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NAMA Survives First Legal Challenge: What Impact for Future Challenges?

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Introduction

The first legal challenge in Ireland to the operations of the National Asset Management Agency (NAMA), (an agency set up to deal with the fall-out from the Irish property and economic crisis) was recently decided in the Irish Supreme Court.

Ireland experienced an unprecedented level of property growth between 2004 and 2007 which led to significant lending by financial institutions to meet the demand. The collapse of the property market in 2008 led to a banking crisis, as the market value of properties fell rapidly during the course of that year leaving financial institutions facing massive losses on their loan books as well as a funding crisis.

In September 2008, the Irish Government responded to the crisis by enacting the Credit Institutions (Financial Support) Act, 2008,¹ which provided the statutory basis for the State to enter into a scheme to guarantee the liabilities of the banks. A review of the loan books of the institutions covered by the scheme took place and following this, it became apparent that recapitalisation of some institutions was required. Following this recapitalisation, the Government announced that an asset management agency would be set up to, inter alia, acquire impaired property and associated loans from the institutions covered under the guarantee scheme in order to remove any uncertainty about those assets. NAMA was subsequently established under the National Asset Management Agency Act, 2009 (the Act)² to carry out this function.

The Minister for Finance when announcing the establishment of NAMA stated that 'because it is clear that the principal uncertainties in relation to asset quality in the Irish banking system lies in the bank's land and development loans and in the largest aggregate associated exposures in the banks, it is

these categories of loans that will be transferred to the Agency. These assets pose the main systemic risk to the banking sector in Ireland and the most significant obstacle to the recovery and restoration of lending by the banking system.'³ In the same statement the Minister indicated that the potential maximum book value of the loans to be transferred to NAMA was estimated to be in the region of EUR80 to EUR 90 billion. Following the establishment of NAMA a lengthy due diligence process was undertaken by each of the participating banks which as at 19 May 2011 has culminated in the transfer to NAMA of property loans of circa 850 debtors with nominal balances totalling EUR 72.3 billion.⁴ NAMA has paid a sum of EUR 2.1 billion for those loans. In light of the level of debt transferred to NAMA a successful challenge to it would potentially have had a catastrophic impact not only on the survival of the agency but also on the steps taken by the Government to stabilise the participating banks.

Background to the challenge

The plaintiff in this case was a long established Irish property developer and business man, Mr Paddy McKillen. He, along with 15 of his companies, had an interest in a portfolio of 62 properties with an estimated value of up to EUR 2.2 billion. 26% of the portfolio consisted of properties in Ireland, with the balance spread between the UK, France and the USA. It became clear during the case that loans secured on those properties in favour of Irish banks covered under NAMA amounted to approximately EUR 2.1 billion. NAMA took a decision to acquire a number of Mr McKillen and his companies' loans ('the McKillen loans') and Mr McKillen challenged that decision on a number of grounds.

Notes

- 1 Credit Institutions (Financial Support) Act, 2008, No. 18 of 2008.
- 2 National Management Agency Act, 2009, No. 34 of 2009.
- 3 Opening Statement dated 26 May 2009 to Joint Committee on Finance and the Public Sector by the Minister for Finance Mr Brian Lenihan TD; available on <www.nama.ie>.
- 4 See Statement made by Chairman of NAMA on 19 May 2011, available on <www.nama.ie>.

The five grounds of challenge

Mr McKillen challenged the decision of NAMA to acquire his loans on five specific grounds.

He claimed firstly that the decision to acquire the McKillen loans was taken before NAMA came into existence and therefore the decision was not legally capable of ratification and had not been ratified by NAMA in a legally permissible fashion.

Mr McKillen also claimed that NAMA did not take into account appropriate considerations when coming to its conclusion that his loans should be acquired by NAMA.

Mr McKillen further argued that the Act interfered in a significant way with his constitutionally protected rights. He claimed that under the Act, he should have been afforded an opportunity to be heard before any decision by NAMA to acquire his loans from qualifying financial institutions was made.

He also raised the question of whether the broad definition of 'eligible bank assets' in Section 69 of the Act and the lack of guidance provided to NAMA as to the exercise of its discretion in the acquisition of bank loans coming within this definition constituted an interference with his constitutionally protected property rights.

Finally, he argued that an earlier decision of the European Commission (which determined that the state aid contained in the Act is permitted under Article 107(2) (b) of the Treaty on the Functioning of the European Union), imposed an obligation on NAMA to only acquire 'impaired loans', whereas his loans comprised impaired and non-impaired loans.

High Court decision

The High Court (Commercial division) delivered its ruling on 1 November 2010⁵ and rejected Mr McKillen's challenge. Reflecting the politically sensitive nature of this case, the three judges devoted the opening paragraphs of the judgment to highlighting that it had not been the function of the court to form a judgment on the merits or otherwise of NAMA, on whether NAMA represented the best or even a good solution to the problems which Ireland faced or indeed on individual aspects of the National Asset Management Act 2009 Act (the Act). The judges emphasised that the court approached the case 'without fear or favour either to the State and its authorities or to Mr McKillen and his companies'. The judges said that the court's role was to 'determine the boundaries of what may be constitutionally permissible, to interpret the legislation and any

other relevant law, and to apply that law to the facts of this case. It is no more and no less than that'.

On the issue of whether the decision to acquire the McKillen loans was taken before NAMA came into existence, the court said that while the decision taken to acquire had been made prior to the formal establishment of NAMA under the legislation, nevertheless it was satisfied that the decisions were adopted by subsequent actions of NAMA following its establishment.

On the issue of whether NAMA had taken into account appropriate considerations when coming to its conclusion that his loans should be acquired, the court said that NAMA had a discretion to decline to acquire an eligible bank asset and this was a discretion solely for the benefit of NAMA, and not one which required a detailed analysis of the loan or loans in question.

On the issue of Mr McKillen's right to be heard, the court said that it was clear from the facts that Mr McKillen had not been afforded an opportunity to be heard prior to the decision by NAMA to acquire the McKillen loans. However, the court said that any constitutionally protected rights which Mr McKillen might have were either not interfered with by the Act, or were interfered with in such a minor or tangential way so as not to require that Mr McKillen be heard prior to the acquisition of his loans.

On the issue of the broad definition of 'eligible bank assets' in Section 69 of the Act, and the claim that this interfered with Mr McKillen's constitutional rights, the court concluded that the Act was a proportionate response to the very grave financial situation in which the State found itself.

Finally, the court said it was satisfied that the decision of the Commission on state aid did not require NAMA to limit the acquisition of bank assets to loans which are either impaired loans or are connected with impaired loans.

Mr McKillen appealed the decision of the High Court to the Supreme Court on all five grounds.

Supreme Court Appeal

In February 2011, the Supreme Court ruled on the three issues raised by Mr McKillen in his appeal namely (i) the legal status of the NAMA decision, (ii) the failure by NAMA to take certain considerations into account in its decision to acquire the loans, and (iii) the European State Aid issue.⁶ It held over at that time consideration on the other grounds of appeal.

Regarding the legal status of the NAMA decision to acquire the McKillen loans taken in December 2009,

Notes

⁵ *Dellway Investment Limited and Others v National Asset Management Agency, Ireland and the Attorney General* [2010] IEHC 364.

⁶ *Dellway Investments Limited and others v National Asset Management Agency, Ireland and the Attorney General* [2011] IESC 4.

Mr McKillen contended that this had no validity as it was taken before NAMA came into existence under the Act. He claimed that the Act provided no mechanism for ratification of decisions made before the establishment of NAMA and that the decision was accordingly not capable of being ratified by NAMA in a legal manner. NAMA, on the other hand, claimed that the decision had been ratified by its Chief Executive in September 2010.

The Supreme Court ruled that the decision of NAMA to acquire the loans had no legal effect. The court said that NAMA is a body established by statute and is governed entirely by the Act. The Act provides no provision to ratify transactions made prior to its establishment. The court said that it is a matter of fundamental legal principle that a statutory body may only perform its functions as authorised by its founding statute. The court went on to say that was an essential pre-condition to the acquisition by NAMA of eligible bank assets that NAMA must form an opinion that it is necessary or desirable to acquire the assets and make a decision to acquire on that basis. That decision must be made by NAMA and that had not been done in this case. As a result the court concluded that the decision to acquire the McKillen loans was a nullity.

The court said that contrary to what was decided by the High Court, the decision to acquire the McKillen loans was not given legal effect by any subsequent act or series of acts of NAMA. The court said that it was open to the NAMA board to make a valid decision to acquire the McKillen loans following its establishment, but it had not done so. In conclusion, the Court confirmed that NAMA had not legally acquired the McKillen loans.

Regarding the NAMA decision to acquire the loans, Mr McKillen argued that while NAMA had made its decision to acquire his loans on the basis that they represented a systemic risk to the banking system, NAMA had not made any qualitative assessment of the loans. The Supreme Court said that the issue of whether NAMA failed to have regard to certain relevant considerations was of no consequence since it had ruled that the decision to acquire the loans had no legal effect.

The Supreme Court also rejected Mr McKillen's claim regarding European State Aid as being without foundation. Mr McKillen had claimed that NAMA was attempting to exercise its powers in breach of Articles 107 and 108 of the Treaty on the Functioning of the European Union and also of the European Commission Decision of 26 February 2010 which approved the NAMA scheme. The breach, Mr McKillen claimed, arose by NAMA purporting to acquire credit facilities without any consideration as to whether Mr McKillen and his companies were impaired borrowers. This

claim was fundamentally based on the Commission Decision having direct effect. Essentially, Mr McKillen was claiming that the proposal to acquire the McKillen loans would constitute an unlawful grant of state aid. The Supreme Court said that NAMA were not in breach of State Aid rules and that the term 'eligible bank asset' in the Act did not require consideration of whether the borrower of the credit facilities is 'impaired'.

Following the Supreme Court judgments in February 2011, NAMA indicated to the Court that it was in the process of considering making a decision to acquire the loans. In light of this the Supreme Court was asked to consider the other aspects of the appeal.

In April 2011, the Supreme Court ruled on the final two aspects of the appeal.⁷ On the constitutional issue, Mr McKillen had argued that the breadth of the definition of 'eligible bank assets' in the Act, combined with the vagueness of the criteria according to which NAMA may acquire such assets, constituted an unjust attack on his property rights. Following an analysis of the Act, the Supreme Court said that it did not accept that the powers of NAMA are 'untrammelled' or vague. The Court rejected Mr McKillen's claim that the vagueness of the criteria according to which NAMA exercises its power to acquire an asset would result in there being an ineffective remedy by way of judicial review. The Court said it was satisfied that the criteria by reference to which NAMA must exercise its discretion in making any decision to acquire specified eligible bank assets are sufficiently delineated in the Act to permit borrowers to effectively pursue before the courts any relief which they may claim to be entitled by way of judicial review. The Court concluded therefore, that the provisions of Section 69 of the Act could not be considered an unjust attack on Mr McKillen's property rights.

On the fair procedures issue, the Supreme Court decided that fair procedures had not been followed and that Mr McKillen was entitled to be duly informed by NAMA of any intention to consider making a decision to acquire eligible bank assets related to their credit facilities with participating banks, so as to afford him an opportunity of making appropriate representations concerning such a proposed decision. The Court pointed out that if the relevant eligible assets were to be acquired, Mr McKillen would be subject to the NAMA statutory scheme and would be deprived of the right to deal with his property portfolio and associated loan contracts as he judged fit in the ordinary way on the commercial market. In addition, the properties could be sold by NAMA in circumstances disadvantageous to Mr McKillen in a way which could not be done by a mortgager exercising a power of sale. This led the Court to conclude that there was a real risk that Mr McKillen's property rights and interests may be directly

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7 *Dellway Investments Limited and Others v the National Asset Management Agency, Ireland and the Attorney General* [2011] IESC 13.

affected by any decision of NAMA under the Act and for that reason he should have a right to make representations to NAMA. The Court however did not go on to set out what form the representations should take and also what consideration NAMA must give to them or indeed whether it was then obligatory on NAMA to furnish reasons for any decision made.

Comment

The dust is beginning to settle following this series of legal judgments. The practical result is that NAMA must now formally make a decision on whether to acquire the McKillen loans. There is no evidence that any other developer whose loans have been acquired by NAMA will be affected by the Supreme Court ruling or indeed

had decided to issue proceedings seeking to overturn a decision by NAMA to acquire loans on the basis of not being given an opportunity to make representations to NAMA as to whether the loans should be acquired or not. From a legal perspective, the judgments have provided some certainty and clarity surrounding the fundamental operation of NAMA and its legal basis. Whether this series of judgments makes NAMA immune from future challenges remains to be seen. Commentators have suggested that the factual circumstances of McKillen would distinguish it from many other developers on the basis that the loans seemed to be performing whereas in the majority of cases, the loans taken over have been so impaired that it makes it difficult if not impossible for a developer to seriously make representations that the loans should not have been acquired by NAMA.

International Corporate Rescue

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