IN THE EFTA COURT

Case E-16/11

ORIGINAL

MINISTRY FOR FOREIGN AFFAIRS OF ICELAND

Reykjavík, 11 May 2012

TO THE PRESIDENT AND MEMBERS OF THE EFTA COURT

REJOINDER

Submitted pursuant to Article 36 (1) of the Rules of Procedure of the EFTA Court in response to the Reply submitted by the EFTA Surveillance Authority by

THE GOVERNMENT OF ICELAND

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

In

Case E-16/11

EFTA Surveillance Authority

v

Iceland

The Government of Iceland has the honour of submitting the following Rejoinder to the Reply submitted by the EFTA Surveillance Authority to the EFTA Court in the present case.

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[1] The Ministry wishes to acknowledge that this Rejoinder 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. In its Reply, the Authority has:

    a. mischaracterised Iceland's case;
    b. failed to engage with the central issue raised by the Defence; and
    c. sought to evade the consequences of its own argument.

2. The Authority's claim is for a declaration that the Icelandic Government has breached the Directive by "failing to ensure payment" to depositors under the Directive. The depositors were not paid by the TIF because the scale of the bank collapse in Iceland was such that no deposit guarantee fund could have possibly paid. The question is what, if any, "obligation of result" rests upon the State in those circumstances? The Authority's position appears to be that:

    a. The Directive does not impose any obligation to provide a state guarantee of the deposits covered by the deposit-guarantee scheme.[2]

    b. There is no obligation to use state funds where a bank failure occurs on such a scale that a deposit-guarantee scheme is unable to pay the compensation required by the Directive.[3]

    c. The Authority does not seek to rely upon a claim of liability against the Icelandic State for failure to properly implement the Directive under *Sveinbjörnsdóttir*.[4]

3. There is, however, a clear contradiction between the Authority's position on these points and the "obligation of result" that it invokes. The Authority accepted in its Notice of Application that the logic of its argument was that "should all else fail" the State must step in.[5] It now seeks to avoid the legal consequences of that claim while preserving its intended result. The fact is that the Authority has no answer to the question: how can this "result" be achieved if not by, directly or indirectly, relying on State resources? In truth,

[2] Reply, paras 33, 39.
[3] Reply, paras 33, 39.
[4] See further at para 41 below.
[5] Notice of Application, para 133.

it is an inescapable consequence of its argument that the State must step in with its own resources, at least when "all else fails".

4. Overall, the Authority's argument is based upon a fundamental misconception of the "obligation of result" imposed by the Directive; a misconception with potentially serious consequences for the Contracting States. It ignores both the economic realities of the operation of deposit-guarantee schemes, particularly at times of economic crisis, and the legal consequences of what it proposes.

5. As to the issue of discrimination, the Authority has provided no answer at all to the Icelandic Government's submissions.

Mischaracterisation of Iceland's case

6. The Authority mischaracterises Iceland's case in two important respects.

7. First, it argues that Iceland "concedes" that the State took "no action to ensure" that the foreign depositors received compensation from the deposit-guarantee scheme.[6] That submission entirely disregards the substance of Iceland's Defence. What Iceland did was to establish, recognise and supervise a deposit-guarantee scheme, in accordance with the requirements of the Directive, and fund to a level that was in accordance with EU norms. That was the "action" required by the Directive. As the Defence also explains, Iceland took a number of further steps to protect the depositors' position, including the grant of priority in the winding up of the estate of Landsbanki.[7]

8. What Iceland did not do was to underwrite the deposit-guarantee scheme using State funds. But it is now the Authority's case that this is not required by the Directive in any event.

9. Secondly, contrary to the suggestion made in the Authority's Reply, it is not the Icelandic Government's case that the Directive is of no application to a systematic banking failure

[6] Reply, paras 2, 16.
[7] Defence, para 60.

of the kind that occurred in Iceland.[8] This was made explicit in Iceland's Defence, which stated:[9]

> "This is not to say there is an 'exception' from the Directive that applies in the case of a systematic collapse of the banking system."

10. Iceland's case is that the Directive did apply, notwithstanding the banking crisis that engulfed Iceland. Its primary case is that Iceland satisfied the obligations imposed by the Directive.[10] The "obligation of result" upon Iceland was to ensure the proper establishment, recognition and supervision of a deposit-guarantee scheme. Iceland did precisely that. This was not a mere "paper wall" as the Authority suggests in its Reply.[11] The Authority does not dispute that the TIF was established and funded entirely in accordance with EU norms. Moreover, the Authority has alleged no breach of the duty of supervision imposed by the Directive.

11. The systemic collapse of the banking system in Iceland is, however, of fundamental importance to this case. As a result of that collapse, and in spite of Iceland's full transposition and implementation of the express provisions of the Directive, the TIF was wholly unable to pay the compensation required by the Directive. Those facts serve to expose the central question in this case: what obligation, if any, lies upon the State itself where a properly established deposit-guarantee scheme is unable to pay?

12. The Authority has failed to engage seriously with this issue.

A further "obligation of result"?

13. The Icelandic Government contends that there is no "obligation of result" upon the State to ensure that a properly established deposit-guarantee scheme is able to pay compensation in all circumstances, and in particular the wholly exceptional circumstances of a systemic bank failure.

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[8] Reply, para 10.
[9] Defence, para 21.
[10] Iceland's alternative submission is that if the Directive obligations are as extensive as the Authority contends, then Iceland was prevented from complying with those obligations by operation of *force majeure*.
[11] Reply, para 38.

14. The Authority confuses the "obligation of result" imposed upon the Contracting States by the Directive, with the social result of improved deposit protection sought by the Directive.

15. It is essential to consider the Authority's argument against the economic realities. The Authority does not dispute the primary facts set out in the Icelandic Government's Defence.[12] Thus it is accordingly not contested that (*inter alia*):

    a. The Icelandic Deposit Guarantee Scheme was funded in a manner that was entirely in accordance with EU norms, as explained in the Commission's Impact Assessment.[13]

    b. 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").[14] Within that average there is wide variance, with the exposure of one state as high as 372% of GDP.[15] The Icelandic Government respectfully refers the Court to the analysis conducted by the Icelandic Institute of Economic Studies,[16] none of which is challenged by the Authority.

    c. No deposit-guarantee scheme could have withstood the shocks upon the Icelandic banking system that occurred in October 2008.[17]

16. The foregoing facts do not reflect a Europe-wide failure by the Contracting States to properly implement the Directive. If there had been such a failure, it might have been expected that the Commission would have commented as such in its Impact Assessment. Rather, they reflect the practical realities of deposit-guarantee schemes. It is inherent to those schemes that they cannot pay out in the event of a widespread banking failure, any more than a fire insurer would be able to pay out if an entire city were to be destroyed by fire, rather than a single house or street.

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[12] There is a dispute regarding the application of the doctrine of *force majeur* as explained below.
[13] Defence, paras 119 – 126.
[14] Defence, para 16, and Report of the Icelandic Institute of Economic Studies, Annex 2 to the Defence.
[15] Annex 2 to the Defence, pg 10.
[16] Annex 2 to the Defence.
[17] Defence, para 5.

17. That does not mean that deposit-guarantee schemes are defective. They simply cannot, however, provide cover against any eventuality, no matter how extreme.

18. The Commission was well aware of this limitation to deposit-guarantee schemes when it first proposed the Directive, and as a result made no provision for any such guarantee. As noted in Iceland's Defence, the Commission explicitly acknowledged that the Directive did not address the circumstances where "the schemes' resources have been exhausted".[18] This practical reality is also fully reflected in the Commission's Impact Assessment.[19] It recognised that deposit-guarantee schemes could not deal with large-scale banking failures.[20]

19. This reality is simply ignored by the Authority. It instead seeks to derive an "obligation of result" upon the State to achieve a result that no deposit guarantee scheme could itself achieve: a guarantee that applied to every account holder irrespective of the scale of the financial crisis.

20. The Authority seeks to evade this difficulty, simply observing:[21]

> "It simply cannot be the result intended by the EU legislature when adopting the Directive that the greater the risk to depositors, the lesser is the protection provided by the schemes."

21. But it is even less likely that the legislator intended that the State itself should bear that burden in the event of an extremely severe economic crisis.

22. It is necessary to step back and to consider the kind of circumstances in which a systematic banking crash is likely to occur. It is unlikely to be during periods of prosperity. It may well be a time of severe economic crisis in which the State itself faces serious financial difficulties, or may even be close to sovereign default. The Authority's argument is that a yet further burden is then placed upon the State – a burden of potentially crippling size, as Iceland's Institute of Economic Studies has shown. This supposed burden is not set out in the express terms of the Directive.

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[18] Defence, para 149
[19] See the extensive quotations at paragraphs 111-148 of Iceland's Defence.
[20] See paras 130 -34 of Iceland's Defence.
[21] Reply, para 11.

23. The Authority's strategy in these proceedings is to abstract itself from these realities and argue that consumer protection nevertheless demands it. But consumer protection is not attained by a measure which may undermine the solvency of the State itself. There is no reason to suppose the legislator disregarded these realities.

The obligation of result: parallels drawn from other directives

24. The Authority's analysis of the "obligation of result" contains a discussion of case law on two other directives. Both lines of case law strongly support Iceland's case.

Directive 90/314 and Blödel-Pawlik

25. At the very outset of its Reply the Authority invokes Case C-134/11 *Jürgen Blödel-Pawlik v HanseMerkur Reiseversicherung AG*, 16 February 2012[22] as authority for the proposition that "an obligation of result is a well known and used technique in EU harmonisation measures".[23] That much is not in dispute. The question is as to the nature and extent of the obligations of result placed on the State itself, rather than the obligations of institutions established under such a directive. The Authority's reliance on this case well demonstrates its confusion of these two very different things.

26. In *Blödel-Pawlik*, the Directive in question (Directive 90/314) governed the provision of package holidays. It required that the travel organiser should be liable for the performance of the holiday contract, and to provide security for the money paid by the consumer. The issue before the Court of Justice was whether an insurance company which provided security on behalf of a travel organiser should pay out to a consumer where the travel organiser had acted fraudulently and then become insolvent. The Court held that the requirement to provide security was unqualified.[24] This "result" concerned the obligations of the travel organiser and its insurer.

[22] Reply, para 7.
[23] Reply, para 7.
[24] Para 21.

27. There is no suggestion in *Blödel-Pawlik* at all that "the obligation of result" was that the State should pay compensation to the disappointed customer in the event of a failure of a holiday organiser or credit institution issuing the security. The obligation of result imposed on the State by Directive 90/314 is to ensure that the organiser is liable to the consumer for proper performance of the contract. It is not an obligation upon the State itself to pay compensation if a travel organiser cannot meet its obligations.

28. To hold otherwise would lead to absurd consequences. For example, Article 4(6) of Directive 90/314 provides that: "If the consumer withdraws from the contract pursuant to paragraph 5, or if, for whatever cause, other than the fault of the consumer, the organiser cancels the package before the agreed date of departure, the consumer shall be entitled: ... b) to repaid all sums paid by him under the contract". If the notion of obligation of result put forward by the Authority's in the present case were to prevail, the State itself would be obliged to pay such sums in the event that the organiser could not do so, as a consequence of its obligation to guarantee the result intended by Article 4(6) of Directive 90/314.

29. The Authority confuses the obligation of result involved in the full and proper transposition and implementation of a Directive provisions with an obligation to guarantee the results which those provisions are intended to produce. If accepted such notion of obligation of result would also have serious consequences for the Contracting States. Whenever a Directive would require setting up a particular legal instrument to protect the financial interests of consumers, workers or any other group of people, the States would have to step in to guarantee those financial interests if such instrument would not be in a position to do it.

30. The only basis in EEA law for ex-post liability is the rule established in the *Sveinbjörnsdóttir* case. But as already noted, the Authority does not argue that the conditions for State liability under that doctrine are satisfied. It instead seeks to establish the responsibility of the State as an automatic consequence of the terms of the Directive itself.

Directive 80/987/EC and Francovich

31. In its Defence, Iceland explained why the *Francovich* case, and the analysis it contains of Directive 80/987/EC on the protection of employees on the insolvency of their employer, further demonstrates that the Authority's case cannot be right.[25] It again illustrates the critical distinction between the obligations upon a State to set up institutions that offer protection of individuals (in that case, employees), and the obligation of a State to actually fund such compensation (payment of outstanding claims by employees of an insolvent employer). In the *Francovich* case the Court held that the payment obligation lay with the guarantee institutions, and that the State could not be considered liable unless the conditions for an award of damages were satisfied.[26]

32. The Authority has sought to meet this point by arguing that the *Francovich* case deals with the consequence of complete failure to implement a directive.[27] That fact is plainly irrelevant to the analysis of the Court of Justice: the question it was seeking to determine was as to the nature of the obligations placed upon the State itself by the directive. It found there was no "obligation of result" upon the State to fund the scheme.

33. The Authority's argument is, moreover, entirely paradoxical. Its case appears to be that where there is a complete failure to implement, as in *Francovich*, there is no obligation of result upon the State to fund the scheme, whereas where (as on the Authority's analysis of the present case) there is at least partial implementation, somehow such an obligation of result arises. Thus, the less that a State does to implement a Directive, the less onerous its "obligations of result" become. That plainly cannot be right.

34. Partial implementation might, naturally, give rise to a claim for *Sveinbjörnsdóttir* damages, where the conditions are satisfied, but that is not this case.

35. In reality, the Authority has failed to provide any material basis upon which to distinguish this case law.

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[25] Defence, paras 231- 245.
[26] Defence, paras 239 and 245.
[27] Reply, para 52.

The contradiction in the Authority's case

36. At the heart of the Authority's case is a contradiction: it disavows any argument that the Directive requires the use of State resources, yet it argues for a position in which, in the event of a widespread bank failure, it is unavoidable that State resources would be required.

37. In its Notice of Application, the Authority argued explicitly for the need for the State to make up any shortfall in a deposit guarantee scheme. It contended that:[28]

> "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)

38. In its Reasoned Opinion it similarly argued:[29]

> "if the compensation of depositors prescribed 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...
>
> 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)

39. Thus it was clear that the Authority sought to argue that the State itself must fund the compensation provided for in the Directive, at least if "all else fails".

40. The Authority has, however made clear that this is not a claim for failure to implement a directive under *Sveinbjörnsdóttir* principles. In its Reasoned Opinion it explicitly stated:[30]

> "At the outset, the Authority makes clear that this infringement is not about wrongful implementation of Directive 94/19/EC."

41. The Authority has never sought to suggest that the conditions for State liability established by *Sveinbjörnsdóttir* have been satisfied, including, *inter alia*, the question

[28] Notice of Application, para 133.
[29] Annex 5 to the Notice of Application, pg 16. See also the Letter of Formal Notice at Annex A3 to the Notice of Application, pg 9.
[30] Annex 5 to the Notice of Application, pg 13.

whether the Contracting Party has manifestly and gravely disregarded the limits on its discretion.[31] Where, for example, a Contracting State fails to establish a deposit guarantee scheme within the time allowed by the Directive, then it is at least possible that it may be held liable to compensate investors on *Sveinbjörnsdóttir* grounds. But that is not this case. The Authority's argument is (or was) that the obligation upon the State to pay compensation was placed upon the State automatically by the Directive itself, not as a result of a liability in damages under *Sveinbjörnsdóttir*.

42. The Directive says nothing of the kind on its face. The Icelandic Government explained in some detail in its Defence why such an obligation could not be read in to it.

43. The Authority apparently now accepts this. In its Reply, it does not seek to argue that there is an obligation of State funding to be found in the Directive. Instead, it seeks to evade this consequence of its argument. It now argues:[32]

> "The Authority does not seek a declaration that Iceland must necessarily compensate depositors from public funds. As already stated, the Authority submits that Iceland was under a duty to ensure payment by the TIF by taking any number of possible measures ...
>
> it is wrong to characterise the Authority's case as being the only measure which Iceland could and should have taken was the grant of a State guarantee."

44. Thus, its argument is that the provision of state funds is not "impossible" under the Directive, but is a matter for the "choice" of the Contracting States.[33] The Authority suggests that it is a matter for the States to somehow give effect to the guarantee provided by the Directive, and essentially, it is not the Authority's concern how they do it.

45. In reality, however, there are only three options for funding the deposit-guarantee scheme: the deposit-taking institutions themselves, the State's own resources, or loans which would themselves require State backing.

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[31] Case E-9/97 *Erla Maria Sveinbjörnsdóttir v Iceland* [1998] EFTA Court Rep 95, paras 66 -68.
[32] Reply, paras 33 and 39.
[33] Reply, paras 17 and 42.

46. The Directive plainly envisages that the deposit-guarantee scheme will be funded by the deposit-taking institutions, as explained in Iceland's Defence.[34] As the Commission explains in its Impact Assessment, that is precisely how such schemes have been funded in practice, whether on an *ex ante* basis (as in Iceland) or on the basis of *ex post* contributions.[35] But the Directive does not require that the deposit-taking institutions set aside enough money to be certain that in all circumstances the deposit guarantee would be paid. That would impose enormous costs – both on the banks, and on consumers. Ordinary fractional reserve banking activities would be impossible.[36] Instead, the Directive seeks to strike a balance between those costs and benefits.[37]

47. The nature of a deposit guarantee scheme is that some assets are set aside in order to provide cover for a bank failure of a certain degree of seriousness. At the time of its Impact Assessment, the Commission found the ratio between *ex-ante* funds and eligible deposits to be between 0.01 and 2.3% in the deposit-guarantee schemes of the EU. The Commission's proposal is to strengthen those schemes by imposing a requirement to fund such schemes to a level where they could cope with a "medium-sized" banking failure, meaning 7.25% of GDP.[38] It has not even contemplated protection to anything like the level experienced by Iceland in this case. That reflects the fact that a system-wide crash of the kind experienced in Iceland is thankfully extremely rare, if not unique, and that the costs of protecting against it would be enormous. Like any form of insurance, the deposit-guarantee scheme serves to provide cover for more likely, rather than more remote, eventualities.

48. As to the possibility of the State's own resources, as already noted, the Authority disavows any argument that an obligation of State funding can be derived from the Directive. The difficulty it faces, however, is that the requirement to provide such funding is an inescapable consequence of its argument.

49. As to the possibility that funding could be secured by loans in the rare case of a system-wide crisis, this too would involve the resources of the State. It is inconceivable that a

[34] Defence, paras 167-177.
[35] Defence, para 121.
[36] Defence, paras 157-166.
[37] Defence, paras 155-166.
[38] Defence, paras 130-134.

bankrupt deposit-guarantee scheme could obtain such loans without at least the benefit of a State guarantee. Furthermore, the Icelandic Institute of Economic Studies has explained that it is simply not possible for this to provide a solution in the event of a system-wide banking failure.[39] The Authority has not sought to challenge this analysis in any way.

50. The Authority argued in its Application that Iceland could have obtained the funds in order to do so through the Icesave Agreements.[40] The Icelandic Government explained the true nature of those Agreements in its Defence – they were not agreements to provide funds to the Icelandic State at all.[41] This is not contested by the Authority in its Reply. The Agreements are simply irrelevant to this dispute, as must now be accepted.

51. The Authority is accordingly driven to an inherently contradictory position:

    a. It asserts that the State is obliged to ensure that compensation is paid to depositors, where a deposit-guarantee scheme cannot.
    b. The only possible source for such compensation is the resources of the State.
    c. The Authority nevertheless disavows any argument that the State is obliged by the Directive to draw upon its own resources.

52. The Icelandic Government contends that this position is wholly unsustainable.

53. To all practical purposes, the Authority's argument leads to a requirement for a State guarantee.

State aid

54. One of the reasons why the Authority seeks to avoid this consequence of its argument is that it is plainly inconsistent with the published views of the European Commission. As Iceland explained in its Defence, the Commission's published position is that an injection

[39] Defence, para 159, Annex II, pgs 3-7.
[40] Notice of Application, para 153.
[41] Defence, para 105. In substance, they were arrangements under which TIF (supported by a State guarantee) would have used the proceeds of the winding up of Landsbanki over a long period to reimburse the sums paid out by the British and Dutch governments to Icesave depositors in those states.

of State resources into the banking system of this kind would amount to State aid.[42] As the Authority notes, the Commission "describes the different ways in which deposit guarantees are financed"[43] including State funding, but the Commission also makes clear that if the States are required to step in "in a systematic crisis" where "DGS may reach their limits" then the State aid rules must be complied with.[44]

55. This is not a mere formality. The result is that such a use of State resources is subject to supervision by the Commission, or the Authority, to ensure that it does not distort competition. This is well illustrated by the *SoFFin* decision, cited by the Authority in its Reply, in which the Commission granted State aid approval for a guarantee granted to the German Deposit Protection fund.[45] The Commission observed:[46]

> "The SoFFin Guarantee comprises state funds which are used to benefit the SdB [the deposit insurer] and therefore all the member banks of the BdB [an association of private banks], and which consequently distort, or threaten to distort competition and affect trade between Member States in which the BdB members, as internationally active banks, participate."[47]

56. The Authority's argument, however is (or was) that there is an <u>obligation</u> to make such payments, as an automatic consequence of the Directive if "all else fails". That is plainly incompatible with the Commission's approach. The case law of the Court of Justice establishes that a payment made by a State under EU legislation does not fall to be considered as State aid: Case T-351/02 *Deutsche Bahn v Commission* [2006] ECR II-1047, paras 99 – 102. Thus, if Iceland's obligation to pay arises under the Directive (as the Authority argued in its Notice of Application, Reasoned Opinion and Letter of Formal Notice), then such payments cannot be State aid, and the approach of the Commission must be fundamentally wrong.

57. The consequence of the Authority's argument is that the large injections of State funds into the banking system that are potentially entailed by the Authority's argument fall

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[42] Defence, para 114-140.
[43] Reply, para 41.
[44] Defence, para 135.
[45] Case N 17/2009 *SoFFin guarantee for Sicherungseinrichtungsgesellschaft deutscher Banken – Germany*, referred to at paragraph 18 of the Reply.
[46] Para 28.
[47] The Authority makes the point that the German authorities acted "swiftly" to secure payment of sums that exceed the amount for which TIF is liable: Reply para 18 and footnote 7. There is of course a difference of scale between the German and Icelandic economies.

entirely outside State aid supervision. Yet their ability to seriously distort competition is self-evident. The Authority suggests that the only concern of the Commission is as to the impact on competition of different levels of protection between Member States.[48] But plainly, the potential for large injections of State funds to support the banking system of a Contracting State raises the serious risk of distortion of competition.

58. This result of the Authority's argument is so surprising, and would have such wide implications, that it cannot simply be read into the Directive. If this had been the intention of the legislator, it plainly would have said so.

59. The Authority also argues that it is a consequence of Iceland's case that there would be a risk of regulatory competition "to provide the best guarantee".[49] As the Commission's Impact Assessment clearly demonstrates, there are material differences in the level of funding for deposit-guarantee schemes at present, resulting from the lack of harmonisation in this field. Nothing in Iceland's argument exacerbates that problem. Moreover, Article 3(1) the Directive itself seeks to preclude such competition by specifically precluding the Contracting States from implementing the Directive through a system by means of a State guarantee.[50]

60. The Authority further argues that bank recapitalisation by the State might be "more costly than the increased coverage of a deposit guarantee scheme".[51] That was certainly not the case in Iceland. But more fundamentally, this comparison makes no sense. It essentially relates to the expected future cost of increasing coverage, in times when no failure has occurred. As such the cost is distributed over time and assumptions made concerning the likelihood of failure. That premise has no relevance in the case at hand. It does not relate to expected future costs. It relates to certain current costs.

[48] Reply, para 23.
[49] Reply, para 23.
[50] See paras 203 and 204 of Iceland's Defence.
[51] Reply, para 43.

Emanation of the State

61. The Authority argues that:[52]

> "the Icelandic Government has not rebutted or even attempted to rebut the evidence set out in paragraphs 99 to 101 that the TIF and the Icelandic State were linked to a degree even though Article 2 of Act No 98/1999 lays down that the Fund is a private foundation..."

62. That is not the legal test. The test is whether (*inter alia*) the entity is "under the control of the State".[53] The Authority does not argue for any wider test, and such argument would have broad implications.

63. It is common ground that the Fund is a private foundation as a matter of law. The Authority seeks to make good its case principally by referring to passages from the SIC Report, although it now acknowledges that the SIC's findings cannot be treated as determinative of the issues in this case.[54] Iceland contends that even if the SIC Report is treated as having probative value for this purpose, it does not suffice to make out the Authority's claim. It may show that the Ministry of Business Affairs had influence in the running of TIF, but the legally relevant question is whether that amounted to "State control" to a degree sufficient to render TIF an emanation of the State – notwithstanding its legally independent character, and notwithstanding that four out of six members of its board are nominated by private institutions.[55] Iceland submits that the Authority has failed to demonstrate this.

64. The Authority argues that the TIF and the State were "so mixed up that they cannot be truly separated in fact",[56] but this form of generalisation is wholly insufficient.

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[52] Reply, para 13.
[53] Case C-356/05 *Farrell and Whitty v MBI* [2007] ECR I-3067, para 41, quoted at paragraph 226 of the Defence.
[54] Reply, para 5. The Authority specifically relies upon the allegation that "the Managing Director [of TIF] was an officer of the Central Bank ... at the material time". This is simply incorrect. From October 2008 until the middle of 2009 the Managing Director of TIF was TIF's Counsel, a Supreme Court Attorney; since then the Managing Director of TIF has been an employee of TIF.
[55] Defence, para 228.
[56] Reply, para 13.

65. More fundamentally, this argument makes no difference. As Iceland argued in its Defence, 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 is nevertheless a further obligation of result upon the State to ensure that such compensation was paid.[57]

Force majeure

66. The Authority seeks to dismiss Iceland's plea of *force majeure* on the basis that "financial difficulties cannot justify non-compliance with the Directive".[58] That is to fundamentally understate the nature of Iceland's position. This was not a case of mere "difficulty". The three cases relied upon by the Authority in support of this proposition deal with difficulties of an altogether more modest kind.[59]

67. The case law does not exclude the possibility that the circumstances giving rise to *force majeure* may be essentially economic, if they are sufficiently severe. It should be emphasised that Iceland does not invoke *force majeure* in order to protect its own economic interest, but rather because of its objective lack of capacity to pay.

68. The Court of Justice's case law does not place an unqualified prohibition upon the Court having regard to such economic realities. In one of the cases relied upon by the Authority, the Court of Justice stated:[60]

> "it should be borne in mind that, according to the case-law of the Court, a Member State may not plead practical or administrative difficulties in order to justify non-compliance with the obligations and time-limits laid down in Community directives. The same holds true of financial difficulties, which it is for the Member States to overcome by adopting appropriate measures." (emphasis added)

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[57] Defence, para 225.
[58] Reply, para 52.
[59] Notice of Application, para 148, footnote 66: Case C-309/84 *Commission v Italy* [1986] ECR 599, concerned a delay in the payment of premiums for abandoning areas under vine. The Court rejected an argument based on "administrative difficulties". Case 42/98 *Commission v Belgium* [1990] ECR I-2821 concerned a failure to comply with a directive concerned with the quality of water intended for human consumption. The Court rejected an argument that the cost and complexity of the works need to render water in conformity with the Directive in respect of the town of Verviers justified an extension of time in which to comply with the Directive. Case C-375/02 *Commission v Italy*, 9 September 2004, an Italian local authority unsuccessfully pleaded lack of financial resources to ensure that a particular landfill complied with a directive on waste.
[60] Case 42/98 *Commission v Belgium* [1990] ECR I-2821, para 24.

69. The question is essentially the same whether circumstances are financial or otherwise: could the State have overcome those difficulties by adopting "appropriate measures" and without "unreasonable sacrifices"?[61]

70. In this case, Iceland has explained that it wholly lacked the resources to do so. By way of answer, the Authority argues that by 2009 the estate of Landsbanki was sufficient to cover "a substantial part of the amount owed by TIF to the depositors".[62] Thus, the argument appears to be that Landsbanki should have been wound up immediately, and indeed prematurely, so as to use those assets for the benefit of TIF. If that had happened, there would have been no prospect of complete recovery of the sums deposited out of the estate, as is now anticipated, and as a result, depositors would actually have been worse off. But more fundamentally, this argument overlooks the fact that the assets of Landsbanki are not the assets of the Icelandic State, or even under its control. They were subject to an independent winding up process, governed by Directive 2001/24/EC on the reorganisation and winding up of credit institutions. The Authority cannot seriously suggest that the Icelandic Government should have simply appropriated Landsbanki's assets.

71. In any event, such a step would not have provided an answer to the Authority's argument. It would no doubt say that payment of a "substantial part" of the sums owed by TIF was not sufficient to discharge the "obligation of result" to make payment of €20,000 to each investor.

72. The Authority hints at a further argument:[63]

> "doubt can be cast on whether the circumstances in which Iceland found itself on 23 October 2009 were unforeseeable ... it could be argued that the Icelandic State had compounded its difficulties by failing to act in a timely manner to prevent excessive liability being incurred by TIF."

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[61] Case C-314/-6 *SPMR* [2007] WCR I-12273, as set out in Iceland's Defence at para 249. Nothing in the Opinion of Sir Francis Jacobs quoted by the Authority at paragraph 45 of its Reply cuts across this analysis. The learned Advocate General observed:[61] "In general directives must be implemented on time even if that proves extremely difficult." C-236/99 *Commission v Belgium* [2000] ECR I-5657, para 16, (emphasis added).
[62] Reply, para 51.
[63] Reply, para 53.

73. The Authority does not go as far as to positively allege any such facts, but confines itself to this tentative suggestion, with the benefit of hindsight. It would be wholly unrealistic to contend that a crash on the scale that occurred, within a very short period of days was "foreseeable", or indeed foreseen.

74. Moreover, as already noted, the Authority has raised no plea of breach of the duty of supervision imposed by Article 3(2) of the Directive.

Non-discrimination

75. The Authority has made no attempt to engage with the arguments on discrimination set out in Iceland's Defence. Instead, it oversimplifies the facts surrounding the restructuring of the Icelandic banks and simply repeats its argument that: "it is a breach of the Directive read in the light of Article 4 EEA to differentiate between depositors protected under the Directive by providing protection for some depositors while leaving others without any or comparable protection". [64]

76. The Authority has still not explained how it can be said that the difference in treatment it complains of falls within the scope of the Directive at all. As the Icelandic Government submitted in its Defence, there was no different in treatment of the deposits as to the implementation and operation of the deposit-guarantee scheme. The treatment of depositors in the domestic branches of the Icelandic banks was part of a restructuring of those banks which had nothing at all to do with the deposit-guarantee scheme.[65] The Authority simply conflates two very different things: a difference in the treatment of deposits arising as a result of a bank restructuring that had nothing to do with the Directive, and a difference in treatment of deposits under the Directive itself. As a result, the essential legal premise of the Authority's argument is simply not made out.

77. Even if the matters complained of did somehow engage the Directive, Iceland went on to explain why any difference in treatment was objectively justified.[66] In essence, the object of the rescue of the Icelandic branches was to safeguard the functioning of the banking

[64] Reply, para 58.
[65] See paragraphs 287-299.
[66] Defence, paras 305-326.

system. The potential failure of the domestic branches carried with it a systemic risk to the banking system and the economy, not posed by the overseas branches. It was simply not possible to extend the same treatment to those overseas branches, as the Authority apparently accepts. In any event, taking all of the measures implemented together, it is far from clear that the overseas investors are worse off.[67]

78. The Authority has offered no reply at all to this argument.

Conclusion

79. The Icelandic Government maintains the submissions made in its Defence and respectfully asks the Court to dismiss this application.

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[67] Defence, para 275.