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Alert


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In an August 2014 Alert,¹ we reported that (most of) the Banking Recovery and Resolution Directive (‘BRRD’)² that was adopted on 15 May 2014 was required to be implemented by the EU Member States through local legislation by 1 January 2015. In the Republic of Austria, the BRRD implementation was done by way of the so-called BaSAG.³ On 1 March 2015, the Austrian regulator FMA,⁴ in its capacity as resolution authority under the BaSAG, issued a decision⁵ (the ‘1 March Decision’) in respect of the Austrian ‘bad bank’ Heta Asset Resolution AG (‘Heta’). In essence, in the 1 March Decision the FMA decided that — under the present circumstances — Heta is to be subjected to the BaSAG. From a legal perspective, one important question this raises is whether the BRRD contemplates (and therefore gives power to EU Member States such as Austria in national implementation legislation) the application of the very broad and far-reaching resolution tools set forth in the BRRD (the ‘Resolution Tools’) to so-called ‘winding-up vehicles’ like Heta.

Brief Background

The lead-up to the establishment of Heta and the 1 March Decision involved complex and lengthy nationalisation and subsequent restructuring (including EUR5.5 billion in EC-approved state aid by the Republic of Austria) of the Austrian credit institution Hypo Alpe-Adria-Bank International AG (‘HBInt’) (which itself was part of a broader group (collectively, ‘Hypo’)). A critical piece of the final restructuring plan for Hypo that was proposed in late 2014 consisted of:

- The sale of Hypo Alpe-Adria-Bank AG (‘HBA’);
- The sale of the so-called SEE Networks (primarily in Croatia and Slovenia); and
- The ‘run off’ of the remaining Hypo assets. The run off was to be done under HBInt’s reorganised guise of the Heta ‘bad bank’, which had been decreed under law ‘HaaSanG’ in the summer of 2014 under Austria’s exercise of the reorganisation measures (including invoking the Credit Institutions Winding Up Directive (‘CIWUD’)).⁶ Using these powers, HBInt’s banking

¹ “The Banking Recovery and Resolution Directive — Should Creditors Be Concerned?”
² Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.
⁴ Österreichische FinanzMarktaufsichtsbehörde.
⁵ Mandatsbescheid.
⁶ Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions.
licence was revoked, leaving a shell of HBInt’s ‘bad assets’ and liabilities (including Austrian and German law-governed notes) to be worked out.

The 1 March Decision recorded that, following various concerns raised by the board of Heta at the end of 2014/beginning of 2015 regarding directors’ liability if Heta were to continue trading while over-indebted, certain Asset Quality Reviews (‘AQRs’) had been conducted to assess the level of Heta’s over-indebtedness and to determine whether the Republic of Austria as the (ultimate) 100-percent owner of Heta would be prepared to backstop such over-indebtedness. When the first valuation results of the AQRs showed Heta’s over-indebtedness to range between EUR4 billion and EUR7.6 billion (being significantly more than was estimated when HBInt’s licence was initially revoked only a short time before), the Republic of Austria was asked at the end of February 2015 if it was prepared to backstop such shortfall. The Republic of Austria’s refusal to provide the required backstop would have forced Heta to file for insolvency proceedings. However, in an effort to avoid such an immediate insolvency filing, the FMA declared a maturity moratorium of 15 months until 31 May 2016 for all Heta liabilities listed in the 1 March Decision. This declaration was purportedly done under authority of BaSAG.

Scope of the BRRD
In our August 2014 Alert, we discussed the BRRD’s very broad and far-reaching Resolution Tools that EU Member States are required to use in the event of the failure of a relevant institution in the home member state. The BRRD represented a deliberate policy decision on the part of the EU authorities to shift the burden of a failing institution from taxpayers to the existing stakeholders of the institution. Against this background, and appreciating that exceptional circumstances must exist before it is deemed appropriate to use the broad and far-reaching Resolution Tools, the question presents itself whether the BRRD should be interpreted broadly as regards the institutions to which the BRRD applies.

This brings us back to Heta. In the context of the BRRD (and prior thereto, CIWUD), was it contemplated that a winding-up vehicle (or ‘bad bank’) such as Heta should be included in its scope? Heta does not have a banking license and does not conduct any new business, but was itself created as a result of the application of Resolution Tools to run off the so-called ‘bad assets’ of Hypo in an orderly manner.

What Happens If Heta Is Not Covered by the BRRD?
The 1 March Decision applies the BaSAG to Heta. However, that decision would be without a valid legal basis if the Republic of Austria was wrong to extend the BaSAG’s scope to institutions such as Heta. The BaSAG, as applied to Heta, would thus be in breach of the BRRD. This would mean that at least the Heta liabilities listed in the 1 March Decision that are governed by German law would be unaffected by the 1 March Decision, since the Austrian government would have no power to affect those liabilities. If the German law-governed Heta creditors were to obtain a judgment from a German court declaring the maturity moratorium invalid and thereby entitling them to declare an Event of Default and accelerate their claims, the question arises whether the judgment would be recognised and enforced in Austria. If it was not recognised in Austria, what would be the time frame and most appropriate procedure to obtain a final decision of the European Court of Justice on the question? This also raises the question whether the Heta creditors should instead (or maybe in parallel) challenge the 1 March Decision in Austria?

In addition, certain of the Heta liabilities benefit from a so-called statutory deficiency guarantee provided by the Austrian State of Carinthia (the ‘Carinthia Guarantee’). It is not clear if, and if so how, the Carinthia Guarantee is affected by the 1 March Decision. If the 1 March Decision had not been made, or if it turns out that the 1 March Decision is invalid, then an insolvency filing by Heta would seem
to be inevitable. That begs the question whether the Carinthia Guarantee could be called by the relevant Heta creditors. If an insolvency of Heta does entitle certain Heta creditors to call on the Carinthia Guarantee, what would happen if the Austrian State of Carinthia is unable to fulfil all its obligations under the Carinthia Guarantee? In that respect, it is rumoured that Carinthia’s exposure amounts to circa EUR10.2 billion, of which the other Austrian states may have a joint liability for circa EUR1.2 billion. Could the Republic of Austria decide to pass new legislation terminating the Carinthia Guarantee? If so, how and on what basis could such legislation be challenged?

Based on the grounds set forth in the 1 March Decision in support of applying the BaSAG to Heta, a decision that the BaSAG cannot apply to Heta would, in addition to political embarrassment, also result in the following:

- It would put in jeopardy the closing of the ‘Project Adria’ Share Purchase and Transfer Agreement of 22 Dec. 2014 in respect of the SEE Networks with the purchaser Al Lake (Luxembourg) S.à.r.l.;
- It would negatively impact the ‘good assets’ of Hypo included in the SEE Networks (inter alia through the reported dependency on Heta’s IT systems, dedicated employees, ISDA derivatives assistance and access to FX payment systems);
- The failure to close the sale of the SEE Networks could potentially destabilise the financial markets in Croatia and Slovenia; and
- A contamination risk may materialise in respect of other Austrian banks, both in and outside of Austria.

**Conclusion**

From the above it is clear that the situation surrounding Heta is far from straightforward. Last year certain junior Heta creditors already started litigation in Austria in the context of the HaaSanG. In addition, there is ongoing litigation in various proceedings between BayernLB and Heta, and between Hypo and the Republic of Austria involving claims and counter claims for amounts of several billion euros. It is further reported that others, such as the nationalised German real estate financing specialist Hypo Real Estate, may have plans to take legal action against Heta.

In short, from a macro political perspective Heta is clearly a very interesting situation to follow, and it is equally so from a legal perspective. Heta may indeed prove to be the first test case for the BRRD.

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If you have any questions concerning this Alert, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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