Possible public and private solutions to the difficulties posed by foreign law to a national bank resolution scheme

Hubert de Vauplane

Partner

Kramer Levin Naftalis & Frankel LLP

KRAMER LEVIN

General outlook on private international law issues related to international insolvency

- Conflict between corporate insolvency regimes and banking insolvency proceedings
  - Protection of creditors versus protection of financial stability
- Conflict between territorial and universal insolvency systems
  - Universal system considers a “unique mass” of assets, while the territorial one defends a plurality of proceedings.
- Conflict between national and international creditors
  - Hull rule which demands that in the event of expropriation compensation of foreign nationals law must be prompt, adequate and effective (Hull was US Secretary of State in 1938)
- Conflict between private and public interest
  - Financial stability versus protection of ownership rights

Conflict between national and foreign laws in bankruptcy proceedings

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Illustration

- Understandably, it often happens that regulators and courts primarily protect **local assets and local creditors**,

  Illustration:

  Rawlinson and Hunter Trustees SA v. Kaupting Bank HF [2011]

  This case highlights how the Courts interpret the Directive 2001/24/EC with regard to the time and place of commencing of *Winding-up proceedings*.

The Lehman protocol

- After the events of September 2008, bankruptcy proceedings were filed in over seventy-five countries (650 entities outside the US). In order to coordinate them, the Cross-Border Insolvency Protocol for Lehman Brothers Group of Companies has been established :
  - Coordination
  - Communication;
  - Information sharing
  - Asset preservation
  - Claims reconciliation
  - Maximize recovery

- The Lehman Protocol is a response to a lack of applicable law which will be binding on all parties to Lehman bankruptcy.

The Lehman protocol

- The lack of a universal system governing international bankruptcy makes a protocol necessary to ensure efficiency during the recovery.

- Despite the agreement, conflicts arose from in course of proceedings.
  - ➢LBIE and Lehmann Japan refused to sign the protocol
  - ➢The Dante case illustrates the shortcomings of the Model Law framework:

    Provision that shifted payment priority upon bankruptcy to certain members of the Lehman group. The UK Supreme Court found that the provision was enforceable whilst the US bankruptcy court found that the provision violated the bankruptrcy code's prohibition against ipso facto clauses.

Conflict between national and foreign laws in case of Resolution

Conflicts in the case of Resolution and Bail-in

- **Resolution is a decision taken by a territorial authority**
  - How to manage international institutions with assets in multiple jurisdictions?
- **Resolution is an administrative proceeding**
  - Determining the trigger for opening restructuring proceedings will raise the question of whether bail-in is legally considered an "insolvency proceeding" in the relevant jurisdictions
- **Resolution could be qualified as nationalisation and be entitled to sovereign immunity**
  - *Fir Tree Capital v. Anglo Irish Bank [2011]*
- **Resolution is not a Court decision:**
  - No exequatur and no recognition by foreign jurisdictions : Paris, September 4 2012, Lazard v. Citi
- **Bail-in tools could be challenged by Courts**
  - "Metliss" problem;

Bail-In : The issue of protection of shareholders and bondholders - conflict between public and private interest

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Resolution authorities' role

Resolution authorities' role

- Draw up resolution plans to be applied in case of a crisis
- Assess the resolvability of institutions and remove possible impediments
- Determine (possibly) whether an institution is failing or likely to fail and (probably) whether a resolution action is in the public interest
- Endorse a fair and realistic valuation of assets and liabilities carried out independently, or directly carry it out in case of emergency (probably on their own decision)
- Verify the level of "bail-inable" debt instruments
- Apply the resolution tools
  - Sale of business tool
  - Bridge institution tool
  - Asset separation tool
  - Bail-in tool
- For the use of the bail-in tool…
  - Cancel existing shares
  - Convert eligible liabilities into shares
  - Write down "bail-inable" debt
  - Approve the business reorganisation plan after the implementation of the bail-in instrument

- How creditors and shareholders rights are protected with such broad powers?

Protection of Property Right

- A write-down of debts will affect the property rights of creditors and so in considering the constitutionality of such proceedings, account will have to be taken of the constitutional guarantee of private property

Protection of Property Right

- Article 1 of Protocol 1 European Convention on Human Rights (ECHR)

- Article 17 of the Charter of Fundamental Rights of the E.U
  - Both texts are protecting property rights ("*peaceful enjoyment of his possessions*")

- Any interference must be
  - (i) duly justified by an overriding interest ("*public interest*")
  - (ii) provided by law
  - (iii) respect the principle of proportionality ("*fair compensation and respect of international law*")

Neftyanaya Kompaniya Yukos v. Russia (application no. 14902/04 - September 2011)

- The European Court of Justice of Human Rights has extensive experience regarding the protection property rights, in particular after the German reunification and due to numerous litigations from former Eastern European countries.
- Last case examined by the Court (2011): the Yukos case.
- Russia's largest and most profitable company and its CEO were accused of embezzlement and tax evasion in the early 2000s. The case finally went to the European Court of Human Rights.
- The Court first read out Article 1 of Protocol 1 (relating to the right to property). It is from paragraph 554 of the case that we see that the Court gives the indication of use of the exception to the right to property.

Public interest

- Interference with property rights may be justified only if it pursues a legitimate aim in the public interest:

  "(…) *an interference with peaceful enjoyment of possession must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights*" *(Jahn and Others v. Germany, ECHR 2005-VI, § 93, 30 June 2005).*

- What is "fair" ? ECJHR left discretion to local laws :

  "*The Court will respect the legislature's judgment as to what is in general interest unless that judgment be manifestly without reasonable foundation*" *(Mellacher and Others v. Austria, 19 December 1989, Series A n° 169, § 45).*

- The 2012 European Resolution framework refers to "public interest" to justify bail-in powers and deprivation of rights for shareholders and bondholders.

- "Public interest" in the draft directive is defined in close relation to various objectives (article 26), all "of equal significance", including the continuity of critical functions, the protection of clients funds and assets, the minimization of the unnecessary destruction of value and the cost of resolution, as well as the protection of financial stability
  - Absence of definition of Financial stability

- What does "public interest" on a worldwide basis?

Cross-border effects of Bail-in

- **Two approaches to increase the likelihood of the cross-border recognition of bail-in power:**
  - One approach would be in each jurisdiction to ensure that debt instruments issued by banks in their jurisdictions include provisions that give effect to any restructuring the home authorities might impose. This approach would add a consensual element to an otherwise involuntary process - which could make it easier to give effect to the restructuring in some jurisdictions. However, by definition, such an approach could only be applied to newly issued debt instruments
  - An alternative approach would be to ensure that relevant jurisdictions put in place legislation that recognizes bail-in powers that are implemented by the authorities in other jurisdictions. One way to do this would be through the direct recognition of orders made by the competent authority in the home jurisdiction (e.g., the home regulator) in other relevant jurisdictions. An alternative would be for the competent authority in the host jurisdiction to issue parallel or protective measures consistent with those taken by the home jurisdiction.
- **The IMF has proposed a framework for enhanced coordination for the resolution of cross-border banks (IMF, 2010).**

IMF Approach

For the IMF, restructuring for international banks would be implemented on the basis of the following principles and applied on a legal-entity-specific basis:

- The *home-country authorities* would initiate, approve, and implement the restructuring process;
- The statutory bail-in powers could, in principle, apply to all liabilities of the ailing bank, including liabilities "held" abroad and claims governed by foreign laws (foreign *lex contractus) ;*
- The process of debt restructuring would be governed by the law of the home country (*lex fori concursus*). However, this process could be undermined by separate proceedings in third countries, including concurrent territorial insolvency procedures of jurisdictions hosting branches.

Conclusion

- **Whether or not the statutory bail-in is applied directly to a single legal entity or to more than one member of the group, the effectiveness of the statutory bail-in will depend crucially on the extent to which all relevant jurisdictions will give effect to its terms.**

Contact Details

Hubert de Vauplane
Partner
Kramer Levin Naftalis & Frankel LLP

47, avenue Hoche
Paris 75008
+ (33) 1.44.09.46.00
hdevauplane@kramerlevin.com
www.kramerlevin.com

KRAMER LEVIN