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German Creditors Challenge Failure of Austrian Hypo Alpe- Adria- Bank

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When ***Hypo Alpe-Adria Bank International AG (Hypo)***, the Austrian bank, failed in 2014, the *Austrian* Government paved the way for the establishment of Heta Asset Resolution AG (Heta) as a wind-down vehicle to assume and manage large parts of its assets. The idea was to wind down Hypo by 2020.

The Austrian "Act on the Recovery and Resolution of Banks" (the Act), was passed in January 2015. It transposed the EU Directive on the Recovery and Resolution of Credit Institutions and Investment Firms (the Directive) in Austria. Heta is not a bank as defined by the EU's Capital Requirements Regulation, but the application of the Directive to Heta has been achieved as a result of a discretionary additional article included during the transposition of the Directive into Austrian law.

The ***Austrian Financial Market Authority (FMA)*** assumed the function of the national resolution authority on 1 January 2015. The FMA has received far-reaching powers conveyed upon its activities as the resolution authority, in order to be able to execute an orderly resolution in the event of the failure or threat of failure of an institution, and to ensure that financial market stability is maintained in Austria. The FMA may take measures for ensuring the continuity of services and avoiding adverse effects on financial stability by separating performing assets from impaired or under-performing assets.

Accordingly, the FMA issued an administrative ruling deferring the maturities of all debt securities issued by Heta and all other liabilities – including interest due dates – until 31 May 2016 (the moratorium). Liabilities affected by the moratorium include also bonds and all repayment claims arising out of Austria against the state of Carinthia and Kärtner Landesholding in relation to security granted for Heta liabilities.

In the meantime a German bank, Bayerische Landesbank (Bayern LB), had initiated legal proceedings in Germany against Heta whereby one of the legal issues before the Munich local court was whether the Directive contemplates the application of its tools and powers to wind-down vehicles such as Heta.

The uncertainty stemmed from the fact that the Directive only applies to financial institutions and banks. Heta as a wind down vehicle does not have such license. In order to ensure that the Directive would actually apply to Heta, the Austrian legislature explicitly made Heta subject to the Act. On 8 May 2015, the Munich court of first instance refused to recognize the moratorium on the basis that the application of the Act to Heta goes beyond the scope of the Directive and, therefore, fell outside of Germany's obligation under the Directive to give effect to measures taken by other resolution authorities. In doing so, the Munich court ordered Heta to pay Bayern LB approximately €2.3 billion. This decision was subject to an appeal by Heta.

In July 2015, the Austrian Government and the German Free State of Bavaria announced that they had reached an agreement that settles the legal disputes between Bayern LB and Heta. The memorandum of understanding sets a minimum payment of €1.23 billion in favour of Bavaria for claims that Bayern LB has against Heta and would end the legal battle between the parties. Heta agreed to the settlement on 22 September 2015. The successful closing of the agreement depends on further decisions and approvals to be made by the two Austrian governmental bodies, the national parliament on 15 October 2015 and the federal parliament at the end of October or beginning of November with regard the modification of the stabilization act and regulatory approvals from the FMA among others, and the enactment of a special law in Austria that is expected to reach a vote in parliament by the end of October.

Furthermore, by its 28 July 2015 decision, the Austrian Constitutional Court annulled the federal legislation which had allowed the Austrian Government to (1) bail-in Heta's subordinated debt holders, and (2) declare void the state of Carinthia's deficiency guarantees on that portion of Heta's subordinated debt amounting to around €800 million. The Constitutional Court has repealed this legislation in its entirety and declared the unequal treatment of junior creditors by a set cut-off date of 30 June 2019 unconstitutional and a violation of property rights. The Court's decision lead to a liability in Heta's half-year statements of additional €800 million and thus increased its negative equity. Consequently, unsecured creditors may ask Carinthia as the guarantor of the deficiency guarantee to compensate them for the difference based on the wind down of the Bank. The ruling sends a strong signal that the value of the deficiency guarantee cannot be fully eliminated by law by retrospective legislation.

In its ruling, the Constitutional Court did not address the payment moratorium

introduced on 1 March 2015 by FMA on Heta's unsecured obligations. This moratorium remains in place until May 2016.

In the meantime, several financial institutions and asset management companies have filed multiple legal claims against Heta since then. The main reason for such legal actions has been that several bonds and Schuldschein of Hypo/Heta had been issued under the deficiency guarantees of the state of Carinthia and Kärtner Landesholding. Under such deficiency guarantees, a secured party may make a direct claim against the guarantor where the debtor is insolvent or where enforcement measures have failed or are likely to fail. In these cases, provided that the secured liabilities are due, a deficiency guarantor will be liable for payment.

Finally, these legal actions have been filed with the Frankfurt/Main Regional Court which has jurisdiction on the action on the basis of effective choice of law clauses in most bond and the Schuldschein loans terms, since the finance instruments issued by Heta and its legal predecessor are governed by German law.

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