**The High Court**

**Record No.: 2011 239 MCA**

**IN THE MATTER OF IRISH LIFE AND PERMANENT GROUP HOLDINGS PLC ("ILPGH" OR THE "COMPANY")**
**AND IN THE MATTER OF IRISH LIFE AND PERMANENT PLC ("ILP" OR "PTSB" OR THE "BANK")**
**AND IN THE MATTER OF THE CREDIT INSTITUTIONS (STABILISATION) ACT, 2010 (THE "2010 ACT")**
**AND IN THE MATTER OF THE SETTING ASIDE, PURSUANT TO SECTION 11 OF THE 2010 ACT, OF THE DIRECTION ORDER IN RELATION TO ILPGH AND ILP, WHICH WAS MADE ON 26 JULY 2011 PURSUANT TO SECTION 9 OF THE 2010 ACT (THE "JULY 2011 DIRECTION ORDER")**
**AND IN THE MATTER OF SECOND COUNCIL DIRECTIVE 77/91/EEC**
**AND IN THE MATTER OF DIRECTIVE 2001/34/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**
**AND IN THE MATTER OF DIRECTIVE 2009/101/EC OF EUROPEAN PARLIAMENT AND OF THE COUNCIL**
**AND IN THE MATTER OF DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**
**AND IN THE MATTER OF DIRECTIVE 2004/39/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**
**AND IN THE MATTER OF ARTICLE 63 OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION**
**AND IN THE MATTER OF ARTICLE 267 OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION**

**BETWEEN**

**Gerard Dowling, Padraig McManus, Piotr Skoczylas and Scotchstone Capital Fund Ltd**

**Applicants**

**AND**

**The Minister for Finance (the "Minister")**

**Respondent**

**Replying / Supplemental Affidavit of Professor Dr. Ted Azarmi**

I, Ted Azarmi, Professor of Finance and Accounting, of Hauptstraße 37, D-74206 Bad Wimpfen Germany, aged eighteen years and upwards hereby MAKE OATH and say as follows:

1. I am Professor and Chair of International Finance and Accounting at the University of Heilbronn and an Adjunct Professor at the Eberhard Karls University of Tübingen, Germany.

2. I have prepared an expert affidavit in relation to the issues arising in the proceedings herein.

3. I make this affidavit from facts within my own knowledge, save where otherwise appears and where so appearing I believe the same to be true and accurate.

4. I beg to refer to the proceedings already had herein and to various affidavits sworn in the proceedings (to which I have already referred in my previous affidavit sworn on 5th December 2013), including the most recent affidavit of Rose McHugh sworn on 20th December 2013, which I have duly considered.

5. The abbreviations I use in this affidavit, such as ILP or ILPGH, have the meaning defined in my affidavit sworn on 5th December 2013.

6. Footnotes in this affidavit in italics denote selected original footnotes from the quoted text.

**DECLARATIONS**

7. I declare that:

(a) I understand that my duty in providing this Affidavit is to help the Honorable Court, and that this duty overrides any obligation to the party by whom I am engaged. I confirm that I have complied and will continue to comply with my duty.

(b) I confirm that I have not entered into any arrangement where the amount or payment of my fees is in any way dependent on the outcome of these proceedings.

(c) I know of no conflict of interest of any kind, other than any which I have disclosed in this Affidavit. I do not consider that any interest which I have disclosed affects my suitability as an expert witness on any issues on which I have given my views.

(d) I will advise the party by whom I am instructed if, between the date of this Affidavit and the trial, there is any change in circumstances which affect my views as set out in this Affidavit.

(e) I have shown the sources of all information I have used.

(f) I have exercised reasonable care and skill in order to be accurate and complete in preparing this Affidavit.

(g) I have endeavored to include in this Affidavit those matters, of which I have knowledge or of which I have been made aware, that might adversely affect the validity of my opinion. I have clearly stated any qualifications to my opinion.

(h) I have not, without forming an independent view, included or excluded anything which has been suggested to me by others.

(i) I will notify those instructing me immediately and confirm in writing if, for any reason, this Affidavit requires any correction or qualification.

(j) I made clear which facts and matters referred to in this Affidavit are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

**THIS AFFIDAVIT**

8. I say and believe that the replying affidavit of Ms. McHugh appears to show that the Respondent and his proxies[1] have failed to understand key aspects of my affidavit sworn on 5th December 2013.

9. In the context of all the extensive materials provided on behalf of the Respondent and his proxies in these proceedings, I say and believe that the efforts on behalf of the Respondent and his proxies appear to be aimed at obfuscating and obscuring the key matters in the proceedings. Many statements on behalf of the Respondent and his proxies are simply not credible and fly in the face of undeniable facts. This affidavit is aimed at further addressing those matters in order to assist the Court. I have further studied and analyzed in-depth the Company's accounts and other documents, which I refer to in this affidavit.

10. For the assistance of the Court, I have structured this affidavit in the following sections:

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[1] Such as ILPGH and ILP, which now, under the regime of the direction orders forced by the Minister, support the Minister in proceedings regarding setting aside those direction orders. I note that, in essence, the fact that direction orders were made and put ILPGH and ILP under an effective control of the Minister for the far-reaching purposes of the direction orders has as a result that ILPGH and ILP support the Minister in court in defending the direction orders in question. In respect of the direction order of 26th July 2011, that means that ILPGH and ILP are now allowed to act against the decisions of the ILPGH EGM of 20th July 2011, which decided to oppose the terms of the takeover of ILPGH which subsequently became the terms of the direction order of 26th July 2011. I say and believe that <u>that is an astounding state of affairs because it means that the sheer fact of forcing a direction order allows the Minister to enlist the company in question (which he controls after having forced the direction order) in defence of legal proceedings regarding setting aside the direction order in question, despite the decisions of the company's general meeting to oppose the terms of the direction order in question</u>. This <u>self-fulfilling</u> machinery of a direction order regime, which is beyond comprehension for an objective outside observer such as me, sheds light on the unparalleled nature of the regime. I elaborate further down in this affidavit on the fact that, following the recent banking crisis, there is not a single example anywhere in the EU of draconian measures parallel to those undertaken against the ILPGH shareholders, based on <u>precautionary</u> capital requirements resulting from extreme assumptions embedded in stress tests <u>scenarios,</u> in order to restore / preserve a long-term strength of a company that was a solvent going concern and had never been subject to execution measures, such as liquidation, intended to put an end to the company's existence, and whose organs have never been suspended, and which never had been subject to a special management or compulsory administration.

**SYNOPSIS**

11. **Evidence shows that in the context of the recent banking crisis and the need for a common EU resolution regime for troubled banks, it is universally acknowledged by the European Commission, the Central Banks and the academics that increasing capital in a financial institution[2] without shareholders' approval is currently unequivocally prohibited by the Second Company Law Directive. This is also confirmed by relevant precedent recapitalizations in the EU.** Furthermore, it is commonly acknowledged that, under the Second Company Law Directive, the shareholders are guaranteed pre-emption rights over newly issued shares.

12. **The European Commission explicitly confirmed that EU company law is a cornerstones of the internal market**. It facilitates establishment of companies while enhancing transparency, legal certainty and control of the company operations. The Commission also explicitly confirmed that ensuring

[2] Which is a public limited company.

effective and proportionate protection of shareholders and third parties must be at the core of any company law policy.

13. **Evidence shows that it is widely acknowledged that there are currently no abrogation provisions in EU law that would allow the State to violate the minimum shareholder protections under EU law, such as those embedded in the Second Company Law Directive. Violating those minimum protections, with an effect of adversely affecting property rights, cannot be tolerated under any circumstances, because it would de-stabilize the foundations of the EU economic and financial system. If property rights could be deemed to be capable of being violated in a manner incompatible with EU law as it stands, then eventually investors would significantly limit investments in the EU financial institutions, which constitute one of the largest single sectors of the EU economy. Such decrease in the investments in the financial sector would have hugely negative consequences for the public interest across the whole European Union and for the Union's competitive position vs. other economic blocks, such as the US or Asia. The consequence would be a significant increase in risk factors and the premium assigned to investments in the EU financial institutions, which would result in increases in interest rates. That would then slow down an economic growth in the EU, which would then increase unemployment across the EU. Another recession would be likely to follow.** Thus, abrogating shareholder rights in an arbitrary manner incompatible with EU law as it stands can in fact de-stabilize the EU financial system. This is tragically paradoxical, given that the stated aim of such misconceived abrogation is purportedly to stabilize the system.

14. **The European Court of Justice has determined that a decision adopted by the European Commission under Article 108 TFEU (in respect of State aid) cannot be interpreted as authorizing the Member State to whom it is addressed to maintain in force, even if only provisionally, a national provision which is contrary to the Second Council Directive 77/91/EEC.**

15. Evidence shows that the recent banking crisis was global and affected all the banks in the world, given the interdependencies among the banks globally. Consequently, most banks in the world suffered from a combination of liquidity and/or solvency problems. **In this context, it is misleading to suggest that the Irish banks, or – even less so – ILP was unique. Evidence shows that it was not so. Each bank has, of course, its individual business model and individual set of challenges associated with that business model. However, all the banks suffered from similar global structural problems during the recent global banking crisis. In light of the recent global banking crisis, most of the banks in the world can be said to have been unable to survive if they had not been supported by the national authorities and by coordinated international efforts.**

16. Since its inception, the Company has continued to exist with its own structures. General meetings of shareholders and the Board of Directors, which are the key organs of the Company, have never been suspended. The Company has never been subject of special management under part 3 of the 2010 Act or of a compulsory administration. ILPGH has never been subject of execution measures, such as liquidation, intended to put an end to the Company's existence.

17. The context of the ILP / ILPGH recapitalization in July 2011 was that the audited accounts under the International Financial Reporting Standards showed that ILPGH was a solvent going concern before the July 2011 Direction Order. **No inherent capital holes were discovered by the Central Bank of**

**Ireland as a result of the March 2011 PCAR/PLAR stress tests; there was no sudden loss of capital that had to be remedied. The Irish authorities acknowledged the <u>precautionary</u> nature of the capital requirements resulting from extreme assumptions embedded in stress test scenarios. The recapitalization of Irish banks in July 2011 was based on a temporary conflation of extreme <u>precautionary</u> measures, i.e. a combination of extreme assumptions embedded in the March 2011 stress tests and the increased tier 1 capital ratio requirements**. An incredible difference between provisions and actual realized losses has been created at ILP; the provisions have been 25 times larger than the realized losses at ILP for the period from January 2010 to June 2013. For the same period, the net provisions have been twice the net realized losses at Bank of Ireland.

18. **Measures undertook against the ILPGH shareholders were unprecedented in the EU. It is plainly incorrect – and without any substantiation in fact – to claim that, as a result of the recent global banking crisis, any EU government undertook (as a precaution) compounded measures that would be similar to those committed against the ILPGH shareholders. Evidence shows that there is <u>not a single example</u> (other than that of ILPGH) of a situation where shareholders of a company that was a going concern were diluted from 100% to less than 1% because an EU State decided, against the decisions of a general meeting, to increase the number of outstanding shares 130-fold (!) (i.e. by 13,000%(!)) and to issue shares below the nominal value (i.e. to forcibly change the memorandum and articles of association to lower the nominal value, and to concurrently issue the shares below the original nominal value), without offering the shareholders their statutory pre-emption rights. <u>Evidence shows that the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible in any other EU Member State</u>.**

19. Furthermore, the ILPGH shareholders are shareholders in a bank's holding company – not in a bank. Yet, the Minister ignores the separate legal personality of ILPGH in this case. The Minister wishes to make the ILPGH shareholders responsible for the potential future debts of ILP, while at the same time arguing that the value of the assets belonging to ILP should not be credited to the ILPGH shareholders as their contribution to the recapitalization. The Minister cannot have it both ways because it would be unreasonable and illegal. The Irish State appears to respect the separate legal personality of ILPGH only when it suits the Minister – it is the Minister who arbitrarily determines at which point in time which of the group companies is relevant for direction orders effected by the Minister, with disregard for the impact his actions have on the key affected party, i.e. the ILPGH shareholders. And the Minister does it while being in full control of all the group companies in question.

20. The Proposal for a Directive of the European Parliament and of the Council establishing a future framework for the recovery and resolution of credit institutions and investment firms (the "RRD") is not the law at present – and was not the law in 2011. **Had the investors known in 2011 that law that was in force in 2011 (and continues to be in force currently), including the minimum shareholder protections embedded in the Second Company Law Directive, would be deemed not to have been in force, then those investors would have likely not invested into ILPGH. The minimum shareholder protections embedded in EU law, such as those included in the Second Company Law Directive, unequivocally did apply to the ILPGH shareholders (and to the Minister) in July 2011 (and continues to apply to them now), and that is the basis on which the shareholders made their investments in ILPGH. Without prejudice to the foregoing, I have concluded upon analyzing the RRD proposal** (which is not in force) **that the averments on behalf of the Minister and his proxies**

**regarding the RRD proposal are misconceived and misleading. Contrary to those misconceived arguments, the RRD proposal does not justify in any way the actions of the Minister in respect of the July 2011 Direction Order. On the contrary, the RRD proposal clearly shows the unreasonableness and excessiveness of the Minister's actions.**

21. Without prejudice to the universality of the aforementioned ban on capital increase without shareholder approval, it is important to differentiate between exceptional intrusive resolution measures in lieu of bankruptcy at a failed institution, on the one hand, and precautionary recovery measures to preserve / restore a long-term strength of a viable institution, on the other hand. Those principles are embedded in the RRD. While the RRD is not in force and it cannot be in any way applied to these proceedings, it is instructive that, even under the stringent terms / principles of the RRD, the Minister's actions would be misconceived and unjustified.

22. Academic research shows that excessive actions incompatible with EU law, undertaken against shareholders, can (paradoxically) contribute to de-stabilizing the EU economic order and financial stability.

**SHAREHOLDER PROTECTION**

**I. <u>Universally acknowledged ban on capital increase without shareholder approval</u>**

23. **In the context of the recent banking crisis and the need for a common EU resolution regime for troubled banks, it is universally acknowledged by the European Commission, the Central Banks and the academics that increasing capital in a publically limited company (e.g. a bank or its holding company) without shareholders' approval is currently unequivocally prohibited by the Second Company Law Directive.** Furthermore, it is also commonly acknowledged that, under the Second Company Law Directive, the shareholders are guaranteed pre-emption rights over newly issued shares. Following are the supporting facts and evidence in these regards:

    A. The document issued on 20th October 2009 by the European Commission entitled "Impact Assessment Accompanying the Communication from the Commission on an EU Framework for Cross-Border Crisis Management in the Banking Sector" states the following[3]:

    *"Banks are subject to general company law rules and in particular certain rules aimed at the protection of the company's shareholders. <u>At European level, there are **mandatory requirements** on the shareholders' approval of any increase or reduction of capital as well as rules on shareholders' pre-emption rights in the Second Company Law Directive</u>. ... Finally, there are also requirements at national level in a number of Member States, such as the requirement to have any material transaction approved by the general meeting."* (Emphasis added).

    I beg to refer to the above-mentioned publication from the European Commission, upon which marked with the letters "**TA1**" I have signed my name prior to the swearing hereof.

[3] Page 32 of the said document.

B. The Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms[4], which was issued by the European Commission on 6th June 2012, states the following:

*"The Second Company Law Directive requires that any increase in capital in a public limited liability company be agreed by the general meeting, while Directive 2007/36 (the Shareholders' Rights Directive) requires a 21 day convocation period for that meeting. **Restoring the financial situation of a credit institution rapidly by means of capital increase is therefore not possible**. ... **Moreover, Company Law Directives require that increase and decrease of capital, mergers and divisions are subject to shareholders' agreement, and pre-emption rights apply whenever the capital is increased by consideration in cash. In addition, the Takeover Bids Directive requires mandatory bids when any person – including the State - acquires shares in a listed company above the control threshold (usually 30-50%).**"*[5] (Emphases added).

I beg to refer to the above-mentioned Proposal for the Directive, upon which marked with the letters "**TA2**" I have signed my name prior to the swearing hereof.

C. The Central Bank of the Netherlands stated the following in its publication entitled "Crisis Management Tools in the EU (2011)":

*"**it is generally not possible to recapitalise banks without shareholder approval in the EU, since this would interfere with the Second Company Law Directive** ... EU countries generally have no recapitalisation instrument at their disposal, since this would conflict with the Second Company Law Directive ... As long as recapitalisation is not compatible with European law, individual EU countries should strive to introduce share transfer powers to facilitate at least a full take-over of a troubled bank."*[6] (Emphases added).

I beg to refer to the said publication by the Central Bank of the Netherlands, upon which marked with the letters "**TA3**" I have signed my name prior to the swearing hereof.

D. Jean-Claude Trichet, then the President of the European Central Bank, stated the following in respect of a bank recovery regime in his aforementioned speech at the Paris Court of Appeal on 7th December 2009[7]:

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[4] The Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010; COM(2012) 280 final 2012/0150 (COD). EU finance ministers reached agreement on the directive on 27th June 2013. Subsequently, an agreement was reached on 12th December 2013 between the European Parliament, EU Member States and the Commission; this political agreement is subject to technical finalisation and formal approval by the co-legislators. According to the European Parliament / Legislative Observatory, the indicative plenary sitting of the European Parliament for the first reading is scheduled for 25th February 2014.

[5] Page 17 of the Proposal of the Directive.

[6] Pages 13, 14, 22 and 26 of the said paper.

[7] The said speech is referenced below in this affidavit.

*"… a restructuring may affect property rights and other fundamental shareholder rights. These rights are guaranteed by national legislation and international law.* ***It is therefore essential that the restructuring is based on a legally sound and clear framework that fully respects the rights of stakeholders****. The courts play a central role in controlling the legality of measures and ensuring that fundamental rights are respected.*

***Let me add that the EU company law itself can be a barrier to rapid restructuring because it requires a general meeting be convened in order to make decisions regarding the company, such as an increase in capital, a merger or a demerger****."* (Emphases added).

E. Valia SG Babis stated the following in the September 2012 publication from the University of Cambridge, Faculty of Law, entitled "Bank Recovery and Resolution: What About Shareholder Rights?" [8]:

*"… national recovery and resolution tools established outside the Draft RRD[9] framework cannot supersede shareholder rights established at EU level. This was demonstrated in the Pafitis case, where the ECJ rejected the "public interest" arguments put forward and refused to derogate from shareholders' rights to decide on capital increase and shareholders' pre-emption rights, in the case of bank reorganization. The ECJ emphasized that the Second Company Law Directive provides no exemptions from shareholder rights for bank restructuring measures. The Draft RRD resolves the issue by modifying the Second Company Law Directive for banks in resolution, and removing the requirements for shareholder approval of capital increase in resolution. However,* ***modifications to EU Directives only apply to resolution tools which are included in the draft RRD, and not to resolution tools under national legislations****."*[10] (Emphases added)

I beg to refer to the said publication by the Faculty of Law, University of Cambridge, upon which marked with the letters "**TA4**" I have signed my name prior to the swearing hereof.

F. Professor Kern Alexander (Queen Mary College, University of London; and The Centre for Financial Analysis and Policy, University of Cambridge) stated the following in the Journal of Corporate Law Studies in the work entitled "Bank Resolution Regimes: Balancing Prudential Regulation And Shareholder Rights" (April 2009):

*"Under EU law, regulators are restricted from acting quickly in restructuring a bank which is not insolvent without ex ante shareholder approval. For instance, if a regulator requires a bank to recapitalise itself by issuing new shares, the Second Directive requires that a majority of shareholders approve the recapitalisation and that the shareholders have pre-emption rights over the newly issued shares. Although most EU state regulators have authority to take measures that*

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[8] Paper No. 23/2012, September 2012; Faculty of Law, University of Cambridge. The paper was presented at the 4th Cambridge International Financial Regulation and Governance conference (6 September 2012).

[9] RRD refers to the 'Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms' [2012] COM(2012) 280/3.

[10] Pages 26 and 27 of the said publication.

*may affect shareholder control or economic rights, they must ordinarily obtain majority approval by shareholders."*[11]

*"In Pafitis, the European Court of Justice ruled, inter alia, that Art 25 of the Directive (77/91/EEC), requiring that an increase in capital of a public limited liability company be approved by a general meeting of shareholders, precluded national legislation under which a temporary administrator outside insolvency could order in exceptional circumstances a bank organised as a public limited liability company to increase its regulatory capital to protect depositors without approval of a general meeting of shareholders."*[12]

*"The exercise of regulatory powers in a special resolution regime raises a number of important legal and regulatory issues regarding how to balance prudential regulatory objectives and shareholder rights. To examine this, it is necessary to analyse the substance and scope of shareholder rights under the ECHR and European Community law."*[13]

*"the Second Company Law Directive provides shareholders in a public limited liability company with the right to approve any proposal by the board or other party to increase or reduce the share capital of the company. Moreover, the Directive lays down procedures for an offer of subscription on a pre-emptive basis which must be offered to the shareholders of a public limited liability company whenever the capital is increased by consideration in cash. This raises the important issue of pre-emptive rights for shareholders in public companies and how it is regulated under EC law. Pre-emptive rights entitle a shareholder to be offered the right to purchase a proportionate number of shares in order to maintain its percentage of ownership and voting control. By having the right to approve the decision of directors to alter the company's capital, shareholders can attach conditions to the issuance of new shares which can prevent the dilution of their equity interest in the company and the loss of their control rights."*[14]

*"EU Company Law Directives provide strong protections for certain shareholder rights. The Second Company Law Directive (Second Directive) contains the rules for formation of a public limited liability company and for the equal treatment of shareholders who own the same class of shares in approving the capital structure of their company. To this end, Article 25(1) requires that the shareholder general meeting approve any alteration, increase or decrease in the company's subscribed capital. Moreover, shareholder approval at the general meeting is required to authorise the board to restrict or withdraw the pre-emption rights of existing shareholders. Indeed, a shareholder's right to maintain its proportional share of its holding in the issued capital of a public limited liability company has been recognised by the European Court of Justice (ECJ) as an inherent right for shareholders … The ECJ has interpreted the Second Directive as protecting the rights of shareholders against any change without approval of the company's capital structure, internal governance procedures and formation. The most important ECJ case to deal with regulatory intervention in the governance of a banking company's capital structure was Panagis*

[11] Pages 76 and 77 of the said paper.

[12] Footnote 1 on page 62 of the said paper.

[13] Page 66 of the said paper.

[14] Page 68 of the said paper.

*Pafitis v Greece. In Pafatis the court reviewed a Greek banking regulation that allowed the Greek National Bank to appoint a temporary administrator to manage the affairs of a bank that took the form of a public limited liability company under Article 25 of the Second Directive. The bank was heavily indebted and posed a serious risk to depositors, and thereby threatened banking stability. Under the regulation, the administrator suspended the governance rights of the shareholders and passed resolutions increasing the bank's share capital. The government initially subscribed to shares which gave it a controlling interest in the bank. Later, the administrator directed the bank to issue more shares through several rights issues, in which existing shareholders were offered to purchase a proportional amount of shares. The original shareholders refused these offers, however, because their interest had been significantly diluted when the government initially injected capital. The Greek court upheld the administrator's authority to reorganise the bank and to raise capital without shareholder approval on the grounds that banking corporations were subject to a different set of supervisory laws and that this justified derogation from the shareholder rights protections in Article 25 of the Directive. The ECJ overruled the national court by holding that under these circumstances Greek banking law could not derogate from the minimum protections afforded shareholders in public limited liability companies under the Second Directive."*[15]

It is instructive to point out here that in the *Pafitis* case, the measures that were undertaken were undertaken in the context of a more intrusive intervention than that at ILPGH, i.e. in the context of an appointment of an administrator who suspended the governance rights (which did not occur at ILPGH, where no special administrator was appointed who would have formally suspend the governance rights). And yet – even in such extreme circumstances as those in the *Pafitis* case – the ECJ confirmed the sacrosanct nature of the minimum shareholder rights embedded in Articles 25 and 29 of the Second Company Law Directive.

I beg to refer to the above paper by Professor Kern Alexander, upon which marked with the letters "**TA5**" I have signed my name prior to the swearing hereof.

G. Dr. Eva Hüpkes, then the Head of Policy and Regulation at the Swiss Financial Market Supervisory Authority (FINMA), stated the following in her paper entitled "Special bank resolution and shareholders' rights: balancing competing interests"[16]:

*"3.2 Under community legislation*

*Shareholders rights also enjoy direct protection under a number of European Directives. The Second Company Directive provides for the equal treatment of shareholders who are in the same position. It also protects the right of shareholders' to determine the capital structure of their company. As such, any increase in the subscribed capital must be decided upon by the general meeting. However, article 25(2) of the Second Company Directive permits companies to opt out from this general provision by permitting shareholders to pass a resolution at a general meeting that would authorise management to increase capital, with or without limit, for a period of up to five*

[15] Pages 72 through 74 of the said paper.

[16] Journal of Financial Regulation and Compliance, Vol. 17 No. 3, 2009, based on a presentation given at the Cass Business School workshop on the proposed new UK regime for resolution of banking problems held on 7 April 2008.

*years. Such a resolution can be renewed without limit. The pre-emption rights of existing shareholders may not be restricted or withdrawn without the consent of the general meeting. Pre-emption rights serve to prevent the dilution of shareholders' control. The European Court of Justice (ECJ) stated that the right of shareholders to retain an unchanged proportional share in the capital of a company as being a right that is inherent in being a shareholder. […]*

*In Karella and Syndesmos Melon the ECJ affirmed that the Second Company Directive is intended to ensure that members' and third parties' rights are safeguarded, in particular in the operations for setting up companies and increasing and reducing their capital. In the Panagis Pafitis case, the ECJ reached conclusions that are frequently cited in connection with the protection of shareholder rights in a bank reorganisation under European law (Hadjiemmanuil, 2004; Mayes et al., 2001). The National Bank of Greece had appointed a provisional administrator for a problem bank. The administrator had decided to increase the capital of the bank without prior formal approval by the general assembly of shareholders and without respecting the shareholders' pre-emption rights. The ECJ ruled that member states must not adopt bank reorganisation measures that infringe the minimum level of protection for shareholders, including, in particular, the shareholders' right to decide upon changes in the capital structure of a banking corporation. […]*

***In the absence of any clear rulings to the contrary and despite subsequent developments in European Union (EU) legislation, the ECJ's judgement in the Panagis Pafitis case confirms that the Second Directive precludes quick recapitalisation of an open bank under the control of a provisional administrator that a capital increase without a resolution of the general meeting. <u>In the Kefalas Case the ECJ confirmed that "the decision-making power of the general meeting provided for in Article 25(1) applies even where the company is experiencing serious financial difficulties" This means that a reorganization involving a change in the capital structure must be voted upon by the shareholders' meeting</u>***. *[…]*

*The Takeover Directive (Official Journal L 142, 2004, pp. 0012-0023) complements the Second Directive by providing for "squeeze-out" rights of the majority shareholder and "sell-out" rights of minority shareholders in the context of takeover bids. Furthermore, the Shareholders Rights Directive establishes requirements for general meetings of shareholders, and in particular the convocation periods and the form of the convocations."* (Emphasis added)

I beg to refer to the said paper by Dr. Hüpkes, upon which marked with the letters "**TA6**" I have signed my name prior to the swearing hereof.

H. Dr. Verannemann and Dr. Gärtner state, *inter alia*, the following in the book entitled *"FMStG, the Financial Markets Stabilization Law"*[17] (2009), which is acknowledged to be an authority on the German recovery and resolution regime:

i. The authors state the following in respect of increasing capital by statute without shareholder approval:

[17] *FMStG, Finanzmarktstabilisierungsgesetz*, Dr. Matthias Jaletzke and Dr. Peter Veranneman, Verlag C. H. Beck Miinchen, 2009, ISBN 9783406587603.

*"II. Capital increase mandated by statue…*[18]

***4. European law**. Permissibility of a capital increase without an approval of a general meeting collides with Article 25 Section 1 and Section 2 of the Second Company Law Directive 77/91/EEC of the Council of 13th December 1976, the so-called **Capital Directive**. The Directive requires that (i) any capital increase must be approved by a general meeting and (ii) only the statutes or instrument of incorporation or the general meeting may authorize an increase in the subscribed capital. Therefore, a question arises as to permissibility under EU law of a capital increase mandated by statute*[19].

*The ECJ held in four similar cases that national rules that allow a capital increase in a company without the decision of a general meeting are incompatible with EU law (ECJ, judgment of 30th May 1991 – C-19/30, Karella and Karellas; ECJ, judgment of 24th March 1992 – C-381/89, Syndesmos Melon; ECJ judgment of 12th March 1998 – C-441/93, Pafitis; ECJ, judgment of 12th May 1998 – C-367/96, Kefalas). The origin for the aforementioned four cases*[20] *was the Greek emergency regime that allowed a special public sector body (a business restructuring organization), on the basis of ministerial orders for the sake of reconstruction, to take over the management of businesses and to decide upon capital increases of the affected entities without approval of a general meeting. In all four cases, the special public sector body*[21] *decided upon capital increases while granting pre-emption rights to the original shareholders. The ECJ did not allow in any of the four cases an exception from the requirements of Art. 25 of the Capital Directive, even after having considered the fact that the affected companies were of considerable importance for the Greek national economy and required restructuring.*

*Due to finality of the ECJ decisions and due to similarity in the objectives of the Greek special regime in question and of the FMStG*[22]*, it is doubtful that the ECJ would adjudicate any differently than previously upon the capital increase mandated by statute embedded in § 3 s. 1 of the Financial Market Stabilization Acceleration Act 2008*[23] *(the FMStBG"). While it could be argued that the dangers associated with the macroeconomic situation and with the financial*

[18] See pages 203 through 204 of the said book.

[19] The word "statute" refers here to legislation or a decree.

[20] Particulars of the *Pafitis* case are specific for the banking sector.

[21] A temporary administrator in the *Pafitis* case.

[22] The German Financial Markets Stabilization Act (2008).

[23] Gesetz zur Beschleunigung und Vereinfachung des Erwerbs von Anteilen an sowie Risikopositionen von Unternehmen des Finanzsektors durch den Fonds "Finanzmarktstabilisierungsfonds —FMS" [Financial Market Stabilization Fund—FMS] (Finanzmarktstabilisierungsbeschleunigungsgesetz) [FMStBG] [Financial Market Stabilization Acceleration Act], Oct. 17, 2008, BGBL. I at 1986, as amended. FMStBG is part of FMStG. I address the German recovery and resolution regime in more detail further below in this affidavit, where I explain the provision in question. In short, Section 3 of the FMStBG empowered the management board, which needed to obtain the consent of the supervisory board, to increase the company's nominal capital by up to 50%. The provision was so heavily criticised by a host of scholars and academics that is has become effectively moot and has never been used.

*crisis in the German economy are significantly larger than the risk of a collapse of a single financial institution, it is nevertheless very doubtful that a clear violation of the Capital Directive would be justified."* (Underlining added)

ii. The authors state further the following in respect of using decisions of the European Commission in respect of State aid as a justification for increasing capital against shareholder approval:

*Moreover, the EC Treaty leaves the Members States no room for short-term suspension of the Directive provisions on the authority of urgent emergency measures (see also Spindler German Tax Law 2008, 2268, 2273). Not even the State aid decision by the Commission can violate or temporarily suspend the provisions of the Capital Directive, given that the discretion of the Commission is limited to Art. 87 of the EC Treaty (on the compatibility of the State aid with the common market, see also the ECJ judgment of 12th November 1992 – C-134/91 and C-135/91, Kerafina). It is, therefore unlikely – also with a view to the other, less intrusive, corporate recapitalization options under FMStG – that an affected company's administration would choose a recapitalization by means of a capital increase mandated by statute. From a practical perspective, the German courts are obliged to interpret national law taking into account both the letter and the purpose of the Capital Directive (see the ECJ Judgment from 13th November 1990 - C-106/89, Marleasing). This binding effect in respect of the supremacy of EU law can demonstrate itself not only through protection under injunctive proceedings against a planned, but not yet executed, capital increase mandated by statute, but holds also directly in respect of the Registry Court, which – given the incompatibility of paragraph 3 FMStBG with the Capital Directive – cannot register such a capital increase (see Ziemons DB 2008, 2635, 2637).[24]* (Underlining added).

iii. Dr. Verannemann and Dr. Gärtner further state the following in respect of abrogating pre-emption rights by statute without shareholder approval:

*"Abrogation of pre-emption rights by statute is not compatible with Art. 29 of the* ***Capital Directive***[25]*. This Article provides that the shareholders strictly must be allowed pre-emption rights, which can only be abrogated by a general meeting or by an authorization given to the Board by a general meeting. The Capital Directive provides no derogation provision and no provision in case of an emergency for Member States"*[26]. (Bold font as per the original).

I beg to refer to the above-quoted excerpts from the German original of the *"FMStG, the Financial Markets Stabilization Law"*, upon which marked with the letters "**TA40**" I have signed my name prior to the swearing hereof.

24. I point out further below in this affidavit that the intrusive measures under the FMStG – which are actually nowhere close to the draconian terms of the July 2011 Direction Order – have been so heavily

[24] Pages 204 and 205 of the said book

[25] The Second Council Directive 77/91/EEC.

[26] Pages 207 and 208 of the said book.

criticized by scholars and academics in Germany in respect of their incompatibility with the Second Company Law Directive that nobody has ever dared to use them. The measures have turned out to be effectively moot.

25. In respect of the above-mentioned ECJ *Kerafina* case (Joined cases C-134/91 and C-135/91) with regard to implications of the Commission's decisions on State aid for capital increases mandated by statute, which is referenced by Dr. Verannemann and Dr. Gärtner, I note that the ECJ held that:

*"**the discretion conferred on the Commission by Article 93 of the Treaty*** [now Article 108 TFEU] ***in the field of State aid does not permit the Commission to authorize Member States to derogate from provisions of Community law other than those relating to the application of Article 92(1) of the Treaty*** [now Article 107(1) TFEU]*."*

The summary of the case in the European Court reports 1992 Page I-05699[27] states further:

***"Consequently, a decision adopted by the Commission under Article 93 cannot be interpreted as authorizing the Member State to whom it is addressed to maintain in force, even if only provisionally, a national provision which is contrary to the Second Directive 77/91 on company law."***

I beg to refer to the above-mentioned European Court reports 1992, upon which marked with the letters "**TA41**" I have signed my name prior to the swearing hereof.

26. I note that, in addition to the above, it is also commonly acknowledged that no shares can be issued below nominal value, as per Article 8(1) of the Second Council Directive 77/91/EEC. That prohibition includes contrived schemes such as those that the Minister used to force the issue of more than 36 billion new ILPGH shares to himself at the value five times lower than the nominal value before his intervention. I provided evidence in this regard in my last affidavit. I wish to make one more reference in this regard. I wish to draw to the attention of the Honorable Court to the fact that in conjunction with the July 2011 capital increase at the AIB Bank, which at that time was already under the control of the Minister, AIB made the following statement in the Circular related to the capital increase:

*"Renominalisation: <u>As the Placing is priced at a price per share less than the current nominal value of an Ordinary Share (€0.32), the Placing would be prohibited by Irish company law unless the nominal value of the Ordinary Shares was reduced</u>. Accordingly, it is proposed to reduce the nominal value of each Ordinary Share from €0.32 to €0.01 per share."* (Emphasis added).

I note that the AIB shareholders were asked to approve terms of the renominalisation similar to those which the ILPGH shareholders were asked to approve at the ILPGH EGM in July 2011. It is instructive that the shareholders were asked to approve the reduction in the nominal value of the share in order to enable the Minister to subscribe for shares below their original nominal value, because "*the Placing would be prohibited by Irish company law unless the nominal value of the Ordinary Shares was reduced*". Clearly, the ILPGH shareholders rejected such a reduction in the nominal value and, therefore, the reduction in the nominal value and the resultant issue of shares below the original nominal

[27] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61991J0134:EN:HTML.

value was prohibited. The sheer act of asking the shareholders to approve the reduction in the nominal value is evidence of the fact that without shareholder approval such reduction is prohibited. Otherwise, the rule prohibiting an issue without shareholder approval of shares below nominal value could be easily circumvented by forcing a reduction in nominal value without shareholder approval, which would be absurd. I am astounded at the persistence of the Minister and his proxies in denying the obvious in this regard, counter to not only the letter of the law, but also counter to the most basic common sense and logic.

I beg to refer to the above-mentioned AIB Circular, upon which marked with the letters "**TA7**" I have signed my name prior to the swearing hereof.

## II. <u>Relevant EU precedents on prohibition of capital increase without shareholder approval</u>

27. Following relevant precedents show that it is legally prohibited in the EU to undertake major restructuring and increase capital against shareholder approval:

A. Fortis is a landmark case quoted in a lot of academic and regulatory literature on the recent banking crisis. The aforementioned document issued on 20th October 2009 by the European Commission entitled "Impact Assessment Accompanying the Communication from the Commission on an EU Framework for Cross-Border Crisis Management in the Banking Sector" states the following regarding the Fortis case:

*"**The Fortis case has demonstrated that resolution-measures of authorities can be attacked by shareholders through the courts and in the absence of a clear legal framework they can be ruled retroactively void**."*[28]

Key facts regarding the Fortis case:

i. Fortis N.V./S.A. was a Dutch/Belgian company active in insurance, banking and investment management. In 2007 it was the 20th largest business in the world by revenue[29].

ii. Relevant facts regarding the "Fortisgate" are summarized succinctly in the Guardian newspaper article of 20th December 2008 entitled "Fortisgate scandal topples Belgian government". The article states, *inter alia*, the following:

*"… angry shareholders in Fortis, once Belgium's biggest financial services company, voted overwhelmingly to keep the business going in the desperate hope of brighter days.*

*As investors railed against an assault on democracy and the rule of law, Jan-Michiel Hessels, acting chairman, warned that Fortis would have gone bankrupt without nationalisation. It lost €23bn of value in a few days in early October. Hessels told about 3,000 shareholders at an*

[28] Page 33 of the said publication.

[29] Fortune Global 500 2007: Fortis. CNN Money. 2007.

*extraordinary meeting: "We didn't have a choice and, if we didn't act then, there was a likelihood that the Belgian state would have gone bankrupt - like Iceland."*

*Shareholders voted against immediate liquidation - and 97% in favour of continuing operations.*

*The government's €11.2bn bail-out of Fortis, worth €40bn a year ago, failed as the bancassurer went into a liquidity crisis. Ministers handed over the group's Belgian banking and insurance operations, including substantial assets, for a knockdown price to France's BNP Paribas.*

*But last week the court of appeal ruled in favour of small activist shareholder lobbies who opposed the sale, and BNP this week froze its planned €14.5bn takeover.*

*Its shares, savaged by investment losses linked to the Madoff scandal, lost 30% in a day and were down more than 5% yesterday. Fortis shares were up marginally at €1.20, or double their all-time low.*

*BNP has said it could return to the Fortis deal if the court of appeal ruling is overturned, with judges last week freezing the deal for 65 days until mid-February. But, with lawyers warning that the case could take a year or more to unravel, Fortis's future is problematic."*

I beg to refer to an article from the Guardian newspaper of 20th December 2008, upon which marked with the letters "**TA8**" I have signed my name prior to the swearing hereof.

iii. Fortis 2008 annual report offers the following summary of key facts and the aftermath of the aforementioned ruling of the Court of Appeal:[30]

*"Due to the turmoil on the financial markets, Fortis had to sell large parts of its operations to the local governments in the Benelux. A chronological description of all transactions is given below.*

*On 29 September 2008, Fortis and the Governments of Belgium and Luxembourg entered into an agreement, whereby the Government of Belgium agreed to invest EUR 4.7 billion in Fortis Bank Belgium in exchange for a 49.93% share in the common equity of the bank while the Government of Luxembourg agreed to invest EUR 2.5 billion in Fortis Banque Luxembourg, a wholly owned subsidiary of Fortis Bank, by subscribing to a mandatory convertible loan issued on 29 September by Fortis Banque Luxembourg.*

*On 3 October 2008, the Government of the Netherlands acquired Fortis Bank Netherlands including the participation of Fortis Bank Netherlands in RFS Holdings, which held the activities of ABN AMRO, Fortis Insurance Netherlands and Fortis Corporate Insurance. The allocation of the overall consideration of EUR 16.8 billion, agreed between Fortis and the Dutch State in the Term Sheet, was subsequently set by the Belgian government as follows: EUR 12.8 billion for the sale by Fortis Bank SA/NV of the Dutch banking activities (sale of the shares*

[30] Pages 16 and 17 of the said publication.

*in Fortis Bank Nederland (Holding) N.V., i.e. including Fortis's stake in ABN AMRO) and EUR 4 billion for the sale by Fortis Insurance N.V. of the Dutch insurance activities (sale of the shares in Fortis Verzekeringen Nederland N.V. and Fortis Corporate Insurance N.V.).*

*On 10 October 2008, the Belgian Government acquired from Fortis the remaining ownership (50% + one share) in Fortis Bank for a total consideration of EUR 4.7 billion in cash. At the same time, the Belgian Government signed an agreement with BNP Paribas on the subsequent transfer of 74,94% of Fortis Bank. Fortis and BNP Paribas furthermore agreed on the sale of 100% of Fortis Insurance Belgium for a total consideration of EUR 5.73 billion in cash, subject to a final closing adjustment of minus EUR 0.2 billion. The transactions between Fortis and the Belgian State on 29 September and 10 October are considered one transaction. <u>However, on 12 December 2008 the Court of Appeal of Brussels ruled that all transactions with BNP Paribas had to be suspended as the shareholders of Fortis SA/NV were not consulted on the transactions</u>. <u>Hence on 11 February 2009 a shareholders meeting was held by Fortis SA/NV. During this meeting the shareholders voted against the proposed agreements (as modified by an Avenant of 1 February 2009). Consequently, new negotiations were started between Fortis, BNP Paribas and the Belgian Government</u>. <u>These negotiations resulted on 12 March 2009 in a new agreement on the structure and content of the transaction</u>."* (Emphasis added)

I beg to refer to the relevant excerpt from the Fortis 2008 annual report, upon which marked with the letters "**TA9**" I have signed my name prior to the swearing hereof.

iv. Dr. Eva Hüpkes describes as follows the Fortis case in her aforementioned paper entitled "Special bank resolution and shareholders' rights: balancing competing interests":

*"In the Fortis case, Belgian shareholders brought a case before the Belgian Commercial Court claiming that the sale to BNP Paribas, which had already been agreed by contract, required shareholder approval. The court's ruling that such approval was not required was overturned upon appeal. The court ordered that the shareholders approve or disapprove the sale of the Dutch banking and insurance activities to the Dutch State, the sale of 50 per cent + 1 share in Fortis Bank to the Belgian State and the sale of 10 per cent of the shares in Fortis Insurance Belgium to BNP Paribas. When the vote took place, the shareholders rejected all three sales. As a consequence, further negotiations between the parties and possibly settlement through the courts became inevitable."*[31]

B. The most recent example of the fact that capital increase in a bank cannot occur without shareholder approval is Italy's third-biggest bank Monte dei Paschi di Siena. The bank was forced at the end of December 2013 to delay a vital Euro 3 billion share sale to raise capital until mid-2014 because of shareholder opposition. Reuters reported in this regard the following on 28th December 2013:

*"SIENA, Italy Sat Dec 28, 2013 (Reuters) - Italy's third-biggest bank Monte dei Paschi di Siena was forced to delay a vital 3 billion euro ($4.1 billion) share sale to raise capital until mid-2014 because of shareholder opposition, plunging its turnaround plan into uncertainty.*

[31] Page 280 of the said paper.

*The bank's chairman and its chief executive may now resign after their plan to launch the cash call in January was defeated at an extraordinary shareholder meeting on Saturday due to the vote of Monte Paschi's top shareholder.*

*The world's oldest bank needs to tap investors for cash to pay back 4.1 billion euros in state aid it received earlier this year and avert nationalization after being hammered by the euro zone debt crisis and loss-making derivatives trades.*

*The unprecedented clash between the lender's executives and its main shareholder - a charitable banking foundation with close links to Siena politicians - casts a pall over a tough restructuring meant to revive its fortunes.*

*Chairman Alessandro Profumo, a strong-willed and internationally respected banker who was formerly the chief of UniCredit, said he and CEO Fabrizio Viola would decide in January whether to step down.*

*"These are decisions one takes in cold blood and in the right place," Profumo said at the meeting.*

*"What I have on my mind is a 3 billion euro cash call because we need to pay back 4 billion euros to taxpayers. Today this is uncertain and at risk," he told a press conference.*
*Viola, sitting at his side, told reporters he would do everything "so that the ship does not sink", but that he could not take responsibility for mistakes made by others.*

*A board meeting is scheduled for mid-January, a bank spokesman said.*

*Profumo and Viola had already secured a pool of banks ready to guarantee the rights issue, but only if it was carried out by the end of January.*

*They said delaying it would make fundraising harder because it would likely coincide with a string of cash calls by other Italian and European lenders triggered by a sector health check, and could precipitate the Tuscan bank's nationalization.*

*But the cash-strapped Monte dei Paschi foundation - whose stake in the bank is big enough to veto any unwanted decision - forced a postponement until at least mid-May to win more time to sell down its 33.5 percent holding and repay its own debts. […]*

*Under the agreement with Brussels, if Monte dei Paschi cannot complete the capital increase by the end of 2014 the Treasury would convert the bonds it bought from the bank into shares, effectively nationalizing it."*

I beg to refer to the relevant Reuters reports from 28th and 30th December 2013 and the bank's formal announcement, upon which pinned together marked with the letters "**TA10**" I have signed my name prior to the swearing hereof.

## III. Separate legal personality of ILPGH

28. By way of important background, it is relevant to reiterate at the outset that the ILPGH shareholders are shareholders in ILPGH – not in ILP. However, the Minister wishes to make the ILPGH shareholders responsible for the potential future debts of ILP, while at the same time arguing that the value of the assets belonging to ILP (such as Irish Life Group Limited[32]) should not be credited to the ILPGH shareholders as their contribution to the recapitalization. The Minister cannot have it both ways because it would be unreasonable and illegal. Valia SG Babis stated in this regard the following in the aforementioned publication from the University of Cambridge, Faculty of Law, entitled "Bank Recovery and Resolution: What About Shareholder Rights?":

*"In banking groups, shareholders' rights and duties are limited to the individual group member in which they have invested, and do not extend to the group as a whole. Shareholders are normally protected by the principles of separate legal personality and limited liability, i.e. they are not liable for the bank's debts with their personal property, and are only liable to contribute up to the value of their shares. This means that, as a matter of law, group companies are not liable for each other's debts just because of their group connection, and consequently, the shareholders of one group member cannot generally be expected to absorb losses which relate to another group member."*[33]

29. The aforementioned publication by the European Commission on the "Impact Assessment Accompanying the Communication from the Commission on an EU Framework for Cross-Border Crisis Management in the Banking Sector" states in this regard the following:

*"2. Legal entity's versus banking group's interest*

*In a crisis situation, all members of a banking group might not have identical interests. While certain subsidiaries might be financially strong, the parent may be faced with difficulties or vice-versa. Although the economic rationale could justify a group-wide solution for the problems, legal provisions can block such outcomes."*

30. In this regard, it is relevant that the March 2011 PCAR/PLAR imposed a huge, sudden and unexpected capital requirement of Euro 4 billion on ILP – not on ILPGH. Yet, the Minister contrived a scheme, whereby he forcibly funneled the capital through ILPGH. It is instructive that the Minister arbitrarily made ILPGH subject of his proposed direction order of 25th July 2011 only in order to appropriate the property of the ILPGH shareholders. That was the only reason. Otherwise, he could have easily and swiftly effected any recapitalization of ILP without interfering with the ILPGH shareholding. That is a very relevant fact to keep in mind when considering all the misconceived arguments about the alleged necessity or urgency of the direction order of 26th July 2011 (the "July 2011 Direction Order"). A legitimate debate could be had about the necessity of recapitalizing ILP[34] – not about appropriating

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[32] The insurance business whose embedded value was about Euro 1.8 billion when it was forcibly sold to the Minister for Euro 1.3 billion pursuant to the direction order made on 28th March 2012 (the "March 2012 Direction Order").

[33] Page 6 of the said publication.

[34] I note in this regard that, as per paragraph 65 of Mr. Skoczylas' affidavit sworn on 30th August 2013, the Applicants herein "unequivocally do not challenge either the ILP's binding prudential capital requirements or the ILP's recapitalisation".

99.2% of the shareholding in ILPGH. The latter plainly cannot be deemed necessary or urgent under any reasonable analysis.

31. It is relevant that the High Court in Dublin determined on 28th June 2012 that the ILPGH shareholders did not even have legal standing to challenge the Direction Order of 28th March 2012 (which forced ILP to sell Irish Life Group Limited to the Minister) because they were shareholders in ILPGH and not shareholders in ILP. It is instructive that the Irish State appears to respect the separate legal personality of ILPGH only when it suits the Minister. In other words, it is the Minister who arbitrarily determines at which point in time which of the group companies is relevant for direction orders effected by the Minister, with disregard for the impact his actions have on the key affected party, i.e. the ILPGH shareholders. And the Minister does it while being in full control of ALL the group companies. Truly, those arbitrary arrangements contrived by the Minister are beyond anything that any reasonable finance minister of any EU Member State could be expected to undertake.

32. The above views are shared as an important background. However, irrespective of those considerations, the actions of the Minister were plainly illegal because they violated EU law.

## IV. Legal basis and rationale for shareholder protection in financial institutions

33. Since the Minister's actions indicate that the Minister seems to be oblivious to the basic principles of shareholder protection, it is important that one mentions the key rationale for shareholder protections in financial institutions and the fundamental importance of the shareholder protections for the EU legal and economic systems.

34. The "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies"[35] from 12th December 2012 states, *inter alia*, the following:

*"European company law is a cornerstone of the internal market[36]. It facilitates freedom of establishment of companies while enhancing transparency, legal certainty and control of their operations."*[37]

35. The "Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward"[38] from 25th May 2003 states, *inter alia*, the following:

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[35] COM(2012) 740 final.

[36] *The scope of EU company law covers the protection of interests of shareholders and others, the constitution and maintenance of public limited-liability companies' capital, branches disclosure, mergers and divisions, minimum rules for single-member private limited-liability companies and shareholders' rights as well as legal forms such as the European Company (SE), the European Economic Interest Grouping (EEIG) and the European Cooperative Society (SCE).*

[37] Page 4 of the said Communication from the European Commission.

[38] COM (2003) 284 final.

*"1.1. The EU Company Law Acquis*

*Historically, most of the initiatives taken at EU level in the area of company law have been based on Article 44 (2) g (ex 54) of the Treaty establishing the European Community. This Article, which appears in the Chapter devoted to the right of establishment, requires the European institutions to attain freedom of establishment, "by co-ordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 (ex 58), with a view to making such safeguards equivalent throughout the Community".*

*This Article has been interpreted to include two important grounds for the adoption of EU initiatives in the area of company law:*

*a)* ***facilitating freedom of establishment of companies****: the harmonisation of a number of minimum requirements makes it easier for companies to establish themselves in other Member States where the regulatory framework is similar;*

*b)* ***guaranteeing legal certainty in intra-Community operations****, where the presence of a number of common safeguards is key for the creation of trust in crossborder economic relationships. [...]*

*2.1. Strengthening shareholders rights and third parties protection*

*Ensuring effective and proportionate protection of shareholders and third parties must be* ***at the core of any company law policy****. A sound framework for protection of members and third parties, which properly achieves a high degree of confidence in business relationships, is a fundamental condition for business efficiency and competitiveness. In particular, an effective regime for the protection of shareholders and their rights, protecting the savings and pensions of millions of people and strengthening the foundations of capital markets for the long term in a context of diversified shareholding within the EU, is essential if companies are to raise capital at the lowest cost.*

*Maintaining efficient protection of members and third parties will be even more important in the future, in view of the* ***increasing mobility of companies*** *within the EU."*

(All emphases by the European Commission)

I beg to refer to the above-mentioned Communication from the European Commission, upon which marked with the letters "**TA11**" I have signed my name prior to the swearing hereof.

36. The aforementioned publication from the University of Cambridge, Faculty of Law, on "Bank Recovery and Resolution: What About Shareholder Rights?" states, *inter alia*, the following[39]:

*"Generally, shareholder protection is an important issue in company law. As the owners of the company, shareholders are entitled to participate in decision-making, especially for significant decisions which can*

[39] See pages 2 and 3 of the said publication.

*affect their investment. Consequently, shareholders need tools and powers to participate actively in the company's management. Shareholders also need tools to control and monitor management because especially in large companies, the separation between ownership and control creates agency problems between shareholders and directors, with the latter potentially disposed towards excessive risk-taking and short-termism, which may be harmful to shareholders' interests. Further, minority shareholders need protection against abuse by majority shareholders.*

*In the banking sector, shareholder protection acquires additional importance. Due to the complexity of the banking business and to the confidentiality of sensitive information, bank shareholders often lack the expertise and information to monitor directors. Agency costs between shareholders and directors are amplified by the large number of shareholders, who may have little control over the bank's affairs.*[40] *In addition, bank directors' perverse incentives may be exacerbated by moral hazard, created by the expectation of public rescues or other public interventions in case the bank fails. Further, because many bank shareholders are themselves financial institutions (banks, insurance companies, pension funds etc.), inadequate protection of these shareholders, especially in case of bank failure, can result in contagion of financial shocks within the financial sector.*

*Bank shareholder protection is also important in the context of banking groups. In large groups, minority shareholders are in a particularly weak position, because of the complexity of banking group structures, the inability to effectively monitor risks and the fact that minority stakes in banking groups are usually small. Finally, banking groups are usually interconnected and therefore prone to intra-group contagion of shocks, which can affect minority shareholders elsewhere in the group."*

## V. **Main shareholder rights**

37. In the above context, it is relevant to briefly review the key shareholder rights. In this regard, I refer again to the aforementioned publication from the University of Cambridge Faculty of Law on "Bank Recovery and Resolution: What About Shareholder Rights?" The author states there, *inter alia*, the following[41]:

*"Generally, the rights of bank shareholders are set out in general company law. Shareholder rights can broadly be classified in four categories. The first category is pecuniary/ property rights, i.e. the right of ownership on shares and the right to participate proportionately as the residual claimants for any value remaining after the satisfaction of creditors in case of insolvency. Rights deriving from shares are protected as property rights under Art 1 Protocol 1 of the ECHR*[42] *and the Charter of Fundamental*

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[40] *See See David Walker and ors, 'A review of corporate governance in UK banks and other financial industry entities', 2009, para 1.11.*

[41] See pages 3 through 6 of the said publication.

[42] *According to the ECtHR in Olczak v Poland [2002] Judgement of ECtHR 7 November 2002, http://cmiskp.echr.coe.int/tkp197/view.asp?item=1&portal=hbkm&action=html&source=tkp&highlight=Poland&sessionid=94199874&skin=hudoc-en. For a concise review on the scope of "property rights" under this provision see: Aida Grgiæ, Zvonimir Mataga, Matija Longar, and Ana Vilfan, 'The right to property under the European Convention on Human Rights', Council of Europe Human rights handbooks No. 10, http://echr.coe.int/NR/rdonlyres/97564258-437D-4FFD-A54D-2766DE255CCA/0/DG2ENHRHAND102007.pdf.*

*Rights of the European Union ("Charter").*[43] *One of the principal manifestations of property is the right to decide whether to transfer one's shares or not.*

*The second category of shareholder rights comprises control/ governance rights, i.e. rights to decide on certain important issues concerning the company (and which consequently have an impact on shareholders' rights or interests). A first sub-set of governance rights has to do with control over directors. Shareholder rights include the right to elect and dismiss directors, and to issue directions to the Board.*

*A second sub-set of governance rights has to do with control over the company's affairs. There is a wide range of issues for which shareholder approvals may be required according to EU legislation, national legislation, or company articles. Shareholder approvals are necessary for important decisions which change the company's statutes, such as a increases and reductions of capital*[44]*, mergers, divisions, and the decision to wind up in case of serious loss of capital*[45]*. Shareholder approvals are also required for significant acquisitions from connected persons*[46]*, share buy-backs, and large transactions or related party transactions.*[47]

*Also, in order not to suffer (unwanted) dilution of their stake, shareholders have pre-emption rights on any new shares issued.*[48]

*A third category of rights is procedural rights, which ensure that shareholders are in a position to exercise their governance rights. For example, procedural rights with regard to general meetings include notifications/ disclosures to shareholders, rules for calling general meetings, procedures for participation and voting, and convocation/ notice periods.*

*A fourth set of shareholder rights aims to protect shareholders against other shareholders (usually minority shareholders against the majority shareholders). The acquirer of shares which exceeds a certain percentage is obliged to make a mandatory bid to all the remaining shareholders*[49]*. Shareholders who are in the same position (i.e. in the same class) are entitled to equal treatment*[50]*. Where there are several classes of shares, decisions are subject to separate vote in each class concerned. In order to protect minority shareholders, certain decisions require an increased majority vote. In addition, when exercising*

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[43] *3 Art 17. The Charter is binding on EU institutions, which should therefore comply with it when proposing and adopting legal rules, including in the area of financial regulation.*

[44] *Second Council Directive 77/91/EEC of 13 December 1976 (as amended) ('Second Company Law Directive') OJ L 26/ 1–13 arts 25, 30*

[45] *Second Company Law Directive art 17.*

[46] *Second Company Law Directive art 11.*

[47] *For example, for companies with premium listing (on the London Stock Exchange), shareholder approvals are necessary for large transactions and for related party transactions, according to LR 10-11.*

[48] *Second Company Law Directive art 29.*

[49] *Directive 2004/25/EC on takeover bids OJ L 142/12, art 5.*

[50] *Second Company Law Directive art 42.*

*its voting rights, the majority is required to consider the interests of all the shareholders. Finally, minority shareholders who are subject to unfair prejudice may have rights of redress under the law.*

*In banking groups, shareholders' rights and duties are limited to the individual group member in which they have invested, and do not extend to the group as a whole. Shareholders are normally protected by the principles of separate legal personality and limited liability, i.e. they are not liable for the bank's debts with their personal property, and are only liable to contribute up to the value of their shares. This means that, as a matter of law, group companies are not liable for each other's debts just because of their group connection, and consequently, the shareholders of one group member cannot generally be expected to absorb losses which relate to another group member."*

38. In the his aforementioned publication "Bank Resolution Regimes: Balancing Prudential Regulation And Shareholder Rights", Professor Alexander points out to the fact that the shareholders are protected by the European Convention on Human Rights:

*"A shareholder's ownership interest in a company's capital stock has been recognised as protected "possessions", and is thus a property right under Article 1 of Protocol 1 of the ECHR … The Strasbourg Court has ruled that shares in a company have economic value and therefore constitute "possessions" within the meaning of Article 1 of Protocol 1.*[51] *In Sovtransavto Holding v Ukraine, the applicant company initially held a 49% stake in a Ukrainian company Sovtransavto-Lugansk. Following the decision of a state agency ordering the company to raise significantly more outside share capital, the percentage held by the applicant company was reduced to 20.7%. The relative decline in the applicant company's share holdings in the company had the result of limiting its ability to influence the direction and management of the company and protect its investment. The Court held that the manner in which the domestic court proceedings were conducted and resolved, and the uncertainty in which the applicant shareholder was left, upset the "fair balance" that was required to be struck between the demands of the public interest and the need to protect the applicant shareholder's right to the enjoyment of its possessions. Consequently, the state failed to comply with its obligation to secure to the applicant shareholder the effective enjoyment of its property right. The case supports the view that Article 1 of Protocol 1 protects shareholders against direct and indirect forms of property deprivation and interference by governmental authorities."*[52]

**Of course, there are limitations to property rights. But, there are currently no abrogation provisions in EU law that would allow the State to violate the minimum shareholder protections under EU law, such as those embedded in the Second Company Law Directive. Violating those minimum protections, with an effect of adversely affecting property rights, cannot be tolerated under any circumstances, *inter alia*, because it would de-stabilize the foundations of the EU economic and financial system. If property rights could be deemed to be capable of being violated in a manner incompatible with EU law as it stands, then eventually investors would significantly limit investments in the EU financial institutions, which constitute one of the largest single sectors of the EU economy. Such decrease in the investments in the financial sector would have hugely negative consequences for the public interest across the whole European Union and for the**

[51] *Sovtransavto Holding v Ukraine, ECtHR (27 September 2001), 937.*

[52] Pages 71 and 72 of the said paper.

**Union's competitive position vs. other economic blocks, such as the US or Asia. The consequence would be a significant increase in risk factors and the risk premium assigned to investments in the EU financial institutions, which would result in increases in interest rates. That would then slow down an economic growth in the EU, which would then increase unemployment across the EU. Another recession would be likely to follow.**

39. In respect to the ECHR requirements, it is relevant to also note that:

i. Dr. Eva Hüpkes, in the paper entitled "Special bank resolution and shareholders' rights: balancing competing interests", which I refer to in more detail below, points out to a definition of shareholders' rights according to the European Court of Human Rights:

*"2.1 A definition*

*The European Court of Human Rights defines the right of a shareholder as the:*

> *[...] right to a share in the company's assets in the event of its being wound up, and other unconditioned rights, especially voting rights and the right to influence the company's conduct*[53]*. [...]*

*3. How are shareholder rights protected?*

*3.1 Under the European Convention of Human Rights*

*A share in a company's capital stock is subject to economic assessment and, as such, protected as the property of a shareholder under European Convention of Human Rights (ECHR) Protocol 1 Art. 1. Shares are therefore protected against deprivation and certain forms of governmental control and interference*[54]*. Property rights in shares also constitute "civil rights" within the meaning of Art. 6 (1) ECHR. This means that disputes concerning property rights in shares must satisfy due process guarantees."*

ii. The ECHR explicitly allows for abrogation of property rights only if this is done in public interest and in a manner compatible with international law. Indeed, Article 1 of Protocol 1 ECHR states in the relevant part that *"[n]o 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"*. Thus, it is clear that, in the absence of express derogation provisions under EU law, violating the minimum shareholder protections embedded in EU law, with an effect of adversely affecting property rights, is plainly precluded by Article 1 of Protocol 1 ECHR;

iii. In respect of an interference with the shareholders' property rights following an administrative decision by a State's authority, the ECHR requires a judicial review *de novo* on questions of fact and issues of law that relate to the dispute. In this regard, Professor Alexander stated the following in his

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[53] *Olczak v. Poland, decision of the European Court of Human Rights (on admissibility) of 7 November 2002.*

[54] *Sovtransavto Holding v. Ukraine, Judgment of the European Court of Human Rights of 27 September 2001.*

aforementioned paper "Bank Resolution Regimes: Balancing Prudential Regulation And Shareholder Rights":

*"Article 6 ECHR requires judicial review of the exercise of state administrative decisions that interfere with property rights. This means that regulatory action that is upheld by an administrative tribunal must still be subject to judicial review de novo on questions of fact and issues of law that relate to the dispute.*[55] *In Credit and Industrial Bank v the Czech Republic*[56]*, the court ruled that the limited scope of judicial review available under Czech law to challenge the insolvency administrator's factual determination of compulsory administration for a Czech bank had violated Article 6(1) on the grounds that the bank's controlling shareholder who had challenged the determination was left with no option but to appeal the finding to an administrative or judicial tribunal."*[57]

40. Dr. Eva Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests", point out to the following shareholder rights in Europe:

*… under the laws of most European countries the shareholders' meeting retains all powers that are not given by statute to the board. The company's charter or shareholders' resolution cannot assign to the board powers that are statutorily attributed to the shareholders' meeting, except in a few limited cases where the statute authorises such a delegation*[58] *… Shareholders in Europe not only vote on these matters, they also vote on various other decisions, such as spin-offs and divisions, the increase or decrease of the company's capital, and the waiver of pre-emptive rights associated with an increase in capital funded by outside investors."*

## ACCOUNTING CONSIDERATIONS

### VI. Relevant and important basics regarding a balance sheet

41. I say and believe that it is important to highlight relevant basics regarding a balance sheet. Thus, I briefly outline those basics in a simplified layman's terms for the convenience of the Honorable Court.

42. A balance sheet consists of three major elements: i) assets, ii) liabilities and iii) shareholders' equity. Those three values are established at the yearend based on audited accounts[59]. The shareholders' equity is a difference between the assets and the liabilities. If assets are larger than liabilities, then the shareholders' equity is positive. The shareholders' equity represents the net worth owned by the

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[55] *Art 6 ECH requires that such decisions must be subject to subsequent control by a "judicial body that has full jurisdiction". See Obermeier v Austria, judgment of the European Court of Human Rights of 28 June 1990) (holding that violations of Art 6(1) can occur when courts of first instance rule that they are bound by determinations of material facts by administrative tribunals).*

[56] *Credit and Industrial Bank v the Czech Republic, ECtHR, No 29010/95, Final Judgment (21 October 2003) 19–22.*

[57] Pages 83 and 84 of the sais paper.

[58] *For instance, regarding limits of the transfer of shares.*

[59] There is no requirement under the IFRS to produce audited accounts during a fiscal year, i.e. more frequently than annually.

shareholders. The shareholders' equity divided by the number of shares outstanding shows the shareholders' equity per share. A company becomes insolvent or bankrupt if the liabilities exceed the assets, and the shareholders' equity becomes negative.

43. The fact that ILPGH was not insolvent is clear from the ILPGH 2010 annual report. As per the ILPGH 2010 annual report (see paragraph 21 of my last affidavit), at the end of 2010 ILPGH had Euro 1,616 million (i.e. c. Euro 5.8 per share) in the shareholders' equity based on the IFRS basis, and Euro 2,045 million (i.e. c. Euro 7.4 per share) in the shareholders' equity based on an embedded value standard (see page 209 of the 2010 ILPGH annual report). As per the evidence provided in paragraph 21 of my last affidavit, it is notable that the Company's equity actually increased between 31st December 2010 and 30th June 2011 (i.e. just before the direction order of 26th July 2011 was made) from Euro 1,616 million (i.e. approx. Euro 5.8 per share) to Euro 1,954 million (i.e. approx. Euro 7.0 per share).

44. It is important to note that a stock market share price is a value, which is normally different from the shareholders' equity per share. A market share price is an aggregate average result of the multitude of purchases and sales of a share in the secondary market. The secondary market is called "secondary" because it constitutes a market in which investors, who are independent from the company in question, buy and sell shares. The secondary market is disconnected from the company in the sense that it does not provide any financing to the company – money flows in the secondary market between an independent buyer and an independent seller of shares. That can be contrasted with the so-called "primary" market, i.e. the market in which the company issues shares in order to raise funds. Once the shares have been issued in the primary market, they are then traded in the secondary market.

45. Even though the secondary market share price is rarely the same as the shareholders' equity per share, one can nevertheless say that, in absence of extraordinary distortions, the secondary market share price could be roughly described as a stock market's estimation or belief as to what the shareholders' equity per share should be. Hence, the discrepancy between the shareholders' equity per share and the secondary market share price could be attributed, in normal conditions, to an aggregate belief of the secondary market participants regarding the difference between the company's assets and liabilities (per share). If the secondary market share price is higher than the shareholders' equity per share, then one can say that the "market" believes that either the assets, as reported by the company, are undervalued, or the liabilities are overvalued. Conversely, if the secondary market share price is lower than the shareholders' equity per share, then the "market" can be said to believe that either the assets, as reported, are overvalued or the liabilities are undervalued. Sometimes, the market's belief is not driven by what happens in the company but by what happens in a wider economy. And, as with any belief, the belief may be correct or it may be incorrect. It is always relevant to contrast the market's belief with a consensus of the beliefs of independent analysts, whose job it is to evaluate the inherent value of the share. Such a reference to independent analyst reports was provided in the affidavit of Mr. Skoczylas sworn on 30th August 2013.

46. Sometimes, however, the market in a share does not function properly and simply does not reflect the realities of either the company or of a wider economy. I described such an instance in respect of ILPGH in my last affidavit, where I showed that there was a false market in the ILPGH share, i.e. that the market in the ILPGH share exhibited sudden significant moves in the share price, which were not caused by inherent changes in the business or in the market, but by external rumors and announcements. Those changes in the ILPGH share price had hardly anything to do with the market's belief regarding the

soundness of the ILPGH assets or liabilities or regarding the inherent business of ILPGH or regarding the wider economy – they had predominantly to do with the market's belief that the shareholders' equity would be significantly diminished as a result of an appropriation of that shareholders' equity by the State.

47. **I have provided the above basics in order to draw the attention of the Honorable Court to the fact that the secondary market's share price is completely irrelevant when assessing a company's solvency. A company's solvency can only be assessed in respect of the shareholders' equity, i.e. the difference between the assets and liabilities, as established based on audited accounts. Whether a company is solvent or not cannot be derived from, or assessed based on, the secondary market share price, which is driven by beliefs of investors and not by audited accounts.[60]**

48. In this context, it is important to reiterate that since its inception, the Company has continued to exist with its own structures. General meetings of shareholders and the Board of Directors, which are the key organs of the Company, have never been suspended. The Company has never been subject of special management under part 3 of the 2010 Act or of a compulsory administration. ILPGH has never been subject of execution measures, such as liquidation, intended to put an end to the Company's existence. It is the indisputable fact that ILPGH was solvent before the July 2011 Direction Order. And it is irrelevant for that fact what the share price was in the stock market. Furthermore, the 2011 PCAR/PLAR did not discover any unexpected holes in the ILP Balance Sheet; there was no sudden loss of capital that had to be remedied. What happened was that the Central Bank of Ireland imposed a new paradigm on the ILP business by imposing a huge, sudden and unexpected <u>precautionary</u> Euro 4 billion capital requirement, which was 16 times higher than the formal capital requirement imposed by the Central Bank of Ireland at the end of November 2010. As confirmed by the Governor of the Central Bank of Ireland on 31st March 2011, the objective of the new huge capital requirements was "*to over-, if you like, overcapitalize the banking system to an extent that provides absolute reassurance to the markets … "We don't actually think those losses will occur, we don't actually think the repossessions will occur." "So that's by no means the Central Bank's forecast for what will happen - far from it.*"[61]. That was echoed by the Minister who said in the Irish Parliament on 31st March 2011 that: *"The State's investment in the banks will lead to very high level of capital in the banks that we own. For instance if their PCAR requirements were met today, AIB and Bank of Ireland would have core tier 1 ratios of circa 22% and 16% respectively while IL&P would be in excess of 32%* [i.e. in case of ILP, the core tier 1 ratio would have been more than three times larger than the minimum level set by the CBI[62]]. *Should the actual results prove to be better than the highly conservative assumptions used in the Central Bank's stress scenarios, we will redeem any surplus capital from the banks.'*[63] **Hence, the authorities acknowledged the <u>precautionary</u> nature of the capital requirements resulting from extreme assumptions embedded in stress test scenarios**.

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[60] I note also that the share price of companies that are 99%-owned by the State is irrelevant and meaningless because the shares are illiquid. I address this matter at the end of this affidavit when I refer to certain averments by Ms. McHugh on behalf of the Minister.

[61] See paragraph 24 of my affidavit sworn on 5th December 2013.

[62] I comment on this matter further below in this affidavit.

[63] See Exhibit TA14 of my affidavit sworn on 5th December 2013.

49. The 2011 PCAR / PLAR did not change the composition of the ILPGH assets and liabilities. As outlined above, the ILPGH shareholders' equity (i.e. the difference between the assets and the liabilities) as at 30th June 2011 – i.e. 3 days after the publication of the Circular of 27th June 2011, which introduced the terms of the ILPGH recapitalization that later became the terms of the July 2011 Direction Order – was Euro 1,954 million (i.e. approx. Euro 7.0 per share). In this regard, it is relevant to look closer at the viability of ILPGH based on the Company's audited accounts under the International Accounting Standards that constitute a part of EU law. I turn to this matter below in this affidavit.

50. In respect of the fact that the Irish Regulator (i.e. the Central Bank of Ireland) had not discovered any holes at ILP, it is instructive to also mention that the Regulator had been proactively – and unsuccessfully – looking for those holes, together with experts from the European Union and the International Monetary Fund, for months before the March 2011 PCAR/PLAR. In this regard, it is instructive to refer to the Wall Street Journal article of 29th November 2010, which quotes Patrick Honohan, the Governor of the Central Bank of Ireland, as saying the following:

*"Patrick Honohan, the governor of the Central Bank of Ireland and a member of the European Central Bank's Governing Council, said there is no indication that Irish banks have more big hidden losses on their books.*

*"There has been no indication in our discussions over the past couple of weeks that there is a hole that we haven't discovered," he said on RTE radio Monday, referring to experts from the European Union and International Monetary Fund who have been in Dublin to set up the country's aid package.*

*"They didn't find a hole," he said, adding that the central bank was constantly looking for additional losses and would disclose and deal with them quickly if any were discovered."*

The same article notes the following in respect of ILP:

*"Separately, the financial regulator has said Irish Life & Permanent, a life-insurance and banking company, must raise €100 million from its own resources over an unspecified period. Observers say the company could generate capital from its life-insurance operations. Irish Life & Permanent said the move will have a "modest impact" on the company.*

*Irish Life & Permanent is unique among Ireland's main financial institutions in not receiving state support, or making use of the National Asset Management Agency, a so-called bad bank, which is buying good and bad property loans from five other Irish financial institutions at a steep discount. Other Irish banks lent billions of euros to property developers, and most of that is now unlikely to be paid back.*

*Irish Life & Permanent Chief Executive Kevin Murphy said the strengthening of the capital position would reassure international investors about the ability of Irish banks to weather the current recession."*

I beg to refer to the said Wall Street Journal article, upon which marked with the letters "**TA12**" I have signed my name prior to the swearing hereof.

## VII. Viability of ILPGH / ILP as per the audited accounts

51. As motioned before, since its inception, the Company has continued to exist with its own structures. General meetings of shareholders and the Board of Directors, which are the key organs of the Company, have never been suspended. The Company has never been subject of special management under part 3 of the 2010 Act or of a compulsory administration. ILPGH has never been subject of execution measures, such as liquidation, intended to put an end to the Company's existence.

52. Prior to the July 2011 Direction Order, ILPGH / ILP were unequivocally a going concern, which was determined by both the management and the auditors in accordance with the legally binding requirements under EU law. In my last opinion, I provided facts, including the quotes from the ILPGH directors and from the formal documents signed by the EU authorities and the Irish authorities, which make it clear that ILPGH was viable. I wish to add to that the following important and relevant facts.

53. Under the International Accounting Standards (the "IAS"), a company's solvency and liquidity at the end of an accounting period is reflected in the concept of the so-called "going concern". Under IAS, an entity either is a going concern or it is not.

54. The IAS are adopted by the EU in the form of regulations as per the EU IAS Regulation (Regulation (EC) 1606/2002). The IAS regulations are directly applicable in all Member States. I beg to refer to the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, upon which marked with the letters "**TA18**" I have signed my name prior to the swearing hereof.

55. The concept of the going concern is driven by the requirements of the International Accounting Standard 1 (the "IAS 1"). I beg to refer to the European Commission's summary of IAS1, upon which marked with the letters "**TA19**" I have signed my name prior to the swearing hereof.

56. In the said summary on the IAS1, the European Commission states, *inter alia*, the following in respect of the going concern requirements:

*"**25. When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.*** (Emphasis in bold by the European Commission).

*26. <u>In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period</u>. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected* *profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate."* (Emphasis added)

57. International Standard on Auditing (ISA) 570 clearly outlines the objectives of the auditor about the use of the going concern basis in the accounts:

    i. to obtain sufficient appropriate evidence about the appropriateness of management's use of the going concern basis;

    ii. to conclude, on the basis of the audit evidence, whether a material uncertainty exists about events or conditions that may cast significant doubt about the entity's ability to continue as a going concern;

    iii. to determine the implications for the auditor's report.

I beg to refer to the International Federation of Accountants ("IFAC") summary on the IAS 570, upon which marked with the letters "**TA20**" I have signed my name prior to the swearing hereof. I also beg to refer to the ACCA[64] article on going concern, upon which marked with the letters "**TA21**" I have signed my name prior to the swearing hereof.

58. According to the IAS 570, the auditors are obliged to qualify their report if they believe that the going concern reporting is inappropriate or inadequate. The above IFAC summary on IAS 570 states the following in paragraphs A25 and A26:

*"A25. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the requirement of paragraph 21 for the auditor to express an adverse opinion applies regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern assumption.*

*A 26. If the entity's management is required, or elects, to prepare financial statements when the use of the going concern assumption is not appropriate in the circumstances, the financial statements are prepared on an alternative basis (for example, liquidation basis). The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the alternative basis is an acceptable financial reporting framework in the circumstances. The auditor may be able to express an unmodified opinion on those financial statements, provided there is adequate disclosure therein but may consider it appropriate or necessary to include an Emphasis of Matter paragraph in the auditor's report to draw the user's attention to that alternative basis and the reasons for its use."*

59. The ILPGH 2010 annual report, which was issued on 4th March 2011, was the last audited report issued before the July 2011 Direction Order. The report is referred to as Exhibit TA3 in my affidavit sworn on 5th December 2013.

[64] ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants.

60. In the ILPGH 2010 annual report, the auditors KPMG stated, *inter alia*, the following on pages 70 and 71:

*"The consolidated and company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the group and company. The Companies Acts, 1963 to 2009 provide in relation to such financial statements, that references in the relevant part of these Acts to financial statements giving a true and fair view are references to their achieving a fair presentation.*

*In preparing each of the consolidated and company financial statements, the directors are required to:*
- *select suitable accounting policies and then apply them consistently;*
- *make judgements and estimates that are reasonable and prudent;*
- *state that the financial statements comply with IFRSs as adopted by the EU, IFRSs issued by the IASB and, in the case of the company as applied in accordance with the Companies Act, 1963 to 2009; and*
- *<u>prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the company will continue in business</u>.*

*[…]*

*Basis of Audit Opinion*

*We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.*

*We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.*

*Opinion*

*In our opinion:*
- *the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2010 and of its profit/(loss) for the year then ended;*
- *the company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Acts 1963 to 2009, of the state of the company's affairs as at 31 December 2010;*
- *the consolidated financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2009 and Article 4 of the IAS Regulation; and*

- *the company financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2009.*

*Emphasis of matter – going concern*
*In forming our opinion on these financial statements, which is not qualified, we have considered the adequacy of the disclosures in Note 1 to the financial statements. These disclosures set out a number of material economic, political and market risks and uncertainties that impact the Irish banking system which may cast doubt upon the group's ability to continue as a going concern. These include the group's continuing ability to access funding from the Eurosystem and the Irish Central Bank to meet its liquidity requirements and its ability to raise additional capital to meet its required regulatory capital ratios. These matters, together with the options available to the group, have been considered by the directors in concluding that it is appropriate to prepare the financial statements on a going concern basis."* (Emphasis added)

61. Furthermore, KPMG stated the following:

*"The net assets of the company, as stated in the company statement of financial position are more than half of the amount of its called up share capital and, in our opinion, on that basis there did not exist at 31 December 2010 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company."*

The above-mentioned Section 40(1) of the Companies (Amendment) Act, 1983 states the following:

*"Obligation to convene extraordinary general meeting in event of serious loss of capital*[65]*.*

*40.—(1) Subject to subsection (4), where the net assets of a company are half or less of the amount of the company's called-up share capital, the directors of the company shall, not later than 28 days from the earliest day on which that fact is known to a director of the company, duly convene an extraordinary general meeting of the company for a date not later than 56 days from that day for the purpose of considering whether any, and if so what, measures should be taken to deal with the situation."*

62. The fact that the organs of the Company has never ceased to function is also corroborated by the Relationship Framework issued on 29th March 2012, which states, *inter alia*, that:

*"The Board has full responsibility and authority for all of the operations and business of ILPGH in accordance with its legal and fiduciary duties and has responsibility and authority for ensuring compliance with the regulatory and legal obligations of ILPGH (including, for the avoidance of doubt, the legal and regulatory obligations of ILP). It is recognised that ILP is a licensed bank that is regulated by the Central Bank and this Relationship Framework will operate at all times in compliance with Regulatory Requirements.*

*It is further recognised that ILPGH has shares and other instruments listed or traded on various exchanges and that ILPGH must comply at all times with the requirements of Listing Rules and other applicable rules relating to securities and instruments.*

[65] I note that this provision of Irish law transposes Article 17 of the Second Council Directive 77/91/EEC.

*This Relationship Framework provides for safeguards as to the separate management of each of the State's interests in Irish credit institutions (including in ILP through ILPGH) in order to ensure that those interests, and the management of those interests, do not lead to a prevention, restriction or distortion of competition in contravention of merger control or competition law rules.*

*The Minister expects the Board and management team of ILPGH to conduct ILPGH's commercial operations in a prudent and sustainable manner which seeks to create a commercially oriented credit institution which recognises the need to encourage and enforce implementation of lessons learned from the financial crisis."*

The Board owes duty to the Minister in respect of certain matters prescribed by the 2010 Act. However, the Board functions – and has continuously been functioning – in accordance with the principles embedded in the aforementioned Relationship Framework. The Minister has certain consultation/consent powers, as defined in the Relationship Framework. I beg to refer to the Relationship Framework, upon which marked with the letters "**TA22**" I have signed my name prior to the swearing hereof.

63. Incidentally, all the above facts have to be distinguished from the fact that the Company has been an emanation of the State by the virtue of the powers the Minister has been using under sections 46, 47, 48 and 53 of the 2010 Act for the purposes of the direction orders forced by the Minister in respect of ILPGH / ILP. It is clear that the Minister has put himself in effective control of the Company based on those powers and based on the 99.2% of the voting share capital that he appropriated. However, it is also clear that the key organs of the Company have never been suspended and have been all functioning. In fact, it is instructive to note in respect of the recapitalization in question here that the shareholders were first asked at the EGM on 20th July 2011 to approve the terms of the recapitalization and of the takeover of ILPGH by the Minister. Those terms were rejected by the shareholders and the Minister forced those terms through the July 2011 Direction Order. This is clear evidence that the organs of the Company were fully functional – the EGM was in fact asked by the Board to approve the restructuring. The reality is that the EGM did not act in accordance with the Minister's wishes and that led to the Minister applying for the July 2011 Direction Order, which revoked the decisions of the EGM. Had the EGM approved the terms of the recapitalization in accordance with the Minister's wishes, then no direction order would have been made (because the respective terms would have been effected by the EGM). This fact was corroborated by the Board in the Circular of 27th June 2011[66]. In this sense, the Minister temporarily – and illegally, i.e. in a manner incompatible with EU law – divested the shareholders of their powers for the sake of the July 2011 Direction Order, i.e. in order to force the terms of the Order. No organs of the Company were suspended following the July 2011 Direction Order – the Company has continued to exist with its own structures. General meetings of shareholders and the Board of Directors, which are the key organs of the Company, have never been suspended. The Company has never been subject of special management or of a compulsory administration. Nor has ILPGH ever been subject of execution measures, such as liquidation, intended to put an end to the Company's existence.

64. On a slightly separate (but relevant) note, I note that on 25th February 2011, i.e. about a month before the announcement of the March 2011 PCAR/PLAR, a transfer order was made by the High Court pursuant to the Credit Institutions (Stabilisation) Act 2010, whereby Irish Nationwide Building Society ("INBS"),

[66] See Exhibit PS7 of the affidavit sworn by Mr. Skoczylas on 30th August 2013 (Sections 10 and 13 of the Circular).

which was a failed credit institution, transferred Euro 3.6 billion of its deposits to ILP. Hence, as per section 33(2) of the 2010 Act, the Minister for Finance, having consulted with the Governor of the Central Bank of Ireland, was of the opinion that making the transfer order in the terms of the proposed transfer order made by the Minister was necessary to secure the achievement of purposes of the Act specified in the proposed transfer order. It is clear that neither the Minister nor the Governor of the Central Bank would have – or could have – allowed for such a huge transfer if they had believed that ILP was not viable. Nor could the High Court have allowed for such a transfer, if there had been any doubt as to the viability of ILP. I beg to refer to the respective ILPGH stock exchange announcements, the so-called RNSs, upon which pinned together and marked with the letters "**TA43**" I have signed my name prior to the swearing hereof.

65. **The above facts make it unequivocally clear that ILPGH was a going concern that was not insolvent or illiquid, or on or a brink of insolvency or illiquidity, which could jeopardize its existence as a going concern**. As mentioned in my last affidavit, the ILPGH Chairman, Mr. Cook, actually confirmed this explicitly at the ILPGH AGM on 18th May 2011, i.e. after the March 2011 PCAR/PLAR announcement (of 31st March), when he stated, *inter alia*, that:

ILP has a *"strong, viable and sustainable future"* and *"can provide healthy competition to the two larger pillar banks" … "The business is not on the brink of insolvency, but there is a requirement for us to guard against a much greater and stringent set of conditions; even though it is unlikely that such conditions will apply in the future."* The finances of the Company were *"not materially different from last September"* [when the Company was required to raise only €100m in new capital above and beyond its then current requirements, amounting to a total of €243m], but that the Central Bank applied a far tougher set of conditions; *"They have applied a killer punch".*

66. The ILPGH half-year report for 2011 (showing status at the end of June 2011, i.e. before the capital injection pursuant to the July 2011 Direction Order), which was issued on 30th August 2011, stated in respect of the Bank's capital position[67]:

***"The group's capital ratios remained strong at 30 June 2011"***

## VIII. Recapitalization was based on temporary conflation of extreme precautionary measures

67. **It is important to stress the fact that the recapitalization of Irish banks in July 2011 was based on a temporary conflation of extreme precautionary measures, i.e. a combination of extreme assumptions embedded in the March 2011 stress tests scenarios and the increased tier 1 capital ratio requirements. This was aimed at instilling stability in the Irish banking system**. The assumptions underlying the Irish capital requirements were not a forecast, as both the Governor of the CBI and the Minister explicitly reiterated.

68. **To illustrate the very conservative nature of the capital requirements in Ireland – and the resultant significant overcapitalization of banks in Ireland** – I beg to refer to a comparative analysis conducted by the National Bank of Portugal, upon which marked with the letters "**TA16**" I have signed my name prior to the swearing hereof. **The analysis shows that an average core tier 1 ratio between**

[67] Page 16 of the ILPGH Half-Year report for 2011 (Exhibit TA4 of my affidavit sworn on 5th December 2013).

**September 2011 and June 2012 for banks in the UK, Germany, France, Italy, Portugal and Spain was consistently between approx. 8% and 10%, while in Ireland it was between approx. 16% and 18% in the same period.**[68]

69. Following the period of the increased tier 1 capital requirements, on 24th December 2013, the CBI announced that the tier 1 capital ratio requirement in Ireland would be made consistent with the minimum requirements under EU law. Details in this regard are provided in the Appendix to this affidavit, where I provide an overview of the increased capital requirements in Ireland vs. the capital requirements under EU law and regulations.

70. I reiterate what I already wrote in my last affidavit, i.e. that nothing that I state should be misconstrued as an attempt on my part to impugn the recapitalization of ILP or the prudential capital requirements. However, highlighting certain facts is important and relevant.

## IX. Incredible difference between provisions and actual realized losses at ILP

71. It is instructive to look closer at the incredible difference between provisions and the actual realized losses at ILP. I note with interest the statements from the ILPGH investor call on 7th April 2011, with the ILPGH Head of Investor Relations and the ILPGH CFO, during which ILPGH stated the following in respect of the March 2011 PCAR:

*"There is no way under the sun that you can envisage ... I mean you are talking about ... in our case you would be ending up with something like thirty thousand repossessions …we have…in the market over the next few years. We have 20% of the mortgage market. That means when the mortgage market at large is five times that. So there is one hundred and fifty thousand repossessions. That actually would amount to probably about four hundred thousand people or so out of their homes. You know…I mean this is nonsense."*[69]

Those statements are consistent with the view I expressed in my last affidavit in respect of the perverseness of the 2,400% "magical" disconnect between the huge provisions and the realized losses at ILPGH over the last three and a half years, i.e. in respect of the fact that ILPGH booked Euro 3.2 billion loan loss provisions between 2010 and the end of June 2013, while the actual realized losses (i.e. the write-downs of provisions used) for the corresponding period were only Euro 128 million[70]. Clearly, ILPGH was right that there was "no way under the sun" that the "nonsense" (quoted words) over-conservative assumptions embedded in the March 2011 PCAR could ever materialize.

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[68] By way of background regarding the technical terms I use, tier 1 capital is a measure of a bank's financial strength from a regulator's point of view; it is composed of core capital, which consists primarily of common equity. It also includes disclosed reserves or retained earnings. It may also include non-redeemable non-cumulative preferred stock. The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total so-called risk-weighted assets (the "RWA"). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula determined by the Regulator.

[69] Paragraph 34F of the affidavit sworn on 12th December 2013 by Mr. Skoczylas.

[70] The respective facts and evidence are provided in my affidavit sworn on 5th December 2013.

To illustrate the extreme nature of the disconnect at ILPGH between the huge provisions and the accrual realized losses for the three and a half years between 1st January 2010 and the end of June 2013, I have now conducted a comparable analysis for Bank of Ireland ("BOI")[71]:

BOI, Provisions Booked vs. Realized Losses, 1 January 2010 – 30 June 2013[72]:

| Period | Net Provisions Booked Euro m | Net Realized Losses (Write-offs) Euro m |
|---|---|---|
| Year 2010 | 4[73] | 729 |
| Year 2011 | 1,924 | 609 |
| Year 2012 | 1,874 | 695 |
| 6 months of 2013 | 766 | 224 |
| **Total** | **4,568** | **2,257** |

Source: BOI accounts, the "Impairment provisions" notes.
Note: Provisions booked are netted against releases of provisions, including releases of provisions on sale of assets to NAMA[74].

Thus, for the three and a half years between 1st January 2010 and 30th June 2013, BOI generated actual net realized losses of approx. Euro 2.3 billion and booked the respective net provisions of approx. Euro 4.6 billion. Therefore, the BOI net provisions were approx. twice as large as the net realized losses (i.e. approx 100% larger than the realized losses). That compares to the ILP's provisions being about 25 times larger than the actual realized losses (i.e. approx. 2,400% (!) larger than the realized losses) for the same period. I say and believe that it is plainly inconceivable that all of the provisions booked at ILP will be utilized; it is very likely that a meaningful part of those provisions will be released to increase profits and shareholders' equity.

In respect of the above-mentioned analysis and quotes regarding BOI, I beg to refer to the relevant pages from the BOI annual accounts, upon which pinned together and marked with the letters "**TA23**" I have signed my name prior to the swearing hereof.

72. Incidentally, it is misleading to suggest that, just because the accounts have been audited, the provisions booked are necessarily properly reflecting future losses. The assessment of provisions inevitably involves significant judgement calls. That is confirmed in both the ILPGH accounts and in the BOI accounts. Specifically:

The ILPGH accounts state:

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[71] On 9th January 2014, the analysis was discussed with and confirmed by Mr. Ciarán McGrath, the Financial Analyst in the Investor Relations Department at Bank of Ireland.

[72] Includes exchange adjustments and other movements.

[73] This number results from netting the Euro 2,116 million of charge against the income statement and the Euro 2,237 million of the release of provision on sale of assets to NAMA.

[74] Excluding the release of provisions on sale of assets to NAMA and other items, the charge against income statement in the period in question amounted to Euro 6,603 million. Using this number vis-a-vis the said realised losses would mean that the provisions were approx. three times as large as the realized losses.

*"2. Critical accounting estimates and judgements*

*… Critical accounting judgements made by management in applying the Group's accounting policies are set out below.*

*Impairment losses on loans and receivables to customers …"*[75]

The BOI accounts state:

*"Critical accounting estimates and judgements"*

*In preparing the financial statements, the Group makes estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. As management judgement involves an estimate of the likelihood of future events, actual results could differ from those estimates, which could affect the future reported amounts of assets and liabilities. The estimates and judgements that have had the most significant effect on the amounts recognised in the Group's financial statements are set out below.*

*(a) Impairment charges on financial assets …"*[76]

73. In the above context of the Company's financial viability and the incredible provisions, claims that the ILPGH shareholders would be granted a "gift" if they had not been diluted from 100% to less than 0.8% is absurd. Rather, the opposite appears to be the case – the Minister appears to be hoping to derive financial benefit from the Company in case the aforementioned 2,400% difference between the provisions and realized losses does not close up. This is in addition to the absurdity of those claims in light of the violations of EU law by the Minister, given that the claims imply that abiding by EU law – and trying to enforce EU law – would be inappropriate.

## BANKING CRISIS AND BANK RECOVERY AND RESOLUTION

### X. Banking crisis – ILP was not uniquely affected by the recent global banking crisis

74. The recent banking crisis was global and affected all the banks in the world, given the interdependencies among the banks globally. Consequently, most banks in the world suffered from a combination of liquidity and/or solvency problems. In this regard, I beg to refer to the IMF note entitled "Progress with Bank Restructuring and Resolution in Europe" (March 2013), upon which marked with the letters "**TA24**" I have signed my name prior to the swearing hereof. The note states that:

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[75] Page 84 of the ILPGH 2012 annual report. Similar statements are made also in other ILPGH accounts. The 2012 ILPGH annual report is referred to as Exhibit PS13 in the affidavit sworn by Mr. Skoczylas on 30th August 2013.

[76] For example, page 172 of the BOI 2012 annual report. Similar statements are made also in other BOI accounts.

*"The global and European financial crises revealed long-standing structural weaknesses that have yet to be fully addressed in individual banks and in banking systems. In large part, they reflected weaknesses in the public, household, and corporate sectors, but the banks themselves contributed to the problems, and the financial sector constituted a feedback channel that reinforced negative tendencies elsewhere.*[77] *[…]*

*During recent years, EU governments have committed unprecedented support for backstopping the financial sector with tax payer money. Over the September 2008–December 2011 period, member states committed a total of nearly €4.5 trillion, i.e., 37 percent of the EU GDP*[78] *[…]*

*Liquidity support has been especially large in the euro area and the United Kingdom. In the euro area, the European Central Bank (ECB) provided enhanced support by (i) broadening the scope of eligible assets for central bank funding and setting up full allotment liquidity facilities for banks; (ii) undertaking refinancing operations at a fixed and historically low rates; and (iii) extending the maturity of central bank funding to a historical high via the Long-Term Refinancing Operations (LTROs); and (iv) actively purchasing assets (Figure 1). A program of Outright Monetary Transactions (OMT) was announced in September 2012 by the ECB. National central banks have also granted Emergency Liquidity Assistances (ELA) in crisis situations. In the United Kingdom, the Bank of England set up an Asset Purchase Facility (APF), for example, to buy high-quality assets, with cumulative assets purchased net of sales and redemptions totaling £360 billion (as of September 2012).*[79] *[…]*

*Led by the EBA, stress testing and recapitalization exercises resulted in banks increasing the quantity and quality of their capital. After the 2010 Committee of European Banking Supervisors CEBS and 2011 EBA EU-wide stress tests, the EBA conducted a recapitalization exercise. Capital plans submitted by banks have led to €200 billion of new capital or reduction of capital needs, for an aggregate capital shortfall of €115 billion, at end–June 2012. Tier 1 ratios are now exceeding 10 percent, against 7 percent in December 2008*[80] *[…]*

*According to DG Comp, 60 EU banks – accounting for 10–15 percent of the EU banking assets – underwent a deep restructuring. Under the State aid regime, 20 banks were resolved.*[81]*"*

75. It is instructive to refer to the speech of 7th December 2009 by Jean-Clause Trichet, then the President of the European Central Bank (the "ECB"), which Mr. Trichet gave at the Paris Court of Appeal. Mr. Trichet stated, *inter alia*, the following:

*"The sudden unwinding of the decade of reckless developments in the financial sphere has led, we know today, to a large scale global financial crisis. The first cracks appeared in the summer of 2007. The fall of a single financial institution in September 2008 acted as a detonator, revealed the fragility of the*

[77] Introduction on page 6 of the said note.

[78] Paragraph 7 on page 7 of the said note.

[79] Page 8 of the said note.

[80] Page 10 of the said note.

[81] Page 17 of the said note.

*global financial system, and triggered a crisis unprecedented since the Second World War. Because of crisis of confidence on large scale, we moved to a global financial panic. We must realize that without the speed, scale and audacity of the decisions taken by central banks on one side and the governments and parliaments on the other, our economies would have fallen into a deep depression. In a globalized financial system, the liquidity crisis would have spread rapidly worldwide, and transformed into a solvency crisis of the entire financial system. The banking sector as a whole would have then had to be declared bankrupt with serious consequences for the economy.*

*Such challenges require leaders of great lucidity and ability to act quickly in taking measures to meet the significant and unexpected challenges imposed by circumstances. At the beginning of the turmoil, the European Central Bank (ECB) was the first central bank to take exceptional measures in its refinancing operations of the banking sector. With the intensification of the financial crisis, we have taken unprecedented monetary policy measures. Some, such as the reduction of the refinancing rate by 325 basis points since October 2008, are part of the package of measures commonly used by central banks. In addition to this unprecedented reduction, the highest ever achieved in such a short period in Europe, we used measures of unconventional monetary policy, which together constitute our policy of enhanced credit support.*

*These exceptional and mainly banking-oriented systemic measures were aimed at supporting the flow of credit to a level above that which would have resulted merely from a lower interest rate level. With the intensification of the crisis in September 2008, transactions on the interbank market have virtually stopped, to the detriment of the first wave of the monetary policy decisions. To overcome these symptoms of dysfunction of a serious liquidity crisis, we have adjusted significantly our regular refinancing operations. We expanded temporarily the already long list of eligible assets in our refinancing operations. Finally, to complete the measures of liquidity management that I have just described, we began a purchasing program for covered bonds issued by banks.*

*These very bold decisions were all taken quickly and averted a major financial crisis from evolving into a depression, given the very close links between the financial sector and the real economy. As I said on behalf of the Board of Governors last Thursday, the gradual improvement in economic activity in the second half of this year confirms that we are out of the freefall period which marked the six months following the intensification of the crisis in September 2008, and expert forecasts of the Eurosystem point to a positive, though weak, eurozone economic growth in 2010, with considerable uncertainty surrounding this outlook"*

I beg to refer to the said speech by Jean-Claude Trichet, upon which marked with the letters "**TA25**" I have signed my name prior to the swearing hereof.

76. Thus, the whole eurozone required, and received, significant assistance from the Euro central bank system in order for the national economies to survive and in order to avoid a global contagion.

77. In the Euro area, the genesis and implications of the crisis for banks across the region were similar and common. In this regard, I beg to refer to the Bank for International Settlement (the "BIS") Working

Paper[82] entitled "Financial crises and bank funding: recent experience in the euro area, upon which marked with the letters "**TA26**" I have signed my name prior to the swearing hereof. The BIS found among others that:

*"… financial markets and banks became strongly interconnected … the rapid growth of investment banking activity, both by pure investment banks and universal banks, led to a growing reliance on wholesale funding, especially at short maturities … financial globalisation let banks tap funding markets beyond national borders …*

*The funding pattern that emerged from these structural changes underwent unprecedented dislocations during the 2007–09 global financial crisis. This acted as a catalyst for major adjustments in banks' business and funding models – adjustments that, in many cases, were reinforced by the subsequent euro area crisis. While the 2007–09 episode was predominantly a banking crisis, the euro area's problems have centred on strongly interconnected sovereign and banking crises.*

*… Experience over this period shows that, when financial markets are severely stressed, even highly rated banks can struggle to access wholesale funding markets, including those for secured financing."*

78. The above-mentioned BIS paper also described succinctly the complex genesis and evolution of the banking crises, as well as interconnections between various aspects of the crises:

*"2.1. How crises and funding are interconnected*

*Financial crises and developments in bank funding are strongly intertwined, as weaknesses on the asset side of banks' balance sheets tend to trigger funding problems (Borio (2009)). Ultimately, these strains expose growing problems in the quality of the underlying assets, leading to fire sales of assets which accelerate declines in asset prices, resulting in further balance sheet pressures. Throughout this process, funding liquidity crises can exacerbate solvency concerns. These tensions feed on imbalances in bank funding structures, such as excessive recourse to debt financing that is reflected in historically high degrees of leverage. As the increase in debt often finances expansion into riskier business areas, this spills over into a deterioration of the quality of bank assets. If it goes unchecked, the process may lay the foundation for future financial crises and severe dislocations in bank funding markets. […]*

*2.2. A classification of financial crises*

*… The links between financial crises and bank funding may be strongest during banking crises. Such crises tend to arise primarily from deteriorating economic fundamentals, notably declines in asset quality (Borio and Lowe (2002, p 44)). Banking crises often originate in credit-induced asset price boom-bust cycles, during which banks build up large exposures to specific asset classes such as real estate or equity. During the bust, plummeting asset prices lead to a sharp rise in non-performing loans, thus eroding the banking sector's financial strength. Examples of important banking crises – which are*

[82] BIS Working Papers are written by members of the Monetary and Economic Department of the Bank for International Settlements, and from time to time by other economists, and are published by the Bank. The Bank for International Settlements is an international organization of central banks which "fosters international monetary and financial cooperation and serves as a bank for central banks".

*all related to shocks originating from the real estate sector – are the Nordic and Japanese crises of the 1990s and the 2007–09 global crisis (for the former, see van Rixtel (2002)).*

*Banking crises have been amplified by banks' overreliance on specific sources of financing. With the growing diversification and complexity of funding instruments, the variety of channels through which these imbalances may develop into systemic banking crises has greatly increased. These vulnerabilities relate to the composition of funding in terms of type of instrument, maturity and currency. The 2007–09 global banking crisis showed the shortcomings of business models that depended disproportionately on short-term wholesale funding, such as those adopted by Northern Rock in the United Kingdom and Bear Stearns and Lehman Brothers in the United States…*

*2.3. The 2007–09 global banking crisis and its impact on funding*

*During the global banking crisis, banks experienced unprecedented shocks to their funding models, in terms of both market access and cost... In the summer of 2007, tensions from the US subprime mortgage markets spilled over to banks' short-term wholesale funding markets, causing liquidity conditions to deteriorate rapidly, particularly for highly leveraged banks. Contagion through the interconnectedness of major global banks and their funding models led*
*to sharp and unprecedented increases in interbank spreads... The disruptions in short-term funding markets prompted central banks worldwide to provide unprecedented amounts of funds. Indeed, central bank liquidity became a major source of wholesale funding. At the same time, governments across the globe provided support through a range of measures, including capital injections, guaranteed issuance programmes for bank bonds and higher deposit insurance ceilings."*

79. **In this context, it is misleading to suggest that the Irish banks, or – even less so – ILP was unique. It was not. Each bank has, of course, its individual business model and individual set of challenges associated with that business model in the context of the market on which it operates. However, all the banks suffered from similar global structural problems during the recent global banking crisis.**

80. **In light of the recent global banking crisis, most of the banks in the world can be said to have been unable to survive if they had not been supported by the national authorities and by coordinated international efforts.**

81. Furthermore, the above-mentioned BIS report points out that the bank crisis was exacerbated by the sovereign debt crisis, which makes it clear that faulting banks for the complex global crisis is misconceived and overly simplistic. The BIS report states:

*"The first tremors of euro area's financial crisis were felt in the first quarter of 2010. They emanated from growing market concerns about the sustainability of public finances in view of rising government deficits and debts in Greece and other peripheral European countries. These strains built up before many European banks had fully purged their balance sheets of impaired assets from the 2007–09 financial crisis. Sovereign concerns spilled over to banks… During these episodes of severe market stress, all banks in the euro area, even the strongest, experienced significant difficulties in terms of both access to funding and its cost. Thus sovereign tensions morphed into a banking crisis… To make matters worse, this crisis became increasingly intertwined with setbacks to economic growth and*

*competitiveness. These factors, in turn, exacerbated the sovereign debt and banking crises, putting further pressure on bank funding …*

*4.4. Long-term wholesale funding*

*The euro area financial crisis also impaired longer-term wholesale funding markets, notably during episodes of market tension. The banks of certain peripheral countries all but lost market access at the height of the crisis in the second half of 2011 and the first half of 2012; particularly during this period, longer-term funding markets became increasingly segmented according to bank nationality. In the process, banks from Greece, Ireland and Portugal were virtually shut out from primary bond markets, while those from Italy and Spain at times experienced severe difficulties in issuing longer-term debt … At the same time, funding stress frequently spilled over to core countries' banks, leading to very low levels of gross bond issuance by banks from Germany, France and the Netherlands in months of severe market turmoil. … In parallel with rising sovereign tensions, Irish, Portuguese, Italian and Spanish covered bond spreads increased markedly… Government-guaranteed issuance became a very important source of longer-term bank funding in 2008 and 2009 at the height of the global financial crisis …*

*4.5. ECB liquidity provision*

*The growing tensions in wholesale funding markets significantly boosted demand for central bank liquidity. The ECB increasingly accommodated this demand through a wide range of open market operations… The euro area financial crisis substantially increased the dependence of national banking systems on central bank liquidity…*

*[Funding] difficulties were the most pronounced for banks from peripheral countries where, regardless of a bank's credit rating, the difficulties faced by its sovereign became the arbiter of the bank's access to funding and its cost … Hence, funding markets increasingly became segmented along national borders, forcing banks from specific countries to resort to ECB liquidity."*

82. It is important to emphasize that the Irish regulator and the Irish government were co-responsible for the banking crisis in Ireland. In this regard, it is instructive to refer to the UCD report entitled "Crisis in the Irish Banking System", dated February 2012, by Professor Blanaid Clarke and Dr. Niamh Hardiman. The authors conclude, *inter alia*, the following:

*"Conclusion*

*The scale of the Irish financial crisis represents the destruction of a whole model of development that had evolved during the 2000s. Because of the guarantees provided by government to the domestic banks, it is also a catastrophe for ordinary Irish citizens. At the core of the disaster is the utter failure of the 'light-touch' model of regulation.*

*We have considered a variety of explanations for the disasters that overtook the Irish banking system. Market-based corporate governance disciplines proved ineffective, and codes of practice associated with good corporate governance provided little resistance to the incentives to increase risky lending practices. While the structure of the regulatory system and the powers and resources available to the financial regulator were contributory factors, a more fundamental problem was that tougher regulation* *was not viewed as either necessary or desirable, either by the regulator's office or indeed by government itself. The reasons why the regulatory failures took the form they did cannot be understood without acknowledging that this approach to regulation was tacitly endorsed by government and state officials themselves. The failures of the Irish financial system reflect the limitations of a particular approach to regulation. But a deeper truth emerges, which is that during a critical period in the 2000s, government priorities were more attentive to the interests of the bankers, the builders, and property developers, than they were to considerations of good governance."*

I beg to refer to the above-mentioned paper, upon which marked with the letters "**TA27**" I have signed my name prior to the swearing hereof.

83. It is also important to note that one of the ways to exacerbate the crisis was to apply misconceived restructuring tools, such as the now-abandoned loan-to-deposit ratio, which was the main driver behind the Euro 2.2 billion PLAR capital requirement for ILP, which has never materialized. In this regard, it is instructive to refer in this regard to a paper by the current Governor of the Central Bank of Ireland, Patrick Honohan, entitled "Resolving Ireland's Banking Crisis" (January 2009), in which Mr. Honohan points out that the Irish regulator was partly to blame for the banking crisis, and that the regulator should not put pressure on banks to reduce the loan-to-deposit ratio (which is exactly what later happened as part of the March 2011 PCAR/PLAR):

*"Regulation: don't constrain loanable funds by insisting on higher loan/deposit ratios*

*The Irish banks are heavily indebted to foreign lenders and operate with very high loan-to-deposit ratios. It would have been better is they had not got into this situation, but a <u>rush to reduce this ratio could be disastrous for the economy's ability to ride out the global recession</u>. Even if a government guarantee is needed for an extended period, this should be made available in order to ensure that a shortage of loanable funds does not takeover from risk-aversion as the chief reason for the credit crunch in Ireland. <u>Certainly the Regulator should not be putting the banks under pressure to reduce loan-to-deposit ratios at present</u>.*

*The danger of regulatory over-reaction must be present, though there is insufficient evidence in the public domain as to the current stance of regulatory policy. Reforms to incentive structures for management would of course be good. But much of the current global rethinking of regulatory design will not necessarily be particularly relevant to the Irish scene: the Irish problems relate to a very old-fashioned credit boom and not to financial innovation. <u>The failure was one of insufficient skepticism on the part of the regulator</u>. With hindsight, it seems evident that the Regulator should have insisted on much more pessimistic loan-loss provisioning on developer loans. The adjustment to capital requirements for high LTV residential mortgages should have been much higher. Beyond that, the danger to be avoided now is that the Regulator might be inclined to impose requirements that discourage exactly the lending that is needed to protect the economy through the downturn and position it for a recovery."*

I beg to refer to the said paper, upon which marked with the letters "**TA28**" I have signed my name prior to the swearing hereof.

84. **In the entire context above, forcing measures incompatible with EU law, which in effect expropriate 135,000 shareholders of a bank's holding company that is a going concern under the IFRS, based precautionary capital requirements resulting from extreme assumptions embedded in stress-test scenarios, is unjustified and unprecedented (in addition to being illegal).**

## XI. Response to the recent crisis in various EU Member States

85. **Measures undertook against the ILPGH shareholders were unprecedented in the EU. It is important to reiterate that it is plainly incorrect – and without any substantiation in fact – to claim that, as a result of the recent global banking crisis, any EU government undertook as a precaution compounded measures that would be similar to those committed against the ILPGH shareholders. To be clear, there is not a single example (other than that of ILPGH) of a situation where shareholders of a bank's holding company that was a going concern were diluted from 100% to less than 1% because an EU State decided, against the decisions of a general meeting, to increase the number of outstanding shares 130-fold (!) (i.e. by approx. 13,000%(!)) and to issue shares below the nominal value (i.e. to forcibly change the memorandum and articles of association to lower the nominal value, and to concurrently issue the shares below the original nominal value), without offering the shareholders their statutory pre-emption rights.**

86. At the outset, it is relevant to reiterate in respect of legal limits within the EU what Professor Alexander concluded in his aforementioned paper on "Balancing Prudential Regulation and Shareholder Rights", i.e. that the Second Company Law Directive precludes, even where a bank is experiencing serious financial difficulties, national rules which would allow to order a recapitalization of an undercapitalized bank without shareholder resolution and approval at a general meeting[83]:

*"As discussed earlier, EU company law requires that measures affecting a bank's capital structure, such as a capital increase or a merger with another bank, are to be decided by shareholders. The ECJ ruled in Pafitis[84] that the Second Company Law Directive precludes national legislation which allows an administrator to order a recapitalisation of an under-capitalised bank without shareholder resolution and approval at a meeting. Similarly, the ECJ ruled in the Kefalas case[85] that "the decision-making power of the general meeting provided for in Article 25(1) applies even where the company is experiencing serious financial difficulties". A reorganisation involving a change in capital structure therefore requires a vote of approval by shareholders at a general or special meeting."*

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[83] Page 91 of the said paper.

[84] *The ECJ ruled in Pafitis that the directive does*

> *"not preclude the taking of execution measures intended to put an end to the company's existence and, in particular, does not preclude liquidation measures placing the company under compulsory administration with a view to safeguarding the rights of creditors. However, the directive continues to apply where ordinary reorganization measures are taken in order to ensure the survival of the company, even if those measures mean that the shareholders and the normal organs of the company are temporarily divested of their powers."*

[85] *C–367/96 Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE) [1998] ECR I–2843.*

87. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests" points out to key legal principles in respect of a bank recovery and resolution regime in Europe[86]:

*"…because shareholder rights are well protected, any curtailment of them needs to respect broad principles. The ECHR itself is built upon a careful equilibrium of public and private concerns. Early intervention and special resolution measures must therefore observe certain legal requirements if they have the effect of curtailing shareholder rights. In addition, they need to be designed in a way to provide shareholders with incentives both to exercise corporate control, in particular over management and management incentives (e.g. the design of remuneration packages), and to take early action to recapitalise the bank or implement other measures that restore market confidence.*

***5.1 Predictability and legal certainty***

***The predictability of procedure – or the absence of arbitrariness – is a general legal principle. Interference with property rights must not be arbitrary. The conditions under which it occurs must be clearly set out in the law. The rule of law is one of the fundamental principles of a democratic society. The Strasbourg Court confirmed that the first and most important requirement of Article 1 of Protocol No. 1 is that any interference by a public authority with property rights should be lawful: the second sentence of the first paragraph authorises a deprivation of such rights only "subject to the conditions provided for by law". The requirement of lawfulness, within the meaning of the ECHR presupposes among other that domestic law provides legal protection against arbitrary interferences by the public authorities with the rights safeguarded by the ECHR.***" (Emphasis added)

88. Dr. Hüpkes points out in the same publication the importance of a staged recovery process, as opposed to a sudden and unexpected imposition of exceptional resolution-type measures. She states[87]:

*"Since it is practically impossible to set out in advance the precise circumstances in which bank resolution powers will be invoked, it is important to have multiple triggers and to create more stages along the path to resolution for the authorities to work their way through. The objective is to alert the bank and its shareholders in advance of the consequences of the worsening financial position of the bank and to provide them with a last chance to remedy the situation before they intervene[88]."*

I note how different those principles are from the realities that the ILPGH shareholders were confronted with. At the end of November 2010, ILPGH was given a relatively clean bill of health from the Central Bank of Ireland, with hardly any capital requirement. Four months later, the Company was confronted with sudden and unexpected huge **precautionary** capital requirement of Euro 4 billion that shocked the management and the financial markets. And the Company was given only four months to raise that huge capital. Furthermore, the resolutions of the ILPGH EGM of 20th July 2011 to ask the European authorities to extend the deadline were forcibly revoked by the July 2011 Direction Order. And what then crossed the line of illegality was that the Minister misused the precautionary capital requirements to

[86] Pages 286 and 287 of the said paper.

[87] Page 287 of the same paper.

[88] *See, e.g. Article 57 of the Belgian Law of 22 March 1993 relating to the statute and supervision of credit institutions.*

appropriate 99.2% of the voting share capital in ILPGH from the original shareholders, against the decisions of the ILPGH EGM, in a manner that was incompatible with the minimum shareholder protections embedded in EU law, such as those included in the Second Company Law Directive.

89. In this context, it is instructive to contrast the key aspects of measures undertaken against the ILPGH shareholders with those undertaken in other in Member States to combat the global banking crisis. That comparison shows clearly that there is no State in the EU that has enabled the executive to effect compounded draconian measures incompatible with EU law similar to those undertaken by the Irish State in respect of the proposed direction order dated 25th July 2011, in the terms of which the July 2011 Direction Order was made. In fact, there are examples of attempts to increase capital in financial institutions without shareholder approval, which were successfully resisted by the shareholders and the national judiciary (e.g., the aforementioned cases of Fortis and Monte dei Paschi di Siena).

90. As mentioned earlier, the eurozone requires a broadly coordinated and uniform approach to a recovery and resolution regime to combat the common banking crisis. Such a common approach, which – in absence of the Recovery and Resolution Directive (which is at a proposal stage) – by necessity had to be based on individual Member State's rules, must exclude extreme unilateral and arbitrary measures characteristic only for one Member State. In this regard, it is instructive to refer to the ECB opinion on the Credit Institutions (Stabilisation) Act 2010, which is referred to as Exhibit PS61 in the affidavit sworn by Mr. Skoczylas on 30th August 2013. The ECB President states there, *inter alia*, the following:

*"In line with its previous opinions, the ECB emphasises that, when adopting measures to deal with the financial crisis, Member States should act in a coordinated manner in order to avoid significant differences in national implementation having a counter-productive effect, which may involve distortions in global banking markets. Moreover, it is crucial to ensure consistency with the Eurosystem's management of liquidity and its operational framework[89]. Against this background, any national measure should ensure a sufficiently level playing field within the euro area, which is of key importance to maintain the integrity of the euro area banking system."*

It is a fact that the draconian and unparalleled measures undertaken against the ILPGH shareholders were nowhere near the *"level playing field within the euro area"* propagated by the ECB President.

***Unprecedented nature of the Irish bank recovery and resolution regime***

91. Ireland enacted an emergency legislation called the Credit Institutions (Stabilisation) Act 2010, which is without precedent in the EU. It is not my intention to make legal submissions in respect of this legislation. However, I say and believe that it is important – and relevant for my opinions in this affidavit and in my last affidavit – to rebut the erroneous notion that this Irish legislation is comparable to other recently introduced banking legislation in other EU Member States. It certainly is not. It is an unprecedented statute without a parallel in the EU.

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[89] *See, for example, Opinion CON/2009/54. All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.*

92. The emergency statute was enacted by the Irish parliament on an expedited basis on 15th and 16th December 2010, before the year's end recess. It is a matter of a public record that the Irish emergency legislation in question here was deemed from the beginning to be an unprecedented statute, uncharacteristic for an EU Member State. In this regard, it is instructive to refer to the statements by the Irish legislators. The following references are very relevant for my opinions, and those references are being made not in order to impugn, or critique upon, any provisions of the 2010 emergency legislation. It is not my intention to construe any provisions of the 2010 emergency bill by reference to anything said during the parliamentary debates. Nor is it my intention to interpret the intent or the will of the legislature. I am expressly not attempting to seek the meaning of the words which Parliament used. Also, I am expressly not making any references to statements made by the Minister for Finance who piloted the bill through the Parliament. The issue at hand here is not one of construing any provisions of the 2010 emergency bill, but of showing its unprecedented nature. That is very relevant for two reasons. Firstly, it means that the Minister was required to be very careful in not misusing the emergency legislation in a manner incompatible with EU law. Secondly, it is relevant when rebutting erroneous assertions that allegedly other EU Member States have introduced similar pieces of legislation, when in fact that is plainly not the case. In this context, the following statements – which are subject of a public record – are very relevant and ought to be of assistance to the Honorable Court. I must also stress that I do not make those references in order to make any member of the national Parliament amenable in any way in respect of utterances made in the Parliament. I do not – and would never – suggest that the following utterances were untrue, misleading or inspired by improper motivation. The following statements simply show a consensus acknowledgment of the exceptionally unparalleled character of the 2010 emergency bill, which, as I will show below, goes far beyond any other banking emergency legislation in the EU:

i. Deputy Joan Burton said the following in the Irish Parliament on 15th December 2011 in respect of the emergency bill:

*"The Labour Party objects to this Bill being taken today. This Bill could probably teach the North Koreans a lesson in ministerial powers […] Outside of totalitarian regimes, I do not believe there has been a proposal to give powers like this to a Minister for Finance. We have received legal advice from a number of sources which agree that section 53 is more than likely unconstitutional, because it seeks to replace the law-making powers of the Oireachtas within the Constitution and transfer them to the Minister for Finance. […] I made two points about this Bill. Section 53 is clearly unconstitutional because it provides most extraordinary powers to the Minister for Finance. […] The provision of these extraordinary powers after a debate of less than four hours on 77 sections and 66 pages is a travesty of democracy. People talk about political reform."*

ii. Deputy Enda Kenny said the following on the same day:

"*I find it absolutely extraordinary that the Government would actually have the audacity to come in here and expect that the Credit Institutions (Stabilisation) Bill 2010, containing 77 sections, would go through by 10 p.m. tonight. This Bill will allocate to the Minister for Finance the most powerful positions in finance ever given to any Minister in any government in the history of the State.*

iii. Senator Joe O'Toole said in upper chamber of the Irish Parliament on 16th December 2010 in respect of the 2010 Act:

*"I do not believe the Bill will survive. I think it is unsafe and unconstitutional. In many ways, it undermines and perverts an existing body of legislation in a variety of areas. It also undermines existing regulation and undermines and perverts common law of many centuries before there was any companies' legislation."*

iv. Deputy Michael Noonan (now the Minister) said the following in respect of the emergency legislation in the lower chamber of the Irish Parliament on 15th December 2010:

*"The proposal to make the Minister the sole agent of the development of future banking policy, with little or no recourse to the Governor of the Central Bank, no recourse to this Parliament and no requirement to consult the Government, is absolutely extraordinary. [...] The Minister is taking to himself one of the roles of the Parliament. The power being taken is, in effect, tantamount to the power to develop new law, using some kind of order as a mechanism. That is a very dangerous precedent. If one examines the measures being proposed in the Bill, one will have serious constitutional doubts [...] The Minister is encroaching on the constitutional role of the Parliament. There are serious doubts about whether he is also encroaching on the separation of powers with the courts."*

v. Deputy Edward O'Keeffe said in the Parliament on 15th December 2010 in respect of the emergency statute:

*"This is the most draconian legislation ever introduced by an Irish Government, especially a Fianna Fáil Government. My colleague, Deputy McGrath, referred to Cuba, but it is even worse than Cuba, it is like something one would hear about in North Korea. The Bill is taking from the rights of the people and putting legislation in place to that effect.*
*[...]*
*This legislation must go before the Supreme Court before it can be enacted. It is the most serious and draconian legislation that has ever come in here, even the Special Powers Act was not as dominant and dangerous to the Irish people as this legislation."*

I beg to refer to a copy of the transcript from the respective debates in the Houses of the Oireachtas of 15th and 16th December 2010, upon which marked with the letters "**TA30**" I have signed my name prior to the swearing hereof.

93. By way of an additional relevant background regarding the enactment of the 2010 emergency legislation, the proposal of the legislation was presented to the lower House of the Irish Parliament on 15th December 2010. The statute's ratification was rushed through the Parliament in about four hours on the same day, which was one day before the 2010 Christmas recess; the ratification of the 2010 Act was then rushed the following day through upper House of the Parliament in similar circumstances:

i. Deputy Michael Noonan (now the Minster) said the following on 15th December 2010:

*"There are 76 sections and every Member knows we cannot deal with this appropriately between now and 10 p.m. with a break of an hour and a half for Private Members' business. It is a ridiculous position to put us in and, despite putting several hours into them last night, I am not sure what all*

*the sections mean yet. I would like to question the Minister and to tease the legislation out with proper Committee Stage and Report Stage debates."*

ii. Mr. Noonan went on to say on the same dame in respect of the 2010 emergency legislation:

*"The electorate is intelligent and when people see us ramming through stuff here that nobody fully understands, they wonder what we are at in this House. It is unnecessary."*

*"In the time available tonight, this extraordinary Bill will receive little scrutiny. The Minister is proposing to take to himself extraordinary and very strong powers."*

iii. Deputy Brian Hayes said on 12th January 2010 in Dáil in respect of the legislation's rushed processing through the Parliament:

*"Not since the time of the Third Reich was a Bill so radically put through a democratic parliament. Is the Minister not stung by the clear and deliberate criticisms that have been levied at him and the Government for the manner in which the legislation was put through the House, as well as its provisions?"*

iv. Deputy Joan Burton – currently the Minister for Social Justice in the Irish Government – added the following on 15th December 2010 in the lower chamber of the Parliament in respect of the legislation's rushed processing through the Parliament:

*"We received copies of this legislation yesterday at around 1 p.m. It is a complex Bill comprising 67 pages with 77 sections and two Schedules, one of which is in five parts. Each part sets out substantive amendments to other pieces of legislation, such as the National Pensions Reserve Fund Act and the NAMA Act. In addition, the Bill before us sets out changes to powers concerning the relationship between the Minister for Finance and the Governor of the Central Bank. We are supposed to deal with all this material by 10 o'clock tonight, out of which 90 minutes will be devoted to Private Members' time.*

*In dealing with such a Bill, Second Stage is obviously more important than Committee Stage. However, Committee Stage will now be limited to the small amount of time we have been allocated, with almost no opportunity for interested parties, publicly-minded citizens, expert academics and lawyers to examine and consider the Bill with a view to how it might be improved or amended, or what might be deleted or altered in its provisions. The Bill is being railroaded through. It is hard to understand what is its purpose, except in the context of a general election happening early in the New Year."*

v. Deputy Joan Burton went on to say on 15th December 2010 in the Dáil in respect of the Act's rushed processing through the parliament:

*"The Bill is very complex. […] On the second last day of the Dáil session before it goes into recess for Christmas and the New Year the Minister has introduced a highly complex Bill comprising 66 pages, 77 sections and several Schedules. […]No academic lawyer in any of our universities, as far as I am aware, has had an opportunity to even cast a reflective thought on the Bill."*

vi. Deputy Pat Rabitte said in the same respect in the Dáil on 15th December 2010:

*"It is most unfair to place Members in a position where the legislation has been thrust upon them 24 hours before the House rises for the Christmas recess and then expect them to make a considered response in respect of it."*

vii. Senator Fiona O'Malley said in this regard during the debate on the Act in the Seanad on 16th December 2010:

*"I agree with the point made about constitutionality. This is very tricky and complex legislation. It is a fair point that we may not have enough time to go through the complexities as we would all wish to do. As with other legislation we may find it will run into trouble."*

viii. Senator Joe O'Toole said in this regard during the debate on the Act in the Seanad on 16th December 2010:

*"We are making a huge mistake with this legislation. I have seen this happen before with rushed legislation. [...] I do not understand what the Minister refers to as the recitals in the first two pages of the Bill, which I presume constitute what we used to call the Long Title. Issues arise in this regard. There are points in the Bill that I do not understand".*

94. The Labour Party has expressed grave concerns regarding the unconstitutionality of section 53 of the 2010 Act. Joan Burton, the current Minister for Social Protection in the Irish Government, on behalf of the Labour Party, has expressed concerns that that section of the 2010 Act seeks to confer power on the Minister to make orders that override the effect of any other legislation. She believes there is nothing in the recitals to the Act that could justify the Government in attempting to seize the power of making law from the Oireachtas (the Irish Parliament) in this way and to seek instead to vest it in the Minister for Finance. She does not believe there are any Articles of the Irish Constitution that could justify a usurpation of powers by a Minister of the Government to make laws on behalf of the State, instead of those laws being made by the National Parliament. I beg to refer to the said statement by Ms. Burton on behalf of the Labour Party, upon which marked with the letters "**TA31**" I have signed my name prior to the swearing hereof. The statement provides *inter alia* the following:

*"Our principal concerns rate to section 53, which contains a purported power, vested in the Minister for Finance, to make orders under statutory instrument, "notwithstanding any other enactment".*

*In basic terms, the section seeks to confer power on the Minister to make orders that override the effect of any other legislation.*

*We believe there is nothing in the recitals to this Bill that could justify the Government in attempting to seize the power of making law from the Oireachtas in this way and to seek instead to vest it in the Minister for Finance.*

*We do not believe there are any Articles of the Irish Constitution that could justify a usurpation of powers by a Minister of the Government to make laws on behalf of the State, instead of those laws being made by the National Parliament.*

*We understand that the basic jurisprudence principles are set out by Chief Justice Murray in his judgment in Mulcreevy v Minister for Environment, Heritage and Local Government & Dun Laoghaire-Rathdown County Council [2004] 1 I.R 72.*

*In that case, the Chief Justice said:*

*"Article 15.2.1 of the Constitution provides that:*

*'The sole and exclusive power of making laws for the State is hereby vested in the Oireachtas: no other legislative authority has power to make laws for the State'.*

*He went on to say that:*

*"It is well established that the exclusive role assigned to the Oireachtas in the making of laws by this Article does not preclude the Oireachtas from empowering Ministers or other bodies to make regulations for the purpose of carrying into effect the principles and policies of the parent legislation. (See Cityview Press Ltd. v An Chomhairle Oiliuna [1980] IR 381. But it is also clear that such delegated legislation cannot make, repeal or amend any law and that, to the extent that the parent Act purports to confer such a power, it will be invalid having regard to the provisions of the Constitution. Thus, in Cooke v Walsh [1984] IR 710, O'Higgins C.J., delivering the judgment of this court, said*

*'... It is necessary to seek a meaning for [the words in the statute] which absolve the national parliament from any intention to delegate its exclusive power of making or changing the laws. Needless to say, if such a meaning is not possible then the invalidity of the subsection would be established'."*

*The Chief Justice then further said that –*

*"It is also clear that, in accordance with the principle of construction applicable in such circumstances, the courts, where it is possible so to do, will adopt a construction of the parent statute which does not empower the making, repeal or amendment of any law by a form of delegated legislation. Giving the judgment of the court in Harvey Minister for Social Welfare [1990] 2 IR 232, Finlay C.J. said:*

*'The court is satisfied that the terms of [the relevant Act] do not make it necessary or inevitable that a Minister ... making regulations pursuant to the power therein created must invade the function of the Oireachtas in a manner which would constitute a breach of the provisions of Article 15.2 of the Constitution. The wide scope and unfettered discretion contained in the section can clearly be exercised by a Minister making regulations so as to ensure what is done is truly regulatory or administrative only and does not constitute the making, repealing or amending of law in a manner which would be invalid having regard to the provisions of the Constitution.'*

*What the Oireachtas is therefore faced with, in the words of Chief Justice O'Higgins, affirmed by Chief Justice Keane, is an attempt to try to seek a meaning for the words in section 53 of this Bill which absolve the national parliament from any intention to delegate its exclusive power of making or changing the laws.*

*The Bill seems to us to have one essential purpose: to provide for the power to amend the law by Ministerial order."*

95. Jean-Claude Trichet, the President of the European Central Bank, expressed on 17th December 2010 his reservations in respect of the 2010 Act and the rushed nature of the consultation with the ECB. Mr. Trichet stated *inter alia*:

*"2.1 The Minister for Finance has requested the ECB to deliver an opinion by 17 December 2010. The ECB notes that, in cases of particular urgency which do not allow for the normal consultation period, the consulting authority may indicate such urgency in its consultation request and ask for a shorter deadline for the adoption of the ECB's opinion. However, even though the ECB welcomes this consultation request and understands the need for an accelerated legislative procedure, it would have appreciated being consulted by the authority preparing the draft legislation at an earlier stage. [...]*

*2.3 The ECB would like to stress that, given the very short time in which it has been consulted on this important legislation, it has not been possible to assess all the many constitutional, other legal and regulatory issues which this draft law undoubtedly raises. In particular, the ECB has serious concerns that the draft law is insufficiently legally certain on a number of critical issues for the Eurosystem."*

2.4 ... The Act's *"emergency powers interfere significantly with the property rights of institutions' shareholders and creditors. Thus it is important for any regime to properly balance these fundamental rights with the general interest in the financial system's stability."*

I beg to refer to the ECB opinion on the Irish 2010 emergency statute; the opinion is exhibited as Exhibit PS61 to the affidavit sworn by Mr. Skoczylas on 30th August 2013. I also beg to refer to a relevant Wall Street Journal article from 20th December 2010, upon which marked with the letters "**TA32**" I have signed my name prior to the swearing hereof.

***Bank recovery and resolution regimes outside of Ireland***

96. The first important thing to reiterate regarding the EU bank recovery and resolution regimes outside of Ireland following the recent financial crisis is that **no EU Member State allows a national authority to forcibly recapitalize a bank's holding company that is going concern, as a precaution, by diluting existing shareholders, against the decisions of a general meeting, by means of increasing the number of outstanding shares 130-fold – or anywhere close to that order of magnitude – and by issuing the new shares below the nominal value (e.g. by forcibly changing the memorandum and articles of association to lower the nominal value, and by concurrently issuing the shares below the original nominal value), without offering the shareholders their statutory pre-emption rights. In short, <u>the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible in any other EU Member State</u>.** In this regard, I beg to refer to Table 1 in the aforementioned publication by the National Bank of the Netherlands "Crisis Management Tools in the EU: What Do We Really Need?" The table shows an "Overview of recently introduced intrusive crisis management tools in the EU".

97. Furthermore, there is no legislation or rules in any EU Member State outside of Ireland that would allow to forcibly issue new shares in a going concern below the nominal value against a decision of a general meeting, or to change the memorandum and articles of association of the going concern against a decision of a general meeting in order to lower the share's nominal value and simultaneously issue new shares below the original nominal value, while depriving the original shareholders of pre-emption rights.

98. The bank resolution legislation in the EU Members States focuses not on recapitalizations, but on share transfers and property transfers in cases of insolvency. In such cases, it is indeed possible to circumvent the shareholders' approval. The aforementioned paper by the National Bank of the Netherlands "Crisis Management Tools in the EU: What Do We Really Need?" states, *inter alia*, the following in respect of the recapitalization instrument without shareholder approval in EU countries:

*"As noted in section 4, EU countries generally have no recapitalisation instrument at their disposal, since this would conflict with the Second Company Law Directive."*[90]

99. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests" concludes the following in respect of the bank recovery and resolution regimes in Italy, Germany, France and Belgium[91]:

*"These measures leave the economic rights and some related governance rights of shareholders in place. As a consequence, restructuring measures would need to be negotiated with the shareholders."*

Dr. Hüpkes then describes circumstances of bank failures / insolvency, when more intrusive measures abrogating shareholders rights are allowed outside of the EU, in Norway and Switzerland. She then goes on to state:

*"4.4 Termination of rights*

*The appointment of a receiver or bankruptcy trustee ends all shareholder governance rights and leaves the shareholder as equity creditor with only a monetary claim that ranks behind all other creditors' claims."*[92]

***Specific comments regarding the UK***

100. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests" summarizes succinctly the key aspects of the UK bank recovery and resolution regime[93]:

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[90] The opening of section 5.3 on page 22 of the said paper.

[91] Page 284 of the said paper.

[92] Page 285 of the said paper.

[93] Page 285 of the said paper.

*"In the UK, the Banking Act of 2009 provides for share transfer powers which may be used to transfer a failing bank to a private sector purchaser or to a bridge bank, or to take the bank into temporary public ownership."*

Indeed, the above is the key relevant characteristic of the UK regime, which allows for share transfers of a failing bank. The UK regime does not allow for precautionary recapitalizations without shareholder approval of a solvent bank (which would be against the Second Company Law Directive).

101. Professor Alexander summarized the UK Banking Act 2009 as follows in his aforementioned paper "Balancing Prudential Regulation and Shareholder Rights"[94]:

*"The Banking Act 2009 introduces a special resolution regime that provides the FSA, the Bank of England and HM Treasury – also known as the tripartite authorities – with new powers to deal with failing banks. Specifically, the Act grants the Treasury and the Bank of England sweeping powers to restructure a failing bank by transferring shares and property to a government-owned bridge bank or private purchaser.[95] The Act also provides a mechanism to compensate shareholders, depositors and third party creditors.[96]"*

*The stabilisation powers consists of three areas: (i) pre-insolvency stabilization powers; (ii) a bank insolvency procedure; and (iii) a bank administration procedure. The Bank of England has the sole responsibility for exercising the stabilisation powers that include: transfers of shares and any other property (including partial property transfers) owned by the failing bank to either a private sector purchaser or a bridge bank, or into temporary public ownership. In exercising these powers, the Bank would have authority to appoint a temporary administrator to manage the affairs of a bank taken into public ownership, or to administer the residual assets of a bank from which shares and property were transferred to a government-owned bridge bank or to a private purchaser."*

102. It is also relevant that the UK regime offers capital to banks in the form of preference shares, which limit dilution of existing shareholders[97]. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests" points out the following in this regard[98]:

*"In the UK, the government established a facility, which makes available tier 1 capital in appropriate form (e.g. preference shares) to "eligible institutions". The government is making available GPD 25 billion to be drawn on by these institutions to assist in this process as preference share capital (or Permanent Interest Bearing Shares of Building Societies) to raise capital."*

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[94] Chapter 6, The UK Banking Act 2009 and Shareholder Rights, page 90 of the said paper.

[95] *Banking Act 2009, ss 11 and 12.*

[96] *Ibid, s 27.*

[97] Preference shares are a hybrid instrument, which ranks between bonds and common shares. They normally do not have voting rights, or have limited voting rights; hence, they do not contribute towards dilution of the existing shareholders. However, they normally have a fixed dividend amount and rank before common stock in case of liquidation.

[98] Page 286 of the said paper.

103. **The conclusion is that the UK regime does not allow a precautionary recapitalization of a solvent bank (that is not in liquidation) against the will of a general meeting (as this would be incompatible with Article 25(1) of the Second Company Law Directive). Nor does the UK Act allow depriving shareholders of their pre-emption rights or issuing new shares below the nominal value or changing the memorandum and articles of association against the decision of a general meeting in order to lower the nominal value and concurrently issue new shares below the original nominal value. In short, <u>the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible under the UK bank recovery and resolution regime</u>**.

***Specific comments regarding Germany***

104. The aforementioned paper by the National Bank of the Netherlands "Crisis Management Tools in the EU: What Do We Really Need?" states, *inter alia*, the following in respect of the bank recovery and resolution regime in Germany:

*"The recently adopted Restrukturierungsgesetz in Germany offers two routes for crisis management: a restructuring route and a transfer order. The restructuring route contains a wide range of instruments, but does not qualify as genuine intrusive crisis management since the meeting of shareholders can not be bypassed. In case the crisis is so severe that a lengthy procedure to reach agreement with groups of shareholders and creditors is not possible, the German supervisor can directly make use of the property transfer instrument."*[99]

105. The Financial Markets Stabilization Law (the Finanzmarktstabilisierungsgesetz or the "FMStG"), and in particular the part of FMStG called the Financial Market Stabilization Acceleration Act 2008[100] (the FMStBG") allowed in certain circumstances to increase a company's capital without shareholder approval. Section 3 of the FMStBG empowered the management board, which needed to obtain the consent of the supervisory board, to increase the company's nominal capital by 50%. The provision expired on December 31, 2010. However, the said capital increase was by no more than 50%. In contrast, I note that the July 2011 Direction Order increased the authorized share capital of the Company by Euro 22,400,000,000 by the creation of 70,000,000,000 new ordinary shares, which represented an increase of approximately 17,500% (!) of the Company's authorized euro denominated ordinary share capital.

106. Furthermore, in practice, this provision of the German regime proved to be ineffective because of a wide criticism by scholars and academics that the provision was incompatible with Article 25 of the Second Company Law Directive[101]. In respect of this criticism, I have quoted extensively above in this affidavit

[99] Page 13 of the said paper.

[100] Gesetz zur Beschleunigung und Vereinfachung des Erwerbs von Anteilen an sowie Risikopositionen von Unternehmen des Finanzsektors durch den Fonds "Finanzmarktstabilisierungsfonds —FMS" [Financial Market Stabilization Fund—FMS] (Finanzmarktstabilisierungsbeschleunigungsgesetz) [FMStBG] [Financial Market Stabilization Acceleration Act], Oct. 17, 2008, BGBL. I at 1986, as amended.

[101] 49. *See* Florian Becker & Sebastian Mock, FMSTG [Commentary on the Financial Market Stabilization Act] § 3 FMS-BeschleunigungsG, paras. 10–24 (2009) (explaining how the provision collides with Article 25 of Directive

excerpts from one of the most respected authorities in Germany in respect of the FMStG, i.e. from the book by Dr. Jaletzke and Dr. Verannemann entitled *"FMStG, the Financial Markets Stabilization Law"*. **The wide criticism rendered the law effectively moot; no one dared to use it.**

107. It is clear that **the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible under the German bank recovery and resolution regime**.

***Specific comments regarding Portugal***

108. In Portugal, the RRD proposal (which I comment on below in this affidavit) and its principles were a guide for the national recovery and resolution regime. Hence, the regime differentiates between a failed institution subject to resolution and a recovery of a viable institution. Furthermore, the Portuguese legislation recognizes that until the RRD proposal is in force, a recapitalization of a financial institution without shareholder approval, depriving the original shareholders of control of the company, is impossible. It is relevant to refer to the 2013 paper on Portuguese recovery and resolution regime by Ana Rita Almeida Campos, Hugo Moredo Santos & Benedita Aires from Vieira de Almeida & Associados. The authors state the following:

*"Attentive to the international fora, the Portuguese legislator has followed the on-going work of the European Commission, the Financial Stability Board and the G20 on this matter, as well as the developments on the awaited EU Directive establishing a framework for the recovery and resolution of credit institutions and investment fi rms1 (hereinafter the "Proposed Directive") and related works, such as the technical document designated "Technical details of a possible EU framework for bank recovery and resolution", dated January 2011.*

*Additionally, an increase of both financial sector stability and depositor protection have been two paramount issues within the Financial Stability Plan. This explains the undertaking by the Portuguese State to reinforce the legal framework on due intervention when situations of potential or effective*

77/91); Peter Veranneman & Mathias Gärtner, *in* Finanzmarktstabilisierungsgesetz [Commentary on the Financial Market Stabilization Act] § 3 BeschlG, (Matthias Jaletzke & Peter Veranneman eds., 2009) (explaining how the Article 25 is not capable of being compatible with the EU law – I quote from this work above in this affidavit); Klaus Hopt, et al., *Kontrollerlangung über systemrelevante Banken nach den Finanzmarktstabilisierungsgesetzen (FMStG/FMStErgG)* [*Gaining Control over Systemically Relevant Banks*], 63 Wertpapiermitteilungen [W.M.] 821, 826 (2009); Oliver Seiler & Jonas Wittgens, *Sonderaktienrecht für den Finanzsektor* [*Special Corporate Law Provisions for the Financial Sector*], 2008 Z.I.P. 2245, 2249 (arguing that the E.U. structure is not compatible with such a domestic provision); Hildegard Ziemons, *Rekapitalisierung nach dem Finanzmarktstabilisierungsgesetz—Die aktienrechtlichen Regelungen im Überblick* [*Recapitalization According to the Financial Market Stabilization Act—The Stock Corporation Law at a Glance*], 61 Der Betrieb [D.B.] 2635, 2637–38 (2008) (discussing how Section 3 of the German Acceleration Act was in violation of Article 25 of the Capital Directive); Hans-Jürgen Hellwig, *Das Rettungspaket verstößt gegen Europarecht* [*The Rescue Package Violates European Law*], FAZ.net (Nov. 4, 2008), http://www.faz.net/aktuell/wirtschaft/rechtsteuern/ finanzmarktkrise-das-rettungspaket-verstoesst-gegen-europarecht-1725389.html (noting the clash between the Acceleration Act and Article 25 of the Directive); Gerald Spindler, *Finanzkrise und Gesetzgeber* [*Financial Crisis and Legislator*], 2008 Deutsches Steuerrecht [D. ST. R.] 2268, 2273–74 (discussing the patent contradiction when comparing the Acceleration Act with the Directive).

*financial instability arise in credit institutions, even if in anticipation of the awaited future European framework on the matter.*

*This context explains the changes to the Banking Law enacted in 2012 through Decree-Law no. 31-A/2012, of 10 February 2012. These changes essentially set forth a new legal discipline for intervention in credit institutions, consisting of a three-pronged strategy: (i) corrective intervention tools; (ii) provisory administration tools; and (iii) resolution tools, the respective choice depending on the risks involved and on the level of breach by a credit institution of the legal and regulatory rules applicable to its activity, as well as on the dimension of the respective consequences and impact on depositors' rights, and on financial sector stability as a whole. It should be pointed out that the choice of any of the said intervention tools, and of the measures related therein, should always be subject to the general principles of necessity, adequacy and proportionality. […]*

*Resolution tools should in principle be applied as last-resort tools, i.e. the Bank of Portugal should only choose them in extreme contexts where application of the remaining tools – either corrective intervention or provisory administration ones – are no longer adequate in light of the relevant scenario. This being said, and notwithstanding the above-mentioned general principles, it is also important to note that the choice of resolution tools is conditional upon the related measures being deemed necessary to avoid systemic contagion or an eventual negative impact in the Financial Stability Plan, to minimise public costs or to protect depositors.*

*In line with the Proposed Directive, resolution under Portuguese law comprises two possible tools, neither of which involves obtaining previous consent of the intervened institution's shareholders or any third party: the sale of business tool; and the bridge bank tool."*[102]

*"In addition to the above, and in light of the financial conditions of the Portuguese sovereign debt, together with widespread international reflection and discussion on rules and mechanisms applicable to credit institutions, the Portuguese legislator has also put forward a range of tools aimed at reinforcing the financial soundness of credit institutions and, more widely, supporting financial stability, as well as making liquidity available in the financial markets. …* ***<u>The intention of this framework is to ensure a mechanism that preserves the control of the management of the banks by their non-State owners during a first phase, and later allows them the option of buying back the government's stake</u>. … The recapitalisation with recourse to public funds may be carried out by either State subscription of special shares of the credit institution, or by subscription of contingent convertible instruments to be held exclusively by the State, or by way of a combination thereof, and such investment may have a maximum duration of five years. … Under this framework, the shares that can be issued are designated special shares and constitute a new category of the bank's shares, being governed by the regime of ordinary shares, but enjoying entitlement to a priority dividend and certain limitations to shareholders' voting rights, except for voting on certain reserved matters, and in the context of a material breach of the recapitalized institution. In such context, the recapitalisation framework currently provides that, regardless of State participation in the voting rights of a recapitalised bank, the State cannot exercise control over such entity.***"[103] (Emphasis added)

[102] Pages 158 and 159 of the said publication.

[103] Page 161 of the said paper.

*“The second alternative corresponds to the issuance of hybrid instruments which must be held by the State in order to be eligible for Core Tier 1 ratio purposes and which remuneration, ranging between 7% and 9.3% and carrying a step-up feature throughout the investment period, is determined by the State in accordance with EU State aid rules. These hybrid instruments include three special features: (i) firstly, an alternative coupon satisfaction mechanism, allowing for coupon payments in kind in ordinary shares of the bank, in case cash payment would jeopardise the respective regulatory capital ratios; (ii) contingent possibility of conversion of the instruments into ordinary or special shares of the bank upon reaching certain contractually established triggers; and (iii) a mandatory conversion trigger into special shares upon a material breach of the bank’s recapitalisation plan (approved by the Bank of Portugal and by the shareholders of the bank), or upon the ineligibility of the instruments qualifying as Core Tier 1 capital.”*[104]

I beg to refer to the said paper, upon which marked with the letters “**TA33**” I have signed my name prior to the swearing hereof.

109. In the above quotes, I have emphasized in bold two important features of the Portuguese regime, i.e.:

A. The recapitalization mechanism embedded in the Portuguese regime – which does not abrogate the shareholders’ rights / control – allows for special shares and/or contingent instruments. Such special instruments limit dilution of existing shareholders because the voting rights attached to those instruments are limited. In fact, in Portugal, the State is precluded from exercising control over the recapitalized entity.

B. The Portuguese regime allows for a claw-back mechanism within five years, whereby any excess capital that may result from the recapitalization is returned to the State, with the resultant restoration of the stake of the original shareholders[105]. In case of ILPGH, that would have meant that, if the provisions – which are currently 25 times (!) larger than the actual realized losses – do not materialize within a reasonable time, then the provisions are released back to profits and shareholders’ equity with the resultant restoration of the stake in the Company of the original shareholders.

110. Those are key features of an equitable recovery and resolution regime, which were completely ignored by the Minister in respect of ILPGH, despite having been explicitly recommended by the both the shareholders and the ILPGH directors.

111. I note that, not only did the Minister ignore a realistic and practical option of offering the ILPGH shareholders a claw-back mechanism such as that described above, but – to make things worse – he actually stated explicitly in the Dáil that *“should the actual results prove to be better than the highly conservative assumptions used in the Central Bank’s stress scenarios, we will redeem any surplus capital from the banks”*[106] while keeping the 99.2% stake appropriated from the shareholders as a result

[104] Pages 161 and 162 of the said paper.

[105] In fact in Portugal, the State’s convertible instrument would convert into shares if the actual realized losses materialize and the capital is not repaid.

[106] As per the quote referenced above in this affidavit.

of the July 2011 Direction Order! In this context, one cannot be faulted for concluding that the Minister's goal appears to have been all along to appropriate the valuable property of the ILPGH shareholders, even if the potential losses embedded in the extreme stress testing scenarios do not materialize.

112. It is clear that **the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible under the Portuguese bank recovery and resolution regime**.

***Specific comments regarding Italy***

113. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests" summarizes succinctly the Italian bank recovery and resolution regime[107]:

*"The Italian Special Administration regime[108] suspends the functions of the general meeting of shareholders. Only the appointed special administrators, subject to authorization by the Bank of Italy, may convene the general meetings and establish the agenda. The financial statements are approved by the Bank of Italy, not the shareholders.* ***However, decisions relating to the capital structure remain within the competence of the shareholder's meeting and require its positive vote as provided for under corporate law****."* (Emphasis added).

114. There is no legislation in Italy that would allow issuing new shares below the nominal value against a decision of a general meeting or that would allow changing the memorandum and articles of association against the decision of a general meeting in order to lower the nominal value and concurrently issue new shares below the original nominal value. This is because that would be against the Second Company Law Directive. There is no legislation in Italy that would allow issuing new shares without offering pre-emption rights to the existing shareholders, against the respective decision of a general meeting. This is because that would be against the Second Company Law Directive, too.

115. Hence, **the sort of draconian measures incompatible with EU law, which were forced by the Minister against the ILPGH shareholders pursuant to the July 2011 Direction Order, would have been plainly impossible in Italy.** The most recent example of the Italian regime in action is the aforementioned recapitalization of Italy's third-biggest bank Monte dei Paschi di Siena, where the shareholders have recently successfully blocked the recapitalization.

## XII. RRD proposal shows unreasonableness and excessiveness of the Minister's actions

***RRD proposal is not the law at present – and was not the law in 2011***

116. The fact is that the future EU bank recovery and resolution regime, including the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (the "RRD") is not yet in force. The RRD proposal is just that – a proposal, whose provisions are by no means in their final

[107] Page 284 of the said paper.

*[108] See Article 72, par. 6 of Consolidated Banking Law.*

form that could be deemed to be legally certain. It is clear from the aforementioned section entitled the "Universally acknowledged ban on capital increase without shareholder approval" that before the new bank recovery and resolution regime comes into force, the current rules of law apply, including the minimum shareholder protections offered by the Second Company Law Directive. For example, the EU Commission states clearly in the Explanatory Memorandum, which constitutes a part of the RRD proposal issued on 6th June 2013, that:

***"The Union Company Law Directives contain rules for the protection of shareholders and creditors. Some of these rules may hinder rapid action by resolution authorities. The Second Company Law Directive requires that any increase in capital in a public limited liability company be agreed by the general meeting … Restoring the financial situation of a credit institution rapidly by means of capital increase is therefore not possible.***"[109] (Emphasis added).

That state of affairs appears to be obvious and clear to all but the Minister and his proxies.

117. The Minister appears to suggest that the new directive (the RRD proposal), which is still at the proposal stage, should impact the adjudication upon the Minister's actions in July 2011, i.e. one year before the proposal of the new directive was even conceived. I say and believe that this position is absurd and flies in the face of the most fundamental canons of corporate governance, which are the foundations of the EU economic and legal system, as well as of the capital market investments.

118. **Of course, had the investors known in 2011 that law that was in force in 2011 (and continues to be in force currently), including the minimum shareholder protections embedded in the Second Company Law Directive, would be deemed not to have been in force, then those investors would have likely not invested into ILPGH. The minimum shareholder protections embedded in EU law, such as those included in the Second Company Law Directive, unequivocally did apply to the ILPGH shareholders (and to the Minister) in July 2011 (and continues to apply to them now), and that is the basis on which the shareholders made their investments in ILPGH.**

119. **Hence, any discussion about the provisions of the proposed new EU-wide bank resolution and recovery regime in relation to the July 2011 Direction Order is purely hypothetical.**

***RRD shows the unreasonableness and excessiveness of the Minister's actions***

120. **Without prejudice to the foregoing, I note that the averments on behalf of the Minister and his proxies regarding the RRD proposal are in fact misconceived and misleading. Contrary to those misconceived arguments on behalf of the Minister and his proxies, even the RRD proposal (which in any case cannot be a yardstick here) does not justify at all the actions of the Minister in respect of the July 2011 Direction Order. On the contrary, the RRD proposal clearly shows the unreasonableness and excessiveness of the Minister's actions.** Upon analyzing in detail the RRD proposal and the academic literature in this regard, I conclude that even under the RRD proposal (which is not in force and, more importantly, was not in force in 2011) the Minister would have to be deemed to

[109] Paragraph 4.4.17 on page 17 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

have failed to respect fundamental principles, which are indeed embedded in the RRD proposal. Specifically, there is a fundamental difference between a precautionary action undertaken to safeguard / preserve / restore a full long-term viability of a bank in the event of a material future deterioration of a financial situation, one the one hand, and extreme intrusive measures aimed at resolving a failed and insolvent institution, on the other hand. In short – using the terminology of the RRD proposal – there is a difference between a preservation / restoration at a pre-resolution stage and a resolution itself. The Minister failed to recognize that precautionary capital requirements resulting from extreme assumptions embedded in stress-test scenarios cannot justify under any circumstances (even under the provisions of the RRD proposal) imposing extreme measures depriving shareholders of the minimum protections embedded in EU law. And given that the Minister's actions were contrary to established and unequivocal case law of the ECJ, in the absence of express derogation provisions under EU law (which so far do not exist), those actions were plainly illegal. The Minister failed to act in a measured and proportional manner compatible with EU law, which would have secured legal certainty of his actions.

121. In this regard, it is relevant to refer to pre-amble 24 of the RRD proposal[110], which states, *inter alia,* the following:

*"the provision of extraordinary public financial support should not trigger resolution where, as a precautionary measure, a Member State takes an equity stake in an institution which complies with or is marginally below its capital requirements. This may be the case, for example, where an institution is required to raise new capital by an impending increase in its capital requirements or due to the outcome of a scenario-based stress test, but the institution is unable to raise capital privately in markets. An institution shall not be considered to be failing or likely to fail solely on the basis that extraordinary public financial support was provided before the entry into force of this Directive."* (Emphasis added).

I beg to refer to the RRD proposal issued by the Council of the European Union on 28th June 2013, upon which marked with the letters "**TA34**" I have signed my name prior to the swearing hereof.

122. In the following paragraphs, I address the RRD proposal in some detail, based mostly on the source documents from the European Commission and from the Council of the European Union, as well as based on the academic research in respect of the RRD proposal.

*Context*

123. When addressing the subject of the new bank recovery and resolution regime, it is relevant at the outset to refer again to the aforementioned speech by Jean-Claude Trichet to the Paris Court of Appeal in December 2009, where Mr. Trichet said:

*"First, in any legal system regarding bank recovery, the conditions that trigger the intervention of the competent authority should be clearly legally established. In normal insolvency proceedings, the insolvency is declared at the request of the debtor or creditor, when a legal insolvency test is satisfied and the procedure aims to satisfy creditors. Under the reorganization of a bank, the procedure would, however, be initiated by the competent authority and the main objective is to preserve financial stability,*

[110] RRD proposal issued by the Council of the European Union on 28th June 2013 (Interinstitutional File: 2012/0150 (COD); 11148/1/13, REV 1; EF 132, ECOFIN 572, DRS 121, CODEC 1511).

*depositor protection, etc... It is therefore all the more important that the trigger factor regarding the intervention is* *<u>legally certain</u>. It must also be specific enough to prevent it from being challenged, yet flexible enough to give some discretion to the authorities."* (Emphasis added).

This is relevant because it shows that "cowboy"-type actions, such as those that arbitrarily and unilaterally ride roughshod over the minimum protections embedded in EU law are precisely something that must be avoided and precluded when implementing any bank recovery measures. Only express derogation provisions under EU law (which currently do not exist) are capable of abrogating EU law provisions, such as Articles 25(1), 29(1), 8(1) and 17(1) of the Second Council Directive 77/91/EEC.

124. Professor Alexander stated the following in his aforementioned paper "Bank Resolution Regimes: Balancing Prudential Regulation And Shareholder Rights":

*"A special resolution regime for banks should respect the principles of legality, due process, limited liability and adequate compensation."*

125. The RRD proposal is based on the notion that: *"the objectives of the action to be taken, namely the minimum harmonisation of the rules and processes for the resolution of institutions, <u>cannot be sufficiently achieved by the Member States</u>"*[111]. The EU Commission stated in respect of the context of the proposal that: *"The framework would equip authorities with <u>common</u> and effective tools and powers to tackle bank crises pre-emptively, safeguarding financial stability and minimising taxpayer exposure to losses in insolvency."*[112] It is clear that references to the RRD proposal make sense only in the context of the EU-wide bank recovery and resolution regime. The RRD proposal is devised as a common EU system, which would not be appropriate as a regime for an individual Member State only. For example:

A. The prudential capital threshold must be common and derived from the Capital Requirements Directive (the "CRD"). Specifically, the RRD proposal states: *"The scope of the proposal is identical with that of the Capital Requirements Directive13 (CRD), which harmonises prudential requirements for institutions including financial institutions included in a banking group, and investment firms."*[113]

B. Also, any potential bank stress-testing must be based on the EBA[114] rules – not on more stringent rules imposed by any individual Member State, such as was the case in Ireland. In this regard, Paragraph 21 IV of my affidavit sworn on 5th December 2013 shows that on 15th July 2011 – i.e. less than two weeks before the July 2011 Direction Order was made – the EBA announced results of the stress tests for European banks. ILP turned out to be the second best capitalized bank in Europe out of 91 banks tested. Excluding the effects of the July 2011 Direction Order, under the EBA stress

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[111] See preamble 7 of the RRD proposal issued by the Council of the European Union on 28th June 2013 (Interinstitutional File: 2012/0150 (COD); 11148/1/13, REV 1; EF 132, ECOFIN 572, DRS 121, CODEC 1511).

[112] Page 2 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[113] Section 4.4.1 on pages 8 and 9 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[114] European Banking Authority.

scenario ILP needed no more than Euro 1.4 billion extra capital – almost three times less than according to the March 2011 PCAR/PLAR.

*Core Principles of the RRD Proposal: Recovery vs. Resolution*

126. **The RRD proposal differentiates between a preservation / restoration of a troubled institution at the recovery stage (i.e. pre-resolution stage), on the one hand, and a resolution of a failed institution, on the other hand. Regarding the former, the shareholders' decision-making powers regarding the company's capital structure (e.g. regarding a capital increase) are preserved. Only regarding the latter does the RRD stipulate – by way of express derogation provisions, which do not exist currently – for abrogating shareholder protections embedded in the Second Company Law Directive**. Consequently, there are three stages in the future EU bank recovery and resolution regime – two at the recovery phase (when the shareholder powers / rights are preserved) and one at the resolution phase (when the shareholder powers / rights can be limited or abrogated):

RECOVERY (SHAREHOLDER RIGHTS / POWERS PRESERVED)

1st Stage: preservation / restoration / preparation and prevention

2nd Stage: early intervention / temporary suspension of certain organs of the company

RESOLUTION (SHAREHOLDER RIGHTS / POWERS LIMITED OR ABROGATED)

3rd Stage: resolution.

127. Obviously, the bank recovery and resolution cannot be arbitrarily truncated just to stage 3 – if a bank offers no hope of recovery, it should then be subject of an insolvency process. The RRD proposal makes it clear that *"In case of failures, banks should be wound down in accordance to the normal insolvency procedures."*[115] Hence, the insolvency process should be the usual remedy for failed banks.

128. The RRD proposal states also that *"The fact that an institution does not meet the requirements for authorisation should not justify per se the entry into resolution, especially if the institution is still or likely to still be viable…. The need for emergency liquidity assistance from a central bank should not in itself be a condition that sufficiently demonstrates that an institution is or will be, in the near future, unable to pay its liabilities as they fall due."*[116] Thus, it is clear that a threshold for a resolution is specifically defined and very high[117], which is aimed among others at avoiding unjustified overbearance of the authorities.

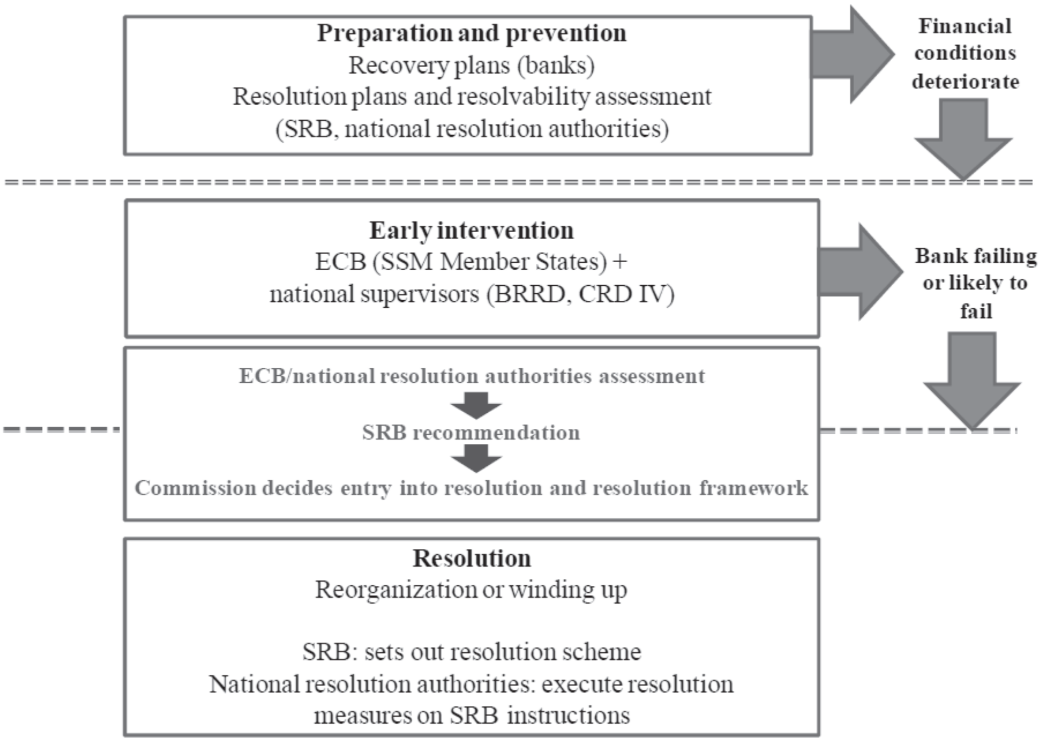
[115] Chapter 3 on page 4 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[116] Preamble 24 of the RRD proposal issued by the Council of the European Union on 28th June 2013 (Interinstitutional File: 2012/0150 (COD); 11148/1/13, REV 1; EF 132, ECOFIN 572, DRS 121, CODEC 1511).

[117] I comment on this more further down below in this affidavit.

129. Stefano Micossi, Ginevra Bruzzone and Jacopo Carmassi offer the following depiction of the three stages of the future bank crisis management in their paper entitled "The New European Framework for Managing Bank Crises" of November 2013:

The new EU framework for bank crisis management:




I beg to refer to the said paper, upon which marked with the letters "**TA35**" I have signed my name prior to the swearing hereof.

130. Hence, at the 1st stage, the shareholders are not supposed to be asked to approve resolution measures from the 3rd stage. The recovery process must be a process that allows a bank to recover. Only, once the recovery process fails does an institution enter the resolution phase, under specific and strict conditions and under supervision of the designated EU authorities.

131. In this regard, I also refer again to the aforementioned publication from the University of Cambridge Faculty of Law on "Bank Recovery and Resolution: What About Shareholder Rights?" The author describe there as follows the three stages of the future EU bank recovery and resolution regime:[118]

*"Interference with shareholder rights can be broadly designed in three (not mutually exclusive) ways. The first is based on pre-packaged contingency plans which make use of the bank's corporate governance rules (e.g. shareholders agree to waive certain rights in case of future emergency situations). The second option is to temporarily suspend certain shareholder rights, and/ or place the bank under the management of appointed officials. The third (and most interventionist) option is to place*

[118] See section 4 "Impact of recovery and resolution on shareholder rights and interests" on pages 13 and 14 of the said publication.

*the bank in a form of receivership and give the responsible official the power to terminate shareholder rights and restructure the bank (e.g. to split the bank in a "good" and a "bad" part, and/ or transfer it to a purchaser or a bridge bank).*

*As the following sections will demonstrate, the recovery and resolution framework which is being developed at EU level makes use of all three methods. The first two are applied in bank recovery. More specifically, <u>at the recovery stage, shareholders retain their rights</u>, but the supervisory authorities can appoint a special manager for the bank. Further, certain shareholder rights can be modified at the recovery stage according to preliminary shareholder agreements. The third method applies to resolution. <u>When a bank enters resolution, the resolution authority takes control over</u> the bank and shareholder rights are no longer applicable (subject to the relevant compensations). The same pattern is followed in resolution under UK national legislation (the Special Resolution Regime introduced by the Banking Act 2009)."*

*<u>1st Stage: Preservation / Restoration / Preparation and Prevention</u>*

132. The RRD proposal states the following in respect of the <u>preservation / restoration</u> stage (when the shareholders retain their rights):

*"<u>The Second Company Law Directive requires that any increase in capital in a public limited liability company be agreed by the general meeting</u>, while Directive 2007/36 (the Shareholders' Rights Directive) requires a 21 day convocation period for that meeting. **<u>Restoring the financial situation of a credit institution rapidly by means of capital increase is therefore not possible.</u>** The proposal therefore amends the Shareholders' Rights Directive to allow the general meeting to decide in advance that a shortened convocation period will apply for a general meeting to decide on an increase of capital in emergency situations. Such authorisation will be part of the recovery plan. This will allow rapid action **<u>while retaining shareholders' decision-making powers</u>**."*[119] (Emphases added).

133. Micossi, Bruzzone and Carmassi state the following in respect of the preparation & prevention stage in their aforementioned paper on "The New European Framework for Managing Bank Crises":

*"Under preparation and prevention, banks will be required to draw up recovery plans detailing measures and actions that they will adopt to restore viability when in distress; these plans must be assessed and approved by supervisors. In turn, the resolution authorities (at EU and national level) will have to prepare resolution plans, explaining how a bank will be resolved while protecting systemic functions and financial stability and minimising the potential burden for taxpayers. Resolution authorities are also required to identify impediments to resolvability and adopt measures that can facilitate it, including changes in banks' structure to reduce complexity; limits to maximum individual and aggregate exposures; reporting requirements; limitations or prohibition of activities, products and business lines; requirement to issue additional convertible capital instruments."*[120]

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[119] Section 4.4.17 on pages 17 and 18 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[120] Page 3 of the said paper.

134. Dr. Hüpkes summarizes with foresight[121] as follows the possible features of the <u>preservation / restoration</u> stage in her aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests"[122]:

*"**This approach operates within the context of existing corporate governance arrangements.** Instead of relying solely on the statutory resolution powers authorities could seek to commit the institutions themselves to a solution. The authorities could require that those institutions which are too complex or too critical to the financial system to be closed and liquidated to develop contractual pre-packaged crisis resolution arrangements. Such arrangements could set out contingency plans for circumstances in which the institution becomes financially distressed and include a series of pre-commitments to reorganisation measures."* (Emphasis added).

<u>*2nd Stage: Early Intervention / Temporary Suspension of Certain Organs of the Company*</u>

135. Micossi, Bruzzone and Carmassi state the following in respect of the early intervention stage in their aforementioned paper on "The New European Framework for Managing Bank Crises"[123]:

*"Early intervention envisages a range of powers and tools that should be available to supervisors in the early stage when a bank's financial position starts to deteriorate. Under the BRR Directive, national supervisors must have the power to require the bank: to adopt measures outlined in the recovery plan; to draw up an action programme and timetable for its implementation; to convene a shareholders' meeting, proposing the agenda or the adoption of certain measures; and to prepare a plan for debt restructuring. Moreover, when the supervisor determines that the bank's solvency may be at risk, it can appoint a special manager for a limited period of time who will take up all management powers (<u>**under the constraint of no prejudice to ordinary shareholders' rights**</u>) with the objective of restoring the viability of the institution." (Emphasis added).*

136. Dr. Hüpkes, in the aforementioned paper on the "Special bank resolution and shareholders' rights: balancing competing interests", summarizes succinctly as follows the key features of this stage[124]:

*"As illustrated by a number of recent cases, requirements for corporate actions, such a shareholder approval requirements, may make a quick restructuring impossible and introduce significant uncertainty into negotiations with potential acquirers. Many jurisdictions provide for special administration or conservatorship <u>under which all corporate bodies – the board and management – are suspended and an appointed official temporarily takes control of the bank's operations</u>. **The powers of temporary administrators however do not extend to the shareholders' power to determine changes to the bank's capital structure**. **As noted earlier, under EU law, measures that affect a bank's capital structure, e.g. a capital increase or a merger need to be decided by the shareholder**."* (Emphasis added).

<u>*3rd Stage: Resolution*</u>

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[121] I note that Dr. Hüpkes prepared her paper in April 2008.

[122] Page 292 of the said paper.

[123] Page 4 of the said paper.

[124] Page 293 of the said paper.

137. Firstly, the RRD proposal confirms that Company Law Directives are currently a barrier to the interventionist measures of the resolution stage, because of shareholder protections embedded in those directives and because of the lack at present of derogation provisions that would allow any derogation from those shareholder protections. Hence, the RRD, if it comes into force, is to provide express derogation provisions in this regard:

*"Company Law Directives require that increase and decrease of capital, mergers and divisions are subject to shareholders' agreement, and pre-emption rights apply whenever the capital is increased by consideration in cash. In addition, the Takeover Bids Directive requires mandatory bids when any person – including the State - acquires shares in a listed company above the control threshold (usually 30-50%). To address these obstacles, the proposal allows Member States to derogate from those provisions that require consent from creditors or shareholders or otherwise hinder the effective and rapid resolution."* [125]

**If the provisions of the RRD proposal come into force, which they have not yet, these will be the first – and the only – express derogation provisions under EU law in respect of the relevant articles of the Second Company Law Directive. Currently, there are no such derogation provisions. There were no such derogation provisions in July 2011.**

138. The aforementioned University of Cambridge Faculty of Law paper on "Bank Recovery and Resolution: What About Shareholder Rights?" summarizes the whole plethora of safeguards embedded in the RRD proposal in respect of the shareholder rights. The safeguards are intended to ensure compliance, *inter alia*, with the ECHR and the Charter of Fundamental Rights of the EU. The paper concludes, *inter alia*, that:

***"recovery or resolution measures <u>in national legislations</u> cannot interfere with shareholder rights established at a higher level (i.e. by EU directives) in the light of the ECJ case law."*** [126] (Emphasis added).

139. Micossi, Bruzzone and Carmassi state the following in respect of the resolution stage in their aforementioned paper on "The New European Framework for Managing Bank Crises"[127]:

*"The decision to place the bank in resolution is then taken by the Commission, which must also set out the framework for the use of resolution tools."*

Micossi, Bruzzone and Carmassi describe in their paper on "The New European Framework for Managing Bank Crises" how elaborate the process would be, including various checks and balances, for the European Commission to finally independently conclude that conditions for starting resolution are met.

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[125] Section 4.4.17 on page 18 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[126] Page 34 of the paper.

[127] Page 5 of the said paper.

140. In the above context, the RRD proposal states that *"In order to safeguard existing property rights, a bank should enter into resolution at a point very close to insolvency, i.e. when it is on the verge of failure."*[128] Furthermore, the RRD proposal states that: *"The European Banking Authority (EBA) should be vested with a clear role to issue guidelines and technical standards to ensure consistent application of the resolution powers, to participate in resolution planning in relation [to] all crossborder institutions, and to carry out binding mediation between national authorities in the event of disagreement on the application of the framework."*[129] Thus, it is clear that no arbitrary actions by national authorities, encroaching on property rights of shareholders, will be possible under the RRD (if/when it comes into force). In the future bank resolution regime, only companies that are insolvent or on a brink of insolvency should be subject to intrusive resolution measures and the respective resolution process will be controlled and supervised under the common and elaborate EU rules established by the EBA. The decision to place a financial institution in resolution will be then taken by the European Commission.

141. Furthermore, the RRD proposal emphasizes the principles of proportionality and compatibility with EU law:

*"... limitations to the right to property that the exercise of the powers proposed may entail must be consistent with the Charter of Fundamental Rights as interpreted by the European Court of Justice. It is for this reason that the point of entry into resolution should be as close as possible to insolvency, and the use of the resolution powers should be limited to the extent necessary in order to meet an objective of general interest, namely preserving financial stability in the Union."*[130]

142. Importantly, the RRD-proposed resolution tools call for an independent expert valuation of the assets and liabilities marked to market for the purpose of assessing a liquidation-like value. According to Article 30 of the RRD proposal, such a valuation has to be "fair and realistic" and must be carried "by a person independent from any public authority, including the resolution authority" out <u>before</u> the resolution action in respect of a failed bank is taken.

143. The related safeguard guaranteed to the shareholders under the RRD proposal in cases of an interference with their property rights during resolution is a fair compensation. The aforementioned University of Cambridge Faculty of Law paper on "Bank Recovery and Resolution: What About Shareholder Rights?" summarizes that matter succinctly as follows:[131]

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[128] Page 5 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[129] Page 6 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[130] Section 4.3 on page 8 of the Explanatory Memorandum of the RRD proposal issued by the EU Commission on 6th June 2012 (COM(2012) 280 final; 2012/0150 (COD)).

[131] See section 6 "Safeguards" on pages 28 and 29 of the said publication.

*“The Draft RRD introduces the principle that shareholders should not incur more losses in resolution than they would incur under normal insolvency proceedings, with the difference between the two covered by compensation,*[132] *which is determined according to independent expert valuation.*[133]*”*

144. **While the RRD is not in force and it cannot be in any way applied to these proceedings, it is instructive that, even under the stringent terms / principles of the RRD proposal, the Minister’s draconian actions would not qualify as justified**.

## XIII. Difference between rescuing a failed institution and recapitalizing a viable institution

145. Without prejudice to the universality of the aforementioned ban on capital increase without shareholder approval, it is important to differentiate between exceptional intrusive resolution measures in lieu of bankruptcy at a failed institution, on the one hand, and precautionary recovery measures to preserve / restore a long-term strength of a viable institution, on the other hand. Those principles are embedded in the aforementioned RRD proposal (which is not yet in force).

146. Both sound banks and failed banks may require recapitalization. “The Communication from the Commission on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition”[134] states the following:

*“Under current conditions, triggered in particular by the collapse of Lehman Brothers, fundamentally sound banks may require capital injections to respond to a widespread perception that higher capital ratios are necessary in view of the past underestimation of risk and the increased cost of funding.”*[135]

I beg to refer to the said Commission’s communication, upon which marked with the letters “**TA29**” I have signed my name prior to the swearing hereof.

147. Historically, examples of failed financial institutions are Lehman Brothers in the US, Northern Rock in the UK or Anglo Irish Bank in Ireland. Lehman Brothers sought a bankruptcy protection (the so-called Chapter 11 bankruptcy protection) in September 2008. Northern Rock was nationalized based on the Banking (Special Provisions) Act 2008 allowing orders to transfer all shares in Northern Rock to the UK government (the Act was especially introduced in order to nationalize Northern Rock). In case of Anglo Irish Bank, the Anglo Irish Bank Corporation Act, 2009 provided for the transfer of all the shares of the bank to the Minister for Finance. In all of those cases, the institution was either made bankrupt or all its shares were transferred to the State.

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[132] *Draft RRD preambles 31- 32, arts 65 and 67. See also European Commission, 'Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms' (n 123), 215. The “no worse off than insolvency” principle in the BA 2009 is limited to creditors.*

[133] *Draft RRD art 66.*

[134] C(2008) 8259 final.

[135] Paragraph 1(4) on page 3.

148. ILPGH was not insolvent or on a brink of insolvency, which was explicitly confirmed by the ILPGH Chairman at the AGM on 18th May 2011. As per the ILPGH accounts under the IFRS, ILPGH was solvent and a going concern. The Minister failed – and continues to fail – to acknowledge that imposing huge, unexpected and sudden precautionary capital requirements on a solvent company, for the sake of instilling stability in the financial system, does not render that company insolvent / failed. If imposing huge, unexpected, sudden and precautionary capital requirements to be met within four months could render a company insolvent or failed, then any company in world, including the largest and most successful companies in the world, could be forced by a government into such an artificial state of insolvency / failure. The following is relevant in this regard:

A. On a general note, it is important to stress that:

i. **Since its inception, the Company has continued to exist with its own structures;**

ii. **ILPGH has never been subject of execution measures, such as liquidation, intended to put an end to the Company's existence;**

iii. **General meetings of shareholders and the Board of Directors, which are the key organs of the Company, have never been suspended;**

iv. **The Company has never been subject of special management under part 3 of the 2010 Act or of a compulsory administration.**

B. As of 31st December 2010, ILPGH's shareholders' equity amounted to Euro 1,616m (i.e. approx. Euro 5.8 per share) under IFRS, and to Euro 2,045m (i.e. approx. Euro 7.4 per share) on the so-called embedded value basis. The Company's shareholders' equity actually increased between 31st December 2010 and 30th June 2011 (i.e. just before the direction order of 26th July 2011 was made) from Euro 1,616 million to Euro 1,954 million (i.e. approx. Euro 7.0 per share). The respective evidence is provided in my affidavit sworn on 5th December 2013. Since then, ILPGH has hardly generated any realized losses, even though it created incredible provisions that are 25 times higher than the realized losses.

C. Even based on the significantly increased temporary prudential capital requirements imposed by the Central Bank of Ireland (the "CBI"), which I describe in the Appendix, ILP had a core tier 1 ratio at the end of 2010 (the last reported value before the July 2011 Direction Order) of 10.6% (or in fact in excess of 12% when including capital support from the life company[136]), which was significantly above the CBI regulatory requirement of 8%. The 10.6% tier 1 ratio for ILP at the end of 2010 was above that of most EU banks. In this regard, it is instructive to refer to a comparison prepared in this regard by the IMF in the aforementioned technical note entitled "Progress with Bank Restructuring and Resolution in Europe". Figure 4 on page 10 of that note shows that an average for 57 EU banks was about 9% at the end of 2010.

[136] David McCarthy, the ILPGH / ILP CFO, said during the management call with investors on 2nd March 2011 announcing the ILPGH 2010 annual results: "Now out of 10.7% risk asset ratio, the Bank has EUR417 million when compared to the minimum regulatory requirement of 8%. And assuming capital support from the Life company, this ratio will increase to in excess of 12%." (Exhibit PS11 of the affidavit sworn by Mr. Skoczylas on 30th August 2013).

D. Importantly, it was determined under the IFRS by the directors and the auditors that the Company was a going concern. As outlined above, in assessing whether the going concern assumption was appropriate, the directors and the auditors were legally required by the IFRS to take into account all available information about the future, which was at least, but was not limited to, twelve months from 31st December 2010.

E. As per the evidence provided above in this affidavit, it is notable that on 25th February 2011, i.e. about a month before the announcement of the March 2011 PCAR/PLAR, a transfer order was made by the High Court pursuant to the 2010 Act, whereby Irish Nationwide Building Society, which was a failed credit institution, transferred Euro 3.6 billion of its deposits to ILP. It is clear that neither the Minister nor the Governor of the Central Bank (whom the Minister consulted before applying for the order that was made in the term of the Minister's proposed order) would have – or could have – allowed for such a huge transfer if they had believed that ILP was not viable. Nor could the High Court have allowed for such a transfer, if there had been any doubt as to the viability of ILP.

F. The ILPGH half-year report for 2011 (showing status at the end of June 2011, i.e. just before the capital injection pursuant to the July 2011 Direction Order), which was issued on 30th August 2011, stated in respect of the Bank's capital position[137]:

*"**The group's capital ratios remained strong at 30 June 2011**"*

G. Up until July 2011 ILP was the only large Irish bank that had not received any State funds. ILP is the only large Irish bank that has not had to sell any "bad" loans to the National Asset Management Agency (the "NAMA"). ILP is, therefore, not an institution participating in NAMA[138].

H. On 15th July 2011 – i.e. less than two weeks before the July 2011 Direction order – the European Banking Authority (the "EBA") announced results of the stress tests for European banks. Excluding the effects of the July 2011 Direction Order, under the EBA stress scenario, ILP needed cumulatively no more than €1.4bn extra capital[139], which was almost three times less than according to the March 2011 PCAR/PLAR (which was the driver of the July 2011 Direction Order).

I. The directors – none of whom has been convicted for, or subjected to any disciplinary or criminal proceedings for, grossly misleading investors – have consistently made formal statements before and after the March 2011 PCAR/PLAR confirming that the Company was not on a brink of bankruptcy, and that it was viable and strong. The executive directors in charge of the Company before the July 2011 Direction Order were not only not removed (as is required in cases of failed financial institutions, if the directors are found unfit to perform their duties), but were in fact allowed to move into leading roles in the divested insurance arm of the Company. In this regard, it is relevant to refer

[137] Page 16 of the ILPGH Half-Year report for 2011 (Exhibit TA4 of my affidavit sworn on 5th December 2013).

[138] The NAMA participating institutions are AIB, BOI, Anglo Irish Bank (IBRC), Irish Nationwide (IBRC) and EBS Building Society (now merged with AIB).

[139] Respective evidence is provided in Exhibit PS40 of the affidavit sworn by Piotr Skoczylas on 30th August 2013.

again to the Statement on Banking Matters, which the Minister made to the Dáil on 31st March 2011[140]; the Minister stated the following in respect of the governance of banks:

*"It is crucial that the reputation of Ireland's banking system is restored. In that context, I welcome recent initiatives made by the Central Bank in this area including the introduction of a new Code on Corporate Governance and the recent issuance of a consultation paper on fitness and probity standards by the Head of Regulation at the Central Bank, Mr Matthew Elderfield. <u>Mr Elderfield has made it clear that the track record of those holding senior positions in financial services will be taken into account in assessing their suitability for taking up or indeed retaining a senior role in a financial institution</u>."* (Emphasis added).

Following their tenure at ILPGH / ILP, both the ILPGH CEO (Mr. Murphy) and the ILPGH CFO (Mr. McCarthy) moved to become, respectively, the CEO and the CFO of Irish Life Group Limited (the insurance arm of ILPGH and the largest insurer in Ireland), once the insurance company had been forcibly sold to the Minister pursuant to the direction order of 28th March 2012. Those executives could not have been allowed to assume such senior positions in one of the largest financial institutions in Ireland (i.e. in Irish Life Group Limited), if according to the Minister, ILPGH (which they had been managing) had failed. Nor would they have been able to be in those roles, if they had misrepresented the position of ILPGH in breach of the IFRS. In this regard, I beg to refer to the CBI 2011 Fitness and Probity Standards (Code issued under Section 50 of the Central Bank Reform Act 2010) as well as the CBI 2011 Draft Guidance on Fitness and Probity Standards, upon which pinned together and marked with the letters "**TA42**" I have signed my name prior to the swearing hereof.

J. In his aforementioned speech to the Irish Parliament on 31st March 2011 (following the March 2011 PCAR/PLAR announcement), the Minister confirmed the following in respect of the ILPGH restructuring: *"Throughout this period of restructuring, the group will operate as normal."* The Minister also stated in the same speech in respect of the severity of the stress test scenarios that: *"The stress scenarios while not implausible are highly unlikely and are not meant to be, nor should they be, interpreted as being forecasts."*

K. The MoU signed by the Irish Minister for Finance and the European Commission in December 2010 stipulated, as mentioned above, that "*public provision of capital will be needed for banks that are <u>deemed to be viable"</u>*. It is notable that Anglo Irish Bank and Irish Nationwide Building Society were not subject to the March 2011 PCAR/PLAR, as they were not deemed to be viable and their loan books were being wound down.

L. It is also notable that, following the March 2011 PCAR/PLAR, ILP was required to develop and submit to authorities a restructuring plan, which happens to be one of the features under the aforementioned RRD proposal of a reform process for the still viable institutions whose financial situation requires early action to restore their long-term strength.

149. Thus, evidence shows that – even under the RRD regime (which cannot be applied to these proceedings) – ILP could have been described at worst as a viable institution, in respect of which an early

[140] The statement is referred to as Exhibit TA14 in my affidavit sworn on 5th December 2013.

precautionary action was undertaken to preserve / restore its full long-term viability in the event of a material future deterioration of financial situation. In actuality, the potential loan losses have not materialized during any of the reporting periods since March 2011 (the actual realized losses between January 2010 and June 2013 amounted to Euro 128 million, as outlined above). Nor have the Euro 2.2 billion PLAR deleveraging losses materialized. Thus, as opposed to cases such as those of Lehman Brothers, Northern Rock or Anglo Irish Bank, it would have been completely inappropriate and unjustified – even under the RRD regime (which is not in force) – to subject ILPGH to any intrusive resolution measures, such bankruptcy or forcing on it extreme resolution measures in lieu of bankruptcy, such as forcible transfers of assets or shares to the State without shareholder approval. And ILPGH should have not been subjected to extreme resolution measures incompatible with EU law, such as the terms of the recapitalization under the July 2011 Direction Order. The measures adopted by the Minister vis-à-vis ILPGH should have been much less intrusive and – importantly – compatible with EU law, including with the minimum protections of shareholder rights, such as those embedded in the Second Company Law Directive.

150. I will conclude this section of the affidavit by referring again to Professor Alexander, who makes the following relevant comments in his said publication "Bank Resolution Regimes: Balancing Prudential Regulation and Shareholder Rights" in respect of the aforementioned *Pafitis* judgment by the ECJ[141]:

*"The court's judgment acknowledged that considerations to protect the interests of depositors and, more generally, banking stability required strict supervisory rules, but it did not agree that the sweeping powers granted to the administrator to reorganise the heavily indebted bank without shareholder approval was necessary to protect depositors. The exercise of these powers to recapitalise the bank without shareholder approval therefore violated the minimum standards of shareholder protection in Articles 25 and 29. The court accepted the Advocate General's argument that the Greek supervisory rules were not necessary to achieve the regulatory objectives, as these could have been achieved by other means, such as through a comprehensive deposit insurance scheme, which would have achieved the same regulatory objective of protecting depositors while not interfering with shareholder rights under Article 25. In other words, it was possible in this case for the Member State, if its regulations did not meet the requirements of the Directive, to adjust its supervisory rules to achieve both their regulatory objectives and the minimum requirements of shareholder protection. Moreover, the court observed that the bank reorganisation measures which Greek authorities had taken were not "execution" measures in the sense that they could suspend company governance rights. Crucially, the court stated:*

> *"the directive does not, admittedly, preclude the taking of execution measures intended to put an end to the company's existence and, in particular, does not preclude liquidation measures placing the company under compulsory administration with a view to safeguarding the rights of creditors. However, <u>the directive continues to apply where ordinary reorganization measures are taken in order to ensure the survival of the company, even if those measures mean that the shareholders and the normal organs of the company are temporarily divested of their powers</u>."* (Emphasis added).

*The court held that the appointment of a temporary administrator under Greek law did not resemble an "execution measure" or even a "liquidation measure", even though all the powers and competencies of*

[141] Pages 74 and 75 of the said paper.

*the company organs were transferred to the administrator. The court made a distinction between the measures that could have been taken under Greek law that would have resulted in the withdrawal of the bank's licence and its liquidation, and the appointment of a temporary administrator that would allow the bank to continue its operations as before. Indeed, the vesting of all powers and competencies of the organs of the company with the administrator was only temporary and all subsequent capital increases following the initial one directed by the temporary administrator were approved by the new shareholders. This proved that the company was not executed into insolvency and that the appointment of the temporary administrator was to ensure the company's survival and therefore could not justify extinguishing the rights of the original shareholders, thus violating shareholder rights under Articles 25 and 29 of the Directive.*

***The Pafitis case establishes the importance of protecting a shareholder's minimum control and economic rights in a company, even if there is an important regulatory objective for interfering with these rights. EU Member States may not adopt bank regulatory measures that infringe minimum shareholder rights, including their right to approve any change in the capital structure of the banking corporation or to purchase shares pre-emptively, or to approve the acquisition or merger of the bank or a spinoff of one of its divisions**."* (Emphasis added).

In this regard, it is relevant reiterate that in case of ILPGH:

a) The recapitalization measures undertaken at ILPGH were precautionary measures resulting from extreme assumptions embedded in stress-test scenarios that did not constitute a forecast, as was explicitly admitted by both the Minister and the Governor of the Central Bank of Ireland. The intervention was not an "execution measure" or a "liquidation measure". Hence, the same conclusions as those reached by the ECJ in the *Pafitis* case apply to the ILPGH case. In fact, unlike in the *Pafitis* case, the powers and competencies of the organs of the Company were at no point transferred to an administrator; so in this respect the ILPGH case must be deemed to be even farther away than the *Pafitis* case from what can be described as an "execution measure" or a "liquidation measure".

b) The Minister did not have to abrogate the ILPGH shareholders' rights in order to recapitalize ILP. The Minister violated the separate legal personality of ILPGH for one purpose and one purpose only – to appropriate the ILPGH stake belonging to the original shareholders. The Minister was required to act in a measured and proportional manner compatible with EU law, which he failed to do.

c) Furthermore, the Minister could have used realistic and practical alternative recapitalization methods, which would have been less intrusive:

   i. The Minister could have used the so-called "B Shares"[142] with limited voting rights, which were explicitly recommended by the ILPGH directors as part of the presentation delivered to

[142] B shares have limited voting rights and, therefore, their issue does not increase dilution of existing shareholders. Nevertheless, the B shares allow the recapitalization by means of core equity. B shares also allow to control key decisions because limited voting rights regarding key decisions can be assigned to B shares. Furthermore, B shares can be convertible into common shares if a trigger threshold is reached, for example, if certain adverse conditions materialize.

the Minister on 10th June 2011[143]. That would have limited the dilution of the ILPGH shareholders while safeguarding the interests of the Minister. Such special shares are explicitly stipulated for by the aforementioned Portuguese special recovery and resolution legislation, which makes it clear that they are a practical and feasible tool[144].

ii. Also, the Minister could have instituted a claw-back mechanism, such as that stipulated for in the aforementioned Portuguese special recovery and resolution legislation, which would have allowed the ILPGH shareholders to regain – or at least partly regain – their stake in ILPGH in case the extreme stress-test assumptions embedded in the March 2011 PCAR/PLAR did not materialize. Evidence shows that such a solution was recommended by both the ILPGH directors and by the ILPGH shareholders.

d) And in any case, there was absolutely no reason or justification compatible with EU law for: i) forcibly depriving the shareholders of their pre-emption rights against the decision of the EGM and ii) contriving against the decision of the EGM a share issue at the price five times below the nominal value that was in force before the July 2011 Direction Order, both of which were incompatible with EU law.

151. Professor Alexander points out in the same publication that in certain circumstances shareholder rights may be restricted, but not by the draconian recapitalization measures incompatible with EU law, such as those effected by the Minister against the ILPGH shareholders. In fact, as per evidence provided elsewhere in this affidavit, there is not a single example in the EU of draconian measures parallel to those undertaken against the ILPGH shareholders, in a similar context. In particular, intrusive recapitalization measures against decisions of a general meeting of a going concern are currently not allowed, because – as Professor Alexander confirms it in his paper – they are precluded by Article 25(1) the Second Company Law Directive; this is in particular so in the case of precautionary capital requirements resulting from extreme assumptions embedded in stress-test scenarios for going concerns[145].

152. No matter how far-fetched scenarios one would make up, there is no ambiguity about the fact that the ILPGH shareholders were protected by the minimum protections embedded in EU law, such as those included in the Second Company Law Directive, which the Minister ignored and/or abrogated.

## XIV. Minister contributed to de-stabilizing EU economic order and financial stability

153. It is clear that the key provisions of the Second Council Directive 77/91/EEC (such as Articles 25(1), 29(1), 17(1) and 8(1)) could not – and cannot – be abrogated until the RRD comes into force. And then, if/when the RRD comes into force, those provisions of the Second Company Law Directive can only be

[143] See Exhibit PS11 of the affidavit sworn by Mr. Skoczylas on 12th December 2013.

[144] Page 161 of the aforementioned the 2013 paper on Portuguese recovery and resolution regime states that *"During 2012 and the first quarter of 2013, three Portuguese private banks (Banco BPI, S.A., Banco Comercial Português, S.A. and Banif – Banco International do Funchal, S.A.) and the Stateowned bank Caixa Geral de Depósitos, S.A., have resorted to public recapitalisation operations in an aggregate amount of €7.25bn."*

[145] I expand on this matter further down in this affidavit.

abrogated in the specific and strict circumstances stipulated for by the RRD, and only under the protection of the safeguards afforded by the RRD. Hence, the arbitrary actions of the Minister against the ILPGH shareholders in July 2011 – i.e. a year before the RRD proposal was even conceived in June 2012 – were plainly illegal and de-stabilizing for the EU legal order.

154. But there is more to it than that. Paradoxically, the Minister's actions actually also contributed to de-stabilizing the EU economic order and financial stability. If other Finance Ministers across the EU were allowed to undertake arbitrary actions incompatible with EU law, similar to those that the Minister undertook against the ILPGH shareholders (which the other EU Finance Ministers, in effect, would be allowed to do, if the Minister's illegal actions are not curtailed by the Court), then the EU economic order and financial stability would be in serious jeopardy. It is relevant in this regard to refer again to the aforementioned publication from the University of Cambridge Faculty of Law on "Bank Recovery and Resolution: What About Shareholder Rights?" The author states there, *inter alia*, the following[146]:

*"… care should be exercised when interfering with shareholder rights. This is not only because of "fairness" considerations, property rights considerations, or the weak position of bank shareholders; it is also because, if not carefully targeted,* ***interference with shareholder rights can have adverse effects for financial stability, which is exactly the opposite of what the recovery and resolution framework attempts to achieve****.*

*As mentioned, bank shareholders are often themselves banks or other financial institutions (including pension funds, insurance companies). Consequently, imposing losses on banks' shareholders may create contagion within the financial sector. It can also result in transferring the cost of failure from taxpayers to other groups of vulnerable groups, such as retail bank shareholders, pensioners and policyholders.*

*Also, a framework which abolishes shareholder rights in case of crisis may discourage capital investments in the banking sector. This can have detrimental effects on banks, which are subject to increased capital requirements under the Basel III rules. Reluctance to invest capital in the banking sector is also harmful from a financial stability perspective, as capital is the most stable form of financing for banks.*

*Admittedly, deterrence from capital investments in banks may not be so strong, given that in order to enter resolution (which has the strongest impact on shareholder rights), a bank should be almost insolvent, and in this case shareholders are protected (at least under the draft RRD) by the principle that they will receive no less than they would have had in insolvency. However, bank shareholders may be concerned that resolution authorities may be tempted to use resolution tools (and consequently, interfere with shareholder rights) too early, even if the bank has prospects of survival, in order to avoid additional costs in case of failure. As already discussed in this article, shareholders may also have concerns regarding the fairness of valuation (which is based on a hypothetical insolvency scenario) and payment of compensation. All these considerations, coupled with the inherent riskiness of the banking business, can deter investors, especially from high-quality capital instruments.*[147]

[146] See pages 31 and 32 of the said publication.

[147] E.g. common stock ("common equity Tier 1" capital) which is considered the highest quality because it is the first to absorb losses.

*Interfering with shareholder rights in recovery and resolution could also deteriorate the situation of the troubled bank. Shareholders will have incentives to sell their shares when a bank approaches the triggers for recovery, and more importantly, for resolution. This could lead to a large number of simultaneous sales, which can depress the value of the bank's shares in the market and lead to downward price spirals."* (Emphasis added).

**AVERMENTS ON BEHALF OF THE MINISTER / ILPGH**

**XV. <u>Significant changes in the positions of ILPGH and of Merrion Capital</u>**

***Position of ILPGH***

155. The July 2011 Direction Order was made in the terms of the proposed direction order made by the Minister on 25th July 2011, in order to revoke decisions of the ILPGH EGM of 20th July 2011.

156. During the said EGM on 20th July 2011, ILPGH decided by an overwhelming majority of shareholder votes to oppose the terms of the ILPGH's takeover by the Minister, which were identical to the subsequent terms of the July 2011 Direction Order.

157. Neither ILPGH nor ILP chose to become applicants pursuant to s. 11(1) of the 2010 Act to oppose the July 2011 Direction Oder, even though they were expressly allowed to do so by s. 11(1) of the Credit Institutions (Stabilisation) Act 2010 (the "2010 Act").

158. Neither ILPGH nor ILP consented to the July 2011 Direction Order pursuant to s. 8 of the 2010 Act.

159. Furthermore, the ILPGH Chairman, Alan Cook, made submissions to the Minister in the letter of 20th July 2011, which reflected the aforementioned decisions of the EGM of 20th July 2011, i.e. effectively the opposition to the terms of the July 2011 Direction Order. In the subsequent letter to the Minister of 25th July 2011, the Chairman of ILPGH / ILP stated[148]:

*"The Board of IL&P Group Holdings plc submissions in relation to the recapitalisation as directed by members at the Extraordinary General Meeting on 20th July 2011 were contained in the letter of 20th July 2011.*

*I confirm that the Companies to not require further time to make additional submissions pursuant to Section 7. SS4(b) of the Credit Institutions (Stabilisation) Act 2010."*

160. The decisions of the ILPGH EGM are binding on the Company, as per Article 80 of the ILPGH's Articles of Association and, more importantly, as per Article 10 of the Directive 2009/101/EC.

161. In respect of the Company's Articles of Association, I note that Article 80 of the ILPGH's Articles of Association state that the business of the Company shall be managed subject to any directions by the members given by ordinary resolution not being inconsistent with the Company's Articles of Association

[148] The letters from the ILPGH Chairman to the Minister of 20th July 2011 and of 25th July 2011 are referred to in Exhibits JM21 and JM27, respectively, of the affidavit sworn on 25th July 2011 by John A. Moran.

or with the Companies Acts. As per Article 25 of the Companies Act, 1963, a memorandum and articles of association of a company constitute a statutory contract that binds the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member, and contained covenants by each member to observe all the provisions of the memorandum and of the articles.[149] Provisions in a company's memorandum and articles of association are of fundamental importance; unless they are altered by members, they plainly cannot be derogated from.

162. Additionally, I note that Directive 2009/101/EC of the European Parliament and of the Council enacts necessary safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies specified within the scope of the Directive. As per Article 1 of the Directive, "The coordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to: [...] Ireland: Companies incorporate with limited liability". Article 10 of the Directive 2009/101/EC unequivocally states that:

*"Acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs."*

163. In the above context, I say and believe that ILPGH unequivocally cannot act in contravention of the EGM decisions. This is, *inter alia*, because it would be incompatible with Article 10 of the Directive 2009/101/EC, which the July 2011 Direction Order is not capable of overriding.

164. In the entire context of the above-mentioned formal statements by the ILPGH Chairman at the AGM on 18th May 2011 and in the context of the ILPGH presentation to the Minister dated 10th June 2011[150], as well as in the context of the statements in the ILPGH 2012 annual report, I note with amazement that ILPGH and its Chairman have "mysteriously" significantly changed their views now that they support the Minister in these court proceedings. I say and believe that it is difficult for one to escape the impression that the current ILPGH position is tailored to the Minister's defense, with disregard for facts and objectivity.

***Position of Merrion Capital***

165. It is instructive that Ms. McHugh, the Head of Corporate Finance at Merrion Capital, offers views that diverge meaningfully from the analyses on ILPGH that Merrion formally offered to its clients in March 2010. I beg to refer to the Merrion broker report on ILPGH from 8 March 2010, upon which marked with the letters "**TA36**" I have signed my name prior to the swearing hereof. The report was written one year before the March 2011 PCAR/PLAR, when the ILPGH share price was Euro 3.2. The report states, *inter alia*, the following:

Header summary: *"**Recapitalisation would alleviate discount valuation** Recapitalisation of IL&P's bank franchise would help unwind the discount valuation of its attractive life assurance franchise. Other self help options exist, but a rights issue appears most likely. Based on a sum-of-the-parts approach, we*

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[149] The Law of Private Companies, 2nd Edition, Thomas B. Courtney [3.096].

[150] The presentation is referred to in Exhibit PS11 of the affidavit sworn by Mr. Skoczylas on 12th December 2013.

*see potential shareholder returns in excess of 60% including recapitalisation needs. We maintain our BUY rating."* (Emphasis by Merrion)

166. In respect of the share valuation, Merrion determined that the "fair value per share" was in the range of Euro 6.35 to Euro 10.17.

167. Merrion identified the capital deficit for ILPGH / ILP of Euro 807 million in 2011.

168. Additionally, in respect of the sum-of-the-parts valuation, Merrion noted the following:

*"**SOTP[151] Suggests 60% Upside**: Despite the revisions and recognising the bank needs to be recapitalised, we remain of the view that IL&P is undervalued. We expect existing shareholders to be able to participate in the recapitalisation, which, while diluting returns, maintains investors' proportionate interests. We estimate upside of over 60% from current levels including recapitalisation needs (see Table 3). This reflects a sum-of-the-parts view, including a 1x multiple of EV for the life business, 1x book for the general insurance associate and 0.7x pro forma book for the bank (while unlikely to earn its cost of capital in the short term, we consider a 10% RoE/€150m of earnings from the bank as achievable in a better economic and competitive environment). The upside for shareholders primarily reflects an unwind of the current discount for the life franchise (Mkt Cap/Life EV currently 0.5x)."* (Emphasis by Merrion)

169. In respect of the recapitalization, Merrion stated the following:

*"**Recapitalisation Requirement Estimate Slightly Reduced**: We estimate IL&P's recapitalisation need for the bank to achieve an 8% equity tier I capital ratio on a standalone basis at €800m (after 2010 and 2011 losses and dividends of €250m and €100m from the life business in 2010 and 2011, respectively, including the benefit of the VIF securitisation). This is above the €600m management estimate, but is slightly below our prior estimate as risk weighted assets decreased more than expected in 2009 (primarily reflecting reclassification of exposures which does not change the risk of the loan exposures but reduces the capital required to be held for regulatory purposes)."* (Empahsis by Merrion).

170. In respect of raising capital from the shareholders through the rights issue[152], Merrion stated the following:

*"**Rights Issue Most Likely Option**: We expect IL&P will look to raise capital via a rights issue. In our opinion, this should be done regardless of potential participation in Irish banking sector consolidation. Other self help options include potential gains from liability management (management estimate is now c.€75m) or asset disposals. While unlikely and strategically less attractive, the most obvious asset is the life business, which, if sold at 1x EV could generate c.€1B of incremental capital. The UK BTL mortgage book might remain difficult to sell in the current market, but a sale at par could reduce capital requirements by c.€160m (this book was about breakeven in 2009; a better capitalised owner might*

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[151] SOTP means Sum Of The Parts.

[152] A rights issue refers to an issue of rights to the company's existing shareholders to buy additional shares for cash in proportion to their existing holdings.

*generate higher net interest income). A sale below par would reduce capital relief but would reduce the loans/deposit ratio and government guarantee charge. The general insurance associate, a 30% interest in Allianz Ireland, has a book value of €122m."* (Empahsis by Merrion).

171. Merrion maintained a BUY rating for ILPGH, the highest possible rating for any of its analyzed stocks.

172. Merrion's above analysis was relatively consistent with the market views regarding ILPGH, as well as in line with the management views. There were no significant extraordinary developments in the ILPGH business during the year in question – between March 2010 and March 2011 – that would justify statements of Ms. McHugh, which are substantially different from the above-mentioned statements from the Merrion report of 8th March 2010. I have provided evidence above in this affidavit and in my last affidavit in respect of the viability of ILPGH. **The March 2011 PCAR/PLAR did not discover any inherent capital holes in the ILPGH business. There was no sudden loss of capital that had to be remedied. The March 2011 PCAR/PLAR imposed an extraordinary, unexpected and sudden capital requirement that created a new paradigm for ILP, which was driven by precautionary motivations to instill stability in the Irish banking sector.**

173. In this context, it is up to the Court to determine the extent of the credibility of the opinions of Ms. McHugh, which are so astonishingly different from the formal position of Merrion.

174. I note that Ms. McHugh attempts to impugn my opinion of 5th December 2013 without offering any substantiation. Based in particular on Ms. McHugh's second affidavit, one cannot be faulted for reckoning that Ms. McHugh is unfamiliar with the concept of the imperative that one's opinions must be based on thoroughly researched and referenced analyses[153]. I say and believe that only opinions based on substantiated and thoroughly researched and referenced sources can be deemed to be credible. I will leave it up to the Court to judge the credibility of the unsubstantiated views of Ms. McHugh, as compared to the researched, referenced and backed up opinions that I have provided the Honorable Court with.

175. I reiterate with incredulity that both the Chairman of ILPGH / ILP and Merrion have strangely changed their views drastically now that they support the Minister in these court proceedings. It appears incredible that such dramatic changes in position should occur in such a coordinated fashion. I reiterate that it is difficult for one to escape the impression that the current position of Merrion (Ms. McHugh) and of ILPGH / ILP (and in particular of the ILPGH / ILP Chairman) are plainly adjusted to the Minister's defense, with indifference for evidence and neutrality.

176. I trust that this affidavit addresses sufficiently robustly the unsubstantiated snippets of criticism expressed by Ms. McHugh. Additionally, I note that certain statements of Ms. McHugh are plainly factually incorrect and cannot withstand rigors of a logical analysis:

[153] I make those statements with all due respect for Mr. McHugh, whom I do not know.

A. Ms. McHugh avers incorrectly that formal statements by the ILPGH directors and the authorities regarding the viability of ILPGH were made only before the March 2011 PCAR/PLAR and, therefore, *"were superseded by the results of the 2011 PCAR/PLAR"*[154]. That is simply not so:

  i. For example, Chairman Cook stated at the ILPGH AGM on 18th May 2011 (i.e. after the March 2011 PCAR/PLAR results) that[155]:

     (a) ILP has a *"strong, viable and sustainable future"* and *"can provide healthy competition to the two larger pillar banks"*;

     (b) *"The business is not on the brink of insolvency, but there is a requirement for us to guard against a much greater and stringent set of conditions; even though it is unlikely that such conditions will apply in the future."*;

     (c) The finances of the Company were *"not materially different from last September"* [when the Company was required to raise only €100m in new capital above and beyond its then current requirements, amounting to a total of €243m], but that the Central Bank applied a far tougher set of conditions; *"They have applied a killer punch"*;

     (d) The stress test results seemed *"profoundly unfair"*;

     (e) The PCAR/PLAR assumptions by Blackrock were *"a set of artificial assumptions"*;

     (f) *"The goalposts have been moved"*;

     (g) The €4bn capital requirements were *"astonishing"* and the rise in ILPGH's capital requirements from €243m to €4bn in less than a year was *"an amazing conundrum"*.

  ii. Also, the statements made by the ILPGH directors before the March 2011 PCAR/PLAR – including those made in the audited accounts – were in no way superseded by the March 2011 PCAR/PLAR. **The capital requirements resulting from the March 2011 PCAR/PLAR were precautionary capital requirements that resulted from extreme assumptions embedded in the stress test scenarios. Those scenarios were not a forecast, as explicitly confirmed by both the Minister and the Governor of the Central Bank. The resultant capital requirements did not by any stretch of imagination result from deficiencies or capital holes discovered by the stress tests in the ILPGH's accounts; there was no sudden loss of capital that had to be remedied.** Hence, the March 2011 PCAR/PLAR (which was announced on 31st March 2011) did not render outdated the Company's recent accounts audited under IFRS and in particular did not render outdated the Company's 2010 annual accounts, which were issued on 4th March 2011.

154 Paragraph 3.2 of Ms. McHugh's affidavit of 20th December 2013.

155 See Exhibit PS39 from the affidavit of Piotr Skoczylas sworn on 30th August 2013.

The approach regarding recapitalizing sound banks was in line with the aforementioned "Communication from the Commission on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition"[156], which states the following:

*"Under current conditions, triggered in particular by the collapse of Lehman Brothers, fundamentally sound banks may require capital injections to respond to a widespread perception that higher capital ratios are necessary in view of the past underestimation of risk and the increased cost of funding."*[157]

Furthermore, the MoU signed by the Minister for Finance and the European Commission in December 2010, which was a basis for the recapitalization of Irish banks, stated that[158]:

*"This reorganization and downsizing of the banks will be bolstered by raising capital standards. While we expect that, in a restructured system, banks will be able to raise capital in the market, we recognize that the higher standards may imply that, in the short run, public provision of capital will be needed for banks that are <u>deemed to be viable</u>."* (Emphasis added).

It is illogical to suggest that the fact that the MoU (which was a basis for the recapitalization of Irish banks) was signed before the March 2011 PCAR/PLAR – which it logically had to be – somehow means that the contents of the MoU in respect of the statement that "*public provision of capital will be needed for banks that are <u>deemed to be viable"</u>* became superseded by the results of the March 2011 PCAR/PLAR.

B. In paragraph 3.3 of her affidavit of 20th December 2013, Ms. McHugh stated in respect of the fact that the ILP provisions are 25 times higher than the realized losses in the period January 2010-June 2013 that purportedly *"the market does not share"* the view that those provisions will be released to profits. Firstly, Ms. McHugh ignores the fact that the ILPGH Head of Investor Relations and the ILPGH CFO confirmed at an investor call that "*There is no way under the sun*" that the "nonsense" PCAR 2011 assumptions would materialize[159]. Secondly, I regret to say that Ms. McHugh appears to be in denial regarding the fact that the current ILPGH share price does not reflect the intrinsic value of the Company because 99.2% of the Company's share capital has been appropriated by the Minister (which is being contested in court in the context, *inter alia*, of the facts provided in this affidavit). Ms. McHugh seems to be oblivious to the plain fact that the ILPGH share is currently illiquid and the share price is irrelevant and meaningless.

To illustrate the fact that the ILPGH share price is irrelevant and meaningless, given the share's illiquidity, it is relevant to refer to the current capitalization of AIB. AIB was recapitalized by the State in July 2011 and the State became 99.8% shareholder in AIB. The shares were issued to the State at 1 cent. Following the issue of the shares to the State, there are 521 billion shares

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[156] C(2008) 8259 final.

[157] Paragraph 1(4) on page 3.

[158] See paragraph 19III of my affidavit sworn on 5 December 2013.

[159] See paragraph 34F of the affidavit sworn on 12th December 2013 by Mr. Skoczylas.

outstanding. That means that at the time of the recapitalization, AIB was worth Euro 5.2 billion in the stock market. Figures from the NPRF show the valuation placed on the State's holding in AIB rose to Euro 10.1 billion at the end of 2013 from Euro 6.4 billion a year earlier (which is reported in the press articles referenced below). However, the shares currently trade at 13.6 cents, giving AIB the notional market capitalization of approx. Euro 73 billion. In fact, in October 2013, the shares traded at more than 15 cents, giving AIB the notional market capitalization of just under Euro 80 billion and making it one of the most valuable banks in the world in terms of the market capitalization. It should be blatantly clear to everybody – including the Minister and his proxies – that AIB is currently not worth Euro 73 billion, despite its market capitalization. The simple fact is that the AIB share price – similarly to the ILPGH share price – is currently meaningless because the shares are illiquid. In this regard, I beg to refer to articles from the Irish Independent from 22nd October 2013 and from the Irish Times from 10th January 2014, reporting on the aforementioned aberrations in the AIB share price, as well as to the Bloomberg and Reuters summaries regarding AIB and its share, upon which pinned together and marked with the letters "**TA37**" I have signed my name prior to the swearing hereof.

I note that aberrations like that in respect of illiquid shares can last for a long time – which has been indeed the case for both ILPGH and AIB – because i) the majority of investors do now care about the share price, given the share's illiquidity; and ii) institutional investors, who are capable of bringing the share price "back to reality", have largely abandoned trading in the shares like that.

To further illustrate the ludicrous nature of the arguments on behalf of the Minister, which make references to the ILPGH share price (which is meaningless), I note that at the time of the writing of this affidavit, on 10th January 2014, the ILPGH share price in the stock market is above the price at which the Minister subscribed for the ILPGH shares. Specifically, the ILPGH share trades in the stock market at 6.9 cents, which is above the 6.345 cents imposed by the Minister pursuant to the July 2011 Direction Order. I beg to refer in this regard to the respective Bloomberg summary from 10th January 2014, upon which marked with the letters "**TA39**" I have signed my name prior to the swearing hereof. If the Minster disagrees with those who state that the ILPGH share price is meaningless because of the share's illiquidity, then he should sell his ILPGH shares to ensure that he recoups his investment. I note that the Minister has not done so. Therefore, if one shared the Minister's (ludicrous) views about the meaning of the ILPGH share price, then one would have to come to a conclusion that the Minister is postponing the sale of his shares in order to make even more speculative profit on the shares.

C. Ms. McHugh stated in respect of the fact that the Minister provided net approximately 64% of equity capital required by the March 2011 PCAR/PLAR that allegedly the *"the Minister provided 100% of the new capital received by ILPGH. The only other capital that needed to be considered in valuing the Minister's investment was the existing capital in ILPGH prior to the Minister's injection of equity. The market unequivocally valued that "old" capital prior to and at the time of capitalisation, and that value was used in pricing the equity share issued to the Minister in return for the equity capital injected"*[160]. These averments fly in the face of facts and are not capable of withstanding rigors of a logical analysis. Of course, the fact is that the Minister indeed provided net approximately

[160] Paragraph 3.4 of Ms. McHugh's affidavit of 20th December 2013.

64% of equity capital required by the March 2011 PCAR/PLAR, as per the evidence shared in my last affidavit (as well as per evidence provided by John A. Moran in his affidavits). Furthermore, the marked did not "value" anything. The ILPGH share price was subject of a false market, as per evidence provided in my last affidavit. The Minister misused the false market's share price, as per the evidence provided in my last affidavit.

Ms. McHugh refuses also to recognize the fact that the embedded value of the ILPGH insurance arm was approx. Euro 1.8 billion, which of course was not recognized by the market for reasons provided in my last affidavit. However, this value contributed unequivocally to the ILPGH recapitalization (albeit to the tune of only Euro 1.3 billion). I trust that Ms. McHugh does not suggest that the Minister contributed the value of the insurance business to the ILPGH recapitalization, because such a suggestion would be absurd. The value of the insurance business came from the assets of ILPGH (which are attributable to its shareholders through their equity stake in ILPGH). Hence, that value must credit the ILPGH shareholders in the post-recapitalization shareholding split.

It is instructive to consider what would have happened if the Minister or ILPGH indeed had looked (which they failed to do) and had found and investor to aid the recapitalization. Let's then assume – which we have to do in order for this hypothetical example to be logically coherent[161] – that ILPGH did not have the insurance arm. In such a scenario, it is clear that ILPGH did not have any valuable asset to aid the Euro 4 billion recapitalization. However, instead, the said investor would have provided the funds amounting to Euro 1.3 billion in return for a stake in ILPGH. According to the Minister's logic, in such a scenario, the investor would receive a 0.8% stake in ILPGH in return for the Euro 1.3 billion investment (out of Euro 3.6 billion total equity recapitalization). Such a proposition is of course ludicrous, and yet this is exactly how the ILPGH shareholders were treated, given that the recapitalization was aided – to the tune of Euro 1.3 billion equity – from the assets of the holding company (which were attributable to its original shareholders through their equity stake in the holding company).

D. Ms. McHugh stated that *"an announcement that is relevant to a company does not normally cause a false market"*. That is not always so. Of course, irrelevant announcements, which do not impact the price (because they are irrelevant), are plainly not capable of causing a false market. Nor does it have to matter that information in question is "complete". In fact, the more complete and relevant the information is, the more capable it can be of creating a false market in the circumstances such as those described in my last affidavit in respect of ILPGH. The fact that the trading in the ILPGH share was suspended speaks for itself and it corroborated the fact that fall of the share price became artificial and the normal functioning of the markets was distorted, which is indeed aligned with the definition of a false market according to Article 3 of Takeover Directive. Ms. McHugh states also that I *"seem to be equating a depressed market with a false market"*. That is not so. Depressed market was characteristic for all the banking shares in Ireland[162]. I provided evidence showing aberration in respect of the ILPGH share.

[161] For the example to be logically coherent, one has to maintain the key recapitalization variables, i.e. the Euro 2.3 billion equity contributed by the Minister and the rest coming from somewhere else. The total equity capital contributed to the recapitalization has to add up to Euro 3.6 billion so the example is relevant to what actually happened.

[162] I provided relevant evidence in this regard in my last affidavit in respect of AIB, BOI and ILPGH.

## XVI. Alleged risk for ILPGH as a result of the court proceedings

177. ILPGH has formally acknowledged it has no reason to believe that any litigation will have a material effect on its results of operation, profit or loss and financial condition. Specifically, the ILPGH 2012 Annual Report[163], which was issued on 26th March 2013, states the following in the section "Legal and Regulatory Risk" on page 26:

*"Adverse regulatory action or adverse judgements in litigation could result in restrictions or limitations on the Group's operations or result in a material adverse impact on the Group's reputation, results of operations or financial condition. ... The Group has no reason to believe that any such litigation and/or regulatory action will have a material effect on its results of operation, profit or loss and financial condition"*

178. Page 58 of the Annual Report; section "Statement of Directors' Responsibilities" states:

*"In accordance with the Transparency (Directive 2004/109/EC) Regulations 2007 (the "Transparency Regulations"), the Directors are required to include in their report a fair review of the business and a description of the principal risks and uncertainties facing the Group and the Company and a responsibility statement relating to these and other matters, included below."*

179. The "Statement of Directors' Responsibilities" dated 26th March 2013 states on p. 59:

*"Each of the Directors, whose names and functions are listed in the Board of Directors section, confirms that to the best of each person's knowledge and belief:*
*the consolidated financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities and financial position of the Group at 31 December 2012, and its loss for the year then ended"*

180. Thus, according to the ILPGH most recent audited annual report, it is clear that this litigation plainly cannot have a material effect on ILPGH. Hence, I say and believe that ILPGH / ILP are estopped from making statements, which contradict the ILPGH 2012 annual report, regarding the alleged catastrophic consequences for ILPGH / ILP as a result of these court proceedings.

**APPENDIX**

## XVII. Capital requirements in Ireland vs. capital requirement under EU law

181. The tier 1 capital ratio requirement has been changing significantly in Ireland over the last years. First, it has gone up as a precautionary measure above the EU requirements. Now it is going down to be consistent with EU law. Specifically, following are the relevant key facts in this regard:

A. The EU regulations stipulated for the following capital requirements up until 1st January 2013:

[163] Exhibit PS13 referred to in Mr. Skoczylas' affidavit sworn on 30th August 2013.

i. Minimum common equity tier 1 ratio of 2%

ii. Minimum tier 1 capital ratio of 4%

According to the so-called Basel III regime (a new capital regime), the minimum Common Equity Tier 1 and Tier 1 requirements will have been phased in between 1st January 2013 and 1st January 2015:

i. On 1st January 2013: the minimum common equity tier 1 requirement rising from 2% to 3.5%; and the tier 1 capital requirement rising from 4% to 4.5%.

ii. On 1st January 2014: 4% minimum common equity tier 1 requirement and the tier 1 requirement of 5.5%.

iii. On 1st January 2015: the 4.5% common equity tier 1 and the 6% tier 1 requirements.

In respect of the above overview, I beg to refer to a report from the Association for Financial Markets in Europe ("AFME") on the changes to the capital requirements[164], upon which marked with the letters "**TA13**" I have signed my name prior to the swearing hereof. I note that Mr. Skoczylas presented a similar publication by Moody's in his affidavit sworn on 30th August 2013[165].

B. The minimum capital requirements imposed by the Central Bank of Ireland were as follows:

i. On 30th March, 10th September and 30th September 2010, the Central Bank of Ireland (the "CBI") announced details and updates of the Prudential Capital Assessment Review ("PCAR") for AIB, BOI, ILP and EBS, which included setting new target capital requirements of 8% Core Tier 1, of which 7% has to be Equity Core Tier 1, under the base case and 4% Core Tier 1 under the stress case after taking account of expected losses. On 30th March 2010, the CBI announced that: *"ILP was not included in the first wave of PCAR as it has not received a government capital injection and is not taking part in NAMA."* I beg to refer to the CBI statement regarding the March 2010 PCAR, upon which marked with the letters "**TA14**" I have signed my name prior to the swearing hereof.

ii. As part of the November 2010 PCAR[166], the CBI moved the target capital ratio under the base case from 8% Core Tier 1 ("CT1") to at least 12% Core Tier 1 and taken account of loan losses associated with the transfer of further loans to the National Asset Management Agency (the "NAMA"). In addition, the ongoing future capital requirement for AIB, BOI, EBS and ILP was set at 10.5% Core Tier 1. As a result of those requirements, ILP was required to raise an additional Euro 98 million. The summary of the capital requirements for the Irish banks was summarized by the CBI in the following table:

[164] See page 8 of the said report.

[165] See Exhibit PS2 referred to in Mr. Skoczylas' affidavit sworn on 30th August 2013.

[166] Announced on 28th November 2010.

Capital Results

| Euro million | Additional CT1 Capital required | Total CT1 Capital still to be raised | Estimated impact of capital injection to CT1 ratio |
|---|---|---|---|
| **AIB** | 5,265 | 9,765 | 14.0% |
| **BOI** | 2,199 | 2,199 | 12.5% |
| **EBS** | 438 | 963 | 13.5% |
| **ILP** | 98 | 243 | 12.7% |
| ***Total*** | 8,000 | 13,170 | |

The CBI announcement stated the following in respect of ILP:

*"Irish Life & Permanent plc ("ILP")*

*The capital requirements resulting from the PCAR exercise previously announced were:*

> *a. Not required to raise any additional capital in respect of the base case, as it meets the 8% Core Tier 1 and the 7% Equity Tier 1 requirement under the base case; and*
>
> *b. An additional €145m of Core Tier 1 capital to meet the stress case target of 4% Core Tier 1.*

*ILP is now required to raise an additional €98m Core Tier 1 capital. Taking account of the capital ILP has still to raise under its capital plan, the bank has now to raise €243m of Core Tier 1 capital, by end-May 2011, a per the original PCAR requirement."*

I beg to refer to the CBI Technical Statement regarding the November 2010 PCAR, upon which marked with the letters "**TA15**" I have signed my name prior to the swearing hereof.

iii. As part of the March 2011 PCAR, the CBI maintained the minimum capital target of 10.5% Core Tier 1 in the base scenario and set the 6% Core Tier 1 in the stress scenario, plus an additional protective buffer. The conservatism of the March 2011 PCAR was described in earlier affidavits. <u>The key is that the resultant capital requirements were a **precautionary** measure resulting from an extreme scenario-based stress test, which was not a forecast, as both the CBI and the Minister explicitly reiterated</u>. In this regard, I note that:

(a) ILP's pro forma core tier 1 ratio for the end of 2010 accounting for the capital injection from July 2011 was 35% (!), which was above any other major bank in the world[167].

(b) To illustrate the extreme nature of the provisions imposed on ILP, I highlight elsewhere in this affidavit that the huge difference between the Euro 3.2 billion provisions built up at ILP between January 2010 and June 2013, which are 2,400% higher than the corresponding Euro 128 million realized losses, is a highly abnormal phenomenon. I contrast it with the case of

[167] See page 39 of the ILPGH Circular of 27th June 2011, which is referred to as Exhibit PS7 in the affidavit sworn on 30th August 2013 by Mr. Skoczylas.

Bank of Ireland, where the corresponding difference is approx. 100% (i.e. the provisions are approximately twice as large as the actual realized losses).

C. On 8th December 2011, the EBA issued the "Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence". The EBA recommended that the competent authorities require the credit institutions, which were identified as having a capital shortfall, to submit to them their capital plans to reach the 9% Core Tier 1 ratio by 20th January 2012. I beg to refer to the said EBA Recommendation, upon which marked with the letters "**TA38**" I have signed my name prior to the swearing hereof.

D. On 24th December 2013, the CBI announced that the tier 1 capital ratio requirement in Ireland would be made consistent with the minimum requirements under EU law:

*"Under Article 465(1)(a) of CRR*[168]*, the Central Bank is entitled to determine the phase-in rate for Common Equity Tier 1 (CET1) and Tier 1. Institutions are required to hold a minimum level of CET1 of 4% and a minimum level of Tier 1 of 5.5% from 1 January 2014. By 1 January 2015, all institutions must meet the full phase-in requirement under CRR of 4.5% CET1 and 6% Tier 1."*[169]

I beg to refer to the CBI publication entitled "Implementation of Competent Authority Discretions and Options in CRD IV[170] and CRR" from 24th December 2013, upon which marked with the letters "**TA17**" I have signed my name prior to the swearing hereof.

182. I confirm that the opinions that I have expressed in this Affidavit represent my true and complete professional opinion.

[168] CRR refers to the Capital Requirements Regulation, i.e.: Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 176/1; Corrigendum to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 208/68.

[169] See the section "Own Funds" on page 8.

[170] CRD IV refers to the Capital Requirements Directive IV, i.e.: Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338; Corrigendum to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 208/73.

Urkundenrolle 2014 Nr. 90

SIGNED:

Ted Azarmi

Sworn by the said **Ted Azarmi**
this 13th day of January 2014 at the following address:

Notar Gerhard Kleine
Deutschhofstraße 35
74072 Heilbronn, Germany

before me, a Notary / Commissioner for Oaths, and I know the Deponent

Signature and stamp of the Notary / Commissioner for Oaths:

R. Schneider, Notarvertreter

Signed by Notary / Commissioner for Oaths

Filed on behalf of the Applicants.