

## **The Icesave conflict**

*By Lárus Blöndal, Supreme Court advocate and Stefán Már Stefánsson, professor at the Faculty of Law, University of Iceland.*

### **Introduction**

Iceland is committed to honour its International obligations. However, by doing so Iceland does not in any way forfeit its inherent and fundamental right to establish and defend its views on the extent of its obligations and indeed to retain its rights to instigate proceedings before Court of Law or if appropriate to go to Arbitration. The Icelandic Act No. 1/2010 (Icesave Act) on State Guarantee on Loans granted to the Depositors' and Investors' "Guarantee Fund" authorizes the Minister of Finance on behalf of the State Treasury to guarantee loans granted to the Depositors' and Investors' "Guarantee Fund". It is evident from the relevant Loan Agreements between Iceland, Britain and the Netherlands relating to the Icesave Act that legal aspects have been set aside. In the event that Iceland shoulders the claims demanded by Britain and the Netherlands without legal liability to do so it is paramount that the effect of any such claims agreed upon does not result in unusual hardship or even cause Iceland to become insolvent. Hence, it is of utmost importance to set out the legal reasoning on this issue. International obligations are determined solely by legal reasoning. If legal liability is not established in this instance or it is uncertain that such liability can be established then Iceland must not under any circumstances guarantee the above mentioned claims as it could result in extreme hardship for the nation at large or even jeopardize Iceland's sovereignty.

The following chapters summarize our principal legal reasoning in the Icesave dispute. We note that in the past few months we have already published nine Articles in Morgunbladid stating our legal reasoning on various aspects on the issue including those discussed herein. In Chapter II we examine if Iceland is liable under Directive 94/19 EC on Deposit-Guarantee Schemes, for deposits held in overseas branches of Icelandic banks in the event these banks become insolvent. Chapter III raises the issue whether Iceland discriminated against depositors in overseas branches of Icelandic banks and hence liable to pay damages. Chapter IV concerns the issue that the European Union could become liable on the grounds of adopting Directive 94/19 EC on Deposit-Guarantee Schemes and finally Chapter V raises the question if the above Loan Agreements constitute a breach or breaches of the Icelandic Constitution. We note that Chapter V was co-written by former Professor Sigurdur Lindal.

Since writing the above mentioned Articles, published in Morgunbladid, the Treaty of Lisbon has come into force and thus several Articles of the Treaty on European Union referred to below have been amended accordingly. We are of the view that this does not warrant an update at this point in time.

## **II**

### **Liability of Iceland under Directive 94/19 EC on Deposit-Guarantee Schemes**

We have come to the conclusion that Iceland is not liable for deposits in overseas branches of Icelandic banks in the event that these banks become insolvent. The liability lies solely with the Icelandic deposit-guarantee scheme, the Depositors' and Investors' "Guarantee Fund", a private

non-profit institution, established in compliance with Directive 94/19 EC on Deposit-Guarantee Schemes.

Our reasoning is as follows:

In accordance with Directive 94/19 EC the objective of the Deposit-Guarantee Schemes does not apply to the banking collapse of an entire nation, such as occurred in Iceland. Had it been the case that such an objective was intended, then enormous amounts of money, equalling a substantial percentage of the total yearly deposits, would have been required to be paid into the Icelandic Guarantee Fund in 2008. This is evident in paragraph 24 of the Preamble to Directive 94/19 EC (the paragraph deals with financing of deposit-guarantee schemes), which states, *inter alia*, that the financing must not “jeopardize the stability of the banking system of the Member State concerned”. In the light of the above the stability of the Icelandic banking system would indeed have been jeopardized. The financing required would have been out of all proportion. Hence, it is necessary to assume that Directive 94/19 EC inherently applies only to a medium sized crisis to avert a situation being created where funding guarantee funds would jeopardize the banking system concerned. The consequences of a banking collapse on Depositors’ and Investors’ Guarantee Funds will be addressed later in this article.

In Iceland specific statutory rules for funding the Icelandic Guarantee Fund are set out in the Financial Services and Markets-Act. No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme. The Act requires that the total assets of the Guarantee Fund’s Deposit Department amount to a minimum of one percentage (1%) of the average amount of guaranteed deposits in commercial banks and savings banks during the preceding year. There are no provisions prescribed in the relevant Directives stipulating the methods of financing the Guarantee Fund, except that the credit institutions must organize the financing themselves. It is noted that the EFTA Surveillance Authority has been duly notified of the specific statutory rules prescribed in the Icelandic Act No. 98/1999 in compliance with Directive 94/19 EC and to the best of our knowledge the Icelandic Authorities have not received in return any comments, reservations or requests. Hence, it is true to say that all requirements in this respect have been duly adhered to. The financing of the various guarantee funds within the European Economic Area vary and this will be addressed subsequently.

If the objective of Directive 94/19 EC is interpreted to include a purpose that depositors are to be paid in full irrespective of the extent of the crisis, small States, in particular, are at risk to be encumbered with enormous financial obligations which can jeopardize their sovereignty. Small States are much more at risk than large States in this scenario as their banks, when expanding and also raising finance in the international markets, may have achieved much more easily a disproportionate ratio of their respective national revenue than possible for banks from larger States. It defies common sense that such disparity between smaller and larger States could possibly be the objective of the Directive or the inherent consequence thereof.

There is no express stipulation in Directive 94/19 EC that Member States are liable for the obligations of their respective guarantee funds. For example, Article 7, paragraph 1 of the Directive states, *inter alia*, that “the aggregate deposits of each depositor must be covered up to ECU 20 000 in the event of deposits’ being unavailable”, whereas there is no stipulation of Member States obligation to pay. On the contrary, the Preamble to the Directive states that Member States may not be made liable in respect of depositors if they have established the mechanism ensuring the compensation or protection of depositors under the conditions prescribed in the Directive.

In view of the above Iceland is not liable for deposits held in branches of Icelandic banks in the event they become insolvent. Iceland has complied with all conditions prescribed in the Directive and hence is not liable on the grounds of non compliance. The extent of Iceland's liability under the Directive is limited to introducing legislative or administrative rules in compliance with the Directive and monitor that these are adhered to within their jurisdiction. If Iceland defaults in this respect Iceland can become liable to pay compensation, subject to the relevant rules relating to liability for damages. This sums up the extent of Iceland's liability under the Directive.

There has been some discussions relating to the interpretation of the Judgment (a Preliminary Ruling) No. C-220/02 of the Court of Justice of the European Community. The English Law Firm Messrs. Mischo de Reya referred to the Judgment in an advice given by them. The Judgment does not directly apply to the matter dealt with in this article. However, the judgment refers to the obligation of Member States to establish a guarantee fund and states that the States obligations are limited "to the introduction and proper functioning of the deposit guarantee scheme". The Judgment does not offer any interpretation on the phrase "proper functioning". Hence, we are of the view that the Judgment is limited in its application to interpret which conditions are required by the Member States when deposit-guarantee funds are established. However, the effect of the Judgment is that it emphasizes the fact that if the Member State complies with the requirements prescribed by the Directive to establish a deposit-guarantee fund it does not incur liability. This view is in conformity with the wording of the Directive as we have previously reasoned. It is appropriate to refer to Section 2 above where it was stated that Iceland notified the EFTA Surveillance Authority of the incorporation of the specific statutory rules and that no comments, reservations or requests were forwarded to Iceland in return.

To further our reasoning that Iceland is not liable for deposits held in branches of Icelandic banks in the event these banks become insolvent, the French Banking Commission in 2000 prepared a comprehensive report for the Central Bank of France. Jean Claude Trichet was then the Chairman of the Banking Commission, whereas currently he is the President of the European Central Bank. The report gives an overview of amendments to the French Banking Act of 1994 as from 1999 when Directive 94/19 EC on Deposit-Guarantee Schemes was adopted by France. On page 187 of the report in its English version it is stated:

"Although the goal of enhancing the stability of the banking system was clearly stated, the system introduced in France, as in most countries possessing formal deposit guarantee schemes, was not meant to deal with systemic crisis, for which other measures are needed".

Accordingly, it appears that the Central Bank of France was of the view that the French deposit-guarantee scheme does not apply to a crisis such as a banking collapse, as other measures are needed. The statement also indicates that France was adamant that it had ensured that the conditions prescribed in the Directive had been fully introduced, as otherwise it would not have enacted the Directive in the manner they did.

In autumn 2008 the European Commission stated, inter alia, in a press release, that the Member States deposit-guarantee schemes differ and that the Member States are at liberty to introduce a national measure best suited to their current banking system. There is no convergence in this respect as some deposit-guarantee schemes allow for immediate payment of deposits, whereas others delay payment. It was further stated that an investigation had taken place as to how efficient the various deposit-guarantee schemes were to deal with bank failures of different magnitude. It was observed that the majority (citation) of the deposit-guarantee schemes were ill equipped to deal with medium crisis (citation). Finally, it was stated that the Commission is

working on certain amendments, in particular, with respect to raising the minimum guarantee level of the deposit-guarantee schemes.

It is appropriate to note that in the autumn of 2008 Ireland decided to introduce a State Guarantee Scheme, as from 30 September 2008 until 29 September 2010, in addition to the already existing Irish deposit-guarantee scheme, which is comparable with the Icelandic deposit-guarantee scheme. The arrangement was designated to only six specific banks. Britain and other European Union Member States objected to this arrangement on the grounds that it constituted State Aid that would distort competition of banks within the European Union Area and hence not permissible. The view was taken by the above Member States that this applied to banks in Europe but, in particular, to banks in Ireland as not all Irish banks were recipients of the State Guarantee. The arrangement is currently being studied by the European Union. Ironically, States that criticized Ireland harshly have since the financial collapse introduced State Guarantees on deposits. More can be read on this on the Bloomberg Web Site, which reported on this issue on 1 October 2008, the Independent News Agency, which discussed the issue the following day, and the Guardian Newspaper on 2 October 2008. The above indicates that at the end of September 2008 the largest Member States of the European Union were of the view that it was not permissible to guarantee deposits by State Guarantee as it would distort competition in financial markets.

Based on the above, the Central Bank of France and the President of the European Union have indicated strongly that the Directive is not designed to deal with a systemic crisis such as banking collapse. In addition, some Member States have made reservations with respect to the legality of providing State Guarantees as well as the guarantee afforded by the deposit-guarantee schemes.

### **III**

#### **Discrimination on ground of nationality**

It has been argued that depositors in overseas branches of Icelandic banks have been discriminated against with respect to pay outs of deposits. We are not in agreement that this is the case and our reasoning is as follows:

Was there discrimination on grounds of priority granted to the depositors of the “old” banks?

Section 6 of Icelandic Act no. 125/2008 on Authority for Treasury Disbursements due to unusual Financial Markets Circumstances (the Emergency Act) stipulates that where division of an estate of a financial undertaking takes place pursuant to Financial Services and Markets - Act No 98/1999 on Deposit Guarantees and Investor - Compensation Scheme, claims for deposits shall have priority in accordance with Article 112, Paragraph 1 of Act No. 21/1991 on Bankruptcy.

In effect this constitutes a priority claim for depositors in financial undertakings, and they will be reimbursed out of the financial undertakings assets prior to all general claims. These provisions on prioritized claims apply equally to depositors in domestic and overseas branches of Icelandic Banks.

Hence the provision does not constitute discrimination against depositors in overseas branches of Icelandic banks as they find themselves in the exact legal position as depositors in Iceland who held deposits in the “old banks”.

**Did the Administrative Decision on taking over the banks constitute inherent discrimination?**

Section 1, Paragraph 3 of the Emergency Act authorizes the Minister of Finance, on behalf of the State Treasury, to establish a limited liability company to take over the administration of a financial undertaking. Accordingly, the Financial Supervisory Authority took over the three banks, Glitnir, Kaupthing and Landsbankinn in the autumn of 2008.

The Financial Supervisory Authority by Administrative Decision removed “domestic banking” from the old banks and government owned limited liability companies were established. All deposits were transferred to the limited liability companies irrespective whether these were held by domestic or foreign subjects. These limited liability companies are not guaranteed by the State in any way. The old banks are to be paid in full for their domestic banking section and the net proceeds will be paid into the respective estates of the old banks and distributed according to law.

It is assumed that depositors in the “new banks” consist of, in particular, subjects or corporations that reside, work or conduct business in Iceland. It is essential for the existence of every sovereign State that there are banking institutions, closely connected to the State, operating within the jurisdiction providing services such as interest bearing deposit facilities and financing for domestic projects. It is true to say that this prerequisite is essential for a Sovereign State to be able to operate and indeed to exist as such.

The question arises if the above mentioned Administrative Decision discriminated against depositors in overseas branches of Icelandic banks in comparison with depositors in the same banks operating within Icelandic jurisdiction.

It is important to note that States are independent entities in accordance with the laws of the European Economic Area and the European Union and that the Member States are the foundation and creators of the pillar structure of the Agreement on the European Economic Area and the Treaty on European Union. Their rights and the continuity of their Sovereignty are expressly secured in the Treaty on European Union and further, the Agreement on the European Economic Area is an Agreement between Sovereign States and the European Union. It is noteworthy to mention in this context that institutions that are operating under the respective Agreement and the Treaty must act strictly within the limits of the powers conferred upon them under the said instruments.

The Maastricht Treaty requires the European Union to honour the Member States national identities and their difference in governance as the continuity of their Sovereignty was taken into consideration in various ways. This is even more important for Member States of EFTA/EEA as these States have not been a part of the process of increasing transnational identity which the European Union aims for. Thus, it is permissible and lawful to take into consideration the imminent economic interests of a Member States without equally taking into consideration the economic interests of another Member State where urgency is not paramount. It is apparent that each Member State is given powers to protect the continuity of its Sovereignty in accordance with the Treaty of European Union and the Agreement on the European Economic Area.

The Administrative Decision made by the Icelandic Authorities was clearly considered necessary to protect and maintain the domestic banking system. The Administrative Decision would have been impossible to carry out if it guaranteed depositors in overseas branches of Icelandic banks the same treatment. The depositors in the overseas branches did not by any means have the

equivalent financial concerns with Iceland as those that held deposits in the domestic branches. Had the Administrative Decision applied to depositors in the overseas branches then they would, in all likelihood, have cashed in their deposits and hence disabled the domestic banking system. It is both unrealistic and unfair to expect that the depositors in the overseas branches would have cashed in Icelandic krona's and then circulated the money within the Icelandic economy in the same way as the depositors in the domestic branches.

The main issue is that depositors in the overseas branches, for ex. in Britain and the Netherlands, are not by any means as reliant on Icelandic interests as subjects and corporations residing in Iceland. This applies, in particular, to investments, taxation, social security and other services.

The fact of the matter is that depositors in the overseas branches were in a different position to the depositors in the domestic branches of the same Icelandic banks. The legal status of the two classes of depositors, namely, the depositors in the overseas branches on the one hand and the depositors in the domestic branches on the other, was not compatible. Hence, the Administrative Decision did not constitute discrimination.

It is important to note that it is well established in European Union law that decisions that are inherently discriminatory can be justified on the grounds of social requirements in the general interest. To enhance our reasoning the European Court of Justice has considered numerous cases on this very point. It is beyond reasonable doubt that if it is concluded that economic collapse was imminent the exemption is justified.

The justification for the exemption is always conditional on the principal of proportionality. It is difficult to comprehend that Iceland would have had an alternative measure available. It is noted herewith, that the case law suggests that the European Court of Justice has become more relaxed in its approach and has taken the view that Member States are somewhat in a position to evaluate that the aforesaid requirements have been fulfilled.

### **Did the Declaration by the Prime Minister of Iceland on State Guarantee for payment to depositors constitute inherent discrimination?**

In late 2008 the Prime Minister declared that Iceland would guarantee depositors payment of their deposits in domestic branches. The Declaration puts forward obligations over and above what Iceland was required to shoulder. The reason for the Declaration is presumably to ensure that domestic banking would continue, to encourage private savings, to ensure economic stability and prevent economic collapse.

The Declaration is not legally binding as it was never incorporated into law (The Declaration must be incorporated into the national budget, the supplementary budget or into general legislation) and it was not acted upon in any way. On the contrary depositors in the "new banks" must accept that that the banks are limited liability corporations and hence their liability is limited by the Bankruptcy Act.

Therefore, the said Declaration does not fall within the scope of Article 4 of the Agreement on the European Economic Area nor any other special provisions on the four freedoms contained therein. No further comments on this issue are warranted as we have already in previous articles reasoned that Declarations, such as the one referred to above, do not fall within the scope of Article 4 of the Agreement.

## **Conclusion**

It is apparent from the above that the Icelandic Authorities did not discriminate against depositors in overseas branches of Icelandic banks, and hence did not incur liability to pay out the deposits. This applies equally in relation to the Emergency Law, the Administrative Decision on taking over the banks and the Prime Ministers Declaration on State Guarantee for payment to depositors.

## **IV**

### **Possible liability of the European Union under Directive 94/19 on Deposit-Guarantee Schemes**

#### **The principle of legitimate expectations under European Union Law**

The rule on legal certainty is one of the principal rules in European Union law. Primarily it reflects the elementary concept that the law is clear, precise and foreseeable. The principle of a legitimate expectation is ancillary to the general principle of legal certainty. Both these principles form a part of non-written sources of European Union law and have been identified and applied by the European Court of Justice. The European Union institutions are bound by these non-written sources of law to the same extent as if they were stipulated in the written European Union Law. The main reasoning is that those bound to comply with the law must be assured of the legislative implications, to enable them to plan ahead their strategy in the commercial market. It is of paramount importance in commerce to draw up future strategic plans. Hence, it is essential that the relevant legislation is clear and precise in order to avoid legal uncertainty which in return promotes successful commercial action.

Anyone involved in the commercial market can, in certain circumstances, rely on the protection mechanism of legitimate expectations if any of the European Union institutions has created expectations with respect to specific matters. Commitments, instructions, Declarations or other documentation originating from European Union institutions can create legitimate expectations. Hence, it can be said that the prerequisite for the principle to apply is that certain legitimate expectations arose as a result of some conduct engaged in by European Union institutions. It is essential that an interconnection be established for the principle to apply.

Further, the principle of legitimate expectations can only apply if the expectations are legitimate, i.e. the criteria that they are justifiable from an objective point of view must to be fulfilled. Therefore, the main criteria, in this instance, is, if a reasonable person of reasonable experience and knowledge would, justifiably, base the decision making on the expectations created.

It is noteworthy, that in European Union law secondary legislation as well as administrative actions can establish (create) legitimate expectations. Secondary legislation that encourages individuals in the commercial markets to pursue certain actions or pledges of innocuity, can establish legitimate expectations in response to circumstances that may arise that the individual could not reasonably foresee or expect.

The argument is that those acting upon representations made by European Union institutions that turn out to be unfounded should not suffer any damage. Therefore, such representations can establish liability for loss suffered. Case law on this point is, for ex., the 1988 Judgment of the European Court of Justice on page 2321 (Case no. 120/86 J Mulder v Minister van Landbouw en Visserij, see also 2005 Judgment no. C-342/03 at page 1975, Spain v European Council).

The conclusion is that representations in European Union secondary legislation, in this case Directives, can establish legitimate expectations, both for individuals and corporations, which confer a right to damages, subject to other prerequisites being fulfilled.

### **Liability of European Union Institutions**

Article 235 of the Treaty on European Union stipulates that the European Court of Justice shall have jurisdiction in non-contractual liability proceedings instituted against the European Union caused by its institutions and/or its servants, when performing their duties. Further grounds for establishing liability are stipulated in Article 288, paragraph 2 of the Treaty. The Article stipulates, *inter alia*, that the Treaty itself does not contain any express provisions on liability but refers to the national laws of the Member States. The European Court of Justice must therefore develop a category of harmonized general rules through its case law. The express reference to Article 288, paragraph 2, provides, that the various national legislations of the Member States will form the basis of non-contractual liability in European Union law.

Thus, the European Court of Justice is bound by the harmonized general rules of law of the Member States, for. ex. such as the principles of causality, damage, negligence etc. For liability to arise a breach must have occurred. The breach or any other potential grounds of liability must be obvious and significant conferred rights must be at stake for the individual in question. The necessity for strict conditions to establish liability are essential to enable the European Union institutions to fully function in their decision making without liability issues becoming too burdensome. This is relevant, in particular, when general rules are being established. Claimants must therefore accept within reason, that their rights can be limited. On the other hand legitimate expectations can beyond doubt establish the right to damages against the European Union institutions as the European Court of Justice case law has shown.

The right to instigate proceedings before the European Court of Justice is wide. Those residing or established in a Member State are entitled to instigate proceedings if they believe that their rights have been infringed upon. It appears that others are entitled to instigate proceedings, subject to certain conditions being fulfilled, for. ex. corporations outside the European Union alleging that the European Commission has committed a breach against them. The Statue of Limitation is also wide, five (5) years, from the alleged incident constituting liability. In the case of Iceland the time limit extends as from the time when the banks became insolvent, i.e. October 2008.

The conclusion is that the European Union institutions are liable for their actions, including liability for secondary legislation, such as Directives. The liability of the European Union can also extend to non Members.

### **Does Directive 94/19 EC on Deposit-Guarantee Schemes constitute liability per se?**

The Preamble of Directive 94/19 EC states, *inter alia*, that “when restrictions on the activities of credit institutions are eliminated, consideration should be given to the situation which might arise if deposits in a credit institution that has branches in other Member States become unavailable”. It is essential in such instances to ensure a harmonized minimum level of deposit protection irrespective of where the depositors are located within the European Union. To implement such deposit protection is equally as important as the prudential rules for the completion of a common market. The Preamble also states that the “deposit-guarantee schemes must intervene as soon as

deposits become unavailable”. The minimum deposit guarantee is also considered and the Preamble states that it appears reasonable to set the harmonized minimum guarantee level at 20,000 Euros. This is incorporated in Article 7 paragraph 1, which states, inter alia, that “Deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to ECU 20 000 in the event of deposits’ being unavailable”.

The Preamble expressly states that Member States are not liable to depositors, if they have introduced deposit guarantee schemes that ensure depositors compensation that is in compliance with the conditions prescribed in the Directive. The main reasons why Iceland is not liable under the Directive have already been set out above. It is important to note in this context that the Directive does not stipulate in any way or form how the deposit-guarantee schemes are to be financed. Inevitably this can cause delays in pay outs, in particular, in situations such as a banking collapse as occurred in Iceland. It appears that the French Banking Commission supports this view and to some extent the European Commission as set out above.

It appears that the European Union has removed all limitations to establish credit institutions within the European Union (and in the EEA Area) and alleviated restrictions on commercial activities. By adopting the Directive the European Union has effectively assured depositors in branches of credit institutions situated in a Member State other than where the credit institution has its head office, that they have nothing to fear as the minimum deposit guarantee will always come into effect in such instances. As indicated above this has not always been the case as there have been instances where deposit-guarantee schemes have not been able to fulfil their promises. On the other hand it is possible that the express wording of the Directive has established legitimate expectations with respect to the depositors in question. In return, the said expectations can establish liability for the European Union institutions as has already been set out above.

## **Conclusion**

The wording of the Directive is unequivocal with respect to the minimum amount of the harmonized guarantee level and the guarantee funds are liable but not the Member States. The unequivocal wording has proved to be unfounded, whereas the representation made in the Directive constitutes legitimate expectations for depositors.

## **Additional comments**

The view can be taken that the European Union has incurred liability in regard to depositors, based on the fundamental principle of legitimate expectations, by adopting the Directive without simultaneously establishing a mechanism which guaranteed depositors payments of the minimum harmonized amount stipulated in the Directive.

If Iceland pays, in full or part thereof, claims derived from administrative declarations on liability, Iceland gains the legal status of the depositors in question and thereby has the right by way of subrogation to instigate compensation proceedings against the relevant European Union institutions before the European Court of Justice .

## **SUMMARY**

1. Chapter II concludes that Iceland is not liable for deposits held in overseas branches of Icelandic banks in the event these banks become insolvent, whereas the Icelandic deposit-guarantee scheme, the Depositors' and Investors' "Guarantee Fund" is.

This is based primarily on the fact that Directive 94/19 EC does not contain any provisions imposing on Member States liability in the event of a banking collapse of such magnitude as occurred in Iceland. To the contrary, it is expressly stipulated that Member States are not liable. A Member State can only become liable if it has omitted to establish a system that fails to comply with the conditions set out in the Directive. If such omission is evident a Member State can become liable to pay compensation, subject to the relevant rules relating to liability for damages. However, in the case of Iceland there are no circumstances that indicate non compliance.

To further Iceland's case, the Central Bank of France and the President of the European Commission have both indicated strongly that the deposit-guarantee schemes established in Member States in compliance with the Directive are not designed to deal with crises such as the collapse of the banking system of a whole nation. In addition, some Member States have made reservations with respect to the legality of providing a State guarantee as well as the guarantee afforded by the deposit-guarantee schemes as such measures have the potential to prove prejudicial to competition in the financial markets.

2. Chapter III raises the issue of discrimination, firstly on the basis that the Icelandic Government guaranteed payments of deposits held in Iceland and secondly that an administrative decision was made to take over the three Icelandic Private banks.

It was considered that in both instances no discrimination had occurred and that Iceland was not liable to pay deposits held in overseas branches. To emphasize this further, the adoption of the Emergency Laws, making administrative decisions to take over the three banks or any other statements made by Ministers with respect to the State Guarantee for deposits did not establish discrimination.

3. Chapter IV emphasized that the European Union could become liable to depositors on the basis that they had a legitimate expectation when the Union adopted Directive 94/19 EC and simultaneously omitted to explain the potential consequences in the case of a systemic financial crisis.

In the event that the Icelandic Government repays the deposits held in the overseas branches in full or part thereof as a result of its Declarations of Liability it will establish the right to initiate proceedings for damages before the Court of Justice of the European Community against the relevant institutions of the European Union.

4. Chapter V concludes that it is likely that the so called Icesave Act, Icelandic Act No: 1/2010, which neither stipulates expressly the exact obligations placed on the Icelandic State nor sets out any time limit on the State Guarantee therein, is in breach of Article 40 of the Icelandic Constitution, which states, inter alia, that the Icelandic State cannot be indebted, except by authority in law. In addition, the Icesave Act could also arguably constitute a breach of Article 2 of the Constitution by inherently limiting the legislative powers of the Icelandic Parliament and as a further result thereof limit the Sovereignty of Iceland over and above what the Constitution allows for.