Hypo Reorganization Act Violates Right to Property

Austrian Constitutional Court
Judgment of 3 July 2015, G 239/2014 et al

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The Constitutional Court had to decide on some of the measures taken with the Hypo Reorganization Act in order to restructure and wind-down 'Hypo Alpe-Adria – Bank International AG'. The Court found that the right to property under Art 5 StGG and Art 1 Protocol No 1 ECHR was violated because the HaaSanG differentiated within the group of subordinate creditors by declaring only those claims expired that matured before 30 June 2019. Another violation of the right to property was seen in the fact that the HaaSanG declared all securities (and among them statutory guarantees) expired together with the respective claims.

I. Facts of the Case

The case was brought as result of applications filed by members of parliament as well as by the regional court of Klagenfurt. The applications drew into question the constitutionality of parts of the Hypo Reorganization Act ('Hypo-Sanierungsgesetz'). The Hypo Reorganization Act comprises four different acts and provides for the restructuring and controlled wind-down of the Hypo Alpe-Adria – Bank International AG ('Hypo'), an Austrian credit institution in financial trouble which had been nationalized in 2009. Part of the Hypo Reorganization Act is the Hypo Alpe Adria Recovery Act 'HaaSanG', which foresees the expiry of certain subordinate claims as well as guarantees thereon, and the deferral of certain disputed claims. Another part is the Act on the establishment of a wind-down unit, 'GSA', which determines the conditions for the winding-down of portfolios by Hypo (henceforth acting under the name 'HETA'). Both HaaSanG and GSA formed part of the proceedings before the Constitutional Court.

II. Relevant Provisions

Austrian Federal Constitutional Law (B-VG)
(Federal Law Gazette 1/1930, as amended by I 65/2012)

Article 13 (1) […]

(2) The Federation, the provinces and the municipalities must aim at the securement of an overall balance and sustainable balanced budgets in the conduct of their economic affairs. They have to coordinate their budgeting with regard to these goals.

(3) […]

Basic Law of 21 December 1867 on the General Rights of Nationals in the Kingdoms and Länder represented in the Council of the Realm (StGG)
(Federal Law Gazette 142/1867 as amended by 684/1988)

Article 5

Property is inviolable. Expropriation against the will of the owner can only occur in cases and in the manner determined by law.

Protocol No 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR)

Article 1 Protection of property

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

Charter of Fundamental Rights of the European Union (CFREU)

Article 17 –Right to property

1. Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest.
2. Intellectual property shall be protected.

Hypo Alpe Adria Recovery Act (HaaSanG)
Federal Law Gazette I 51/2014

§ 3 With the promulgation of a regulation in accordance with § 7, all claims maturing before the cut-off date, which are not disputed claims (§ 2 item 5), expire. At the same time, securities including guarantees for such claims expire, excluding the securities listed in Art 21 to 23 of Directive 2001/24 / EC of 4 April 2001 on the reorganization and winding up of credit institutions.

§ 6 Creditors whose claims expire according to § 3 or § 4 para 5, will, at the point in time mentioned in § 214 Abs 1 Stock Corporation Act, gain a new claim up to this amount against the recovery institute in so far as and to the extent as there are assets to be otherwise distributed to shareholders.

[…]

Austrian Civil Code

§ 1356 The guarantor may, however, even if he has expressly guaranteed just for the case of default of the principal debtor, only be drawn on first, when insolvency proceed-

ings have been opened over the assets of the principal debtor or if the whereabouts of the principal debtor are unknown at the time the payment should be made and the creditor has not acted negligently.

Holding Act of the Province of Carinthia (K-LHG)

§ 4 Guarantee of the transferring bank

In accordance with § 8a para 10 of the Banking Act, Federal Law Gazette 63/1979, last amended by Federal Law Gazette 475/1990, the transferring Kärntner Landes- und Hypothekenbank guarantees with all its assets for all current and future liabilities of the corporation in the event of its insolvency as deficiency guarantor under § 1356 Civil Code. […]

§ 5 Guarantee of the province in favour of the stock company

(1) The guarantee of Carinthia as deficiency guarantor under § 1356 ABGB in the event of insolvency of the corporation for all liabilities of the transferring Kärntner Landes- und Hypothekenbank at the time of registration of the stock company in the commercial register remains in place

(2) The province of Carinthia is also liable as deficiency guarantor under § 1356 ABGB in case of insolvency of the corporation or their legal successors under the conditions specified in paragraph 3 for all liabilities of the stock company and its legal successors incurred from the date of registration of the stock company in the commercial register until 2 April 2003. For all liabilities of the corporation and its legal successors incurred from 3 April 2003 to 1 April 2007, the province of Carinthia is liable as deficiency guarantor under § 1356 ABGB under the terms of paragraph 3, only insofar as the liabilities mature before 30 September 2017. For liabilities of the corporation and its legal successors incurred after 1 April 2007, the province of Carinthia assumes no guarantees, warranties or other commitments, except in accordance with para 6.

[…]

III. Ruling of the Constitutional Court

§ 3 HaaSanG stipulates that with the publication of the ordinance by the Financial Markets Supervisory Authority ('FMA'), all subordinate claims and shareholders' claims substituting equity maturing before the 30 June 2019 ('cut-off date') expire. § 6 HaaSanG stipulates that creditors, whose claims fall under § 3 HaaSanG, may gain a new claim against HETA if, after the completion of the wind-down, assets remain. Disputed claims (claims whose status as subordinate or as shareholder's claim is unsure) are deferred at least until this date or until the proceedings in which their status is decided on are completed. According to the explanatory remarks to the government bill, a period of around five years with the cut-off date on 30 June 2019 was deemed to ensure an orderly wind-down of portfolios at the best possible conditions, while allowing to honour the remaining subordinated claims.

The applicants, however, submitted that the expiry of claims violated the fundamental right to the protection of property. They saw it as an expropriation or restriction of property rights. Since only claims of certain subordinate creditors were affected while other (equally subordinate) creditors as well as the Austrian federation as the owner of

HETA could keep their claims, the pari passu principle was not respected. Even if a public interest were to be granted, the restriction of the right to property would be disproportional and violate the right to equal treatment. An ordinary insolvency procedure could have avoided this discrimination.

The Court took up on these concerns. The creditors' claims were deemed to fall under the right to property as protected under constitutional law (Article 1 Protocol No 1 ECHR and Article 5 StGG) and under European law (Article 17 CRFEU). However, the Court found that the expiry of claims according to the HaaSanG was not an expropriation strictu senso, since the claims were chosen solely for their worth. Moreover, the restructuring of Hypo was in the public interest. Since the legislator had a wide margin of appreciation when making economic prognoses, he could chose a wind-down over ordinary insolvency proceedings. Also a 'hair-cut' was potentially seen as necessary for the resolution of a bank in crisis. The differentiation between different groups of creditors ('normal' and 'subordinate') was legitimate, since subordinate creditors would also leave empty-handed in insolvency proceedings. Regarding the differentiation between subordinate creditors and the Austrian federation as the owner of HETA, it had to be taken into account that the Austrian federation had already put in more than € 5 billion to mitigate damages in the interest of other creditors.

However, the Court found that the right to property was nonetheless violated because the HaaSanG differentiated within the group of subordinate creditors by declaring only those claims expired that matured before 30 June 2019. Subordinate creditors with such claims were discriminated further as the securities and guarantees on their claims expired together with the claim, while other equally subordinate creditors were not affected at all and even kept their interest claims. Since it turned out that the cut-off date could not prevent HETA from failing before the end of the restructuring period (measures under the Bank Restructuring and Resolution Act had been taken with regards to the remaining creditors after the entry into force of the Hypo Reorganization Act), this discrimination could not be justified with ensuring an orderly restructuring and resolution.

The Court also agreed with the applicants regarding the expiry of all securities together with the claims foreseen in § 3 HaaSanG (and § 1356 Civil Code). This particularly affects guarantees by the province of Carinthia according to the Holding Act of the Province of Carinthia ('K-LHG'). The Court emphasised that claims resulting from such statutory guarantees (rendering the claims quilt-edged and equipping them with qualified protection) constitute a severe restriction of the right to property. While the government claimed the protection of creditworthiness of Austrian provinces as well as the prevention of an insolvency of the province of Carinthia, the Court saw no reason solely for the specific group of subordinate creditors to be drawn on. The expiry of guarantees, which exclusively applied to those subordinate creditors, whose claims expire, while guarantees for other creditors remained unaffected, was found to be neither factually justified nor proportionate. Guarantees issued by a federal province must not be rendered invalid retroactively, even when the province is evidently incapable of bearing the risk.

As regards the GSA, the applicants submitted, inter alia, that it was unclear which assets may be transferred to other entities in the course of the winding-down of Hypo and that the minister of finance had too great a discretion in deciding how this transfer was effected (by way of ordinance or ruling). However, the Court found that owing to the legislator's margin of appreciation and the flexibility needed for the resolution of Hypo,

the GSA is in conformity with the constitution. Thus, also certain (eg cancellation or approval) rights may legitimately be limited when deciding on restructuring measures and specific insolvency rules foreseen for a wind-down unit.

The Court thus concluded that the HaaSanG was unconstitutional and repealed it in its entirety. Consequently, the FMA ordinance based on it was repealed as well. A deadline for correction was not set and, thus, the HaaSanG is no longer applicable. As far as the applications concerned the GSA, they were dismissed as unfounded.

IV. Assessment

The present judgment, in which the Constitutional Court repeals the HaaSanG in its entirety, is an important victory for HETA's (predominantly institutional) creditors to the detriment of Austrian taxpayers. Of course, the proportionality assessment of the Constitutional Court is to be respected. It lies in the nature of the proportionality test, however, that a different outcome would have been conceivable as well.[1] Be that as it may, the present judgment is remarkable not so much because of its conclusion (that the differentiation within the group of subordinate creditors according to a 'cut-off date' and the expiry of all securities on the respective claims violate the right to property under Art 5 StGG and Art 1 Protocol No 1 ECHR) but because of its wider implications.

First, the Court clarified that both (subordinate and certain shareholders') claims and the securities thereon constitute rights protected under Art 5 StGG and Art 1 Protocol No 1 ECHR (mn 272, 303). Moreover, it held that the expiry of the claims and securities had to be qualified as a restriction of the right to property rather than an expropriation (mn 275 f, 304). Considering the case-law of the ECtHR on de facto expropriations[2] this might be challenged. However, it is perfectly in line with the rather formalistic take on expropriation the Constitutional Court established in its earlier jurisprudence[3], and thus did not come as a surprise. The outcome, however, would, in any case, have been similar since the 'appropriate compensation' (needed to justify an expropriation) for claims which would evidently not be considered in insolvency proceedings may be seen in the gaining of new claims according to § 6 HaaSanG.[4]

Moreover, the Constitutional Court held that the legislator's wide margin of appreciation had to be respected. He was free to choose a wind-down under special rules (such as the Hypo-Reorganisation Act) over an insolvency proceedings (mn 278), so long as these rules ensured equal treatment of the respective groups of creditors (mn 295). This has direct implications for the inclusion of HETA in the regime of the Austrian Bank Recovery and Resolution Act (BaSAG), which implements the Bank Recovery and Resolution Directive 2014/59/EU (BRRD). Given that HETA's authorisation to take deposits (and thus its qualification as a credit institution according to Art 4 section 1 no 1 Capital Requirements Regulation 575/2013) ended before the entry into force of the BaSAG,

1 Arguing for the constitutionality of the HaaSanG cf Michael Potacs and Claudia Wutscher, `Zur verfassungs-, unions- und völkerrechtlichen Beurteilung des HaaSanG´[2014] JRP 248; cf also Thomas Müller, `Verfassungsrechtliche Überlegungen zum "Hypo-Sondergesetz"´, in Gerhard Baumgartner (ed), *JB Öffentliches Recht 2015* (NWV 2015) 3152.

2 Eg *Sporrong and Lönnroth v Sweden* (1982) Series A no 52, § 63.

3 Eg VfSlg 8981/1980; see also VfSlg 17071/2003.

4 Cf Potacs/Wutscher (n 1) 252.

HETA's creditors had (elsewhere) questioned the legality of the application of the BaSAG on HETA as explicitly foreseen in § 162 para 8 BaSAG. While the Constitutional Court clearly rejects this position, it remains open whether or not HETA necessarily had to be included in the BaSAG, as well as what effects the application of the BaSAG on HETA has. Given that many proceedings against HETA take place in Germany under German law, the recognition of Austrian measures by German courts (which essentially depends on the answer to these questions) is crucial. However, these are questions of a correct interpretation of the BRRD which are best left to the CJEU.

Returning to the present judgment, it has to be emphasized that the Constitutional Court does not object to a 'hair-cut' of creditors as such. Moreover, it explicitly clarifies that the restructuring of Hypo was in the public interest and a 'hair-cut' may be necessary for the resolution of a bank in crisis (in particular mn 280). After the entry into force of the BRRD (and soon the Single Resolution Mechanism, SRM), any other position would have arguably been in conflict with EU-law, anyway. Also the differentiation between different groups of creditors ('normal' and 'subordinate') was deemed legitimate (mn 281). The violation of the right to property, according to the Constitutional Court, rather lay in the differentiation *within* the group of subordinate creditors which resulted from the cut-off date (mn 288 f). Creditors with claims maturing after 30 June 2019 were not affected by the hair-cut and, thus, were found to be in a better position for no legitimate reason. In particular, and even though new claims under § 6 HaaSanG could be gained if assets remained after the wind-down, these claims would lack the securities of the expired claims (mn 289). The paradox in the Constitutional Court's argumentation is that it seems a hair-cut including *all* subordinate creditors would have been legitimate. Or, in other words: had the legislator not introduced the cut-off date *in order to* ensure proportionality (it would have seemed to go beyond what is necessary when [ex ante] a five-year period was enough, but all subordinate shareholders' claims expired), the provision would have been proportionate. The Constitutional Court grants that the legislator's ex ante prognosis was legitimate but holds that when the opening of a resolution procedure over HETA according to the BaSAG in early 2015 showed that the limitation to claims maturing before 30 June 2019 was not sufficient, the HaaSanG was (rendered) unconstitutional (mn 291 f).

Moreover, when explaining why creditors not affected by the hair-cut were better off despite their claims being subordinate, the Constitutional Court strongly based its argument on the fact that creditors affected by the hair-cut lost all securities together with their claims (mn 289). However, at least as far as the securities of the province of Carinthia or the Carinthian Holding according to §§ 4 and 5 K-LHG are concerned, this argument is not convincing. Regarding the guarantee of the state of Carinthia according to § 5 K-LHG, it is evident that there simply *are no creditors* with claims maturing after 30 June 2019 and guarantees under this provision, since § 5 K-LHG explicitly (and for EU-law reasons necessarily) limits the state guarantee to claims maturing before 30 September 2017. As far as § 4 K-LHG is concerned, the explanatory remarks to the state bill[5] strongly suggest that this provision was not meant to confer rights to individuals but was meant as a declaratory reference to a provision at federal level (§ 8a para 10 KWG, now § 92 para 9 BWG). Any other understanding would not only conflict with constitutional

5 Explanatory remarks to the state bill Zl Verf-234/22/90, p 8.

law provisions on the division of powers between the *Länder* and the Federation, but also violate EU law. Because the European Commission had found the guarantees for the then state owned banks to constitute illegitimate state aid and allowed them to be kept only for a transition period until 2007 as far as claims maturing before 30 September 2017 were concerned, and only if the respective provisions were to reflect this compromise. While § 5 (and 9) K-LHG were adapted accordingly, § 4 was left unaltered and thus (if not read as a declaratory provision) could not be applied any longer (primacy of EU law).

This brings us to the second strand of the Constitutional Court's reasoning which essentially finds that the expiry of all securities together with the respective claims violates the right to property. The argument drew on the fact that many of the expired claims were equipped with statutory guarantees (by the *Länder* or the Federation) rendering the claims quilt-edged and equipping them with qualified protection under Austrian law. Given that statutory guarantees fall under § 1356 Civil Code (ABGB), an expiry of the claims (even without the clarification in § 3 HaaSanG), however, necessarily leads to the ceasing of the respective guarantees (accessoriness of security rights). It seems, while generally not opposing to a hair-cut of subordinate creditors as such (mn 280), any bill providing for such a hair-cut would need to deviate from the general rule of accessoriness of security rights in order to comply with constitutional law. The Constitutional Court namely found that guarantees issued by a federal province must not be rendered invalid retroactively. On the side, the Constitutional Court mentioned that by issuing the guarantees when it was evidently incapable of bearing the risk (at the time of the judgment, the guarantees still amounted to around € 10.2 billion), the province violated a legal obligation (possibly stemming from Art 13 para 2 B-VG?). Doing away with the statutory guarantee could, however, only be done *pro futuro.* An expiry of securities together with the claims was found not to be necessary to ensure the orderly wind-down of HETA, since it would have sufficed to exclude the recourse claim of Carinthia against HETA (mn 308). An amendment to the BaSAG which has been proposed in October 2015 now aims at clarifying that statutory guarantees are not affected by bail-ins under the new resolution regime[6].

However, the Constitutional Court admitted that the reputation of Austria on the financial markets and its credit-worthiness were legitimate public interests (mn 294). Moreover, a debt regulation/reorganisation procedure for provinces was found to be generally possible and within the public interest (mn 289) as well. This dictum is particularly important given that the government has since proposed a bill with which it aims to do away with Carinthia's statutory guarantees by buying creditor's claims for a quota of the nominal amount (the attractiveness of this offer for creditors will depend on a comparison to what they could expect to get from Carinthia in a hypothetical insolvency scenario).[7] However, ECtHR case-law according to which a lack of funds cannot justify a state not honouring his obligations from a binding judgment against him[8] , suggests that any limitation to execution proceedings against public bodies might be problematic under the light of Art 1 Protocol No 1 ECHR. While this may be true if the protection of state funds were the only goal of an interference in creditor's rights, I believe the standard must be a different one if the functioning of the polity as such is concerned. Thus, limits

6 154/ME XXV. GP of 7 October 2015.
7 796 BlgNR XXV. GP.
8 See eg *Luca v Italy* App No 43870/04 (ECtHR, 24 Sept 2013).

to an enforcement of claims against provinces which ensure that the province can keep fulfilling its public functions[9] should be possible. However, in such a debt restructuring proceedings for provinces, which could involve hair-cuts, equal treatment of creditors would have to be ensured (mn 315).

The points mentioned are only starting points for discussion, highlighting some of the most pressing issues. Given the number of pending proceedings somehow related to the wind-down of HETA[10], it can, however, be expected that on many of these issues, the last word is yet to be spoken.

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9 See Michael Potacs and Claudia Wutscher, `Grenzen der Einbringlichkeit von Forderungen gegen Bundesländer´ [2015] wbl 61.

10 An application (G 315/2015 ua, V 100/2015) against the inclusion of HETA into the BaSAG regime was dismissed for formal reasons on 7 October 2015, other proceedings on the legality of the state guarantees and the inclusion of HETA into the BaSAG are still pending. Meanwhile, yet after the completion of this assessment, literary discussion of the present judgment has started, see Bernhard Raschauer, 'Lehren aus dem HETA-Erkenntnis' [2015] ecolex 928; Kurt Retter, 'Anordnung des Erlöschens von Verbindlichkeiten und Haftungen im Hypo-Sanierungsgesetz unverhältnismäßig' [2015] wbl 601.