JUDICIAL REVIEW OF BANK SUPERVISORY DECISIONS IN THE FORMER SOVIET REPUBLICS: THE CASE OF KYRGYZSTAN

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"[The] judges' capacity of legal analysis and the knowledge of laws, their command of facts, are impressive. Unfortunately, their rulings often have nothing to do with either the law or the facts." [1]

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[1] Ariel Cohen, *Business & Economics: Seeking Investors, Kazakhstan Downplays Weak Institutions*, EurasiaNet Commentary (August 12, 2003) (quoting Scott Horton, Managing Partner for Emerging Markets, Paterson Belknap Webb & Tyler, New York), *available at* http://www.eurasianet.org/departments/business/articles/eav081203.shtml.

I. Introduction

The above passage refers to the judiciary of the former Soviet Republic of Kazakhstan, but it could just as easily have been written about the judiciaries of virtually any of the former Soviet Republics with the possible exception of the Baltic States, which have recently attained membership in the European Union. Justice in most of the former Soviet Republics is notoriously lacking. The courts are almost uniformly viewed as pitifully understaffed, grossly underpaid, dangerously overworked, embarrassingly ill-equipped, appallingly deficient in market-oriented legal skills, and as if all of this were not enough, hopelessly corrupt.[2]

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[2] *See* Michael Nusbaummer, *Building Judicial Capacity in the Commercial Law Sector of Early Transition Countries*, *in* EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT LAW IN TRANSITION 2005: COURTS AND JUDGES 39-40 (Oct. 2005) (on file with the Annual Review of Banking & Financial Law); *see also* AMERICAN BAR ASSOCIATION CENTRAL EUROPEAN AND ASIAN LAW INITIATIVE, JUDICIAL REFORM INDEX FOR KYRGYZSTAN (June 2003) [hereinafter ABA CEELI Judicial Reform Index] (on file with the Annual Review of Banking & Financial Law); U.S. GENERAL ACCOUNTING OFFICE, FORMER SOVIET UNION: U.S. RULE OF LAW ASSISTANCE HAS HAD LIMITED IMPACT (April 2001);World Bank, *Financial Sector Assessment Program, Kyrgyz Republic* (May 2003) at 4, *available at* http://wbln0018.worldbank.org/FPS/fsapcountrydb.nsf/(attachmentwebFSA)/Kyrgyz_FSA_web.pdf/$FILE/Kyrgyz_FSA_web.pdf [hereinafter World Bank FSAP Report]; Ethan S. Burger, *Corruption in the Russian Arbitrazh Courts: Will There Be Significant Progress in the Near Term?*, 38 INT'L LAW. 15 (2004); Thomas Caruthers, *The Rule of Law Revival*, FOREIGN AFFAIRS, March-April 1998, at 3;

This author has served as a legal advisor to central banks and bank supervisors in transition economies since 1995, under programs sponsored by the United States Agency for International Development ("USAID"), the World Bank, and the Asian Development Bank ("ADB"). All of these organizations have provided technical assistance with drafting of banking laws and regulations, training of bank examiners and offsite analysts in principles of financial analysis, risk assessment, collateral valuation, bank corporate governance, problem bank resolution, and so forth. Yet, there has been surprisingly little emphasis on ensuring that actions taken by the bank supervisor will survive challenges in court. Typically, international donor assistance in this area has consisted of little more than insertions of short articles into the commercial or central banking law setting forth a rudimentary procedure for challenges to decisions of the bank supervisor. The assumption seems to be that a transition country court will approach these kinds of cases in the same fashion as a court in a western industrialized country would. Unfortunately, this is not the case. In virtually every transition country, there are procedural provisions in other laws or codes, or simply a judicial attitude, that can have an enormous impact (often negative) on the ability of the bank supervisor to enforce the laws and regulations that it is charged with administering. While there are numerous commercial law projects sponsored by a wide variety of international development organizations, there has been little focus on public administrative law reform. Yet, an emphasis on the latter topic is critical as part of the next generation of international assistance.

From 2002 to 2004, this author spent much time in the former Soviet Republic of Kyrgyzstan, assisting the National Bank of the Kyrgyz Republic ("NBKR") on financial sector reform programs undertaken by USAID and the ADB. A substantial portion of this assistance was devoted to issues relating to judicial review of decisions of the NBKR, in particular those concerning revocation of bank licenses and bank insolvency proceedings. This article will summarize the current state of judicial review of bank supervisory decisions in the Republic of Kyrgyzstan, and will offer some suggestions for reform of that process that will hopefully be helpful to similarly situated transition economies and donor organizations. The intended audiences for this article are (1) government officials in

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Cynthia Guttman, *Kyrgyzstan, Breaking Out Of The Old Shell*, UNESCO COURIER, November 1999, at 21.

transition economies who wish to implement an effective program of financial sector supervision founded upon the rule of law, recognizing specifically the accountability of public supervisory authorities, the concepts of the administrative record and deference to the expertise of the financial sector supervisor; and (2) international donor and development organizations that may wish to provide assistance to transition economies as they go about the above task.

While this article is specifically written from the point of view of Kyrgyzstan, its observations should be helpful to any transition economy, and in particular those in the former Soviet Republics, where the legal systems are based on the same model and share remnants of the same Soviet heritage.[3] Also, while this article is written from the perspective of the bank supervisor, its observations and recommendations are cross-cutting. The adoption of modern administrative law and judicial review procedures can also benefit any financial sector regulatory body – a securities commission, an insurance supervisor, a pension fund regulator, or a "super-regulator" which combines some or all financial sector regulatory functions in a single agency. Indeed, most of the principles discussed in this article are by no means unique to the financial sector supervisory field, but are standard principles of administrative law in more advanced countries. Any public regulatory authority in a transition economy that is charged by law with making decisions based on complex analysis of facts and the application of specialized expertise should benefit from the observations of this article.

II. Overview of the Kyrgyz Legal System

A. Courts

The judicial system of the Kyrgyz Republic consists of the Constitutional Court, the Supreme Court and local courts.

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[3] *See* Christopher Osakwe, *Anatomy of the 1994 Civil Codes of Russia and Kazakstan: A Biopsy of the Economic Constitutions of Two Post-Soviet Republics*, 73 NOTRE DAME L. REV. 1413, 1419 (1998). A 1991 Model Civil Code served as the model for the rest of the countries in the Commonwealth of Independent States. *See id.* at 1425-27; Lane H. Blumenfeld, *Russia's New Civil Code: The Legal Foundation for Russia's Emerging Market Economy*, 30 INT'L LAW. 477, 513-14 (1996).

Specialized courts may be constituted by constitutional laws.[4] The Supreme Court consists of collegiums, including collegiums for "criminal and administrative cases;" "economic cases;" and "civil" cases.[5] Judicial panels are established within each of the collegiums.[6] The Kyrgyz Constitution was amended significantly in 2003, affecting sections including court organization and administration. The Law of the Kyrgyz Republic on the Supreme Court and Local Courts was amended in 2004 to implement the constitutional changes.

Local courts consist of inter-rayon and equivalent courts, and oblast courts.[7] Arbitration (*arbitrazh*) courts, which had previously operated under a 1997 law and a Code of Arbitration Procedure, were abolished in 2003.[8] These courts handled economic and business matters and were organized approximately like the rayon courts in that they served both first and second instance functions.[9] Cases involving only juridical persons, or between juridical persons and the State, were heard by these courts.[10] There was a Supreme Arbitration Court, which existed apart from the Supreme Court.[11] The 2003 changes merged the arbitration courts into the regular court system, and created "inter-rayon" courts.[12] Inter-rayon courts consider, among other cases, (1) cases challenging normative legal acts issued by public authorities contradicting applicable legislation and violating rights, freedoms and interests of legal persons and ordinary citizens, except for cases assigned by law to the constitutional court; and (2) cases challenging non-formal acts, resolutions and actions (acts of omission) performed by public

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[4] KYRG. CONST. ch. 6, art. 79, § 3 (1996). As this article is being prepared, various constitutional amendments are under consideration in Kyrgyzstan, including some that would affect the judiciary and court system. *See European Commission for Democracy Through Law (Venice Commission), Interim Opinion On Constitutional Reform in the Krgyz Republic*, Opinion No. 342/2005 (Oct. 24, 2005), *available at* http://www.venice.coe.int/docs/2005/CDL-AD(2005)022-e.pdf.

[5] The Law of the Kyrgyz Republic, "On Supreme Court of the Kyrgyz Republic and Local Courts" art. 13, ¶ 2 (2003).

[6] *Id.* ¶ 3.

[7] *Id.* art. 25.

[8] *Id.* art. 40.

[9] *See* The Law of the Kyrgyz Republic, "On the System of Arbitration Courts of the Kyrgyz Republic" art. 19 (1997).

[10] *Id.*

[11] *See* KYRG. CONST., ch.6, art. 79, § 3 (1996).

[12] The Law of the Kyrgyz Republic, "On Supreme Court and Local Courts" art. 25(2) (1997).

authorities, local governments, their public officers and officials.[13] Cases involving challenges to decisions of the NBKR are thus heard originally by the inter-rayon courts.

Oblast courts are appellate level courts. The Military Court of the Kyrgyz Republic and Bishkek City Court have legal status equivalent to oblast courts.[14] Oblast courts function as appellate and cassation courts for decisions of the inter-rayon courts.[15] The oblast courts are divided into "Collegiums" or "Cassation Panels."[16] The collegiums are organized categorically like the Supreme Court collegiums. The collegiums sit as courts of appellate jurisdiction with regard to judicial acts issued by rayon and equivalent courts that have not become effective; they sit as "cassation panels" with regard to judicial acts issued by rayon and equivalent courts that have become effective.[17] There is no substantive difference between the "appeal" process and the "cassation" process.[18]

Procedural issues are governed by the Civil Procedural Code. In 2004, extensive changes were made to the Civil Procedural Code to make it consistent with the 2003 constitutional changes and the 2004 changes to the Law on the Supreme Court and Local Courts.

Prior to the 2004 changes to the Civil Procedural Code, decisions of the first instance courts could be submitted directly to the Supreme Court for review in "supervisory procedure."[19] This is no longer possible. Such decisions now must first be submitted to the Oblast court (or the Bishkek City Court) before they can be submitted to the Supreme Court. There are two methods of doing this. Judgments of first instance courts that have not become effective can be "appealed" within one month of the date of the decision.[20] Judgments of first instance courts that have become effective can be submitted for review in "cassation procedure" within 3 months of the effective date of the decision.[21] However, if a party does not submit a petition for cassation review within the requisite 3-

[13] *See id.*
[14] *Id.* art. 25.
[15] *Id.* art. 29(7).
[16] *See id.* art. 29.
[17] *Id.*
[18] *See* discussion *infra* notes 20-21 and accompanying text.
[19] *See* Kyrgyz Republic Civil Procedure Code [Civ. Pro. C.] ch. 41 (1999).
[20] Civ. Pro. C. ch. 39, art. 315(1) and art. 316(2) (Kyrg.).
[21] Civ. Pro. C., ch. 39-1, art. 337-1(1) and art. 337-2(2) (Kyrg.).

month period, he can still request an additional 3 months to submit the petition.[22]

Judgments of oblast collegiums, whether based on appellate or cassation procedure, can be appealed to the Supreme Court within 1 year.[23]

The NBKR has had an enormous amount of difficulty over the years in having its supervisory actions upheld by courts.[24] Part of the difficulty, no doubt, stems from misapplication of new and unfamiliar legal provisions by inexperienced judges. While there is certainly a considerable measure of truth in this perception, the problem is considerably deeper.

B. Legal Hierarchy

In the Kyrgyz Republic, the Constitution is the supreme law of the land.[25] Ordinary legislation is considered subservient to the Civil Code, which is subservient to the Constitution.[26] Ministries, institutions and other state bodies may issue acts regulating civil relationships, but these acts must comply with the Civil Code.[27] In the event of a conflict between these two legal regimes, the Civil Code provisions will be given priority.[28] Thus, banking legislation is considered subservient to the Civil Code and other codes. As a result, as will be shown below, questions of public administrative law tend to become intertwined with civil law concepts.

C. The Post-Soviet Concept of Administrative Law

Until very recently, the whole idea of "administrative law" in the western sense did not exist in the former Soviet republics. In a holdover from the Soviet era, "administrative law" usually refers to a series of rules under an "administrative offenses (or violations) code," which imposes punishments for various lower level infractions that are less serious than those found in the criminal

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[22] *Id.* art. 337-6(2) (Kyrg).
[23] Civ. Pro. C., ch. 41, art. 344 (Kyrg.).
[24] *See* World Bank FSAP Report, *supra* note 2.
[25] KYRG. CONST. ch. 1, art. 12, § 1 (1996).
[26] Civil Code of the Kyrgyz Republic [Civil Code] ch.1, art. 2(4) (1996).
[27] *See id.* art. 5.
[28] *Id.* art. 6.

code.[29] Historically, the purpose of the administrative offenses code was to solidify control of the citizenry by the authorities. The notions of accountability of governmental authorities, limited judicial review of decisions of public authorities based on the administrative record, and judicial deference to the expertise of the regulatory authority, were completely unknown concepts.

In the past few years, this situation has begun to change, as a number of former Soviet republics, including Kyrgyzstan, have adopted, or are in the process of adopting, administrative procedure codes or laws creating administrative courts to govern disputes between private parties and public bodies. In Kyrgyzstan, as in most of such republics, these provisions are in their infancy.

In mid-2003, the Supreme Court of the Kyrgyz Republic published a paper entitled "Conception of Further Improvement of Activity of the Supreme Court of the Kyrgyz Republic and of the Local Courts" ("Concept Paper"), which was aimed at improving the quality and efficiency of justice in Kyrgyzstan.[30] The Supreme Court's paper specifically mentioned the submission of a draft law on administrative courts and the need to create specialized administrative courts, organized along the lines of the inter-rayon courts.[31] As of October 2004, draft laws on administrative courts on administrative procedures were being prepared, but to date neither of these laws has been adopted.[32] The Draft Law on Administrative Courts would have provided for the creation of specialized courts, organized along the lines of the inter-rayon courts, to consider cases involving challenges to acts of public authorities.[33] The Draft Law on Administrative Procedures would have created procedural rules to

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[29] *See* ABA CEELI Judicial Reform Index, *supra* note 2 at 12. *See generally* Howard N. Fenton, *An Essay on Administrative Law Reform in the Former Soviet Union*, 7 J. E. EURO. L. 47, 56-65 (2000).

[30] *Conception of Further Improvement of Activity of the Supreme Court of the Kyrgyz Republic and of the Local Courts*, ERKIN-TOO NEWSPAPER NO. 39 (Bishkek, Kyrgyzstan), May 30, 2003, *available in Russian at* http://shentsov.toktom.kg/student/list] [hereinafter Supreme Court Concept Paper] (on file with the Annual Review of Banking & Financial Law).

[31] *Id.* at 2-5.

[32] *See* (Draft) Law of the Kyrgyz Republic on Administrative Procedures [hereinafter Draft Law on Administrative Procedures] (on file with the Annual Review of Banking & Financial Law); (Draft) Constitutional Law of the Kyrgyz Republic on Administrative Courts of the Kyrgyz Republic [hereinafter Draft Law on Administrative Courts] (on file with the Annual Review of Banking & Financial Law).

[33] Draft Law on Administrative Courts, *supra* note 32 arts. 1 & 2.

be followed by public authorities when considering challenges to their own decisions.[34]

The Concept Paper and the preparation of the above-mentioned draft laws represent positive steps forward. Clearly, however, they are only the beginning. Much more needs to be done if Kyrgyzstan is to have a system of public administrative law that is on par with those of more advanced countries. The basic problem is that there are no special procedural rules that govern judicial review of decisions of the NBKR (or, for that matter, any other public regulatory authority). The courts treat cases between the NBKR and supervised entities in the same fashion as cases between private parties. Cases are conducted entirely in accordance with the Civil Procedural Code (and formerly, the Code of Arbitration Procedure when there were *arbitrazh* courts), which contains a number of provisions that are incompatible with an effective public law system.

Neither of the above-referenced draft laws would have dealt with these issues effectively. Neither, for example, would have created special procedural rules for the administrative courts, nor would they have addressed either the scope or standard of judicial review. Instead, the Draft Law on Administrative Procedures simply would have provided that judicial appeals against decisions of public bodies would be conducted in accordance with existing procedural legislation (*i.e.*, the Civil Procedural Code).[35] As the following discussion will demonstrate, these provisions fall considerably short of what is needed.

D. Procedure for Challenging NBKR Decisions

1. Overview

Any American lawyer who has been even tangentially associated with a case involving judicial review of a decision of a public authority has a reasonably good idea of how the process works in the United States. The legal standard for review of most decisions of administrative agencies is set forth in the Administrative Procedure Act ("APA").[36] Decisions of public administrative bodies are entitled to great deference from the courts – a strong "presumption of correctness." A reviewing court will not overturn

[34] Draft Law on Administrative Procedures, *supra* note 32 ch. 6, arts. 44-49.
[35] *See* Draft Law on Administrative Courts, *supra* note 32 art. 44, ¶ 3.
[36] 5 U.S.C. §§ 557 (2000).

the agency's decision unless it determines that the decision was "arbitrary or capricious," or amounted to an "abuse of discretion."[37] When the correct interpretation of a statutory provision is unclear (i.e., where the words in a statute can reasonably be interpreted in more than one way), the court does not substitute its own judgment for that of the regulatory agency. Instead, it simply decides whether the agency's interpretation was legally permissible given the purposes of the statute.[38] So long as the agency's interpretation was reasonable, the court will not disturb the decision, even if the court does not agree with the decision and might have decided the matter differently if it had been the regulator. In reviewing disputed factual issues, the court will uphold the agency's factual findings, so long as the court can determine that they are supported by "substantial evidence."[39] As a practical matter, this means that the court will not disturb agency factual findings if any reasonable trier of fact could have found as the agency did.[40] In addition, the court generally will not consider additional facts that were not before the agency's decision-maker; the petitioner is not allowed to introduce facts in court that the agency did not consider. The court confines its review to the "administrative record," the compilation of factual materials and legal analysis that culminate in the agency's decision.[41]

In Kyrgyzstan, the situation is precisely the opposite. Indeed, the relevant legal provisions literally turn the American principle of judicial deference on its head. To begin with, the label "judicial review" is something of a misnomer. There is no concept of "judicial review" of actions of public authorities, as distinct from "appeals." The entire process is described in terms of an "appeal." Thus, Chapter 27 of the Civil Procedural Code is entitled "Proceedings on Cases on Appealing Against Decisions and Actions (Inaction) of State Authorities, Local Governments, Officials."[42] Similarly, Chapter 28 is entitled "Proceedings On Cases Of Appealing By Individuals, Legal Entities, Procurators Against

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[37] *Id.* at § 706(2)(A) (2000).
[38] Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 843 (1984).
[39] 5 U.S.C. § 706(2)(E) (2000). There are several other grounds upon which an agency decision may be overturned. *See* 5 U.S.C. § 706(2) (2000). The "arbitrary or capricious/abuse of discretion" test and the "substantial evidence" test are the most prevalent.
[40] Richardson v. Perales, 402 U.S. 389, 401 (1971).
[41] Camp v. Pitts, 411 U.S. 138, 142 (1973).
[42] *See* Kyrgyz Republic Civil Procedure Code [Civ. Pro. C.] ch. 27 (1999).

Normative Legal Acts."[43] The scenario established by the relevant code provisions in Kyrgyzstan is not a "review" at all (nor is it claimed to be), but rather a second opportunity for the petitioner to persuade the ultimate decisionmaker (which turns out to be the court) of the merits of its position.

This differs significantly from the situation in countries with more mature legal systems, and particularly administrative law regimes. In most countries, "judicial review" of a decision of a public authority is quite different from an "appeal." In an appeal, the appellate level court can examine both legal and factual issues, though the exact scope of review varies from country to country. In common law countries, appellate courts are generally deferential to the trial court's factual findings unless they are clearly erroneous, and focus primarily on correcting errors of law.[44] In many civil law countries, the appellant can submit new factual material that the trial court did not consider, though the modern trend is for the appellate court to rely on the factual record prepared below.[45] The appellate court is expected to independently analyze both the facts and the law, and to arrive at its own independent judgment.[46] Judicial review, by contrast, involves the authority of a court to review, and possibly nullify, laws and governmental acts that violate the country's constitution or higher norms.[47] Under judicial review, the court is

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[43] *Id.* ch. 28.

[44] *See, e.g.*, Fed. R. Civ. P. 52(a).

[45] *See* JOHN HENRY MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA 120 (2d ed. 1985). *See also* Michele Taruffo, *Cassation: Scope, Character and Managing the Flow of Appeals* 2 (April 15-17, 2002) (unpublished paper presented by at the seventh meeting of the Presidents of European Supreme Courts, organized by the Council of Europe in collaboration with the Supreme Court of Georgia, Tbilisi, Georgia, on file with the Annual Review of Banking & Financial Law).

[46] MERRYMAN, *supra* note 45; Taruffo, *supra* note 45.

[47] *See* Dickinson v. Zurko, 527 U.S. 150, 159 (1999), *quoting* Morgan v. Daniels, 153 U.S. 120, 124 (1894) (stating that a petition to set aside an action of an executive department of the government is "more than a mere appeal," and requires a more deferential standard of review). *See generally* Bernd Hartmann, *The Arrival of Judicial Review in Germany Under the Weimar Constitiution of 1919*, 18 BYU J. PUB. L. 107, 108 (2004) (comparing the American and German experiences); Hon. James J. Spigelman AC, Chief Justice of New South Wales, Jurisdiction and Integrity - The Second Lecture in the 2004 National Lecture Series (Aug. 5, 2004), *available at* http://www.lawlink.nsw.gov.au/lawlink/supreme_court/ll_sc.nsf/pages/SCO_speech_spigelman050804 (noting the distinction between judicial review and merits review and comparing the Australian and English experiences);

concerned primarily with questions of law and procedure, but factual issues are considered only minimally, if at all.[48] The court considers only the facts that the public authority (or in some countries, the first instance court) considered. In this sense, judicial review, whether in a common law or civil law setting, is more analogous to the civil law concept of the "cassation" proceeding.[49]

Challenges to NBKR decisions are conducted in accordance with Chapters 27 and 28 the Civil Procedural Code.[50] Any person may appeal in court against a decision, action, or inaction of a state authority, local government, or official if he considers that his rights and freedoms have been violated.[51] Such a petition may be filed within three months from the date when the person became aware of the alleged violation of his rights and freedoms.[52] Even if a person misses this deadline, however, all is not lost. First, missing the deadline is not a ground for the court to refuse to accept the petition. Rather, the reasons for missing the filing deadline must be studied by the court in the course of consideration of the merits of the petition, and "may" serve as one of the grounds for refusal.[53] Second, the Civil Code contains a general 3-year statute of limitations.[54] Thus, any decision of the NBKR can be challenged in court at any time within 3 years of its enactment.

The NBKR, rather than the petitioner, has the burden of proof when one of its decisions is challenged in court.[55] There is no "presumption of correctness" that attaches to a decision of the NBKR, as there is in many other countries when a decision of the

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ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, ADMINISTRATIVE PROCEDURES AND THE SUPERVISION OF ADMINISTRATION IN HUNGARY, POLAND, BULGARIA, ESTONIA AND ALBANIA 76, 132 (1997), *available at* http://unpan1.un.org/intradoc/groups/public/documents/NISPAcee/UNPAN006733.pdf.

[48] *See* discussion *infra* at Part III. For example, in the United States, an appellate court reviewing an act of an administrative agency can consider factual issues, but generally only for the purpose of determining whether the agency's factual findings satisfy the "substantial evidence" test of the APA. In France, the *Conseil d'Etat*, the highest administrative court, sits in cassation, meaning that it considers only issues of law and procedure, but not fact.

[49] *See* Taruffo, *supra* note 45.

[50] *See* Kyrgyz Republic Civil Procedure Code [Civ. Pro. C.] ch. 27 (1999).

[51] *Id*. art. 262(1).

[52] *Id.* art. 264(1).

[53] *See id*. art. 264(2).

[54] Civil Code of the Kyrgyz Republic [Civil Code] ch.1, art. 212 (1996).

[55] Civ. Pro. C. ch. 27,art. 265(3) and art. 268(4) (Kyrg.).

bank supervisor is challenged in court.[56] Indeed, paragraph 2 of Article 269 states: "[w]here the petition is reasonable the court in its judgment, shall recognize the normative legal act invalid, either in full or in part . . . ."[57] This is precisely the opposite of how courts treat petitions for review of decisions of public bodies in more advanced countries: if an act of a public body was reasonable given the facts and the standard set forth in the law, the act stands. It is for the petitioner to convince the court that an act or decision of a public authority should be annulled.[58]

There is also no concept of the "administrative record." There are no exceptions from the general procedural rules set forth elsewhere in the Civil Procedural Code when decisions of a public regulatory authority are challenged. Thus, Article 158 requires the court to directly examine the proofs of the case, hear explanations of the parties and third persons, witness testimony, and expert statements; and to familiarize itself with written proofs and examine exhibits.[59] "Proofs" under the Civil Procedural Code consist of any factual information that the court finds significant for proper settlement of the case. Proofs can consist of explanations of the parties in the dispute and of the third parties, witness testimony, written proofs and exhibits (material evidence), audio and video records, and experts' statements.[60]

The above procedures virtually guarantee that the court will substitute its own appreciation and assessment of the facts for that of the NBKR, unlike the approach taken in many other countries.

2. Challenges to Decisions of Inter-Rayon Courts

A party who is dissatisfied with a decision of a first instance court has two options with regard to taking the proceedings to the next level. It is possible to "appeal" against a judgment of a first instance court, or to submit a petition for "cassation review."[61] Both procedures are carried out by the collegiums of the oblast or

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[56] *See* discussion *infra* at Part III.
[57] Civ. Pro. C. ch. 28, art. 269 (Kyrg.).
[58] *See* discussion *infra* at Part III.
[59] Civ. Pro. C. ch. 16, art. 158(1) (Kyrg.).
[60] *Id*. ch. 7, art. 59(1) and (2).
[61] Law of the Kyrgyz Republic, "On the Supreme Court of the Kyrgyz Republic and Local Courts," art. 29(7) (2003); Civ. Pro. C. ch. 39-1, art. 337-2 and art. 337-6 (Kyrg).

equivalent courts.[62] As noted above, judgments of first instance courts that have not become effective can be "appealed" within one month of the date of the decision.[63] Judgments of first instance courts that have become effective can be submitted for review in "cassation procedure" within 3 months of the effective date of the decision.[64] A party can also request an additional 3 months to submit the petition for cassation review if he misses the 3-month deadline.[65]

Appeals from decisions of inter-rayon courts are carried out under the procedures set forth in Chapter 39 of the Civil Procedural Code.[66] Appellate proceedings largely duplicate the proceedings of the first instance courts. In fact, Article 329 of the Civil Procedural Code is actually entitled "Trial in the Court of Appeal."[67]

Appellate proceedings are carried out under the rules established for courts of the first instance, taking into account the provisions of Chapter 39.[68] Examinations of the parties' proofs are carried out in accordance with the procedure established for courts of the first instance.[69] The appellate court can examine the newly submitted proofs.[70] The parties can apply for summoning and questioning of new witnesses, and for provision of other proofs the examination of which was rejected by the court of the first instance.[71]

In theory, there is a distinction between an appeal and a cassation proceeding: in the former, new proofs are allowed, whereas in the latter, they are not. In substance, however, there is no real difference. In fact, even the articles on cassation procedure use "appeal" terminology, which leads to confusion as to what sort of proceeding is really being conducted. The Civil Procedural Code is also unclear on the scope of review of the oblast court panel when it sits as a cassation panel. On the one hand, the Civil Procedural Code purports to preclude the submission of new proofs, which were not subject to examination in the rayon court.[72] This is in keeping with

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[62] Law of the Kyrgyz Republic, "On the Supreme Court of the Kyrgyz Republic and Local Courts," art. 29(7).
[63] Civ. Pro. C. ch. 39, art. 315(1) and art. 316(2) (Kyrg).
[64] Civ. Pro. C. ch. 39-1, art. 337-1(1) and art. 337-2(2) (Kyrg).
[65] *Id.* art. 337-6(2).
[66] *See id.* ch. 39.
[67] *See id.* ch. 39, art. 329.
[68] *Id.* art. 328(1).
[69] *Id.* art. 329(3).
[70] *Id.* art. 329(4).
[71] *Id.* art. 329(5)
[72] *Id.* art. 337-3(1).

the traditional view of a cassation proceeding.[73] On the other hand, Article 337-11(4) expressly permits the oblast court to examine newly presented proofs, provided it determines that these proofs could not have been presented by the party in the court of the first instance.[74] It thus seems clear that despite the supposed prohibition on the submission of new material in the cassation proceeding, such submissions are allowed if the party can simply convince the court that it was impractical to submit the material to the first instance court. Whether performing an "appellate" function or a "cassation" function, the oblast court can consider new facts, hear new witnesses and expert testimony and re-examine the facts that the first instance court considered.

3. Appealing to the Supreme Court

Finally, a party who is dissatisfied with a decision of the oblast court may submit a petition for review in "supervisory procedure" before the Supreme Court of the Kyrgyz Republic.[75] In most cases, including cases involving challenges to decisions of the NBKR, such petitions may be submitted within one year of the effective date of the decision of the oblast court.[76]

In general, the Supreme Court examines correctness of the legal norms applied by the lower court, within the limits of arguments of the complaint or procurator's report.[77] The Court may, however, go beyond the scope of the complaint in the interests of law.[78] Grounds for cancellation or amendment of judicial acts in the supervisory procedure include substantial violations or incorrect application of the legal norms and groundlessness of judicial acts. If there are no other grounds for revising the judicial act, the Constitutional Court of the Kyrgyz Republic may choose to

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[73] *See* discussion *infra* at Part III.
[74] Civ. Pro. C. ch. 39, art. 337-11(4) (Kyrg.) (emphasis added).
[75] *See generally,* Civ. Pro. C. section IV (Kyrg.). Prior to the 2004 changes to the Civil Procedural Code, decisions of the first instance courts could be submitted directly to the Supreme Court for review in supervisory procedure, thus bypassing the appellate level, within 3 years of the date of the first instance court's decision. *See* Civ. Pro. C. ch. 41 (Kyrg.).
[76] Civ. Pro. C. ch. 41, art. 344(1) (Kyrg.).
[77] *Id*. art. 354(1).
[78] *Id*. art. 354(2).

recognize that the law upon which the judicial act was based does not correspond to the Constitution of the Kyrgyz Republic.[79]

As is readily apparent, the above provisions can create significant problems for the NBKR in the exercise of its supervisory functions. Indeed, the situation could be described, to paraphrase the late Professor Raoul Berger, as "bank supervision by judiciary," a scenario that bank supervisors in most countries would undoubtedly find most distasteful.[80]

The following section examines some representative cases involving legal challenges to NBKR decisions. Most cases involving such challenges involve license revocations and the decision to institute various bank resolution procedures, such as liquidation or bankruptcy.[81] The NBKR rarely issues "cease-and-desist" orders in the American sense, though the Banking Law does provide for the imposition of various corrective measures.[82] Most violations of law and NBKR regulations are handled informally or through the imposition of insignificant fines.[83]

Until early 2004, cases involving license revocation and bank resolution were handled under the provisions of the Banking Law and the Law on Bankruptcy, which was originally passed in 1997 and was amended in 2002 to add special provisions for banks.[84] In November 2003 (effective February 2004), a new law was enacted that applies specifically to banks.[85] Formerly under the general Law

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[79] *Id*. art. 357(1).

[80] *See* RAUOL BERGER, GOVERNMENT BY JUDICIARY: THE TRANSFORMATION OF THE FOURTEENTH AMENDMENT (Liberty Fund, 2d ed.1997) (1977).

[81] *See, e.g.,* The Law of the Kyrgyz Republic, "On Banks and Banking Activity in Kyrgyz Republic" [Banking Law] art. 45-1(4) (1997) (authorizing license revocation); *id.* art. 45-1(6)(6) and (7) (bankruptcy proceedings); The Law of the Kyrgyz Republic, "On National Bank of the Kyrgyz Republic" [NBKR Law] art. 32(6)(6) and (7) (bankruptcy proceedings) (1997); The Law of the Kyrgyz Republic, "On Conservation, Liquidation and Bankruptcy of Banks" [Bank Bankruptcy Law] (2003). The Bank Bankruptcy Law was amended in 2005. *See* The Law of the Kyrgyz Republic No. 47 (Mar. 10, 2005).

[82] Banking Law, *supra* note 81, art. 45 (Improvement of the Financial Condition of a Problem Bank); *id*. art. 45-1 (Preventive Measures and Sanctions); *id*. art. 46 (Order on Elimination of Revealed Violations); *id*. art. 48 (Limitation on Certain Types of Banking Operations).

[83] *See id*. art. 47 (1997) (authorizing monetary penalties of up to one percent of paid-in authorized capital for banks, and twenty minimum salaries for individuals). *See also id.* art. 45-1(2); NBKR Law, *supra* note 81, art. 32(2) (1997).

[84] *See generally* The Law of the Kyrgyz Republic, "On Bankruptcy (Insolvency)" [Law on Bankruptcy] (1997); *id*. ch. 11 (2002).

[85] Bank Bankruptcy Law, *supra* note 81.

on Bankruptcy, and currently under the Bank Bankruptcy Law, the NBKR must petition the court to commence the process of resolving a bank.[86] The Court, communicating with the NBKR, carries out this process.

E. Representative Judicial Decisions

1. Kramds Bank

The NBKR's difficulties with the Kyrgyz courts are perhaps best illustrated by a series of cases beginning in 2000 and involving KyrgyzKRAMDS Bank ("Kramds"). The courts have repeatedly thwarted the NBKR's attempts to take effective supervisory action regarding this bank on the basis of legal reasoning that would strike any western lawyer or bank supervisor as bizarre.

The supervisory saga begins in 1997, when the European Bank for Reconstruction and Development ("EBRD") provided a line of credit to Kramds. By 1999, Kramds was in considerable financial trouble, and from January 28, 1999 to January 20, 2000, it was under conservatorship.[87] When Kramds failed to repay the outstanding EBRD credit, NBKR became the creditor.[88] In 1999, the NBKR and Kramds reached an agreement pursuant to which Kramds undertook to repay its debt to NBKR for 19.5 million som in principal and a 267,621 som fine by December 27, 1999.[89] The due date was later extended to July 1, 2000.[90] The modification contained an acceleration clause under which the NBKR could annul the agreement and demand immediate repayment of the whole outstanding debt if the bank failed to meet the repayment schedule.[91] The conservatorship of the bank was terminated on January 20, 2000, on the conditions that the bank would be recapitalized, in an amount of 200 million som by February 29, 2000, and would adhere to a

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[86] *See* Law on Bankruptcy, ch. 11; Bank Bankruptcy Law, art. 22.

[87] Kramds Arbitration Court Decision, Case #B-01-340/2000-s4, at 3 (July, 2000) [hereinafter Kramds July 2000 Arbitration Court Decision] (on file with the Annual Review of Banking & Financial Law).

[88] While it is not entirely clear from the court decisions, it appears that when Kramds failed to repay the outstanding EBRD loan, NBKR satisfied the obligation and later sought to collect directly from Kramds.

[89] Kramds July 2000 Arbitration Court Decision, supra note 87, at 1.

[90] *Id.* at 1.

[91] *Id.* at 1.

business plan approved by the NBKR. As of May 2, 2000, the bank had not met either of these conditions.[92]

In May 2000, after Kramds (insolvent by then) failed to make the scheduled payments to the NBKR, the NBKR made the decision to suspend the bank's banking transaction licenses for six months and appointed a temporary administrator in order to safeguard the assets of the bank. The NBKR also petitioned the Court to recognize Kramds as bankrupt and requested that the Court commence the procedure of special administration and liquidation under the Law on Bankruptcy (as it was in effect at the time).[93] The Court dismissed the NBKR's petition in a decision dated July 6, 2000,[94] on the ground that Kramds' principal shareholder had arranged to obtain sufficient funds to repay the debt (ignoring the fact that the money was merely on deposit in a third party bank and had not actually been injected into Kramds).[95] In a letter dated July 6, 2000 – more than two months after the NBKR's decision – the shareholders' authorized representative requested the NBKR to restructure the debt and, in the event of a positive response, to commence repayment.[96] The Court, sufficiently persuaded by this gesture, denied the NBKR's petition. [97]

Following the July 6 decision, the NBKR and Kramds entered into an "amicable agreement" under the Law on Bankruptcy, which called for Kramds to be recapitalized in the amount of 120 million som before September 1, 2000, and to fully repay its debt to the NBKR by February 25, 2001 on the principal amount, and by June 28, 2001 on the accrued interest.[98] The NBKR also recalled the temporary manager and renewed all of Kramds' licenses.[99]

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[92] *Id.* at 2.

[93] *Id.* One of the interesting points about this series of cases is that throughout these proceedings, Kramds had no depositors. When the bank became insolvent, the NBKR transferred its deposits and performing assets, along with those of some other insolvent banks, to Kairat Bank, a newly-established institution under NBKR ownership. *See* ASIAN DEVELOPMENT BANK, PROGRAM COMPLETION REPORT ON THE FINANCIAL INTERMEDIATION AND RESOURCE MOBILIZATION PROGRAM (LOAN 1723 KGZ [SF]) AND COMMERCIAL BANK AUDITS (TA LOAN 1724 KGZ [SF]) TO THE KYRGYZ REPUBLIC (August 2002), at 2 – 3, *available at* www.adb.org/Documents/PCRs/KGZ/pcr_IN203_02.pdf.

[94] Kramds July 2000 Arbitration Court decision, supra note 87.

[95] *Id.* at 3.

[96] *Id.* at 4.

[97] *Id.* at 5.

[98] Kramds Arbitration Court Decision, Case No. B-01-813/2000c4, at 1 (December 15, 2000) [hereinafter Kramds December 2000 Arbitration Court decision] (on file with the Annual Review of Banking & Financial Law). *See* The Law of the Kyrgyz

By September 2000, only 47 million som had been injected and Kramds' capital was still negative.[100] From September to November 2000, NBKR's enforcement measures did not yield positive results.[101] Finally, on November 27, 2000, the NBKR revoked the Kramds' license.[102] However, Kramds petitioned the Arbitration Court of Bishkek City to invalidate the NBKR's resolution and the Court granted the petition.[103]

The Court focused on the amicable agreement rather than on the content of the law. The agreement stipulated that in case of non-fulfillment of the terms, the parties could apply to the arbitration court to require enforcement.[104] Moreover, the capitalization agreement established that in case of non-fulfillment of the investment schedule by the shareholders, the latter would pay a penalty to Kramds for delaying the capital injection.[105] Thus, according to the Court, the proper remedy for the NBKR was to apply to the arbitration court to enforce the amicable agreement, not to revoke the bank's operating license.[106] The Court also noted that in accordance with Article 32 of the Law "On the National Bank of the Kyrgyz Republic" ("NBKR Law"), the NBKR applies measures and sanctions for the purposes of protecting the interests of creditors and/or to preserve the stability of the financial and banking systems of the Republic; and since there were no depositors in this case, there were no interests to protect.[107] In fact, the Court was impressed by the fact that at the time of license revocation, the shareholders invested an additional 99 million som, including the repayment of debt to the NBKR, which according to the Court, actually contributed to the stability of the Kyrgyz banking system.[108] The Court also noted that an additional 42 million Som had been placed with a third party bank, confirmed by a letter dated December 14, 2000.[109] This additional sum, deposited more than two weeks after

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Republic, "On Conservatorship, Liquidation And Bankruptcy Of Banks" [Bankruptcy Law] art. 2 and 7-1 (2003).

[99] Kramds December 2000 Arbitration Court decision, *supra* note 98, at 3.

[100] *Id.* at 2.

[101] *Id.*

[102] *Id.* at 1, 3.

[103] *Id.* at 4

[104] *Id.* at 3.

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *Id.* at 4.

the NBKR's decision, and just one day before the Court's ruling, could satisfy the capitalization requirement.[110]

Following the December 2000 decision, the NBKR and Kramds entered into another amicable agreement, approved by the appellate instance of Arbitration Court of Bishkek City on January 31 2001, and pursuant to which, Kramds was to repay its debt to the NBKR, which by that time amounted to 31 million som.[111]

On June 13, 2001, the NBKR adopted a resolution on the commencement of bankruptcy procedure and special administration procedure at Kramds.[112] The NKBR's resolution was not based on Kramds' failure to perform under the January 31 agreement (a situation which ultimately would happen, but had not at that point), but on the bank's unsatisfactory financial condition, which is addressed in Article 32 of the Law on the NBKR.[113] At the time, Kramds' capital was still negative, despite the supposedly imminent capital injection cited by the Arbitration Court in its 2000 decisions.[114] A major bank shareholder appealed against the NBKR's June 2001 decision in court.[115] The Arbitration Court, in both the first and appellate instances, sustained the petition, and these results were ultimately upheld by the Supreme Arbitration Court in a decision dated January 10, 2002.[116] Despite the fact that Kramds conceded that it was insolvent, the Court determined that the NBKR did not have the authority to initiate extrajudicial bankruptcy proceedings against a bank on its own.[117] Instead, the Court determined that the NBKR could do so only in support of another creditor, or, if the NBKR was the creditor itself, the NBKR met the conditions set forth in the Law on Bankruptcy for appointing a special administrator.[118]

The Supreme Arbitration Court focused almost exclusively on the Law on Bankruptcy. The Court noted that in accordance with

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[110] *Id.*
[111] *See* Kramds Supreme Arbitration Court Decision, Case No. B-01-14/"O"-13 at 1 (Dec. 9, 2002) [hereinafter Kramds December 2002 SAC Decision] (on file with the Annual Review of Banking & Financial Law).
[112] Kramds High Arbitration Court Decision, Case No. B-01-438/2001-C6 at 1 (Jan. 10, 2002) [hereinafter Kramds January 2002 HAC decision] (on file with the Annual Review of Banking & Financial Law).
[113] *Id.* at 5.
[114] *Id.* at 2.
[115] *Id.* at 1.
[116] *Id.*
[117] *Id.* at 6.
[118] *Id*.

Article 9(1) of that law, a debtor is considered to be insolvent, and can be recognized or declared bankrupt or insolvent if on the maturity of the payment, the debtor does not satisfy, refuses to satisfy, or is incapable of satisfying the legitimate requirements of the creditor.[119] Because neither the NBKR nor any other creditor had any outstanding and unsatisfied debt from the bank, this avenue was not available to the NBKR.[120] In essence, this was a case of a conflict between the provisions of the Law on Bankruptcy and the Law on the NBKR. The Court gave priority to the Law on Bankruptcy, because Article 120(1) of that law stipulated that the special administration procedure be conducted exclusively in accordance with the norm of that law.[121] The Court also noted that according to Article 116 of the Law on Bankruptcy, rehabilitation procedures may be applied to a bank where unstable financial standing poses a threat to the creditors.[122] Moreover, by applying Article 32 of the Law on the NBKR, the Court noted that the NBKR had disregarded the fact that part 6 of that article is applied in presence of a threat of recognizing the bank as bankrupt only for the purposes of protecting interests of creditors and depositors. Since Kramds had no depositors at the time, Article 32(6) was inapplicable.[123]

The Court also noted that under the Law on Bankruptcy, if the NBKR is not a creditor of the bank satisfying the conditions for commencing action under that law, it could only give its consent to initiation of the special administration procedure in support of other creditors or the bank itself.[124] The NBKR could commence the special administration procedure on its own only if the NBKR was itself a creditor.[125] Because the creditors and participants of the bank had not addressed the NBKR with a request to support their claims, the NBKR's resolution was not lawful or justified.[126]

Following the January 2002 decision of the Supreme Arbitration Court, the NBKR took a number of additional actions involving Kramds. First, on January 18, 2002, it adopted a resolution canceling the special administration procedure, which had been

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[119] *Id.* at 5.
[120] *Id.*
[121] Kramds January 2002 HAC decision, *supra* note 112, at 5.
[122] *Id.*
[123] *Id.*
[124] *Id.* at 6.
[125] *Id.* at 5.
[126] *Id.* at 6.

initiated as part of the bankruptcy process, and appointed a temporary administrator.[127] In that resolution, the NBKR acknowledged that the bank's shareholders had pledged to invest 200 million som into the bank, but determined that only 60 million of that amount could be counted as capital because (1) 140 million som was only stated (and not paid up) capital at that point; and (2) the placement of the bank's shares, which would have resulted in the capital increase, had not been approved in accordance with the procedure established by relevant securities legislation.[128] The next day, the NBKR adopted another resolution restricting the bank's activities due to its unsatisfactory financial condition.[129] Kramds did not challenge these resolutions when they were adopted.

Then, on August 14, 2002, when Kramds had failed to comply with the terms of the January 2001 agreement, the NBKR filed an application with the Arbitration Court of Bishkek City to declare Kramds bankrupt.[130] This time, the Arbitration Court rejected the NBKR's petition on the grounds that the NBKR was not an appropriate petitioner. On August 26, 2002, the Court held that where the state acts as a creditor, under the Law on Bankruptcy (as amended in June 2002), the State Body on Bankruptcy was the only state representative that could initiate bankruptcy procedures for debtors.[131] The Supreme Arbitration Court affirmed the lower arbitration court's decision in a case brought under supervisory procedure in December 2002, completely ignoring the fact that that same Court, less than a year earlier, had specifically stated that the NBKR could initiate such a process if it were the creditor.[132]

In the meantime, on April 29, 2002, the NBKR Board adopted another resolution revoking all banking licenses of Kramds and initiating the liquidation process.[133] The NBKR's resolution was eventually the subject of two sets of Arbitration Court decisions, one

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[127] *See* Kramds Appellate Division of the Arbitration Court Decision, Case No. b-01-500/c-9-02c8 (Apr. 28, 2003) [hereinafter Kramds April 2003 AC decision] (on file with the Annual Review of Banking & Financial Law).
[128] *See* NBKR Appellate Complaint, Case No. #B-01-500/C9-02C8, May 28, 2003 [hereinafter NBKR Appellate Complaint] at 5 (on file with the Annual Review of Banking & Financial Law).
[129] *Id.*
[130] *See* Kramds December 2002 SAC decision, *supra* note 111, at 1.
[131] *Id.* at 2.
[132] *Id.*
[133] Kramds April 2003 AC decision, *supra* note 127, at 1.

on the NBKR's liquidation petition, and another on Kramds' appeal of the NBKR's license revocation decision.

In the first instance, the Arbitration Court granted the NBKR's liquidation petition in a decision dated June 11, 2002, and Kramds appealed.[134] On July 20, 2002, the appellate division of the Arbitration Court granted Kramds' appeal and overturned the June 11 decision of the first instance tribunal.[135]

With regard to the license revocation decision, the Arbitration Court satisfied Kramds' appeal on October 3, 2002 and invalidated the NBKR's April 29 resolution. This decision was affirmed by the appellate instance of the Arbitration Court, in a decision dated November 27, 2002. The NBKR appealed to the Supreme Arbitration Court, which, in a decision dated February 13, 2003, revoked the prior holdings and sent the case back to the Arbitration Court.[136]

The NBKR and Kramds later entered into an amicable agreement, which was approved by the Arbitration Court on December 31, 2002. Pursuant to this amicable agreement, the NBKR agreed to recall the temporary manager from the date of capitalization of the bank, return the bank's license and lift all limitations then in place.[137]

On March 6, 2003, the NBKR restored Kramds' license but kept the restrictions imposed in January 2002 intact.[138] Kramds then amended its complaint and decided to challenge the January 19, 2002 NBKR Board resolution restricting the bank's activities after all.[139] The amended complaint's purported theory was that the January 19 and April 29, 2002 resolutions were interrelated because they were adopted for the same reasons.[140] However, the bank's real grievance

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[134] *Id.*
[135] *Id.* at 2.
[136] Kramds Supreme Court Decision, Case #B-01-500/C9-02c8 (Oct. 23, 2003) at 2 [hereinafter Kramds October 2003 SC Decision] (on file with the Annual Review of Banking & Financial Law). *See* Kramds Supreme Arbitration Court Decision, Case No. B-01-500/C9-02 (Feb. 13, 2003) [hereinafter Kramds February 2003 SAC Decision] (on file with the Annual Review of Banking & Financial Law). The basis for the February 2003 ruling was that both the first instance and appellate decisions had been adopted without a thorough and a comprehensive examination of the proofs in the case; the Supreme Arbitration Court therefore directed the courts to investigate the circumstances further. *Id*. at 3-4.
[137] *Id*. at 6.
[138] Kramds October 2003 SC Decision, *supra* note 136, at 6.
[139] *Id.* at 2, 6.
[140] *Id.*

appeared to be that the March 2003 resolution incorporated the January 19, 2002 resolution's activity restrictions rather than that the two resolutions were connected. The March 2003 resolution, once adopted, "resurrected" the issues from the January 2002 resolution, which the bank could have challenged, but did not, in its immediate aftermath. The March 2003 resolution, in other words, gave the bank a free bite at the January 2002 apple.

The Arbitration Court of Bishkek City granted Kramds' appeal in a decision dated April 28, 2003.[141] In its decision, the Court focused on two issues: (1) the 200 million som capital injection, of which the NBKR determined only 60 million could be recognized as capital; and (2) the fact that the bank had been operating under NBKR control, in the form of temporary or special administration, since June 2001.[142] As to the capital issue, the Court determined that the NBKR had improperly disallowed 140 million som, ignoring the fact that this amount did not qualify as bank capital as either a matter of law or fact.[143] As to the second issue, the court noted that since the NBKR had been running Kramds since June 2001, the bank's owners and managers could not be held responsible for its condition.[144] In essence, the court seemed to believe that NBKR's control of Kramds since June 2001 had somehow caused the bank's financial difficulties, completely overlooking the fact that the NBKR made its June 2001 decision in the first place because the bank had negative capital – a point that even Kramds itself did not dispute at the time.[145]

While the NBKR's appeal was pending, the NBKR Board, in a resolution dated June 18, 2003, cancelled the limitations in the March 6 resolution.[146] Shortly thereafter, in a decision dated July 8, 2003, the appellate instance of the Arbitration Court of Bishkek City rejected the NBKR's appeal and left the April 28, 2003 decision unchanged.[147] The NBKR appealed this decision to the Supreme Court, which overturned the April 28 and July 8 decisions for two reasons. First, the December 31, 2002 amicable agreement between the NBKR and Kramds, approved by the Arbitration Court of Bishkek City, meant that there was no subject matter of dispute on

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[141] *Id*.
[142] *Id.* at 3-4.
[143] NBKR Appellate Complaint, *supra* note 128, at 5.
[144] Kramds October 2003 SC Decision, *supra* note 136 at 3-4.
[145] *Id.*; *see* Kramds January 2002 HAC Decision, *supra* note 112, at 2.
[146] Kramds October 2003 SC Decision, *supra* note 136, at 7.
[147] *Id.* at 2.

the indicated resolution of the NBKR.[148] Second, the limitations on the last transaction (*i.e.*, in the March 2003 resolution) were considered newly imposed restrictions, and the restrictions set by the NBKR in its resolution of April 29, 2002 could not form the basis for subject matter jurisdiction for the appellate instance of the Arbitration Court of Bishkek City in its July 8, 2003 decision.[149]

The *Kramds* line of cases highlights the procedural and substantive problems inherent in the judicial review process which prove disastrous for banking supervision. At one point during mid-to-late 2002, multiple sets of cases concerning essentially the same subject were simultaneously pending before the courts: (1) cases stemming from the NBKR's April 29 decision to revoke the bank's license and commence liquidation culminating in the arbitration court decisions of October 3 and November 27 (on the bank's appeal of the license revocation decision), which were eventually returned to the arbitration courts by the Supreme Arbitration Court; and (2) cases stemming from the NBKR's August 14 bankruptcy petition, culminating in the December 2002 decision of the Supreme Arbitration Court. The mere fact that such cases can proceed in tandem is problematic enough; at the very least, the system is duplicative and wasteful.[150] When considering that the first instance panels of the Arbitration Court of Bishkek City actually reached two different conclusions, granting the NBKR's liquidation petition on June 11 (based on the April 29 resolution) and rejecting the NBKR's bankruptcy petition on August 26 (based on the August 14 resolution), the irrationality of the system becomes patently obvious.

Procedural questions aside, virtually every case demonstrates numerous problems with the courts' reasoning. In its January 2002 decision, the Supreme Arbitration Court determined that the NBKR could not initiate a liquidation petition unless it, or some other creditor whom it was supporting, satisfied the criteria under the Law on Bankruptcy.[151] In so doing, the Court ignored the plain language of Article 32 of the Law on the NBKR. Paragraph 6 of that Article states:

> 6. Should there be a risk of declaring the bank as bankrupt (if the bank's capital adequacy ratio is less

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[148] *Id*. at 7.
[149] *Id.*
[150] Additionally, recall that the NBKR's liquidation petition was eventually reversed by the appellate instance court on July 20, just three weeks before the NBKR again petitioned the court to commence the bankruptcy process.
[151] Kramds January 2002 HAC Decision, *supra* note 112, at 5-6.

> than two percent), in order to protect interests of depositors and creditors the Bank of Kyrgyzstan, apart from authority provided for in the present Law, as well as by the Law of the Kyrgyz Republic "On Bank and Banking Activities in the Kyrgyz Republic," [the NBKR] shall have the right to undertake any of the following measures:
>
> > (6) to initiate out-of-court bankruptcy proceedings;
> >
> > (7) to meet the request of the bank, its shareholders or creditors of the bank to initiate bankruptcy proceedings against the bank (in court or out of court).[152]

The Court determined that when instituting the extrajudicial bankruptcy procedure under subparagraph 6, the NBKR should have followed the norms of Article 9 of the Bankruptcy Law and acknowledged Kramds as bankrupt under one of the conditions listed in that article.[153] However, nothing in Article 32 of the Law on the NBKR requires any such connection to Article 9 of the Bankruptcy Law. Article 32 of the Law on the NBKR quite clearly states that in the presence of certain facts (*i.e.*, a capital adequacy ratio of less than two percent), the NBKR has the authority to initiate extrajudicial bankruptcy procedure with regard to a bank.[154]

In emphasizing the indicators of bankruptcy in Article 9 of the Bankruptcy Law, the Court apparently felt that it was necessary to analyze Kramds' situation to determine whether there was a "threat of bankruptcy" within the meaning of Article 32 of the Law on the NBKR. There are a number of problems with the Court's reasoning.

First, Article 32 does not contemplate any such situational analysis of the bank's financial position to determine the threat of bankruptcy. Instead, Article 32 contains a specific definition of such a threat, namely a capital adequacy ratio of two percent or less.[155] The numerical benchmark removes any guesswork from the analysis and expressly authorizes the NBKR to initiate the extrajudicial bankruptcy procedure upon reaching that benchmark. The court's

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[152] NBKR Law, *supra* note 81 art. 32(6).
[153] Kramds January 2002 HAC Decision, *supra* note 112, at 4-5.
[154] NBKR Law, *supra* note 81 art. 32(6).
[155] *Id.*

belief as to whether a capital adequacy ratio of less than two percent actually creates a threat of insolvency is not relevant.

Second, the Court adopted an unrealistically restrictive view of "protecting the creditors' interests." According to the Court, since Kramds had no depositors, any concern about protecting creditors was unnecessary.[156] Since the non-depositor creditors had yet to actually experience an event of default, the court seemed to think default would never occur.[157] The reality, of course, is that if a bank has negative capital, as Kramds admittedly did, then the danger of default is very real indeed.

Third, the Court equated the words "protecting the creditors' interests" with "supporting a creditor's application." This misinterprets both the plain language of the law and the purpose behind it. The introductory portion of paragraph 6 states the statute's purpose with the phrase "to protect the interests of depositors and creditors." Paragraph 6 also gives the NBKR several tools to accomplish that purpose. Initiating out-of-court bankruptcy proceedings (subparagraph (6)) and supporting the application of a particular creditor or creditors (subparagraph (7)) are two of the lawful means to achieve that creditor-protection goal. The Law authorizes the NBKR to support creditors when those creditors determine that filing a bankruptcy petition is in their best interest (subparagraph (7)). The Law also authorizes the NBKR to determine on its own, regardless of any action an individual creditor might take, when it would be necessary to initiate extrajudicial bankruptcy procedure in a given case to protect all creditors. This is in keeping with the purposes and functions of a bank supervisor: if the bank supervisor determines that a bank's financial condition is perilous and that bankruptcy is a threat (as evidenced by the bank's capital adequacy ratio being less than two percent), the supervisor must have the authority to initiate the bankruptcy process when, in its judgment, doing so will maximize the possibility that there will be at least something left to be divided among all creditors before the bank actually becomes insolvent. In other words, the purpose of subparagraph (6) is protection of all creditors (*i.e.*, the group of creditors as a whole), whereas subparagraph (7) is aimed at supporting the position of a particular creditor or group of creditors who have chosen to file a bankruptcy petition (while still being mindful, of course, of the NBKR's role as a supervisor and the

[156] Kramds January 2002 HAC Decision, *supra* note 112, at 6.
[157] *Id.*

necessity to protect all creditors). In short, the drafters of the NBKR Law chose to use different terminology to describe different substantive situations.

The Court's position on this point would, in essence, mean that subparagraphs (6) and (7) are duplicative: if the court were correct that NBKR could only initiate the extrajudicial bankruptcy procedure to support the petition of a creditor (subparagraph 6), then the reference to "creditors" in subparagraph (7) would be repetitive. Clearly, the better interpretation is that subparagraph (6) is phrased in broader terms to reflect a broader purpose – *i.e.*, the protection of the interests of all creditors as opposed to simply supporting the position of a specific creditor or creditors (subparagraph (7)).

Fourth, the Court confused the special administration process, referred to in Article 120, with the Article 9 definition of insolvency.[158] According to the Court, Article 120 meant that the NBKR could not proceed under Article 9.[159] This analysis, however, is flawed. Article 120 stated nothing more than that the process of special administration of a bank was carried out in accordance with the Law on Bankruptcy, a point with which the NBKR did not disagree. It did not address the question of what conditions call for instituting that process in the first place. That question was answered by Article 32 of the Law on the NBKR, which quite specifically set out the conditions under which the NBKR could initiate out-of-court bankruptcy proceedings. Special administration, under the Law on Bankruptcy, entailed a number of steps, including sale or alienation of the debtor's assets to third parties for the benefit of creditors, restructuring of the insolvent enterprise, or liquidation.[160]

Finally, the Court ignored the purposes of bank supervision, as distinguished from private bankruptcy law issues. A bank with negative capital simply should not be permitted to continue to operate. The Court played down the negative capital aspect by emphasizing that the bank had no depositors at the time, but actually this was a rather fortuitous blessing. Unlike a fully operating bank, an insolvent bank with no depositors' funds at risk can be liquidated easily and quietly without triggering a "run" on deposits. It is far

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[158] *Compare* The Law of the Kyrgyz Republic, "On Bankruptcy (Insolvency)" [Law on Bankruptcy], art. 9 (defining "insolvent debtor") *with id*. art. 120 (specifying how special administration of a bank is conducted).
[159] Kramds January 2002 HAC Decision, *supra* note 112 at 4 - 5.
[160] Law on Bankruptcy, art. 2 & 5(2002). *See also id*., Ch. 2.

preferable to dispose of such banks efficiently, than to risk the possibility that they will eventually become deposit-takers.

The Supreme Arbitration Court compounded its error in the December 2002 decision.[161] Quite apart from the fact that the Court reached a completely contrary result in December than it had reached a year earlier (concluding that the NBKR could only support the petition of a creditor other than itself, after determining in January that it could file a petition on its own if it were the creditor), the Court completely misconstrued Article 27-2 of the Bankruptcy Law. That article, as it applied at that time, stated that the following persons and entities could file a petition with the court:

> (1) the debtor;
> (2) a creditor or group of creditors;
> (3) the state body in charge of bankruptcy cases, as stipulated by [the Bankruptcy Law];
> (4) the NBKR, in cases stipulated by [the Bankruptcy Law];
> (5) other persons and entities, in cases stipulated by [the Bankruptcy Law].[162]

The NBKR filed a petition in its capacity as a creditor, because Kramds owed it money and did not pay, per subpoint 2. The court determined that the NBKR could not use subpoint 2 because subpoint 4, which was peculiar to the NBKR, limited its application to those cases "stipulated by [the Bankruptcy Law]," and a separate article (Article 119) stipulated what those cases were. According to Article 119, a person who wished to initiate the special administration process of a bank had to file an application with the NBKR, which could then (1) sustain the application; (2) sustain the decision of the bank owners, if the bank itself had filed the application; or (3) commence the special administration process of the bank on its own behalf by appointing a special administrator.[163] Because Article 119 mentions only third party creditors, the NBKR in its own capacity could not utilize it, and was thus precluded from using subpoint 4 according to the Court.[164]

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[161] Kramds December 2002 SAC decision, *supra* note 111.
[162] Law on Bankruptcy, *supra* note 158, art. 27-2.
[163] *Id*. art. 119(2) and art. 119 (3).
[164] Kramds December 2002 SAC decision, *supra* note 111 at 4.

This position, however, overlooks the possibility that the NBKR itself could be a creditor. In order for the Court to arrive at the conclusion that it did, it is necessary to interpret subpoint 2 as meaning a "creditor or group of creditors other than the NBKR." This interpretation adds language to subpoint (2) not in the text of the law, and also leads to an illogical result.

Article 119 addresses the particular situation where a bank's third-party creditors can petition the NBKR to commence the bankruptcy process regarding that bank. It does not, and obviously was not intended to, address the situation where the NBKR itself was the creditor. In the latter situation, the Court's position would effectively leave the NBKR without a remedy in situations in which it is the creditor of a bank. To illustrate the difficulty of the Court's position, consider the following hypothetical example: assume that a non-bank debtor (such as a store or factory) owed money to the NBKR and could not pay, and otherwise met the definition in the Bankruptcy Law of an insolvent debtor. Presumably, the Court would interpret subpoint 2 of Article 27-2 as permitting the NBKR to petition the Court under those circumstances. A contrary view would mean that the NBKR would not have the ability that every other creditor in the Kyrgyz Republic has to petition the court to commence the bankruptcy process given the presence of certain facts. The Court thus took the untenable position that the law allowed the NBKR to petition the court with regard to a non-bank debtor, but not with regard to a bank. The text of the law, however, does not contain any such distinction. Clearly, the better view is that the NBKR can petition the court in the same manner as any other creditor, with respect to any debtor, including a bank (as Article 27-2(1), subparagraph 2 would indicate), and can also do so with regard to banks in the special circumstances relating to its position as a supervisory authority set out in Article 119 (in accordance with Article 27-2(1), subparagraph 4).

The 2002 Supreme Arbitration Court decisions also highlight the pitfalls of mixing bank supervisory decisions with ordinary debtor-creditor issues. By any reasonable standard, the NBKR should have been able to revoke Kramds' license and resolve its affairs no later than May 2000, if not earlier. The fact that Kramds owed money to the NBKR, however, gave the courts a convenient pretense to ignore the Banking Law and give priority to the Law on Bankruptcy.

Finally, in its April and July 2003 decisions, the Arbitration Court of Bishkek City adopted a position that loosely resembles the

"unclean hands" doctrine, improperly blaming the NBKR for, in effect, mismanaging the bank during the period of temporary administration.[165] The fact that the bank was already insolvent when the temporary administrator was appointed was apparently of no relevance.

The October 2003 Supreme Court decision vindicated the NBKR, but only temporarily. A year later, the successor bank to Kramds was again the subject of NBKR efforts to take strong action. This time, the NBKR was not as fortunate.[166]

2. Issyk-kul Bank

On July 1, 2001, the NBKR initiated temporary administration at Issyk-kul Bank.[167] The NBKR took this action due to the initiation of criminal investigations involving the vice president and chief accountant of the bank, as authorized by Article 45(9) of the Banking Law.[168] Following the appointment of the temporary administration in July, the bank experienced a "run" on its deposits, resulting in a loss of some forty-seven percent of its deposit base.[169] Subsequently, on September 17, 2001 the NBKR initiated combined temporary administration and conservatorship regimes at the bank.[170]

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[165] *See* Kramds October 2003 SC Decision, *supra* note 136 at 2-3.

[166] *See infra* part II.E.3.

[167] Issyk-kul Arbitration Court Decision, Case No. B-01-332/Oc9-02 at 3 (Arbitration Court of Bishkek City, July 23, 2002) [hereinafter Issyk-kul July 2002 AC decision] (on file with the Annual Review of Banking & Financial Law).

[168] *Id.* The basis for the July 2001 action is not mentioned in the respective court decisions, but the author has been informed by lawyers who represented the NBKR during these proceedings that the criminal investigation of the bank's management was in fact the reason for the NBKR's decision.

[169] This fact is not reflected in the court's decisions, but the author has been so informed by lawyers who represented the NBKR during these proceedings.

[170] Issyk-kul Arbitration Court Decision, Case No. B-01-267/s8-02 at 1 (Arbitration Court of Bishkek City, June 11, 2002) [hereinafter Issyk-kul June 2002 AC Decision] (on file with the Annual Review of Banking & Financial Law); Issyk-kul July 2002 AC Decision, *supra* note 167, at 2. Kyrgyz banking legislation mentions both "temporary administration" (or "temporary management"), The Law of Kyrgyz Republic, "On Banks and Banking Activity in Kyrgyz Republic" [Banking Law] art.45 (1997), and "conservatorship," The Law of the Kyrgyz Republic, "On National Bank of the Kyrgyz Republic" [NBKR Law] art. 32 (1997). The former can be imposed on a variety of factual circumstances, including initiation of criminal proceedings involving the bank's management. Banking Law art. 45. The latter is used where there is a threat of bankruptcy of the bank. NBKR Law art. 32. The Law on Bankruptcy at the time also referred to a conservation procedure for banks,

On April 29, 2002, after determining that Issyk-kul Bank was insolvent and failed to meet the NBKR's minimum capital requirement, the NBKR revoked the bank's license and applied for the commencement of liquidation of the bank under the Law on Bankruptcy.[171] The NBKR's resolution was eventually the subject of two arbitration court decisions: one on the NBKR's liquidation petition and one on Issyk-kul's appeal of the NBKR's license revocation decision. The Arbitration Court decided against the NBKR in both cases.[172]

In a decision dated June 11, 2002, concerning the NBKR's petition to initiate liquidation proceedings, the Arbitration Court of Bishkek City determined that the NBKR was not an "authorized state body," and was therefore unable to petition the court.[173] The court reasoned that, upon revocation of Issyk-kul's license, the resulting entity was no longer a "bank" but merely a legal entity, and the NBKR could only petition the court with respect to banks.[174] The Court took great pains to point out that the NBKR had based its petition on Article 96 of the Civil Code rather on the Law on Bankruptcy.[175] Because that Article stated that only an authorized state body could petition the court in the case of a non-bank legal entity and did not mention the NBKR, this avenue was unavailable to the NBKR.[176] Conceivably, the outcome could have been different if the NBKR had based its petition on Article 39(2)(9) of the Banking Law, which gives the NBKR the right to commence liquidation proceedings in case of insolvency of the bank in compliance with the legislation on bankruptcy.[177]

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which was part of the bankruptcy process and was used when the NBKR determined that conservatorship would be preferable to special administration. *See* NBKR Law arts. 117-118.

[171] *See* Issyk-kul June 2002 AC decision, *supra* note 170, at 1. Curiously, the June 2002 decision clearly indicates that the bank was insolvent, and that this fact was undisputed by the bank, *id.* at 3, while the July decision indicates that it was solvent. Issyk-kul July 2002 AC decision *supra* note 167, at 5. The discrepancy is not discussed in either decision. According to the explanation of the NBKR attorney who represented the NBKR at the court hearings, the bank was in fact insolvent, but the court believed that the insolvency was caused by the NBKR's decision initiating the temporary administration.

[172] Issyk-kul June 2002 AC decision, *supra* note 170, at 4; Issyk-kul July 2002 AC decision, *supra* note 167, at 5.

[173] Issyk-kul June 2002 AC Decision, *supra* note 170, at 3.

[174] *Id.*

[175] *Id.*

[176] *Id.*

[177] *See id.*

There are a number of flaws in the Court's analysis. First, as the Court itself acknowledged in the opening paragraph of its decision, the NBKR's petition was based not only on Article 96 of the Civil Code, but also on Article 16 of the Bankruptcy Law, Article 32 of the Law on the NBKR and Article 39 of Banking Law.[178] The latter article clearly states that in the event of insolvency of a bank (a fact that the bank conceded), the NBKR may initiate the liquidation process in accordance with bankruptcy legislation.[179]

Second, focusing on the Civil Code rather than the Law on Bankruptcy or the Banking Law, Article 96 of the Civil Code expressly states that, in case of revocation of an institution's license for which the activity enumerated in the license is the single permitted type of activity, the institution may be liquidated.[180] The NBKR is the only public body that has any supervisory authority over the activities of a bank. Once the license is removed and only the "shell" of the entity remains, no other state body has any authority over the activities of the entity (indeed, there are no "activities" to supervise). While Article 96 does not expressly state that the NBKR can petition the court to commence liquidation of a "legal entity that was a bank before it lost its license," the clear intent of Article 96 is that once a bank loses its license, it is liquidated; in other words, revoking the license is the substantive event that triggers the procedural commencement of liquidation. While there may be a measure of plausibility to the Court's viewpoint, the Court seems to have been unnecessarily splitting hairs.

In fact, sound policy reasons exist for rejecting the Court's "no longer a bank" approach. First, the bank supervisor, through its oversight role, is in a better position than a court, creditors' committee or other public authority, to know whether a banking institution is viable.[181] Second, since the presence of insolvent or nearly-insolvent banks can threaten the financial stability of a country, the bank supervisor must have the tools to deal with such situations.[182] Third, the "no longer a bank" approach does not support depositor protection, a principal purpose of banking

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[178] *Id.* at 1.
[179] The Law of Kyrgyz Republic, "On Banks and Banking Activity in Kyrgyz Republic" [Banking Law] art. 39(2)(9) (1997).
[180] Civil Code of the Kyrgyz Republic [Civil Code] ch. 5, art. 96(2) (1996).
[181] *See* Eva H.G. Hüpkes, *Learning Lessons and Implementing a New Approach: Bank Insolvency Resolution in Switzerland*, *in* WHO PAYS FOR BANK INSOLVENCY? 242, 250 (David G. Mayes & Aarno Liuksila eds., 2004).
[182] *See id.*

supervision – indeed, it has the opposite effect. While the remaining entity may no longer have a banking license, there are likely to be creditors who placed their funds with the bank as depositors when the entity unquestionably was a bank. To magically transform those depositors (who should be in a very high priority position when a bank fails) into ordinary unsecured creditors upon the revocation of the banking license does not make sense, and certainly does nothing to encourage depositor confidence.

Subsequently, the same court issued a ruling granting Issyk-kul's appeal of the NBKR's license revocation decision.[183] The NBKR based its decision on three factors: (1) the bank's lack of executive officials who met the professional aptitude requirements under the Banking Law and NBKR regulations; (2) the bank's failure to meet the requirements on the minimum amount of capital; and (3) the bank's failure to meet the NBKR's requirement regarding open foreign currency positions.[184]

The Court rejected the first ground, noting that after the vice president and chief accountant resigned in July 2001, Issyk-kul submitted candidates for these positions to the NBKR in accordance with the law and had not received a response.[185] Shortly thereafter, the NBKR instituted the temporary administration and conservatorship process.[186] Thus, according to the court, since the NBKR was running the bank at that point, the lack of qualified key officials could not be considered the bank's fault.[187]

The Court also rejected the NBKR's determination based on Issyk-kul's capital deficiency. According to the Court, because the NBKR had been operating the bank under conservatorship and temporary administration since September 2001, the bank had no real opportunity to replenish its capital.[188] In other words, the capital deficiency must be the fault of the NBKR rather than the bank.[189] In support of this assumption, the Court noted that Issyk-kul had a profit of 922,000 som in July 2001, but that the profit was only 20,000 som by January 2002, and that the bank had experienced losses of 3.8 million som over the previous year.[190] By April 2002,

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[183] Issyk-kul July 2002 AC Decision, *supra* note 167, at 5.
[184] *Id.* at 2.
[185] *Id.*
[186] *Id.*
[187] *Id.*
[188] *Id.* at 3.
[189] *Id.* at 3-4.
[190] *Id*. at 3.

when the NBKR's new capital requirement of 25 million som took effect, the bank no longer met this requirement.[191] The Court thus determined, without citing facts to support its conclusion, that the NBKR-appointed conservatorship must have been responsible for causing the capital deficiency.[192] The Court noted, moreover, that Issyk-kul's board of directors had searched for new investors during the conservatorship period and informed the NBKR about this, and that some investors had expressed a willingness to inject new capital, contingent upon the termination of the conservatorship.[193] Finally, the Court noted the lack of proof that the NBKR conservators had sought out new investors or other means to restore the bank's capital.[194]

The Court's treatment of the capital issue overlooked a very basic fact: once a bank is taken into supervisory custody, a "run" on deposits and an eventual capital decline is highly probable, especially if a country does not have deposit insurance, or if deposit insurance coverage is minimal. This is simply the market participants' reaction based on the perception that all is not well with the bank. Issyk-kul's insolvency (a factual point that was not in dispute) was the result of depositor panic, and not the appointment of the temporary administration *per se*. To assume that the conservatorship or temporary administration somehow caused the capital decline is simply not credible. Taking supervisory control of a bank when the bank's top management is implicated in possible criminal activity is appropriate, especially when the relevant statute expressly contemplates such action.

Furthermore, the Court misunderstood the nature and purpose of bank conservatorship. The Court noted that under the Law on Bankruptcy, the goal of conservation is to satisfy the bank's creditors and restore its solvency, but determined that once the conservatorship was in place, the NBKR's responsibility was to meet regulatory requirements.[195] In so holding, the court failed to perceive that conservatorship does not necessarily refer to the supervisory authority's temporary management of a bank with the goal of turning the bank around and restoring owners and managers to their previous positions (a course of action that makes little sense where, as in this

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[191] *Id*.
[192] *Id.* at 4.
[193] *Id.* at 3-4.
[194] *Id.*
[195] *Id.* at 4.

case, the previous management was implicated in possible criminal activities). It is often an intermediate step in the overall process that culminates in the ultimate resolution of the bank's affairs, and normally is instituted in order for the supervisor to buy some time while it determines the most appropriate course of action.[196]

The Court based part of its decision on the fact that, just days before the license revocation decision, members of the NBKR Bank Supervision Department and the NBKR-appointed conservators had recommended terminating the conservatorship, restoring the license and establishing a temporary administration on the condition that the bank would achieve legal compliance within a specified timeframe.[197] According to the Court, this confirmed that the new NBKR capital requirement applied only to actively-operating banks and not banks that were in the bankruptcy process.[198] The Court's reasoning on this point is flawed for two reasons: first, the recommendations of the supervisors and conservators were just that – recommendations; the actual decision to act was for the NBKR Board.[199] Second, the Court's conclusion does not follow from the premise. It is one thing for the supervisory staff and conservators to recommend a given course of action based on the particular

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[196] For example, in the United States, under either conservatorship or receivership, the shareholders lose the bank. *See* 12 U.S.C. § 1821(d)(2)(A)(i) (2000) (stating that FDIC as conservator or receiver succeeds to "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution . . . ."). "The principal difference between a conservator and a receiver is that a conservator may operate and dispose of a bank as a going concern, whereas a receiver has the power to liquidate the bank and wind up its affairs." Hecht v. Ludwig, 82 F.3d 1085, 1090 (D.C. Cir. 1996), *cert. denied*, 519 U.S. 1077 (1997) (citing 12 U.S.C. § 1821(d)(2) (1994) *and* H.R. CONF. REP. NO. 209, 101st Cong., 1st Sess. 398 (1989)). As originally conceived, the title "conservator" was "akin to receiver but less harsh on the public ear." Walker F. Todd, *Bank Receivership and Conservatorship*, FEDERAL BANK RESERVE OF CLEVELAND ECONOMIC COMMENTARY 2 (1994), *available at* http://www.clevelandfed.org/Research/Com94/1001.pdf (citing JESSE H. JONES & EDWARD ANGLY, FIFTY BILLION DOLLARS: MY THIRTEEN YEARS WITH THE RFC (1932-1945) 21-22 (1951)). The original object of conservatorship was "to stave off creditors long enough to rehabilitate a bank rather than let it go into receivership." *Id.*

[197] Issyk-kul July 2002 AC Decision, *supra* note 167, at 4.

[198] *Id.*

[199] *See* The Law of the Kyrgyz Republic, "On Bankruptcy (Insolvency)" [Law on Bankruptcy] art. 117 and art. 118 (2002) (concerning bank conservation); The Law of the Kyrgyz Republic, "On National Bank of the Kyrgyz Republic" [NBKR Law] art. 32 (1997) (concerning license revocation).

circumstances of a particular bank; it is quite another to extrapolate from that recommendation a general proposition about the application of the NBKR capital requirement.

The Court also rejected the NBKR's petition based on Article 96 of the Civil Code, ostensibly because liquidation is not mandatory when a solvent bank's license is revoked.[200] According to the Court, the NBKR did not have the authority to apply to the Court to liquidate a solvent bank.[201] The Court apparently made this determination on the same basis as its decision the previous month.[202] The court's ruling in the July decision, however, misreads the Civil Code to an even greater extent than in the June decision. Article 96 of the Civil Code quite clearly states that where a bank's license is revoked, the bank can be liquidated.[203] While the court was correct that liquidation in this situation is not mandatory, it is nevertheless permitted. More important, the Civil Code does not require a bank to be insolvent before its license can be revoked.[204] Article 96 of the Civil Code merely refers to revocation of the bank's license without specifying the grounds for this action; the substantive grounds for such a decision are located in Article 32(4) of the Law on the NBKR, and most of these grounds are not based on insolvency.[205]

The court also emphasized that the NBKR had not issued a compulsory order to Issyk-kul regarding the remedying of violations before revoking the license, noting that the issuance of such an order, and a bank's failure to comply with it, is one ground for license revocation under Article 32 of the Law on the NBKR.[206] According to this viewpoint, the NBKR may not revoke a bank's license unless it has first issued an order to the bank and the bank has failed to comply.[207] Nothing in the law, however, requires this.[208] Rather, the NBKR is authorized to revoke a bank's license where the developments mentioned in paragraph 1 of Article 32 are present,

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[200] Issyk-kul July 2002 AC Decision, *supra* note 167, at 5.
[201] *Id*. Note, however, that in the June decision, it was undisputed that the bank was in fact insolvent at the time. *See* Issyk-kul June 2002 AC Decision, *supra* note 170, at 3.
[202] *See* Issyk-kul June 2002 AC Decision, *supra* note 170, at 3.
[203] *Id.*
[204] *See id.*
[205] *See* NBKR Law art. 32(4).
[206] Issyk-kul July 2002 AC Decision, *supra* note 167, at 5.
[207] *See id.*
[208] NBKR Law art. 32(4).

and the NBKR determines that it is necessary to revoke the license.[209] Paragraph 1, in turn, mentions, among other things, violation of banking laws, prudential norms, or rules, regulations or instructions of the NBKR.[210] In sum, the only requirements for license revocation are that a violation has occurred and that the NBKR has determined in good faith that license revocation is necessary for depositor protection. Therefore, a bank's capital deficiency is the kind of situation in which a bank supervisor may reasonably conclude that license revocation is appropriate, regardless of the bank's previous actions to remedy the situation.

The Court rejected the NBKR's petition based on Issyk-kul's failure to comply with the NBKR's regulatory requirement regarding the open foreign currency position for similar reasons.[211] The cases involving Issyk-kul were eventually settled via amicable agreement.[212]

Like the *Kramds* cases, the *Issyk-kul* cases highlight the dangers inherent in mixing public law matters such as bank supervisory decisions with legal concepts, such as those in the Law on Bankruptcy, that are designed primarily for private parties. This situation was remedied somewhat by the adoption in February 2004 of the Law of the Kyrgyz Republic "On Conservation, Liquidation and Bankruptcy of Banks" ("Bank Bankruptcy Law").[213] Many problems remain, however. This fact is illustrated by the next section.

3. Ak-Bank

The *Ak-Bank* cases were the first series of cases decided under the new Bank Bankruptcy Law. Ak-Bank was the successor institution to Kramds.[214] On September 1, 2004, the NBKR revoked Ak-Bank's bank license and appointed a conservator in accordance

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[209] *Id.*
[210] *Id.* art. 32(1).
[211] Issyk-kul July 2002 AC Decision, *supra* note 167, at 4.
[212] Issyk-kul Arbitration Court Decision, Case No. B-01-267/s8-02 (Arbitration Court of Bishkek City, Sept. 20, 2002) [hereinafter Issyk-kul September 2002 AC Decision] (on file with the Annual Review of Banking & Financial Law).
[213] *See generally* The Law of the Kyrgyz Republic, "On Conservatorship, Liquidation and Bankruptcy of Banks" [Bank Bankruptcy Law] (2004).
[214] *See* Kramds October 2003 SC Decision, *supra* note 136.

with Article 22 of the Bank Bankruptcy Law.[215] Ak-Bank's capital was less than 50% of the amount of capital required – a situation in which appointment of a conservator is mandatory.[216] In accordance with Article 12 of the Bank Bankruptcy Law, the bank had ten days within which to submit a petition for review of the NBKR's decision.[217] The bank did not exercise this option within the requisite ten-day period. The next step, therefore, was for the NBKR to petition the court to commence forced liquidation of the bank.[218] When the NBKR eventually petitioned the court, it set in motion a series of court cases that culminated in the Supreme Court ordering the NBKR to return the license to Ak-Bank.[219]

In accordance with Article 22(2) of the Bank Bankruptcy Law, the NBKR initially petitioned the Inter-rayon Court in Bishkek to commence compulsory liquidation of the bank, terminating banking activity.[220] The Court declined the petition, holding that the application of liquidation procedure was premature: the Bank Bankruptcy Law allows the NBKR to initiate conservation and appoint a conservator when a bank's capital is less than fifty percent

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[215] Bank Bankruptcy Law art. 22; Ak-Bank Supreme Court Ruling, Case No. 07-000156/05.ED at 1 (Supreme Court of the Kyrgyz Republic, Sept. 9, 2005) [hereinafter Ak-Bank September 2005 SC Ruling] (on file with the Annual Review of Banking & Financial Law).

[216] Bank Bankruptcy Law art. 8(3); Ak-Bank September 2005 SC Ruling, *supra* note 215, at 4-5.

[217] Bank Bankruptcy Law art. 12(1).

[218] *Id.* art. 22(2).

[219] The problems involving the interaction between the Bank Bankruptcy Law and the Banking Law are legion, and as a practical matter full discussion of these issues cannot be undertaken in this article. Simply stated, the fundamental problem is that the two laws are not entirely consistent with each other. When the NBKR petitions the court to undertake liquidation of a bank, the court is required to inquire into a number of issues that can substantially overlap with the NBKR's decision to revoke the bank's license, some of which may not have even been the basis for the NBKR's decision. Bank Bankruptcy Law, *supra* note 81 art. 77. Since the court is required to make its own determination, the NBKR's decision thus basically becomes irrelevant. Even where the NBKR's decision tracks the standards in the Bank Bankruptcy Law, the bank has the right to submit a response to the NBKR's petition and to attempt to persuade the court that the petition should be denied. *See id.* art. 75. The proceeding on the liquidation petition thus can easily morph into a rehash of the license revocation decision, in effect giving the bank a second opportunity for judicial review of the NBKR's decision, even if the bank had not done so within the requisite ten-day period under Article 12. This is what happened in the *Ak-Bank* case.

[220] Ak-Bank Inter-Rayon Court Decision, Case No. 03-370/mo4 c8 at 1 (Inter-Rayon Court of Bishkek City, Feb. 4, 2005) [hereinafter Ak-Bank February 2005 IC Decision] (on file with the Annual Review of Banking & Financial Law).

of the required amount of the capital adequacy standard, but does not necessarily require the NBKR to revoke the bank's license.[221] Because the Banking Law envisions the possibility of financial recovery of a problem bank, the NBKR should only revoke a bank's license if the conservation procedure fails to achieve positive results.[222]

Shortly thereafter, in a decision dated March 15, 2005, the same court considered a petition of Ak-Bank to invalidate the September 1, 2004 decision to revoke the bank's license.[223] The Court granted the bank's petition, despite the fact that the bank had missed the 10-day period for filing an appeal under Article 4 of the Bank Bankruptcy Law by several weeks.[224] Along with some alleged procedural irregularities (the factual accuracy of which the NBKR disputed), the Court reasoned that the Bank Bankruptcy Law obligates the NBKR to appoint a conservator when the bank's capital drops below fifty percent of the required amount.[225] The court noted that the bank's management had repeatedly approached the NBKR during the months leading up to the NBKR's decision to revoke the license, apparently in an effort to find a way to restore activities of the bank.[226] The Bank Bankruptcy Law entitles the NBKR to undertake financial rehabilitation of the bank in the course of conservation, but according to the court, the NBKR may revoke a bank's license only as a last resort.[227] The Bishkek City Court and the Supreme Court of the Krygyz Republic upheld this decision in respective rulings dated May 10, 2005 and September 9, 2005.[228]

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[221] *Id.* at 4-5.
[222] *Id.*
[223] Ak-Bank Inter-Rayon Court Decision, Case No. ED-72/05MBc2 at 1 (Bishkek Inter-Rayon Court for Economic and Administrative Cases, Mar. 15, 2005) [hereinafter Ak-Bank March 2005 Economic IC Decision] (on file with the Annual Review of Banking & Financial Law).
[224] *See* Bank Bankruptcy Law, *supra* note 81 art. 4. Presumably, the court allowed Ak-Bank to file its petition under the 3-month time frame contained in the Civil Procedure Code, or the general 3-year statute of limitations contained in the Civil Code, although this is not discussed in any of the relevant court decisions. *See* Civ. Pro. C. art. 264(1) (Kyrg.); Civil Code of the Kyrgyz Republic [Civil Code] art. 212.
[225] Ak-Bank March 2005 Economic Court IC Decision, *supra* note 223, at 3.
[226] *Id.*
[227] *Id.*
[228] Ak-Bank City Court Decision, Case No. AB-165/05-AD at 4 (Appellate Instance of Bishkek City Court, May 10, 2005) [hereinafter Ak-Bank May 2005 City Court Decision] (on file with the Annual Review of Banking & Financial Law); Ak-Bank September 2005 SC Ruling, *supra* note 215.

The crux of the lower court and Supreme Court decisions was the provision in the Bank Bankruptcy Law that mandates the appointment of a conservator when a bank's capital declines to less than fifty percent of the required amount.[229] The court decisions, however, reveal a fundamental misunderstanding of the purpose and process of conservatorship, and a disturbing lack of attention to procedural matters.

In the first place, the stated purpose of conservatorship is not necessarily the rehabilitation of the bank. According to the law, the purpose of conservatorship is to take control of a bank in order to secure the safety of assets, accounting books, and banks' records.[230] Rehabilitation of the bank, under a plan put forth by the conservator, is only one of several options available to the NBKR once the conservator is appointed. The conservator is charged with making a recommendation to the NBKR on one of the following options:

> [a] recommendation on revocation of the license; [a] detailed plan of bringing the bank into a sound state in accordance with normative requirements of the National Bank, including the appropriate time frame; [a] detailed plan on the bank's sale, merger with another bank or partial sale of assets and/or liabilities of the bank.[231]

The ultimate decision, however, is left to the NBKR, which may accept or reject the conservator's recommendation.[232]

Second, the Bank Bankruptcy Law specifically provides that when the NBKR revokes a bank's license, it must immediately appoint a conservator for the bank and make the appropriate application to the court.[233] The law thus expressly contemplates that the NBKR may decide to revoke a bank's license – provided there

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[229] Ak-Bank March 2005 Economic Court IC Decision, *supra* note 223, at 3; Ak-Bank May 2005 City Court Decision, *supra* note 228, at 3-4; Ak-Bank September 2005 SC Ruling, *supra* note 215, at 3 & 5.

[230] The Law of the Kyrgyz Republic, "On Conservatorship, Liquidation and Bankruptcy of Banks" [Bank Bankruptcy Law] art. 8 (2004). *See also id.* art. 2 (defining conservatorship as "a procedure whereby the National Bank of the Kyrgyz Republic appoints the Conservator for the purpose of taking control of a bank and ensuring safeguarding of its assets, accounting books and other documents.").

[231] *Id.* art. 13.

[232] *Id.*

[233] *Id.* art. 22(2).

are legal grounds to do so under the Banking Law – at the same time that it appoints the conservator.[234] Nothing in either the Bank Bankruptcy Law or the Banking Law requires the NBKR to appoint a conservator *prior* to making a decision to revoke the bank's license.

Third, the Bank Bankruptcy Law gives the bank ten days to either file an administrative appeal with the NBKR, or file a judicial appeal.[235] A bank that fails to file an administrative appeal within the 10-day period is deemed to have consented to the appointment of the conservator.[236] Ak-Bank did neither; logically, then, there should be no task for the Court to perform except to grant the NBKR's liquidation petition. Instead, the Court improperly engaged in a re-examination of the NBKR's license revocation decision, in effect allowing the bank to resurrect the arguments that it could have made, but did not, during the requisite ten-day period under Article 4.[237]

The courts, at all levels, compounded their procedural errors by second-guessing the wisdom, rather merely reviewing the legality, of the NBKR's decision. The Bishkek Inter-Rayon Court, in its March 15, 2005 decision, cited the provision of the Bank Bankruptcy Law allowing the NBKR to undertake financial rehabilitation of a bank for which it has appointed a conservator as a reason for overturning the NBKR's decision – overlooking the fact that Article 9 merely authorizes, but does not require, such action.[238] The Inter-Rayon Court also noted that Article 32 of the Law on the NBKR obligates the NBKR to be "guided by the necessity to maintain high standards of banking practices and stability of banking practices, and the stability of the financial system of the Kyrgyz Republic," and then decided, without discussing the reasons for its conclusion, that revocation of Ak-Bank's license was not compatible with these goals.[239] Finally, the Inter-Rayon Court justified its decision by stating that license revocation must be applied only as a last resort, clearly confusing law with policy.[240] The Appellate Court and Supreme Court both confirmed this viewpoint, noting that the Bank Bankruptcy Law provides for the "initiation of conservation procedure in a problem bank prior to the license revocation,"

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[234] *Id.*
[235] *Id.* art. 4(1) (concerning judicial appeals); art. 12(1) (concerning administrative appeals, or "representations").
[236] *Id.* art. 12(1).
[237] *See* Ak-Bank March 2005 Economic IC Decision, *supra* note 223.
[238] *Id.* at 3.
[239] *Id.*
[240] *Id.*

ignoring the fact that the law does not require such action.[241] Finally, all three of the courts faulted the NBKR for not cooperating with Ak-Bank in its rehabilitation attempts prior to the license revocation decision.[242]

III. International Perspectives

As the above examples demonstrate, the Kyrgyz administrative law regime is seriously out of sync with those of more advanced countries, which have developed detailed procedures governing judicial review of decisions of public bodies. The following sections will provide some comparative observations from the international arena, and suggest some possible areas of reform.

A. The Importance of Effective Administrative Law for Effective Bank Supervision

Financial sector supervision is radically different today than was the case twenty years ago. Banking activity is much more complex and increasingly difficult to analyze. Technological improvements have made it possible to move money faster and further, and involve more market participants, than at any other time in history.[243] Banks engage in increasingly sophisticated transactions and lines of financial business, and often affiliate with other companies (both financial and non-financial) under the same corporate "umbrella."[244] As a result, it is no longer sufficient to build a financial sector supervision program around compliance with relatively simple rules. Modern financial sector supervision is more judgmental than mechanical, more art than exact science. Bank supervisors need to understand banking risks, and monitor these risks, being vigilant to prevent those risks from becoming excessive or uncontrollable. This is particularly important when a country

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[241] Ak-Bank May 2005 City Court Decision, *supra* note 228, at 3-4; Ak-Bank September 2005 SC Ruling, *supra* note 228, at 5.

[242] Ak-Bank February 2005 Economic IC Decision, *supra* note 223, at 3; Ak-Bank May 2005 City Court Decision, *supra* note 228, at 3-4; Ak-Bank September 2005 SC Ruling, *supra* note 228, at 5.

[243] *See generally* DOMINIC BARTON ET AL., DANGEROUS MARKETS: MANAGING IN FINANCIAL CRISES 19-21, 56-57 (2003); George A. Walker, *The Law of Financial Conglomerates: The Next Generation*, 30 INT'L LAW. 57-58 nn.3 & 5 (1996); THOMAS M. FRIEDMAN, THE LEXUS AND THE OLIVE TREE (2000).

[244] Walker, *supra* note 243.

offers a deposit insurance program, which adds a new burden to the role of banking supervision.

The legislation under which modern banking supervisors operate must reflect this necessity, and must give the banking supervisors an appropriate amount of discretion to take supervisory action that they deem necessary to protect depositors.

Recognizing these realities, most Basel Committee countries have written their banking legislation in ways that will maximize the opportunities for the use of discretionary judgment of the bank supervisor, rather than stressing compliance with specific rules. In its *Core Principles for Effective Banking Supervision* ("*Core Principles*"), the Basel Committee for Banking Supervision cautions against mechanical application of quantitative criteria, and urges countries to allow their supervisors to make discretionary determinations based on judgment. The Committee points out that:

> [B]anking supervision is a dynamic function that needs to respond to changes in the marketplace. Consequently supervisors must be prepared to reassess periodically their supervisory policies and practices in light of new trends or developments. *A sufficiently flexible legislative framework is necessary to enable them to do this*.[245]

Indeed, the Basel Committee specifically mentions that the supervisor's legal authority to apply qualitative judgment is critical to effective bank supervision and is one of the "essential criteria" for determining whether a country is in compliance with the *Core Principles.*[246]

The Basel Committee had stressed this concept even prior to the promulgation of the *Core Principles* in 1997. In its September 1994 *Report on International Developments in Banking Supervision,* the Committee emphasized the need for bank supervisors to have considerable flexibility in overseeing banks:

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[245] BASEL COMMITTEE ON BANKING SUPERVISION, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (Sept. 1997) at 10 (emphasis added) [hereinafter CORE PRINCIPLES].

[246] See BASEL COMMITTEE ON BANKING SUPERVISION, CORE PRINCIPLES METHODOLOGY (Oct. 1999) at 13, Principle 1(4) ("Suitable Legal Environment"), Essential Criteria, Point 2, and 25 (addressing Core Principle 10 on "connected lending"), Essential Criteria, Point 1.

> As banks move away from traditional activities, supervision becomes more judgmental, requiring an assessment of the appropriateness of an individual bank's business strategy in light of its management capabilities and of overall market conditions. . . . Increasingly, supervision needs to find solutions for complex risks along the lines being developed by the market leaders. . . . Supervisors in the emerging markets are subject to very similar challenges, albeit at a less advanced stage of development. As banks are allowed to engage in a wider range of activities, or non-banks encroach on the traditional banking turf, and as controls on market mechanisms such as interest or exchange rates are gradually lifted, supervision becomes more important and more complex. *Attention has to be paid more to management capacity and to qualitative aspects of a bank's performance than to straightforward quantitative criteria.*[247]

More recently, the Basel Committee has noted, "legislation frequently adopts a rules-based approach. However, it is also helpful if the legislation permits the supervisor to exercise discretion in the deployment and timing of supervisory tools."[248]

The message of the above passages is clear: in order to implement a world-class financial supervision program, the bank supervisor must have the legal authority, the substantive knowledge and the political willingness to exercise *judgment*, and to make difficult determinations on the basis of its critical analysis and evaluation of facts that do not always present obvious answers. In other words, the supervisor must be willing to look beyond simple form and make decisions based on substance.

The Basel Committee's member countries take this advice very seriously. Even a cursory review of banking legislation in Basel Committee countries confirms that bank supervisors have an enormous amount of discretion to critically analyze and evaluate facts, and to exercise judgment when making decisions based on their evaluations and analysis of relatively indefinite legal concepts. The banking laws of these member countries are replete with broad,

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[247] BASEL COMMITTEE ON BANKING SUPERVISION, REPORT ON INTERNATIONAL DEVELOPMENTS IN BANKING SUPERVISION (1994) at 3 (emphasis added).

[248] *See* BASEL COMMITTEE ON BANKING SUPERVISION, SUPERVISORY GUIDANCE ON DEALING WITH WEAK BANKS, (Mar. 2002) at 6.

discretionary terms such as "safety and soundness" (United States),[249] "trustworthiness" (Germany),[250] and "significant influence" (Germany, Switzerland and various European Union banking directives).[251] Banking legislation seldom defines these terms. Instead, bank supervisory authorities must determine, based on their analysis and evaluation of facts, whether a given set of facts falls within one of these legal standards. This is the case in both common law countries such as the United States and the United Kingdom, and civil law countries such as the countries in continental Europe.[252]

The Basel Committee member countries' approaches have profound implications for the effectiveness of a financial supervisory regime in emerging market and transition countries. Following the collapse of the Soviet Union, most of the former Soviet Republics began the early 1990s with banking laws that provided only a rudimentary and skeletal framework for banking supervision and regulation. Under such laws, when a decision of a bank supervisor was challenged in court, the court's task was relatively simple, because the supervisory task itself was relatively simple. The applicable legal standards were rather mechanical and required little or no sophisticated analysis. Thus, in the past, regulatory authority was based on straightforward applications of purely objective legal criteria, such as numbers, ratios and straightforward facts.[253] As a

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[249] *See*, *e.g.*, 12 U.S.C. § 1818 (2000).

[250] "Gesetz über das Kreditwesen" §§ 1(2), 2b, 24, 32, 33, 34 (F.R.G.), *translated in* BANKING ACT [hereinafter German Banking Act], *available at* http://www.bundesbank.de/bank/download/pdf/kwg_e.pdf.

[251] *See* German Banking Act, *supra* note 250, at § 1(9); "Loi fédérale du 8 novembre 1934 sur les banques et les caisses d'épargne (Loi sur les banques, LB)" art. 3, para. 2 c bis (Switz.), *translated in* FEDERAL LAW ON BANKS AND SAVINGS BANKS [hereinafter Swiss Law on Banks and Savings Banks]; Council Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 Relating to the Taking Up and Pursuit of the Business of Credit Institutions, 2000 O.J. (L 126) at art. 1(10) [hereinafter E.U. Banking Directive], *as amended by* Council Directive 2000/28/EC, 2000 O.J. (L 275) and Council Directive 2001/24/EC, 2001 O.J. (L 125).

[252] Nine of the twelve member countries of the Basel Committee are European countries, eight of which are members of the European Union (Switzerland being the exception). Eight of the nine European members of the Committee are continental European countries with strong civil law traditions (the United Kingdom being the common law exception).

[253] For example, the Russian Banking Law to this day still requires Bank of Russia approval only for the purchase of twenty percent or more of a credit institution's shares, but does not contain any such requirement in the case of *de facto* "control" or

result, there was, at least in theory, a low probability that reviewing courts would reverse a regulatory action, because the legal provisions were so rigid and perfunctory.

As these transition countries have developed increasing degrees of financial sophistication, however, they have recognized the need to move from compliance-based supervision regimes to risk-based ones, under which the legal standards are quite different. By necessity, risk-based standards are more qualitative in nature, requiring the bank supervisor to closely analyze and evaluate facts, and then make a decision which, in its judgment, will be most likely to protect bank depositors, the financial system as a whole, and the deposit insurance fund, if the country has such a fund.

As we have seen, modern, market-oriented banking legislation does not use rigid, concrete terms, as was the case in the past, and instead uses rather flexible and imprecise terms. The legislation is purposely written in a relatively indefinite manner, so that the bank supervisor will have the flexibility to critically analyze and evaluate fact situations (which are often quite complex); draw expert conclusions based on that evaluation and analysis; and then apply the supervisory measures which, in its judgment, are most appropriate to allow the supervisor to fulfill its legal mandate of protecting depositors and maintaining the stability of the financial and payment systems.

"significant influence" in the absence of such direct formal ownership. *See* Federal Law No. 17-FZ [Russian Banking Law], Feb. 3, 1996, art. 11 (Rus.) [hereinafter Russian Banking Law]. Obviously, this sort of standard is easy to apply, but is also easy to evade. *Compare* E.U. Banking Directive, *supra* note 251, art. 16 (requiring supervisory approval for acquisition of a "qualifying holding" in a credit institution, defined as direct or indirect 10 percent ownership or the ability to exert a "significant influence" over the institution. *Id.* art. 1(10). In addition, the Russian Banking Law requires only mechanical qualifications for bank executives, such as higher education, a certain number of years' work experience and lack of a criminal conviction, rather than a more general and discretionary "trustworthiness" test. *Compare* Russian Banking Law, *supra* art. 14 ¶ 1(8) *with* German Banking Act, *supra* note 250 § 1(2) (requiring that all bank managers be "trustworthy"). Essentially the same situation existed in Kyrgyzstan prior to the 2005 amendments to the Banking Law. Formerly, Article 44 of the Banking Law required NBKR approval if a person wished to "acquire a block of shares" which entitled him to "perform direct or indirect control" of a bank. *See* Banking Law, *supra* note 8181 art. 44 (1997). Article 44 now requires NBKR approval for a person to become a "significant participant" in a bank, which is more broadly defined and generally follows the E.U.'s "qualifying holding" definition. *See* Banking Law, *supra* note 81 art. 2-1 and art. 44 (2003). *See generally infra* note *365* and accompanying text.

The Kyrgyz Banking Law contains some of these kinds of provisions already. Reflecting the advice of American and western European advisors, Article 24 now requires each bank to have an "adequate and efficient internal control system."[254] Articles 47 and 48 empower the NBKR to take measures in the event of "unsafe or unfaithful banking practices" and "insecure and unhealthy practices."[255]

It is critical that the bank supervisor have the legal authority to construe these relatively broad legislative provisions, and to apply these provisions to facts in the manner that the supervisor deems to be most appropriate in view of the law's purpose. A necessary corollary to this is that the courts must respect the supervisor's decisions unless a given decision is patently unreasonable. For example, the banking supervisor must have the ability, within the bounds of reason and common sense, to determine when a given set of facts amounts to "danger to the financial stability of a bank" requiring corrective action. The banking supervisor must have the power to take action which, in its judgment, will best alleviate that situation, and to have confidence that the decision will not later be annulled by a court based merely on a different opinion as to the correct understanding of these words and phrases.

This principle is applicable to decisions of any public body whose legal mandate requires the use of critical analysis, but it is particularly important in complex fields such as banking supervision. Banking supervision is a highly technical field demanding the application of specialized expertise, and the blending of data from such disciplines as accounting, financial analysis, collateral valuation, and business risk management. Because bank supervisors are much better qualified than judges to undertake such analyses and to draw such expert conclusions from facts, courts in Basel Committee countries rarely overturn bank supervisory decisions.[256] Instead, the courts give a great deal of deference to the expertise of the bank supervisory authority, and will annul a supervisory decision only in the unusual case where the petitioner can demonstrate to the court's satisfaction that the regulatory body's understanding of the law was manifestly incorrect as applied to the given facts.

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[254] The Law of the Kyrgyz Republic, "On Banks and Banking Activity in Kyrgyz Republic" [Banking Law] art. 24 (1997).
[255] *Id.* arts. 47-48.
[256] *See* EVA H.G. HÜPKES, THE LEGAL ASPECTS OF BANK INSOLVENCY: A COMPARATIVE ANALYSIS OF WESTERN EUROPE, THE UNITED STATES AND CANADA 116-17 (2000).

Of course, if a supervisory body's pure factual findings are blatantly wrong (for example, if the supervisory body bases a decision on inaccurate statistics), courts in most countries can almost always find a way to quash the supervisor's action under one legal theory or another. But more often than not, the dispute is not about the physical correctness of facts, but rather the supervisory body's assessment of those basic facts and its conclusion, under a flexible legal provision, based on its assessment. Clearly, for example, a determination by a bank supervisory agency that a bank has engaged in "unsafe or unsound practices" is quite different from simple confirmation of objective facts or financial data. A decision of this kind entails a complex determination consisting of, first, a number of purely factual observations (such as, for example, the factual characteristics of a bank's credits, borrowers' income and previous credit history, the contents of the bank's credit policies, the bank's level of capital, its earnings trend over a certain period of time, and so forth) and secondly, an analysis and evaluation of those "primary" or basic facts to determine whether they do or do not amount to an "unsafe or unsound practice." Questions of this sort do not have clear "right" or "wrong" answers. This evaluation necessarily depends on the supervisory agency's judgment, exercised on the basis of its experience.

B. Lessons from the West

This section will briefly summarize judicial review principles as applied to bank supervisory decisions in the United States and France. These countries offer particularly useful models for any transition economy. The United States is a good example because of the experience of the 1980s savings and loan crisis. Many U.S. savings and loan associations failed during this time, and many banks challenged enforcement actions (including the appointment of conservators and receivers) in court. The United States has thus developed a wealth of case law illustrating the courts' attitudes and methodology for dealing with challenges to bank supervisory decisions, and from which transition economies can learn a great deal.

Many scholars consider the 1804 Code Napoleon, which remains in effect to this day and is the "textbook" Civil Code, to be France's principal contribution to the legal world. . But very nearly as important has been the French contribution to administrative law,

which has become the model for many countries of Continental Europe, as well as for the European Union itself.[257]

1. The United States

American banking legislation contains rather imprecise legal terminology and broadly delegates discretion to bank supervisory agencies. The banking agencies in the United States have a large degree of legal authority to apply their judgment to facts under some very broad legislative provisions.

The central concept of U.S. bank supervision is "safety and soundness," a phrase that appears in numerous places in American banking legislation. For example, the U.S. Congress authorizes the banking agencies to take enforcement action on the basis of "unsafe or unsound" banking practices.[258] The Federal Deposit Insurance Corporation ("FDIC") may appoint a conservator or receiver for a bank in the event of unsafe or unsound practices resulting in a substantial dissipation of assets, or if the bank is in an unsafe or unsound condition to transact business.[259]

The phrase "unsafe or unsound practices" is not specifically defined in American legislation. However, American courts in numerous cases have accepted a general elaboration which had been developed by American bank supervisors, focusing on the potential (rather than existing) danger to a bank from a given practice.

During the 1960s, during debates on the passage of the Financial Institutions Supervisory Act, which gave the bank regulators stronger enforcement authority, the U.S. Congress relied heavily on the advice of Mr. John Horne, who was then the Chairman of the Federal Home Loan Bank Board, the agency that regulated savings and loan associations.[260] In a written memorandum to the Congress, Chairman Horne noted, in part:

> The concept of unsafe or unsound practices is one of general application, that touches on the entire field of operations of a financial institution. For this reason, it would be virtually impossible to attempt to

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[257] *See id.* at 117.
[258] 12 U.S.C. § 1818(b), (e) (2000).
[259] 12 U.S.C. § 1821(c)(5)(B)(ii), (C), (H) (2000).
[260] The Bank Board was the predecessor agency of the U.S. Treasury Department's Office of Thrift Supervision ("OTS"), which now supervises savings associations in the United States.

> catalog within a single, all-inclusive or rigid definition the broad spectrum of activities that are embraced by the term. The formulation of such a definition would probably operate to exclude those practices not set out in the definition, even though they might be highly injurious to an institution under a given set of facts or circumstances, or a scheme developed by unscrupulous operators to avoid the reach of the law. Contributing to the difficulty of framing a comprehensive definition is the fact that a particular activity, not necessarily unsafe or unsound in every instance, may be so when considered in the light of all relevant facts. Thus, what may be an acceptable practice for an institution with a strong reserve position, such as concentration of higher risk lending, may well be unsafe or unsound for a marginal operation.
>
> Like many other generic terms widely used in the law, such as 'fraud,' 'negligence,' 'probable cause,' or 'good faith,' the term 'unsafe or unsound practices' has a central meaning which can, and must, be applied to constantly changing circumstances. *Generally speaking, an unsafe or unsound practice embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.*[261]

Relying on Chairman Horne's advice to the Congress, American courts have repeatedly held that the progressive definition and eradication of "unsafe or unsound practices" is a matter that is committed to the discretion of the bank supervisory agencies.[262]

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[261] See 112 CONG. REC. 26,474 (1966), *Memorandum on Unsafe or Unsound Banking Practices*, House Banking Committee (statement of John Horne, Chairman, Federal Home Loan Bank Board) (emphasis added).

[262] *See generally* Greene County Bank v. FDIC, 92 F.3d 633, 636 (8th Cir. 1996); Northwest Bank v. Comptroller of the Currency, 917 F.2d 1111(8th Cir. 1990); First Nat'l Bank of Bellaire v. Comptroller of the Currency, 697 F.2d 674, 679 (5th Cir. 1983); First Nat'l Bank of Lemarque v. Smith, 610 F.2d 1258, 1264 (5th Cir. 1980);

1) Review of General Enforcement Decisions

In the United States, ordinary enforcement orders such as "cease-and-desist" orders and "removal and prohibition" orders (banning an individual from the banking business) are issued following an agency hearing, unless the institution or individual consents to the issuance of the order.[263] The FDIC conducts it hearings in accordance with the Administrative Procedure Act ("APA").[264] Petitioners may seek judicial review of such enforcement orders in the court of appeals.[265] Courts review enforcement orders in accordance with the judicial review provisions of the APA.[266]

Courts review agency findings of fact under the "substantial evidence" test of the APA.[267] Substantial evidence is "more than a mere scintilla, but less than a preponderance; it is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."[268] An agency's given finding may meet the standard of substantial evidence despite conflicting evidence in the record; the reviewing court will not disturb an agency's findings so long as they

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Groos Nat'l Bank v. Comptroller of the Currency, 573 F.2d 889, 896 (5th Cir. 1978); First Nat'l Bank of Eden v. Dep't of the Treasury, 568 F.2d 610, 611 (8th Cir. 1978).

[263] 12 U.S.C. §§ 1818(b)(1) (concerning cease-and-desist orders), (e)(4) (concerning removal/prohibition orders) (2000).

[264] 12 U.S.C. § 1818(h)(1) (2000). The banking agencies have each developed internal procedures to implement this requirement. Hearings are held before an administrative law judge in accordance with formal evidentiary and procedural rules. *See* Comptroller of the Currency Rules of Practice and Procedure, 12 C.F.R. pt. 19 (2005); Federal Reserve Board Rules of Practice for Hearings, 12 C.F.R. pt. 263 (2005); Federal Deposit Insurance Corporation Rules of Practice and Procedure, 12 C.F.R. pt. 303 (2005); Office of Thrift Supervision Rules of Practice and Procedure in Regulatory Hearings, 12 C.F.R. pt. 509 (2005).

[265] 12 U.S.C. § 1818(h). This is distinguished from judicial review of decisions to appoint a conservator or receiver, which begin in the district courts and thereafter proceed to the appellate courts. *See* 12 U.S.C. § 1821(c)(7) (2000).

[266] 12 U.S.C. § 1818(h).

[267] Candelaria v. FDIC, 134 F.3d 382 (10th Cir. 1998); Hendrickson v. FDIC, 113 F.3d 98, 102 (7th Cir. 1997); Hutensky v. FDIC, 82 F.3d 1234, 1239 (2d Cir. 1996); Grubb v. FDIC, 34 F.3d 956, 961 (10th Cir. 1994); Sunshine State Bank v. FDIC, 783 F.2d 1580, 1584 (5th Cir. 1986).

[268] De la Fuente v. FDIC, 332 F.3d 1208, 1220 (9th Cir. 2003); *Grubb*, 34 F.3d at 961.

are supported by substantial evidence in the record, even if the court may have decided the matter differently.[269]

After a banking agency has found that a bank has engaged in unsafe or unsound practices (or violated a law, rule or regulation), the agency has broad discretion to exercise its expertise in fashioning an appropriate remedy to halt the practices or violations, to prevent future occurrences and to correct the effects of the practices or violations. A remedy will be set aside only if it is arbitrary or capricious, an abuse of discretion, or otherwise not in accordance with law.[270] To meet this burden, a petitioner must convince the court that "the agency has relied on factors which Congress has not intended for it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[271] An agency abuses its discretion when it imposes a sanction that is "unwarranted in law" or "without justification in fact."[272] Even an agency decision of less than ideal clarity will survive judicial review if the court can reasonably discern the agency's plan.[273]

All of the above legal standards are highly deferential, and within their own sphere of applicability they all mean much the same thing: the court will not substitute its own judgment for that of the agency, either on matters of fact, interpretations of law, or the chosen remedy, so long as the court can discern a reasonable basis for the agency to have determined as it did.[274]

The leading case applying these principles in the bank enforcement context is *Sunshine State Bank v. FDIC*.[275] The FDIC issued a "cease-and-desist" order against a bank located in Florida, based in part on a large number of classified loans in the bank's

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[269] *Sunshine State Bank*, 783 F.2d at 1384.
[270] *Id.*; Fitzpatrick v. FDIC, 765 F.2d 569, 574 (6th Cir. 1985); Bank of Dixie v. FDIC, 766 F.2d 175, 178 (5th Cir. 1985); Groos Nat'l Bank v. Comptroller of the Currency, 573 F.2d 889, 897 (5th Cir. 1978); Brickner v. FDIC, 747 F.2d 1198, 1203 (8th Cir. 1984).
[271] *Grubb*, 34 F.3d at 963.
[272] *Id.*
[273] Pharoan v. Bd. of Governors of the Fed. Reserve Sys., 135 F.3d 148, 156 (D.C. Cir.), *cert. denied*, 525 U.S. 947 (1998) (quoting Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983)).
[274] *Pharoan*, 135 F.3d at 156.
[275] Sunshine State Bank v. FDIC, 783 F.2d 1580 (5th Cir. 1986).

portfolio.[276] During the course of the hearing on the notice of charges, the administrative law judge ("ALJ") applied a *de novo* standard of review.[277] In essence, the ALJ conducted his own "examination" of the bank, assigning to each loan the classification that he deemed appropriate.[278] Ultimately the ALJ disagreed with many of the FDIC examiners' loan classifications, disregarded those classifications and substituted his own analysis.[279]

Following the issuance of the ALJ's Recommended Decision, the FDIC Board rejected the ALJ's classifications, and reinstated all but a few of the examiners' classifications. The FDIC Board ruled that because of the examiners' specialized expertise, the examiners' classifications were entitled to great deference, and could not be changed without compelling evidence that they were arbitrary and capricious (*i.e.*, outside of a "zone of reasonableness").[280] On review, the Court of Appeals for the Eleventh Circuit found that the FDIC was correct in its analysis.[281] In its opinion, the Court quoted with approval from the FDIC's final decision and adopted it as its own.[282] While being careful not to suggest that the examiners' conclusions are unreviewable, the Court drew a clear distinction between review of strict factual findings and those discretionary decisions requiring the exercise of informed judgment:

> Asset classifications are based upon objectively verifiable facts. For example, an examiner might find that a loan has been delinquent for six months; that collateral for the loan is a certain parcel of land; and that the borrower's annual salary is $30,000. Because each of these conclusions consists of objectively verifiable facts requiring no particular training or expertise, the ALJ as fact finder is entitled to reach his own de novo conclusions as to the correctness of these underlying factual findings.
>
> After ascertaining the relevant facts, the examiner then applies his expertise and training to those facts to reach certain conclusions about the

[276] *Id.* at 1581.
[277] *Id.* at 1582.
[278] *Id.*
[279] *Id.*
[280] *Id.* at 1584.
[281] *Id.*
[282] *Id.*

> likelihood of a particular loan being repaid. It is with respect to this second step, where certain expert inferences and judgments are made, that the ALJ is required to defer to the examiner's expertise in reviewing the examiners' classification conclusions. The ALJ may not substitute his own subjective judgment for that of the examiner, but may set aside the classification if it is without objective factual basis or is shown to be arbitrary and capricious.[283]

A noteworthy point about *Sunshine State Bank* is that the unique obligation of the bank examiners to make predictive judgments greatly diminishes the role of substantial evidence – already a highly deferential standard.[284] In fact, because of their extensive training, apprenticeship and evaluation, "commissioned" federal bank examiners enjoy an exalted status even among experts.[285]

In *Brickner v. FDIC*,[286] the FDIC issued an order removing two directors from their positions in a bank. There, a loan officer made a number of extremely poor-quality loans. The FDIC examiners criticized the loans during several examinations of the bank and told the board of directors that they needed to improve the bank's loan underwriting processes, and in particular, to curb the loan officer's authority to make loans. Two of the directors were also bank managers who had direct responsibility for overseeing the loan function. The directors failed to take the appropriate corrective steps, despite their assurances to the FDIC that they would do so. Eventually, the bank experienced significant losses due to the loans that the loan officer had made. The FDIC issued orders removing the two directors from their positions in the bank.

The legal standard for the FDIC's removal order was found in section 8(e) of the Federal Deposit Insurance Act ("FDIA"), which

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[283] *Id.* at 1583. *See also Hutensky*, 82 F.3d at 1239 (2d Cir. 1996) (noting that in reviewing an FDIC decision and order, the court must accord deference to the agency's reasonable construction of the statutes that it administers); Cavallari v. Comptroller of the Currency, 57 F.3d 137, 143 (2d Cir. 1995) (noting that an agency's reasonable construction of its own regulations is given controlling weight) (citing Thomas Jefferson University v. Shalala, 512 U.S. 504 (1994)).

[284] *Id.* at 1582 (quoting Missouri-Kansas-Texas Railroad Co. v. United States, 632 F.2d 392, 406 (5th Cir. 1980)).

[285] *Id*. at 1583. A federal bank examiner can become a "commissioned examiner" after going through the rigorous process described in *Sunshine State Bank. See id*.

[286] Brickner v. FDIC 747 F.2d 1198 (8th Cir. 1984).

at that time stated that a banking agency could remove an officer or director from a bank if the person has committed a violation of a law, rule, or regulation, engaged or participated in an unsafe or unsound practice, violated a fiduciary duty to his bank; as a result of the above violation, practice, or breach, the bank has suffered or will probably suffer a substantial financial loss, or the person received financial gain; and the violation, practice or breach entailed either "personal dishonesty" or "willful or continuing disregard" for the safety or soundness of the bank.[287]

The Court of Appeals for the Eighth Circuit agreed with the FDIC in its determination that the directors' failure to supervise the loan officer was precisely the kind of breach of fiduciary duty that the statute envisioned, and that their repeated failure to institute the promised appropriate corrective measures was precisely the kind of "continuing disregard" for the bank's safety and soundness that the law contemplated.[288] The Court noted that the governing statute does not specifically define "fiduciary duty," but commits this issue to the sound discretion of the banking agencies.[289]

Occasionally, of course, a bank supervisory agency will take clearly disproportionate action out of an excess of regulatory zeal. When this happens, a court will overturn the agency's action as being "arbitrary or capricious" or an "abuse of discretion." In *Kim v. Office of Thrift Supervision*, the OTS had issued an order banning the petitioner from the banking and savings and loan businesses for life.[290] The basis for the order was that the board of directors of a savings association had approved a few loans that contained minor, technical violations; that these loans either did, or could have, resulted in losses to the institution; and that these violations took place while the petitioner was the chief executive officer and a member of the board.[291] As noted above, one of the necessary elements for issuing such a lifetime prohibition order is that the person's conduct must amount to either "personal dishonesty" or "willful or continuing disregard for the safety or soundness" of the institution. The Court of Appeals for the Ninth Circuit determined that while the facts might have established the petitioner's

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[287] 12 U.S.C. § 1818(e) (2000). The legal standard for removals has changed somewhat since the *Brickner* case was decided in 1984, but is still essentially the same today.
[288] *Brickner*, 747 F.2d at 1203.
[289] *Id*. at 1203-04.
[290] Kim v. Office of Thrift Supervision, 40 F.3d 1050 (9th Cir. 1994).
[291] *Id.*

negligence, they did not amount to "willful" or "continuing" disregard for the institution's safety or soundness.[292] Furthermore, the Court reasoned that if a banking agency is going to ban a person from the industry for life, it must show at least "heedless indifference to possible consequences."[293] Because the facts in the record did not support any such finding, the court overturned the agency's prohibition order.[294]

2) Conservatorship and Receivership: Review "Upon the Merits"

In the United States, conservatorship and receivership decisions are not subject to the same kind of notice and hearing requirements imposed on ordinary enforcement orders. Rather, these decisions are premised on the administrative record the agency compiles internally, with the bank retaining the right to seek judicial review of the decision in federal district court.[295] The agency's administrative record typically consists of examination reports about the given bank, supervisory reports filed by the bank, reports of the bank's outside auditors, correspondence between the agency and the bank, and other such documents.[296]

The grounds for appointment of a conservator or receiver for depository institutions are contained in section 11(c)(5) of the FDIA.[297] Each of the federal banking agencies has separate authority to appoint a conservator or receiver if grounds (as described in the

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[292] *Id.* at 1054-55.
[293] *Id*. at 1054, *citing Grubb*, 34 F.3d 956, 961 (10th Cir. 1994).
[294] *Kim*, 40 F.3d at 1055; *See also* Kaplan v. Office of Thrift Supervision, 104 F.3d 417 (D.C. Cir. 1997); Wachtel v. Office of Thrift Supervision, 982 F.2d 581, 586 (D.C. Cir. 1993); Gulf Federal Savings and Loan Ass'n v. Federal Home Loan Bank Board, 651 F.2d 259, *cert. denied*, 458 U.S. 1121 (1981) (holding that an association's use of the 365/360 method of interest rate calculation, when loan contracts called for the use of the 365/365 method, did not amount to an unsafe or unsound practice, as it did not endanger the financial stability of the institution). Note the similarity between this approach and the French concept of "manifest error in the appreciation of facts." *See infra* part III.B.3.b.
[295] 12 U.S.C. § 1821(c)(7) (2000).
[296] *See, e.g.*, Franklin Savings & Loan Ass'n v. Director, Office of Thrift Supervision, 934 F.2d 1127, 1135 (10th Cir.1991), *cert. denied*, 503 U.S. 937 (1992).
[297] 12 U.S.C. § 1821(c)(5) (2000).

FDIA) exist with respect to any depository institution that they supervise.[298]

In most cases, judicial review of conservatorship or receivership decisions is not governed by the APA, but as a practical matter the analysis is virtually identical. The standard of review is contained in various statutory sections relating to the authority of the particular federal banking agency in question, all but one of which provide that the federal district court must, "upon the merits," either dismiss the institution's application or direct that the conservator or receiver be removed.[299]

The phrase "upon the merits" has been subject to varying interpretations by different courts, but the majority of courts that have considered the issue have interpreted the phrase in the same manner as the "arbitrary and capricious" standard of the APA.[300] Thus, the reviewing court will examine the factual record that the agency had before it when it made the conservatorship or receivership decision, and will uphold the appointment if there is any reasonable basis for doing so. A few district courts have gone further and have allowed the parties to introduce additional evidence – the theory being that "upon the merits" must mean something more than mere examination of the administrative record, otherwise Congress

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[298] *See* 12 U.S.C. §§ 191, 203 (2000) (authorizing the Comptroller of the Currency to appoint a receiver or conservator for a national bank); 12 U.S.C. § 1464(d)(2)(A) (2000) (authorizing the Director of the Office of Thrift Supervision to appoint a conservator or a receiver for any federally insured savings association); 12 U.S.C. § 1821(c)(4)(B) (2000) (authorizing the FDIC to appoint itself as conservator or receiver for any state chartered insured depository institution).

[299] *See* 12 U.S.C. § 1821(c)(7) (2000); 12 U.S.C. §1464(d)(2)(B) (2000). The National Bank Receivership Act, which relates to the Comptroller of the Currency's authority to appoint a receiver for a national bank, makes no provision for judicial review of these decisions. *See* 12 U.S.C. § 191. Judicial review of such appointments is therefore conducted in accordance with the APA. James Madison Ltd., by Hecht v. Ludwig, 82 F.3d 1085, 1094 (D.C. Cir. 1996), *cert. denied*, 519 U.S. 1077 (1997). By contrast, the Bank Conservation Act, 12 U.S.C. §201 *et seq*. (2000), which authorizes the Comptroller to appoint a conservator for a national bank, specifically provides for judicial review, stating that the district court "upon the merits, shall dismiss such action or shall direct the Comptroller to terminate the appointment of such conservator." 12 U.S.C. § 203(b)(1) (2000). The same section also provides that the Comptroller's decision may be set aside only if the court finds that such decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" – tracking the language of the APA. *Id.* It thus seems clear that in the case of a decision to appoint a conservator for a national bank, the "merits" test is, in fact, the "arbitrary or capricious" test of the APA.

[300] *See supra* note 299.

would have simply provided for review on the record.[301] This approach, however, is clearly the exception rather than the rule. Moreover, even when district courts have taken this approach, the banking agencies have always prevailed at the appellate level. This is the case regardless of whether the district court decides the case in favor of the banking agency or in favor of the institution seeking review. Appellate courts invariably apply an "arbitrary or capricious" or "abuse of discretion" analysis, in substance if not always in form. Their reasoning is that while the phrase "upon the merits" does not expressly state the standard to be used, Congress has given the banking agencies broad discretion to determine when to take action that is permitted by the law. Accordingly, the "merits" of the agency's decision simply refers to whether there was a reasonable basis for the action, making the "arbitrary or capricious" analysis appropriate.[302] There has never been a successful challenge to a conservatorship or receivership appointment at the appellate level, and none of these cases has reached the United States Supreme Court.

The savings and loan crisis of the 1980's produced a number of cases interpreting these provisions. In *Biscayne Federal Savings*

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[301] *See, e.g.*, Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 904 (D.D.C. 1990); Haralson v. Federal Home Loan Bank Board, 721 F. Supp. 1344, 1353-54 (D.D.C. 1987); Fidelity Savings & Loan Ass'n v. Federal Home Loan Bank Board, 540 F. Supp. 1374, 1377-78 (N.D. Cal. 1982), *rev'd on other grounds*, 689 F.2d 803 (9th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983); Telegraph Savings and Loan Ass'n v. Federal Savings and Loan Insurance Corporation, 564 F. Supp. 862, 868-70 (N.D. Ill. 1981), *aff'd sub nom*. Telegraph Savings and Loan Association v. Schilling, 703 F.2d 1019 (7th Cir.), *cert. denied*, 464 U.S. 992 (1983) (holding that the petitioning institution was entitled to a *de novo* hearing, and rejecting the arbitrary or capricious test in favor of a less rigorous "incorrect by the greater weight of the evidence" test); *see also* Collie v. Federal Home Loan Bank Board, 642 F.Supp. 1147, 1149-52 (N.D. Ill. 1986) (rejecting the "arbitrary or capricious" test and stating that additional evidence is appropriate in some circumstances, but granting summary judgment to the agency on the basis of the administrative record because it was clear that the association had had a meaningful opportunity to present its views and the record supported the agency's decision "on the merits").

[302] First National Bank & Trust v. Department of the Treasury, 63 F.3d 894, 899 (9th Cir. 1995); Franklin Savings & Loan Ass'n v. Director, Office of Thrift Supervision, 934 F.2d 1127, 1141-42 (10th Cir.1991), cert. denied, 503 U.S. 937 (1992); Woods v. Federal Home Loan Bank Board, 826 F.2d 1400, 1408-09 (5th Cir. 1987), cert. denied, 485 U.S. 959 (1988); Guaranty Savings & Loan Ass'n v. Federal Home Loan Bank Board, 794 F.2d 1339, (8th Cir. 1986); Biscayne Federal Savings & Loan Ass'n v. Federal Home Loan Bank Board, 720 F.2d 1499, 1503-05 (11th Cir.), cert. denied, 467 U.S. 1251 (1984). *See also* James Madison, Ltd., *supra* note 299, at 1098-99 (applying the arbitrary or capricious test under the APA).

& Loan Association v. Federal Home Loan Bank Board,[303] the Federal Home Loan Bank Board ("FHLBB") appointed a receiver for an insolvent savings association. Both the agency and the association had recognized that the association was insolvent.[304] However, the association's petition was based on the alleged deceptive behavior of certain members of the agency's staff in negotiations with a potential purchaser for the association.[305] The district court held a lengthy trial and allowed both parties to introduce evidence beyond the administrative record.[306] The Court overturned the agency's decision, finding the staff members' behavior to be "outrageous," "outlandish," "egregious" and "wrapped in a shroud of deception."[307] On appeal, the Court of Appeals for the Eleventh Circuit reversed, ruling that once a statutory ground for receivership (in this case, insolvency) had been met, a court had no authority to set aside the agency's decision.[308] Judicial inquiry ends when one of the legal grounds for receivership is present.[309] The court also noted that the wisdom of the agency's decision to exercise its power to appoint a receiver was not an issue that the court had the authority to determine: Congress has vested that decision in the agency, not the court.[310]

In *Alliance Federal Savings and Loan Association v. Federal Home Loan Bank Board*, [311] the FHLBB appointed a conservator for a savings association based on a substantial dissipation of assets or earnings due to violations and unsafe or unsound practices; an unsafe or unsound condition to transact business; and a willful violation of a cease-and-desist order. The Court of Appeals for the Fifth Circuit noted that the law, while authorizing the courts to review the agency's decision to appoint the conservator, did not expressly define the scope of judicial review.[312] The court noted, however, that

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[303] *Biscayne*, 720 F.2d at 1499. The Federal Home Loan Bank Board was the predecessor agency of the Office of Thrift Supervision, which is the bureau of the U.S. Treasury Department created in 1989 to supervise savings associations.
[304] *Id.* at 1502 n.6.
[305] *Id.* at 1501.
[306] *Id.* at 1501-02.
[307] *Id.* at 1502.
[308] *Id.* at 1506.
[309] *Id.* at 1503-05.
[310] *Id.* at 1505.
[311] Alliance Federal Savings and Loan Association v. Federal Home Loan Bank Board, 782 F.2d 490 (5th Cir. 1986), *modified on other grounds*, 790 F.2d 34 (5th Cir. 1986).
[312] *Id*. at 493.

Congress had vested a "vast amount" of control and authority in the agency to regulate savings and loan associations.[313] Because of this fact and citing *Biscayne*, the Court ruled that its jurisdiction to review the agency's decision was limited to a determination of whether one of the legal grounds existed at the time of the appointment of the conservator – in effect, applying the "arbitrary or capricious/abuse of discretion" test without expressly using such language.[314] Interestingly, in the original opinion in *Alliance*, the Fifth Circuit stated that the plaintiff would have been entitled to a *de novo* trial in the district court had it requested one.[315] On petition for rehearing filed by the FHLBB, the Court redrafted the paragraph containing this statement and deleted the reference to the availability of a *de novo* trial.[316] This implicitly left open the scope of review.

Two years later, the issue again came before the Fifth Circuit, which came down squarely in favor of the arbitrary or capricious test. In *Woods v. Federal Home Loan Bank Board*,[317] the FHLBB appointed a receiver for a savings association in Texas. The grounds for the appointment were: "(1) insolvency; (2) a substantial dissipation of assets or earnings due to unsafe or unsound practices; and (3) the association was in an unsafe or unsound condition to transact business."[318]

The district court applied the "arbitrary or capricious" standard and concluded that based on the administrative record the agency's decision should be affirmed.[319] The plaintiff, the association's sole shareholder, contended that the court had applied the wrong standard and that the phrase "on the merits" meant that the court should have utilized a *de novo* review by holding an evidentiary trial and allowing the association to introduce more evidence.[320] On appeal, the Fifth Circuit essentially equated the "on the merits" standard with the "arbitrary or capricious" standard, and affirmed the district court's decision.[321] The court explained that the phrase "on the merits" does not define the scope of review, but

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[313] *Id.*
[314] *Id*.
[315] *See id*. at 496.
[316] *Alliance*, 790 F.2d at 34-35.
[317] Woods v. Federal Home Loan Bank Board, 826 F.2d 1400 (5th Cir. 1987), *cert.denied*, 485 U.S. 959 (1988).
[318] *Id.* at 1402.
[319] *Id.*
[320] *Id*. at 1406.
[321] *Id.*

according to Supreme Court precedent, "in cases where the Congress has simply provided for judicial review without setting forth the standard to be used or the procedures to be followed," judicial review is to be based only on the administrative record and "no *de novo* hearing may be held."[322] Further, the Court held that the phrase "on the merits" means that the district court is to affirm or reverse the agency's decision to appoint the receiver only on the basis of the existence of one of the legal grounds for such appointment – not on procedural or policy grounds (in other words, not based on whether or not the court agrees with the agency's action).[323]

> The court explained the rationale for its decision as follows:
>
> Congress has granted the [Federal Savings and Loan Insurance Corporation ("FSLIC")] extensive powers to regulate and supervise insured savings and loan institutions. . . . Pursuant to its congressional mandate, the Bank Board has promulgated a comprehensive regulatory scheme to protect the FSLIC's financial interests. . . . The reasons for such extensive regulation and the broad congressional mandate are obvious: insured institutions derive their principal financial integrity from the federal insurance scheme; a major portion of the risk of financial failure falls squarely upon the FSLIC as insurer of every depositor's account. . . . We previously observed that "Congress wanted the FSLIC to be able to act quickly and decisively in reorganizing, operating, or dissolving a failed institution, and intended that the FSLIC's ability to accomplish these goals not be interfered with by other judicial or regulatory authorities.[324]

Citing previous Supreme Court cases, the Fifth Circuit ruled that under the "arbitrary or capricious" standard of review: (1) the

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[322] *Id.*
[323] *Id.*
[324] *Id.* at 1406-07 (citations omitted). The Federal Savings and Loan Insurance Corporation insured the deposits of federally insured savings and loan associations until the passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 355 (1989) ("FIRREA"). With the passage of FIRREA, the FSLIC was abolished and its functions were absorbed into the FDIC.

petitioner has the burden of showing that the agency's decision is arbitrary or capricious; (2) the agency's decision is entitled to a "presumption of regularity," and (3) the court's review of the agency's decision is confined to the administrative record.[325]

Perhaps the best "hornbook" on judicial review of conservatorship and receivership decisions in the United States is *Franklin Savings and Loan Association v. Director, Office of Thrift Supervision*.[326] There, the OTS appointed a conservator for a savings and loan association. The grounds were (1) that the institution was in an unsafe or unsound condition to transact business; (2) the institution had incurred losses depleting substantially all of its capital; (3) that there was no likelihood of replenishment without federal assistance; and (4) that the institution had committed violations of laws or regulations, or unsafe or unsound practices, which were likely to cause insolvency or substantial dissipation of assets or earnings.[327]

When the association sought review of the agency's appointment, the agency filed the administrative record with the district court and argued that the Court's review should be limited to that record.[328] The record consisted of three volumes of material and contained the agency's examination reports; the association's monthly, quarterly and annual financial reports; supervisory directives to the association by the agency; the most recent annual independent audit report; and many other documents.[329] The district court rejected the agency's contention that judicial review was limited to the administrative record and conducted a full trial.[330] The Court ruled that the association should have the opportunity to submit evidence beyond the administrative record for the purpose of determining whether or not such evidence was considered by the director of the agency, and to develop any facts bearing on the question of whether one of the legal grounds existed for the appointment of the conservator.[331] Although the district court purported to apply the "arbitrary or capricious" standard and to put the burden of proof on the association, the court in fact applied a

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[325] *Id.* at 1408-09.
[326] *See* Franklin Savings & Loan Ass'n v. Director, Office of Thrift Supervision, 934 F.2d 1127 (10th Cir.1991), *cert. denied,* 503 U.S. 937 (1992).
[327] *Id*. at 1135.
[328] *Id.*
[329] *Id*.
[330] *Id.*
[331] *Id.*

"hybrid" standard of review and held a *de novo* trial.[332] The court heard live testimony from twenty-five witnesses, accepted deposition testimony from eighteen other witnesses and received 650 exhibits.[333] The Court characterized the case as a "dispute over accounting practices," evaluated the testimony of the association's experts against the agency's experts, and was more persuaded with the association's experts. [334] The Court made its own findings, determined that the agency lacked any factual basis for its decision and therefore held that the decision to appoint the conservator was arbitrary and capricious.[335]

The Court of Appeals for the Tenth Circuit reversed the district court's ruling, finding that the district court had applied the wrong scope and standard of review, and had improperly substituted its own judgment for that of the agency.[336] Because the appellate court's analysis is quite thorough and illuminating, it is worth examining in some detail.

The Tenth Circuit agreed with the Fifth Circuit in *Woods* that the phrase "on the merits" means that the agency's decision must be reviewed on the basis of the administrative record and that the issue is whether there was any reasonable basis for the agency's decision based on that record – in other words, whether the decision was arbitrary or capricious.[337] The Court noted that, based on previous Supreme Court and appellate court decisions interpreting the APA, a district court may consider evidence outside of the administrative record only for limited purposes.[338] Examples of such purposes would be where the administrative record fails to disclose the factors considered by the agency; where examination of evidence outside of the administrative record is necessary for background information; where it is necessary to determine whether the agency considered all relevant factors, including evidence contrary to the agency's position; or where it is necessary to explain technical terms on complex subject matter.[339] The Court noted, however, that these exceptions to the general rule were narrow, and that such evidence

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[332] *Id*. at 1135-36.
[333] *Id*..at 1140.
[334] *Id.* at 1136.
[335] *Id.* at 1136.
[336] *Id* .at 1151.
[337] *Id.* at 1141-42.
[338] *Id.* at 1137-40.
[339] *Id.* at 1137.

should be received with caution.[340] Moreover, none of these conditions was present in the instant case. The agency's administrative record was voluminous and detailed, and clearly indicated that the association had had numerous opportunities to present its views to the agency. The substance of those positions was considered by the director of the agency, and the record contained ample material showing why those positions were rejected.[341]

Because the agency's decision in the *Franklin* case was not based on insolvency (which is fairly easy to calculate), but rather on other grounds which entailed a more subjective determination by the agency, it is instructive to review the appellate court's treatment of the evidence and its analysis of standard of review applied by the district court.

The agency initially noted that the association was in an unsafe or unsound condition to transact business.[342] The factual basis for this determination was that the association had an unacceptable level of high risk assets and had too high a level of "brokered" deposits.[343] It was uncontested that forty percent of the association's assets were in the "high-risk" category.[344] The agency determined that this level was too high, while the association's experts testified that this level was acceptable.[345] The district court disregarded the agency's analysis and accepted testimony of the association's experts.[346] The appellate court, however, noted that conflicting expert opinion was not sufficient to overcome the presumption of correctness of the agency's analysis.[347] It is noteworthy that the appellate court did not attempt to determine for itself what level of high risk assets was actually acceptable, but rather focused on whether the agency had drawn reasonable conclusions from the undisputed facts and had supplied a well-reasoned basis for its decision. Specifically, the agency determined that the association's assets were not sufficiently diversified; that it had too high a concentration of assets in high-risk securities; that the association would have to sell these assets to match the maturities of its deposits, and that when it did this it would likely incur losses

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[340] *Id.* at 1140.
[341] *Id.*
[342] *Id.* at 1143.
[343] *Id.*
[344] *Id.* at 1143.
[345] *Id.* at 1144.
[346] *Id.* at 1143.
[347] *Id*. at 1144.

because the market for these securities was quite volatile (since the assets' values could change significantly and rapidly).[348] The administrative record contained reasoned analysis for all of these conclusions. The appellate court found that the district court had improperly substituted its own judgment for that of the agency and had ignored the agency's predictive judgment.[349]

With regard to brokered deposits, it was undisputed that more than seventy percent of the association's deposits were "brokered" (meaning that the association obtained the funds by paying commissions to deposit brokers, who in turn solicited money to be placed in insured institutions at higher rates of interest.)[350] Brokered deposits present two problems for financial institutions: (1) they increase the institution's cost of funds, and (2) they impair the institution's liquidity because they are mainly short-term, so the institution often must sell assets in order to obtain the money to pay off the maturing deposits.[351] Again, the institution produced experts who testified that its level of brokered deposits was acceptable, and the district court accepted their testimony.[352]

The other grounds for appointment of the conservator were that the association had suffered losses depleting substantially all of its capital, and that there had been a substantial dissipation of its assets or earnings.[353] It was undisputed that the association's net interest margin had steadily declined in recent years; that the association was paying dividends and large bonuses in spite of these losses; and that it had been unsuccessful at raising outside capital.[354] A significant concern of the agency was the association's accounting treatment, which had resulted in deferral of actual cash losses and understatement of current losses.[355] The district court heard testimony from both the agency's and the association's expert accountants, and accepted the association's testimony. The district court found that both the association's and the agency's accounting treatment were acceptable under Generally Accepted Accounting Principles.[356] It decided to accept the association's treatment

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[348] *Id.*
[349] *Id.*
[350] *Id.*
[351] *Id.*
[352] *Id.*
[353] *Id.* at 1146-48.
[354] *Id.* at 1146-47.
[355] *Id.*
[356] *Id.*

because, although it was not widely used, it had been approved by the association's outside auditors and the Court believed that the agency's treatment was too conservative.[357] Again, the appellate court determined that the district court had improperly substituted its own judgment for that of the agency, and had ignored the agency's predictive judgment.[358]

The appellate court concluded its opinion with the following observations:

> The ultimate question underlying this dispute is: who is vested with the responsibility for determining the quality of assets, appropriate accounting standards, and the numerous other questions relating to the safe and sound condition of a financial institution? Congress has answered this question by enacting [the Financial Institutions Reform, Recovery, and Enforcement Act], which clearly vests this authority in the director.
>
> The district court first improperly expanded its scope of review when it allowed testimony of Franklin's experts giving opinions on such matters as acceptable levels of brokered deposits and high-risk assets. Secondly, the district court erred by improperly applying the standard of review when it accepted such expert opinion. By doing so, the district court effectively usurped [the] Director's regulatory and enforcement powers and placed these powers into the hands of Franklin. Congress has given the director, not the courts, the power to define what is an unsafe and unsound condition.[359]

2. Concepts of Judicial Review in Civil Law Countries

At first glance, it might seem like too much to ask for Kyrgyzstan to adopt judicial review principles that resemble the American approach in any meaningful sense. The American approach, after all, has its roots in the common law system, the

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[357] *Id.*
[358] *Id.* at 1147-49.
[359] *Id.* at 1150-51.

principle of *stare decisis* and case law developed over time by judicial decisions in specific disputes. The former Soviet Republics, by contrast, inherited their legal system from the civil law tradition of continental Europe, which, it is generally assumed, is radically different from the Anglo-American common law system.[360] In theory, in the civil law tradition, the only source of law is the literal text of the statute.[361] Legislative history, the intent of the drafters, previous judicial decisions, public policy considerations and even simple common sense are of no relevance.[362] Judges have no power to interpret the law. Indeed, the need for any sort of sophisticated legal analysis rarely arises, because civil law statutes are drafted with such clarity, precision and detail that there is little of substance for the court to do: the answer to any legal question is obvious if one can simply locate the relevant passage in the statute. As Professor John Henry Merryman, a leading American expert on the civil law tradition, has explained:

> The picture of the judicial process that emerges is one of fairly routine activity. The judge becomes a kind of expert clerk. He is presented with a fact situation to which a ready legislative response will be readily found in all except the extraordinary case. His function is merely to find the right legislative provision, couple it with the fact situation, and bless the solution that is more or less automatically produced from the union. The whole process of judicial decision is made to fit into the formal syllogism of scholastic logic. The major premise is in the written statute, the facts of the case furnish the minor premise, and the conclusion inevitably follows. In the uncommon case in which some more sophisticated intellectual work is demanded of the judge, he is expected to follow

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[360] *See* Fenton, *supra* note 29, at 52 (noting that while the Soviet legal system was nominally based on Roman law concepts imported from western Europe, the system was in fact designed primarily to ensure control and maintenance of order over the general population).

[361] See Craig R. Geisze, *Helms-Burton in Light of the Common Law and Civil Law Legal Traditions: Is Legal Analysis Alone Sufficient to Settle Controversies Arising Under International Law on the Eve of the Second Summit of the Americas?*, 32 INT'L LAW. 51, 62-67 (1998).

[362] *Id.*

> carefully drawn directions about the limits of interpretation . . . . The net image of the judge is one of an operator of a machine designed and built by legislators. Judicial service in civil law countries is a bureaucratic career; the judge is a functionary, a civil servant; the judicial process is narrow, mechanical, and uncreative.[363]

Thus, according to popular belief, the entire concept of flexible legislative provisions, a key component of an effective bank supervisory regime, can never work in a civil law environment. Moreover, the notion of judicial deference – the logical extension of legislative flexibility – could not even arise. Since the statutes are written such that they can only be understood in one way, there is nothing for either the bank supervisor or the court to interpret. All the supervisor has to do is "apply" the law, and, in the event of a dispute, all the court has to do is make sure that the supervisor applied the law correctly. This appears to be a very common attitude in transition economies (although this is gradually changing).[364] Post-Soviet legislators and other public officials have historically preferred rigid, mechanical statutory provisions that leave no room for discretion on the part of the bank supervisor, or for that matter, any public administrator.[365] In this sense, the drafters' approach

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[363] MERRYMAN, *supra* note 45, at 36-38. *See also* HERMAN SCHWARTZ, THE STRUGGLE FOR CONSTITUTIONAL JUSTICE IN POST-COMMUNIST EUROPE 246 (University of Chicago Press, 2000) (referring to "the archaic civil law notion that the law is fixed, clear and discoverable and that all judges do is discover and apply it.")

[364] *See* Gary A. Gegenheimer, *Bank Regulatory Reform in the Republic of Kazakstan*, 17 ANN. REV. BANKING L. 153, 189-94 (1998) (noting the lack of a general "safety and soundness" standard in Kazakhstani banking legislation). *But see* discussion *supra* at Section III (noting the increasing use of flexible terminology in the Kyrgyz Banking Law). Interestingly enough, this attitude seems to be alive and well even in the German bank supervisory community, though as a practical matter German bank supervisors exercise much more judgment than even they themselves are prepared to admit. *See* Edward L. Rubin, *Discretion and Its Discontents*, 72 CHI.-KENT L.R. 1299, 1325-35 (1997).

[365] *See* Hernan L. Fuenzalida-Puelma, *Book Review: Reforming the Russian Legal System*, FIN. MKTS. INT'L NEWSLETTER 8 (Jan. 2001), *available at* http://www.fmi-inc.net/dmt_jan_2001body.htm ("A conceptual and operational rigidity permeates the entire economic and legal system, notwithstanding almost a decade of reform. This is especially true of new laws and regulations in the commercial and financial sectors."). Fuenzalida describes a conversation between a western legal consultant and the Director of the licensing department of a post-Soviet securities regulator, in

seems closer to that of the early civil code drafters, who attempted to make the law "judge-proof" by adopting specific rules for every conceivable (or so it was thought) fact situation – an obvious impossibility in practice.[366]

There are two problems in attempting to apply the foregoing view of judicial deference to decisions of financial sector regulatory bodies in civil law countries. First, as Professor Merryman and others have pointed out, the reality of legislative drafting and analysis in civil law countries is far different from the common perception. Civil law courts can, and do, consult decisions in previous cases, as well as legislative history, in framing their decisions – although civil law courts consider these sources more as informal research tools, rather than as the common law system considers them – as formal sources of law.[367] Indeed, the courts are virtually required to look beyond the literal words of the statute, because more often than not, statutes in civil law countries are not drafted with any more precision or detail than their supposedly more amorphous common law counterparts.[368] While civil law purists will vehemently deny that judges are "interpreting" the law when they determine the meaning of an indefinite legislative provision, the reality is that they are doing exactly that.

Second – and this is an enormous source of misunderstanding in the former Soviet Republics – historically, ordinary civil code provisions were never intended to govern judicial review of decisions of public administrative bodies in the first place. In fact, one of the major motivations for adopting the civil codes in the 18th and 19th centuries was to take such authority away from the ordinary courts, because they had abused the judicial process so flagrantly.

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which the advisor questions why two investment firms with the same name are both being given operating licenses. The Director acknowledges that one purpose of the investment fund law is to prevent confusion on the part of public investors, but believes that the regulatory body is legally obliged to give licenses to both firms because the law does not expressly state that investment firms must have different names. The job of the administrator is merely to apply, but not interpret, the law.

[366] MERRYMAN, *supra* note 45, at 29; RUDOLF B. SCHLESINGER, COMPARATIVE LAW, CASES AND MATERIALS 232 (1970) (both citing the early Prussian experience).

[367] See MERRYMAN, *supra* note 45, at 43, 47; Taruffo, *supra* note 45, at 6; SCHLESINGER, *supra* note 366, at 233.

[368] *See* discussion *supra* at Section III(A) (referring to the banking legislation of Germany, Switzerland, and the EU).

In contrast to the situation in England, where the common law courts generally had been a positive influence on the development of the law, by the 18th century courts in many continental European countries had grown corrupt and inefficient. This was particularly true in France, where they had come to be associated with the hated *ancien regime*.[369] Supporting the interests of the landed aristocracy against the peasantry and middle classes, and against the central government in Paris, the courts refused to apply new legislation, interpreted laws contrary to their intent, and hindered the attempts of public officials to administer them.[370]

Following the teachings of Montesquieu and others, the early civil code drafters believed that the best way to prevent this kind of abuse was to separate the legislative and executive functions from the judicial function and then to regulate the judiciary carefully to ensure that it merely "applied" the law as drafted by the legislature and did not interfere with public officials in the performance of their administrative functions.[371] Thus, judges were expressly prohibited from exercising jurisdiction over cases involving actions of public bodies. One of the earliest legislative enactments following the French Revolution stated this principle in unequivocal terms:

> Judicial functions are distinct and will always remain separate from administrative [executive] functions. It shall be a criminal offence for the judges of the ordinary courts to interfere in any manner whatsoever with the operation of the administration, nor shall they call administrators to account before them in respect of the exercise of their official functions.[372]

Similarly, a 1795 decree stated: "[t]he prohibition is renewed against the courts taking cognizance of the acts of the administration of

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[369] SCHELESINGER, *supra* note 366, at 239-42.
[370] MERRYMAN, *supra* note 45, at 15-16, 87.
[371] *Id.* at 16. *See also id.* at 133.
[372] L. NEVILLE BROWN & JOHN S. BELL, FRENCH ADMINISTRATIVE LAW 43 (4th ed. 1993) (translating *Code de l'organisation judiciare*, August 16-24, 1790, Title II at art. 13); *see also* Bron McKillop, *The Judiciary in France – Reconstructing Lost Independence*, *in* FRAGILE BASTION: JUDICIAL INDEPENDENCE IN THE NINETIES AND BEYOND, *available at* http://www.judcom.nsw.gov.au/fb/fbmckill.htm.

whatever kind they may be."[373] Both of these provisions are still in force today.[374]

The civil code would thus govern only private legal matters, such as those involving the law of persons (legal and natural), the family, inheritance, property and obligations (roughly the equivalent of contracts and torts in the common law world), and judges would be strictly limited in their interpretive powers.[375] Questions concerning the authority of public bodies in the non-criminal setting were beyond the purview of the courts altogether. Although civil law organization and terminology dominate the legal way of thinking in civil law countries, the public and private fields are quite different categories.[376]

Still, some form of review of the legality of administrative action was clearly necessary in the interests of justice and sound public administration. In France, the *Conseil d'Etat* (which stood at the head of the public administration and thus was not part of the judiciary) was given this task. A highly respected institution in France, the *Conseil d'Etat* has built the entire body of French administrative law through its decisions with only a minor legislative foundation.[377] An alternative approach later adopted in Germany was to establish separate administrative courts at the federal level. These courts form part of the judicial hierarchy, along with the labor courts, the social courts, the tax courts, and the ordinary courts. Still, as in France, the basic separation is maintained: the ordinary courts have no power to review the legality of actions of public bodies. That power rests with the administrative courts.

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[373] BROWN & BELL, *supra* note 372 (translating Decree of 16 fructidor, an III (1795)); *see also* George A. Bermann, *The Scope of Judicial Review in French Administrative Law*, 16 COLUM. J. TRANSNAT'L L. 195, 197 n.6 (1977).

[374] BROWN & BELL, *supra* note 372.

[375] MERRYMAN, *supra* note 45, at 29, 39.

[376] *See id.* at 68. Actually, the division of law into clearly delineated public and private law realms has a long history in the civil law tradition, dating back at least to the *Corpus Juris Civilis* of Justinian and possibly to classical Roman times. MERRYMAN, *supra* note 45, at 91. There is no question, however, that this distinction was made even stronger by the adoption of the civil codes and the strict separation of the judicial from the executive function. *See id.* at 93; SCHLESINGER, *supra* note 366, at 243. In addition, European public law developed in large part from the revolutionary developments of the late 18th century and does not have the deep Roman and medieval roots that characterize the civil law. MERRYMAN, *supra* note 45, at 14.

[377] MERRYMAN, *supra* note 45, at 88.

The public-private law distinction is also reflected in the "sub-species" of "special legislation" which is characteristic of civil law countries. As Professor Merryman notes, some of this legislation merely elucidates and fills in gaps in the code provisions, completing and clarifying the original code design.[378] But the great bulk of it does something entirely different: it sets up specialized legal regimes, with different purposes and functions from those of the civil code. Such regimes are not mere supplements to the civil code - they exist apart from it, and, in a sense, are even incompatible with it.[379]

Professor Merryman uses the example of labor legislation to illustrate this point:

> In the classic civil codes, the "labor relation" is treated merely as one variety of contract between individuals exercising freedom of contract; labor contracts are not greatly different from other contracts, except that here money is exchanged for labor, rather than for goods or real estate. But in modern civil law nations, just as in the United States, the central players are big labor and management, not private individuals. Labor legislation has a variety of objectives quite unfamiliar to the regime of the civil codes: the welfare and safety of workers, industrial peace and productivity, regulation of the internal affairs and public accountability of labor unions and employers' associations and so forth. Whereas the traditional civil codes left it to private individuals to pursue their own interests, with the state acting primarily in the restricted role of a "referee," the new regimes embody policy choices and are designed to further specific social objectives. The microsystem of labor law is thus fundamentally different in approach and technique from the code provisions for labor contracts.[380]

Bank regulatory and supervisory legislation clearly falls into the same category. The major players in the banking sphere are not

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[378] MERRYMAN, *supra* note 45.
[379] *Id.* at 151-52.
[380] *Id.*

private parties, but bank supervisors, central banks, and deposit insurers. Whereas the typical civil code will contain provisions governing relationships between banks and their customers, such as deposit and credit relationships, most banking legislation embodies a wide variety of public policy objectives for which the civil code simply was not designed: the safety of depositors' money, protection of the deposit insurance fund, the integrity of the payment system, and so forth. Logically, then, one would expect that questions of the legality of actions of the bank supervisor would be governed by the provisions of specialized banking legislation, not the civil code. The civil code would be consulted, if at all, only as necessary to answer a question that the special banking legislation did not address.[381]

This history and distinction are almost always lost in the former Soviet Republics. Under the Soviet system there was no private law, simply because there was no private enterprise in the first place. Thus, all law was public law and, in particular, reflected Marxist-Leninist ideology.[382] Although the post-Soviet civil codes establish private free enterprise principles, the drafters did not completely "sever the Soviet era umbilical cord" and did not fully grasp the public-private distinction, despite the influence of western advisors.[383] The result is that the public-private law distinction is muddled in the post-Soviet codes. Moreover, ordinary legislation of any type, whether dealing with public or private matters, is often considered subservient to the civil code. The result is that the civil codes are often considered sacrosanct and have been exalted to "quasi-constitutional" status, a standing unknown among the civil codes of Continental Europe.[384] As the above brief historical foray demonstrates, this is not in keeping with the civil law tradition as it has developed over many years, and it is not conducive to an effective bank supervision regime.

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[381] *See id.* at 152-53. *See also id.* at 92 (noting that the tremendous growth in public functions in the 20th century is a phenomenon that the early civil code drafters simply could not have foreseen).
[382] *See* Osakwe, *supra* note 3, at 1415.
[383] *Id.* at 1416, 1420-25, 1502.
[384] *Id.* at 1417, 1434-35 (stating, "together, these legal rules [consisting of all civil legislation] form a huge pyramid at the top of which majestically stands the Civil Code."). *See also id.* at 1447, 1505-08. *See also* Blumenfeld, *supra* note 3 at 494-95.

3. A Closer Look at France

The French Monetary and Financial Code gives the Banking Commission (the "*Commission Bancaire*" or "*Commission*") broad powers to supervise banking institutions, monitor the soundness of their financial situation, and ensure that sound banking practice standards are observed. These powers include the authority to require banks to adopt corrective measures and to impose sanctions for violations. Many of these legal provisions are quite broadly-worded and imprecise. For example, the *Commission Bancaire* may enjoin any credit institution, company or other person subject to its supervision to "take appropriate measures to restore or bolster [its] financial situation, improve [its] management methods or ensure that [its] organisation is suitable for [its] business or [its] development plans."[385] The *Commission* may issue a warning to a bank if it finds that the bank has "fail[ed] to comply with the profession's rules of good conduct."[386] The *Commission* may appoint a provisional administrator on its own initiative if it determines that "the management of the institution or company can no longer be carried out in normal conditions."[387] The *Commission* also has broad discretionary authority to impose sanctions (ranging from a warning to deleting the bank from the list of authorized institutions and appointing a liquidator), if, among other things, the bank has contravened a law or regulation relating to its business, has not responded to a recommendation, has not heeded a cautionary notice, or has failed to comply with an injunction.[388]

As noted above, decisions of administrative agencies in France are subject to review in special administrative courts, the highest of which is the Council of State ("*Conseil d'Etat*" or "*Conseil*"). While these administrative tribunals are referred to as "courts," in fact they are part of the executive branch rather than the judicial branch.[389] The *Conseil* serves the dual purpose of being both the supreme administrative court and an advisory body to the government.[390] French administrative judges receive specialized training at a rigorous and prestigious school of public administration,

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[385] French Monetary and Financial Code, art. L613-16, *available at* http://www.legifrance.gouv.fr/html/codes_traduits/moneang.htm.
[386] *Id.* art. L613-15.
[387] *Id.* art. L613-18.
[388] *Id.* art. L613-21.
[389] BROWN & BELL, *supra* note 372 at 43-46.
[390] *Id.* at 59.

l'Ecole Nationale d'Administration. Administrative court judges, especially judges of the *Conseil*, are typically those who have excelled in these studies.[391]

The *Conseil* has developed an impressive body of case law. Indeed, most of the legal principles under which the *Conseil* reviews agency actions do not have an express basis in the written law, but have been developed by the *Conseil* based on its experience over the years – in a manner remarkably similar to that in which English and American judges developed the common law.[392] As a result, the *Conseil's* jurisprudence has thus developed almost entirely outside of the realm of the Civil Code.

In reviewing actions of administrative bodies, French administrative courts make a clear distinction between *légalité* (the conformity of administrative action to law) and *opportunité* (the wisdom and advisability of that action). While the courts' analysis of *légalité* can be quite rigorous, *opportunité* is considered to be the domain of the administrator, not the courts.[393]

The French system also distinguishes between "full review" ("*contrôle normal*") and more limited review ("*contrôle minimum*").[394] Full review is somewhat analogous to a "de novo" review in American or English law: the court determines for itself the factual basis for the administrator's action and the conformity of that action to applicable legal principles (though still keeping in mind the distinction between *légalité* and *opportunité*).[395] Full review entails a closer examination of whether the administrator has gone beyond what is necessary to achieve the law's purpose. Full review is generally most appropriate for questions where the administrative body is under an affirmative obligation to act and has no discretion in the matter.[396]

Limited review (*contrôle minimum*) is more restricted. Under limited review, a court will annul an administrative action if it finds that the administrator acted unreasonably under the standards set forth in the law. More specifically, minimum review allows a court to review for errors of pure fact (*i.e.*, the physical correctness of facts); mistake of law (*i.e.*, where the administrator is under a clear

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[391] *Id.* at 78-79; Bermann, *supra* note 373, at 197 n.8.
[392] SCHLESINGER, *supra* note 366, at 350.
[393] BROWN & BELL, *supra* note 372, at 172-73, 237. *See also* Bermann, *supra* note 373, at 225.
[394] Bermann, *supra* note 373, at 211-13; BROWN & BELL, *supra* note 372, at 250.
[395] Bermann, *supra* note 373, at 211-13; BROWN & BELL, *supra* note 372, at 250.
[396] Bermann, *supra* note 373, at 211-13.

duty to act or refrain from acting in a certain manner); "manifest error in the application of facts" (see below); or, in some cases, misuse of power.[397] *Contrôle minimum* is typically applied in cases involving national security measures; in technically complex areas that require the application of specialized expertise; or where the decision was based on the agency's discretionary authority.[398]

Most appeals from administrative agency actions in France begin in the lower administrative courts (the *tribuneaux administratif).*[399] Agency actions in France are, for the most part, a good deal less formal than they are in the United States. Thus, there is less likely to be an "administrative record," in the American sense, for the court to review. The first-instance administrative courts, therefore, have broad powers to confirm the physical correctness of facts upon which the agency relied in arriving at its decision. As a result, the lower courts conduct much more far-reaching factual investigations than do American courts in reviewing administrative agency actions. It is only when a case is appealed to the intermediate-level administrative court, or to the *Conseil*, that it is in roughly the same shape as a case being reviewed by an appellate court in the United States.[400] There are, however, some exceptions to this general rule. Challenges to the legality of acts of a group of "specialized administrative jurisdictions," which operate under "quasi-judicial" procedures, are filed directly with the *Conseil*. The *Commission Bancaire* is one of these agencies.[401] In fact, when the *Commission* takes enforcement action under the Monetary and Financial Code, it is specifically functioning as an administrative court.[402] Its judicial decisions are subject to review, on points of law

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[397] *Id.* at 213.
[398] *Id.* at 228-36.
[399] BROWN & BELL, *supra* note 372.
[400] Bermann, *supra* note 373, at 204.
[401] BROWN & BELL, supra note 372, at 57, 153-54, 235, app. D at 292. This is analogous to the situation in Switzerland where petitions for review of decisions of the Federal Banking Commission are filed directly with the Supreme Court. *See* Swiss Law on Banks and Savings Banks, *supra* note 251 art. 24(1) (providing that decisions of the Commission can be appealed to the "Federal Court;" the Federal Court consists of the Supreme Court and the Federal Insurance Court. *See* The Federal Authorities of the Swiss Confederation, http://www.admin.ch/ch/e/welcom.html (last visited June 10, 2006).
[402] French Monetary and Financial Code, *supra* note 385, at art. L613-23, ¶ I.

only, before the *Conseil*.[403] In this kind of lawsuit, the Conseil sits in cassation, which is important for two reasons.

First, when the *Conseil* considers a case in cassation, reviewing a decision of one of the "specialized administrative jurisdictions" such as the *Commission Bancaire*, the agency will have established its own administrative record through its own "quasi-judicial" procedure.[404] In these cases, the *Conseil* reviews only the administrative record compiled by the agency.[405] Second, while all administrative bodies benefit from a "presumption of correctness" to a certain extent, that presumption is even stronger when a decision of one of the specialized administrative jurisdictions is challenged.[406]

As in many other countries where the principles of financial sector supervision and judicial review are well-developed, bank supervision in France is recognized as a highly complex and specialized field. The *Conseil* thus gives the *Commission* wide latitude in performing its tasks in order to provide for an appropriate "margin of maneuver."[407]

There are three grounds for reversal of a decision of a specialized administrative jurisdiction in France: (1) incompetence, (2) violation of procedure (*vice de forme*) and (3) violation of law.[408] The first two grounds are essentially procedural, and are akin to the common law concept of *ultra vires*.[409] A fourth ground, exceeding of authority (*detournement de pouvoir*), is available against ordinary administrative agencies but not against a specialized jurisdiction, presumably because the French system considers it inconceivable that a "judicial" body would engage in such a practice.[410] The scenarios in which the *Conseil* can consider the substance of a Commission decision are discussed below.

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[403] Banque de France, Fact Sheet No. 132: The Commission Bancaire 4 (December 2004), *available at* http://www.banque-france.fr/gb/supervi/telechar/combanc061204.pdf. The Commission's administrative decisions, however (as distinguished from its judicial decisions), are subject to appeal in the lower administrative courts. *Id.* at 3.

[404] Bermann, *supra* note 373, at 216-17.

[405] *Id.*

[406] *Id.* at 218; BROWN & BELL, *supra* note 372, at 236.

[407] *See* Mads Andenas & Duncan Fairgrieve, *Misfeasance in Public Office, Governmental Liability and European Influences,* 51 INT'L & COMP. L.Q. 757, 769-70 (2002).

[408] BROWN & BELL, *supra* note 372, at 223, 235.

[409] *Id.* at 226-28.

[410] *Id.* at 235.

1) Violation of Law

This ground for annulment refers not only to the particular legislative provision in question, but also to violation of any legal provision that may be applicable. Thus, constitutional provisions as well as "general principles of law" developed by the legislature or the *Conseil* can provide the basis for annulment of an administrative action.[411] While this category may seem quite broad at first, the *Conseil*'s willingness to invalidate an administrative act on this basis is not nearly as sweeping as it may first appear.

This doctrine applies only where there is an affirmative obligation on the part of the government to act if certain facts are present (which the French call "*compétence liée*").[412] Professors Brown and Bell use the example in which an administrative department is obliged to issue a permit to operate a business establishment if there are less than a certain number of similar establishments in the same town. If an applicant is denied a permit, and the number of such establishments is below the prescribed minimum, the denial will be cancelled (assuming all other procedural requirements have been met). It is thus apparent that the "violation of law" category is only utilized where the facts are subject to clear objective verification, and despite the existence of those facts, the government takes action that it is forbidden to take (or declines to take action that it is required to take).

The more typical case, however, is where the public body has discretionary authority (*pouvoir discretionnaire*) to draw inferences from facts that it finds to exist and to take certain action if those facts are deemed to be present. In these cases, if an administrative court is to invalidate the government's action on substantive grounds, it will not be because of a "violation of law" but rather because of a "manifest error in the appreciation of facts."[413] This is a difficult ground for an applicant to establish.

2) "Manifest Error in the Appreciation of Facts"

It is not entirely clear whether "manifest error in the appreciation of facts" is a separate and distinct ground for review, or

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[411] *Id.* at 228-29.
[412] *Id.* at 229.
[413] *See* discussion *infra*.

a subfield of another category.[414] Plainly, however, it is not one of the traditional grounds for annulment of an administrative decision in France. It was referenced by the *Conseil* for the first time only in 1953 and was not actually used to nullify an administrative decision until 1962.[415] The *Conseil* developed it along with the increasing functions and authorities of public bodies in the years following World War II.

Regardless of how it is characterized, the manifest error test is invoked when the *Conseil* determines that the administrator was correct in its findings of "pure" fact but has nevertheless committed a "manifest error" in drawing conclusions from those facts (or, in other words, in applying the law to those facts). Closely resembling the "arbitrary or capricious" test under the Administrative Procedure Act in the United States, it is intended to be a "safety valve" used in extreme cases in which, theoretically, the administrator has absolute discretion but has acted in a clearly irrational or disproportionate manner.[416] When this occurs, the *Conseil* will annul the decision – but only if the error is indeed "manifest." The English or American analogy is that no reasonable administrator could have reached the given conclusion based on the given facts – in practice, a highly unlikely (though by no means impossible) scenario. In other words, the administrator has the flexibility to draw a wrong conclusion, and thus make a wrong decision, but the courts will not interfere unless it is a *manifestly* wrong decision.[417] Therefore, in France, a "manifest error" is sometimes found "when the administration, willingly or not, abuses the discretion vested in it, or exceeds the limits of reasonableness in the judgment that it makes on the basis of the information that is available."[418]

Manifest error appears to be reserved for highly specialized fields, and not surprisingly, it is seldom argued successfully. For the *Conseil* to set aside an administrative decision on this basis, the administrator's action must be more than distasteful – it must be

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[414] *See id.* at 223, 235 (noting the grounds for review, which do not include manifest error) and 249-50 (suggesting that manifest error could be considered an expansion of the "general principles of law" under the "violation of law" category). *But see* Hüpkes, LEGAL ASPECTS OF BANK INSOLVENCY, *supra* note 256, at 117 (suggesting that manifest error is a separate category).

[415] Bermann, *supra* note 373, at 237-38.

[416] BROWN & BELL, *supra* note 372, at 245-46.

[417] *Id.*

[418] Bermann, *supra* note 373, at 244.

almost egregious.[419] In the bank supervisory context, it is apparently such a demanding standard that few petitioners even bother to raise it. Only two cases involving *Commission* decisions under the Monetary and Financial Code even mention this doctrine, both of them arising from the same set of facts and decided on the same date in December 2002 (rejecting the petitioners' claims).[420] The principal reason, of course, is that invalidating a supervisory decision on the basis of "manifest error" necessarily entails an examination of the substantive content of the decision itself – and anything more than a minimal review would mean that the court would be crossing the line from determining *legalite* to determining *opportunite,* which is inappropriate.

Given the apparent propensity of former Soviet judges to substitute their own judgment for that of the bank supervisor, foreign advisors need to be rather cautious about recommending a "manifest error" test (or its American cousin, the "arbitrary or capricious" test) in transition economies. Still, some sort of check on arbitrary supervisory action is clearly necessary given the need for flexible legislative provisions that allow the bank supervisor to critically analyze facts and exercise judgment. The manifest error test has considerable potential for this purpose. Western advisors should therefore emphasize that the doctrine should only be used in the uncommon case where the supervisor's action is *clearly* beyond the pale of reason.

The *Conseil*'s published decisions (*arrêts)* are rather terse and uninformative documents; they satisfy the basic minimum legal requirements for publication of court decisions, but they do not discuss in detail the legal principles upon which they are based, nor do they closely analyze the facts in light of relevant legal provisions or analogous cases as an American or English court decision would. For elaboration of these matters, a French administrative lawyer must consult the conclusions of the *Commissionaire du Gouvernement,* to

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[419] *Id.* at 246. Interestingly, prior to the adoption of the APA in the United States, the Court of Customs and Patent Appeals, the predecessor to the Court of Appeals for the Federal Circuit, used a "manifest error" standard on factual issues, which the Supreme Court has characterized as even more deferential to administrative agencies than the "clearly erroneous" standard (now contained in Rule 52(a) of the Federal Rules of Civil Procedure) is to district courts, and appears to be an ancestor of the APA's substantial evidence test. *See* Dickinson v. Zurko, 527 U.S. 150 (1999). While the American and French uses of this terminology arise in somewhat different contexts, both indicate an extremely respectful attitude toward agency expertise.

[420] CE, Dec. 30, 2002, Rec. Lebon 490.

the extent that these materials are available.[421] An additional problem for American researchers who are not fortunate enough to be fluent in French is that most of the decisions are only available in French.

Nevertheless, the *Conseil's* high degree of deference to the *Commission* is clearly reflected in the statistics regarding challenges to decisions of the *Commission* under the Monetary and Financial Code. By this author's reckoning, since the Code became effective in 2000, twenty-four such petitions have been filed. Out of this number, the *Conseil* has annulled a *Commission* decision only once, in a July 30, 2003 decision involving the imposition of a reprimand under Article L.613-21, and this was due to a procedural error.[422] The statistics are similar for the period prior to the adoption of the Monetary and Financial Code when actions were taken under the Banking Act of 1984.[423] In twenty cases in which a petitioner requested the annulment of a *Commission* action, the *Conseil* annulled only five such actions, three of which came in a decision involving five petitions arising from the same set of *Commission* actions.[424]

The "manifest error" terminology has found its way into EU law. A good example can be found in Article 33 of the Treaty Establishing the European Coal and Steel Community ("ECSC Treaty") which governed review of decisions of the European Commission by the European Court of Justice. That article provided:

> .[T]he Court of Justice may not, however, examine the evaluation of the situation, resulting from

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[421] BROWN & BELL, *supra* note 372, at 110.

[422] CE, July 30, 2003, Rec. Lebon 352. In this case, the members of the Commission's general secretariat took their decision outside of the presence of representatives of the bank, depriving the bank of the opportunity to defend itself, which is contrary to normal procedures. The author's methodology consisted of running a search on "legifrance," the French legal website, http://www.legifrance.gouv.fr. The search entailed using the key words "commission bancaire" and "code monetaire et financier" within the "Conseil d'Etat" jurisdiction in the "Administratif" category. A similar technique was used to find decisions involving the 1984 Banking Act and that are available on the above website. Some *Conseil* decisions in this category entail consideration of multiple cases together.

[423] Law No. 84-46 of Jan. 24, 1984, J.O., Jan. 25, 1984, at 390, *translated at* http://www.banque-france.fr/gb/publications/telechar/autres_telechar/bankact.pdf.

[424] CE Sect., July 29, 1994, Rec. Lebon 394 (annulling *Commission* decisions of Jan. 26, Feb. 26 and June 15, 1990).

> economic facts or circumstances, in the light of which the Commission took its decisions or made its recommendations, save where the Commission is alleged to have misused its powers or to have manifestly failed to observe the provisions of this Treaty or any rule of law relating to its application.[425]

While the above language was included only in the ECSC Treaty, as a practical matter the European Court of Justice applies a similar approach when reviewing other actions of the European Commission under other EU treaties.[426] The Court has also used similar language specifically in the financial regulatory field, rejecting a challenge to the adoption of a directive on deposit insurance.[427] The European Central Bank (ECB) has various powers in the bank supervision field.[428] While there have not as yet been any cases involving challenges to the supervisory authority of the ECB, it can be expected that the Court will likely take a similar approach when such cases arise.[429]

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[425] Treaty Instituting the European Coal and Steel Community art. 33, Apr. 18, 1951, 261 U.N.T.S.140, as amended by Treaty of Nice, ¶15, 2001/C/ 80/ 01, 2001 O.J.., Mar. 10, 2001 (art. 4). The ECSC Treaty expired in 2002 and its key provisions were incorporated into the Treaty Establishing the European Community. *See From the ECSC Treaty to the Constitution*, *available at* http://europa.eu.int/scadplus/treaties/ecsc_en.htm.

[426] *See*, *e.g.*, Case 78/74, Deuka v. Einfuhr-und Vorratsstelle fur Getreide und Futtermittel, 1975 E.C.R. 421, 432; Case 57/72, Westzucker GmbH v. Einfuhr-und Vorratsstelle fur Zucker, 1973 E.C.R. 321, 340.

[427] Case C-233-94, Germany v. Parliament and Council, 1997 E.C.R. I-2405 at ¶¶ 54, 55 (noting that in the "economically complex" field of financial regulation, the Court cannot substitute its own assessment for that of the Community legislature absent a showing that the legislative choice was "manifestly incorrect" or "wholly disproportionate" to the advantages offered).

[428] Protocol to the Treaty Establishing the European Union, On the Statute of the European System of Central Banks and of the European Central Bank, 1992 No C 191/68, 1992 O.J. (July 29, 1992) art. 19 (giving the ECB the authority to establish minimum reserve requirements and to impose sanctions for violations) and art. 25(2) (giving the ECB the authority to perform specific supervisory tasks in accordance with decisions of the Council under Article 105(6) of the Treaty).

[429] *See generally* Päivi Leino, *The European Central Bank and Legitimacy: Is the ECB a Modification of or an Exception to the Principle of Democracy?* 12-13 (Harvard Jean Monnet Program, Working Paper 1/01, 2000), *available at* http://www.jeanmonnetprogram.org/papers/00/001101-02.html#P122_47674. It should be pointed out that there is another school of thought, mainly advanced by various human rights advocates, which holds that any final decision of a public

4. Cassation and Appellate Procedure

In most countries that have a cassation procedure, there is a clear distinction between this type of proceeding and a true "appeal." The processes are considerably different. However, this distinction is not well-understood in Kyrgyzstan.

Unlike the current legal regime in Kyrgyzstan, a given court normally performs either a "cassation" function or an "appellate" function, but not both. Which function the court performs reflects a policy choice as to whether the court should have the ability to consider factual issues or only legal and procedural ones, as well as whether the court should be able to revise the trial court's decision, merely confirm it, or quash it. The distinction has nothing to do with whether or not a given judicial act has become "effective," as is currently the case in the Kyrgyzstan legal regime.

The "cassation" terminology originated in France and is based on the French word "*casser*," which means to "quash" or "annul."[430] Cassation procedures, based to varying degrees on the

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authority should be subject to full review in the courts. This is the approach taken in Germany, where the administrative courts view themselves as guardians of fundamental rights, which is believed to be necessary to prevent the abuses of the Nazi era from recurring. *See* Georg Nolte, *General Principles of German and European Administrative Law – A Comparison in Historical Perspective*, 57 MOD. L. REV. 191, 205 (1994). According to this approach, there is only one correct interpretation of a legal provision, no matter how discretionary or indefinite it may be. It is the judge's job, not the administrator's, to provide that interpretation. *See id.* at 197; *see also* MAHENDRA P. SINGH, GERMAN ADMINISTRATIVE LAW IN A COMMON LAW PERSPECTIVE 176 (2d ed., Springer 2001). The ultimate question is not whether the administrative decision was reasonable, but whether it was right. *Id.* In addition, the court is not bound by the administrative record created by the public authority, but is free to accept new facts and other evidentiary materials. *Id.*at 134-35. While this approach may be understandable in some contexts, in this author's opinion full review is not practical in a field as specialized as bank supervision. Judges simply do not have the technical expertise to engage in full review of decisions of this kind. In highly specialized fields, such as financial sector supervision, limited review is more appropriate. *See* Hupkes, LEGAL ASPECTS OF BANK INSOLVENCY, *supra* note 256, at 120-21. In fact, even in Germany, there have been some indications in recent years that limited review is preferable in some areas. *See* SINGH, *supra* at 177-81; Nolte, *supra* at 197. And, as a practical matter, German courts generally try not to usurp the functions of public regulatory bodies. *See, e.g.*, Dieter Lorenz, *The Constitutional Supervision of the Administrative Agencies in the Federal Republic of Germany*, 53 S. CAL. L. REV. 543, 582 (1980); Ernst K. Pakuscher, *The Use of Discretion in German Law*, 44 U. CHI. L. REV. 94, 102-03 (1976).

[430] MERRYMAN, *supra* note 45, at 39.

French model, are now common throughout continental Europe. The cassation procedure is typically utilized by the highest level court, such as the Supreme Court (in fact, in France and some other countries, the highest court for civil and criminal matters is actually called the Court of Cassation). Appellate proceedings are carried out by intermediate-level courts, such as the oblast and equivalent courts in Kyrgyzstan.

The key distinction between an "appeal" and a "cassation" proceeding is that in an appeal, the appellate level court can examine both legal and factual issues. On appeal, the court determines whether the lower court correctly interpreted all the facts and whether there was sufficient evidence in the record for the lower court to have reached the factual and legal conclusions that it reached. If this judgment differs from that of the lower court, the first judgment ceases to have effect and is replaced by the new judgment.[431]

In cassation proceedings, by contrast, it is assumed that all the facts determined by the trial court are correct. It is therefore not possible to complain in a cassation proceeding that the trial court got the facts wrong or failed to consider certain relevant facts; the cassation court merely examines whether the lower court applied the law correctly and whether it complied with applicable procedural requirements.[432] If the Cassation Court concludes that there has been a mistake of law or that the required procedure was not followed, it annuls the decision and, in some instances, may also refer the case back to the lower court for reconsideration taking account of the Cassation Court's opinion.

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[431] In some countries, the appellant may attack any aspect of the first instance judgment with the effect of bringing the whole case to the appellate court, filing new claims and defenses, presenting fresh evidence to the appellate court, and seeking a new judgment dealing with the whole merits of the case. In other countries, an intermediate appeal is more limited. Here, although the appellant may obtain from the appellate court a new judgment on the merits of the case, as a rule he is not allowed either to file new claims and defenses or to present fresh evidence. The system of the "limited appeal" seems to be the most prevalent. The two models are based upon different conceptions of the function and purposes of the intermediate appeal. *See* Taruffo, *supra* note 45.

[432] *Id.*

IV. Conclusion: A Modest Reform Proposal

A transition economy, such as the Kyrgyz Republic, that wishes to implement a world-class bank supervisory regime must consider the impact of judicial review on decisions of the bank supervisor. Similarly, international development organizations that are providing assistance in financial sector supervision must factor in the possibility that the laws and regulations they are helping to draft may be reviewed by inexperienced judges and under legal standards of review that bear little resemblance to what the advisors are used to in the west.

This article has tried to point out the areas in which judicial review of decisions of the NBKR falls short of international standards. Clearly, much work remains to be done. As the *Kramds* and *Issyk-kul* cases in particular demonstrate, the Kyrgyz courts seem too willing to accept new facts that were not before the NBKR, even facts that materialize well after the NBKR's decision was taken. In these circumstances, "judicial review" is a mischaracterization – to even call this process an "appeal" is a stretch. The courts clearly are acting in a manner that goes well beyond the traditional judicial function (whether characterized in terms of an appeal or more circumscribed judicial review) because they are basing their decisions on facts that the NBKR had no opportunity to consider.

Moreover, the cases evidence a fundamental lack of understanding of the role and functions of a bank supervisor. By criticizing the NBKR for not cooperating with bank owners and managers in their recapitalization efforts (*Kramds*), or for its management of banks under provisional administration (*Issyk-kul*), the courts fail to perceive that the NBKR's task is not to prevent individual banks from failing but to protect the financial system as a whole and to minimize the impact on that system when banks do fail.[433]

Yet it would be a mistake to blame this situation entirely on incompetent or corrupt judges. While there is no denying that there are fundamental problems in the judiciary that must be addressed, there are issues that cannot be explained by some of the common criticisms. For one thing, an enormous problem is the lack of clarity in the underlying legislation, exemplified by the disharmony between

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[433] *See* BASEL COMMITTEE, CORE PRINCIPLES, *supra* note 245, at 9. BASEL COMMITTEE ON BANKING SUPERVISION, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (September 1997) at 9.

the Banking Law and the Bank Bankruptcy Law. A legal case involving the interaction of these two laws – as challenges to license revocation decisions invariably do – presents the judge with a legal puzzle reminiscent of Rubik's Cube. Trying to square this circle would be difficult even under judicial review principles as advanced as those in the American or French systems. Furthermore, the procedural legislation under which the courts operate is not well-suited to modern judicial review principles, especially in the financial supervision sphere. Yet, warts and all, it is the law that the courts are required to apply. No matter how well the underlying banking laws are written, or how many seminars are taught for judges on western administrative law techniques, the NBKR will keep encountering difficulties in court unless the procedural rules themselves change.

There are a number of steps that can be taken to upgrade the Kyrgyz approach to judicial review of NBKR decisions. Having expressed a desire to improve its financial sector supervisory regime, the Kyrgyz Republic has an opportunity to serve as a model for other countries in the former Soviet Union. As concerns judicial review of financial sector supervisory bodies, the government and international development organizations should seek to ensure that the following conditions are in place.

1) The legislative categories should be revised.

The Kyrgyz Republic should revamp its legislative scheme to more clearly reflect the distinction between private and public law, as befits its civil law heritage. Bank supervisory legislation should not be subservient to the Civil Code, or any other code written primarily to govern legal relations between private parties or to serve different purposes.

2) The "appeal" and "cassation" processes should be revamped.

Under the current legislation, the distinction between "appeals" and "cassation review" is a distinction without a difference. A one-month time deadline for submitting an appeal is meaningless if the party has six months to submit a petition for cassation review, particularly since ultimately there is no substantive difference between the two procedures. Only one procedure is

necessary for having decisions of first-instance courts or public authorities considered by an appellate court. The Kyrgyz Republic should consider adopting appellate and cassation procedures that are more in line with mainstream civil law jurisdictions. The distinction between judicial acts that have become effective and those that have not become effective should be abolished. Appellate courts should have the ability to consider judgments of the inter-rayon courts on issues of fact and law ("appellate procedure"), while the Supreme Court (following "cassation procedure") should review judgments of the appellate courts only to determine whether the court correctly applied the law and whether the proper legal procedure was followed. Alternatively, the Kyrgyz Republic may wish to adopt a "mixed" system whereby the Supreme Court could consider both legal and limited factual issues.[434] But in either case, appellate level courts should consider only the materials that the first-instance court or public authority considered (see point 7). In both appeal and cassation processes, the court's review should be based on the record of the NBKR.

3) Specialized administrative courts should be created.

The Kyrgyz Republic should adopt a special Law on Administrative Courts to create specialized courts to review decisions of public bodies such as the NBKR as set forth in the Supreme Court Concept Paper. Petitions for judicial review of decisions of the NBKR should be filed directly with an appellate-level administrative court or perhaps even directly with the Supreme Court (analogous to submission of appeals of enforcement cases directly to the *Conseil d'Etat* in France), rather than with a first-instance court.

4) A specialized cadre of administrative judges should staff the administrative courts.

These judges should receive rigorous specialized training in public administration (analogous to the French model) and, especially, in administrative law and governance principles. It would

[434] Taruffo, *supra* note 45.

also be helpful to train judges who are expected to consider banking cases specifically in banking and financial law matters.

5) There should be special time frames within which the administrative courts must consider petitions for review of NBKR decisions.

This is especially true in cases involving license revocation/bank resolution where decisions must be taken and actions instituted quickly. The absolute maximum term allowed to submit a petition for review in any court should be 30 days (and perhaps shorter in some cases). Under no circumstances should a bank or its shareholders have up to six months to submit a petition for review (as is now permitted for petitions for cassation review in the oblast or equivalent courts) or one year to appeal to the Supreme Court.

6) The Civil Code statute of limitations should not apply to challenges of decisions of the NBKR.

The three-year statute of limitations is problematic when applied to any supervisory action, but it can be positively disastrous in cases involving resolutions of failed banks where decisions must be made quickly and efficiently in order to maintain depositor confidence. Effective bank resolution often entails a fundamental restructuring of the bank, via a "purchase-and-assumption" transaction (in which a healthy bank purchases the good assets of the failed bank and assumes its deposit liabilities), merger of the failed bank with a healthy bank, or, if these kinds of solutions are not feasible, liquidation. These actions cannot be undone once a certain point is reached. Attempting to do so is tantamount to "unscrambling the eggs." The process simply cannot work effectively if there is a possibility that the NBKR's decision will be annulled months or years after the license revocation decision was taken, and the bank resolution process is well under way or even completed.

7) The reviewing court should consider only the materials that the NBKR

considered in making its decision (the "administrative record").

The reviewing court, whether a first-instance court or an appellate court, should only consider the facts that the NBKR considered. Additional material should not be introduced later during the court proceedings. While a reviewing court can have the ability to examine the facts in the record to determine whether the first-instance court or NBKR reached the correct factual determinations, it should not solicit or accept additional facts. If the reviewing court determines that the first-instance court or NBKR came to an erroneous factual conclusion based on the materials in the record, it should have the authority to annul the NBKR's decision (in a manner analogous to the "substantial evidence" test in the United States). If the reviewing court determines that evidence or witness testimony was erroneously excluded by the NBKR, it should remand the case to the NBKR for consideration of the excluded materials. The reviewing court should not, however, function as a first instance court, hearing new witness testimony and considering new facts. The Civil Procedural Code or analogous procedural legislation should reflect this.

8) The NBKR should adopt detailed procedural and evidentiary rules for use in arriving at final decisions.

The previous point, of course, requires that the NBKR have a complete and accurate record of the facts upon which it made its decision. The NBKR should therefore develop internal procedures for its own enforcement actions that resemble simplified judicial proceedings, analogous to the procedures used in the United States and France. This would facilitate the creation of an administrative record, which would serve as the basis for judicial review. The NBKR should set forth in writing its reasons for taking a given action and should articulate its reasoning in sufficient detail so that the court can discern a connection between the facts that the NBKR found and the decision that it made.

9) The standard for judicial review of decisions of public bodies such as the NBKR should be written into the law.

The standard should recognize the superior expertise of the public bodies within their regulatory sphere and should require courts to uphold the supervisory body's action unless that action was patently inconsistent with the applicable legal standard or the supervisory body did not follow the prescribed legal procedure. The supervisor's application of legal standards that involve the exercise of judgment and discretion should be followed if there is any reasonable basis for that application. This should apply even if the court disagrees with the substance or outcome of the decision, so long as the decision is reasonable given the language in the law. Questionable cases (*i.e.*, if there are two or more reasonable applications of a given legal standard or fact situation) should be decided in favor of the NBKR. A "manifest error" test or an "arbitrary or capricious" test would be helpful.

10) The Banking Law and the Bank Bankruptcy Law must be harmonized.

These laws need to be completely consistent with each other. As the *Ak-Bank* case demonstrates, the possibility of conflicting court decisions on the bank's appeal of the NBKR's license revocation decision and its petition to commence the bank resolution process is very real. A bank should be given a short period of time (preferably ten, but certainly no more than thirty days) to petition for judicial review of the NBKR's decision to revoke its license. Ideally, there should be only one judicial proceeding involving judicial review of the latter decision. If the court rejects the bank's petition, the bank resolution process could commence with the NBKR or an expert administrative body conducting it.[435]

If the courts must be involved in a decision to commence the bank resolution process (as opposed to merely considering the bank's petition for judicial review), the NBKR could petition the inter-rayon court to commence the substance of the bank resolution process once the judicial review proceeding was complete (assuming that the court

[435] Kyrgyzstan actually has a Debt Resolution Agency ("DEBRA") for this purpose, but as of yet it does not have sufficient resources to fully carry out its tasks. *See* World Bank FSAP Report, *supra* note 2, at 4.

rejects the bank's judicial review petition). In this situation, approval of the NBKR's petition by the inter-rayon court should be routine and automatic. The court should not have to independently determine the existence of facts upon which the bank resolution process can be undertaken; the revocation of the bank's license by the NBKR should provide the basis for this decision. The facts supporting that decision should be contained in the administrative record and should be the only material that the court considers. The only determination that the inter-rayon court should have to make is that the bank's license has indeed been revoked and that there are no appeals pending in the administrative courts. Clearly, the bank should not have the ability to present to the inter-rayon court the arguments that it unsuccessfully presented to the court in its petition for judicial review. The case is even stronger if the bank does not choose to seek judicial review of the NBKR's license revocation decision. In this scenario, the bank should not have the ability to "resurrect" in the bankruptcy proceeding the arguments that it could have pursued (but did not) when it had the opportunity to seek judicial review.

A cautionary note is necessary: while courts should apply a strong "presumption of correctness" and should accord great deference to supervisory expertise, it is also true that bank supervisors need to earn the right of judicial deference. Bank supervisors should not expect the courts to simply take their submissions on faith without an adequate explanation of the connection between the facts found and the decision made. There must be a solid administrative record that will provide a good "road map" for the court. In addition, the greater the degree of discretion given to the bank supervisor on substantive issues, the greater the need for procedural provisions to protect the rights of regulated persons. While the burden should be on the petitioner once a case reaches the court, the supervisory staff should have the initial burden of convincing the supervisory body's final decisionmaker that a given action is appropriate and legally defensible. Hence, the administrative record – which will contain such information – is of the utmost importance. It is also necessary that the supervisory staff possess the substantive knowledge and expertise to be able to analyze and evaluate basic facts, assess the risks to which a bank is exposed, and formulate an appropriate course of supervisory action.

As transition economies continue to progress and international development organizations consider how best to frame their next generation of assistance in the financial sector area, they

would do well to seriously consider focusing heavily on administrative law reform. Such an emphasis is essential to ensure that the central banks and bank supervisory authorities that the development organizations have worked so hard to help establish and train over the past decade can perform their tasks effectively in an increasingly complex and rapidly changing world.