Financial Market Authority (FMA) issued a 15-month moratorium on liabilities owed by Heta, including in relation to the disputed

[1] *Guardians of New Zealand Superannuation and Others v Novo Banco SA.*

claims of Bayern LB against Heta, purportedly in the exercise of its authority under Austria's implementation of the BRRD, the Federal Act on the Recovery and Resolution of Banks (BaSAG).[2]

One of the legal issues before the Munich court was whether the BRRD contemplates the application of its tools and powers to wind-down vehicles such as Heta. The uncertainty stemmed from the fact that the BRRD only applies to MiFID firms and credit institutions within the meaning of the Capital Requirements Regulation – in other words, banks. Heta, however, no longer had a banking license. In order to ensure that the BRRD would apply to Heta nonetheless, the Austrian legislature explicitly made Heta subject to BaSAG. On May 8, 2015, the Munich court of first instance refused to recognize the moratorium on the basis that the application of BaSAG to Heta goes beyond the scope of the BRRD and, therefore, fell outside of Germany's obligation under the BRRD to give effect to measures taken by other resolution authorities. In doing so, the Munich court ordered Heta to pay Bayern LB approximately €2.3bn. This decision is now subject to an appeal by Heta.

Conclusion

The success of bank resolution depends, to a large extent, on the courts of Member States recognizing and giving effect to the actions of another Member State's resolution authority. In the above two decisions, national courts have taken a narrow view of the recognition obligations in the BRRD. These decisions emphasize the need for resolution authorities to be careful in how they frame their actions if they wish to avoid their schemes being disrupted by legal action in other Member States.

[2] The BRRD essentially is a Europe-wide model law that is required to be implemented locally by each of the Member States.

9 APPOLD STREET | LONDON | UK | EC2A 2AP

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069