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Eurozone Collective Action Clauses and Specialised Agencies of the United Nations as International Organisations: Do CACs Constitute an Expropriation under International Law?

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Abstract

In February 2012, Eurozone Member States signed a modified version of the Treaty Establishing the European Stability Mechanism (ESM).[1] This convention provides, inter alia, for the mandatory inclusion of standardised and identical CACs in all new Eurozone sovereign bonds from 1 January 2013. A sub-committee of the Economic and Financial Committee on EU Sovereign Debt Markets developed and published the terms of mandatory CACs on 26 March 2012 (the "Model CAC").[2] As a result, from 1 January 2013, Eurozone sovereign bond issuers will be obliged to include the Model CAC in bonds with a maturity greater than one year, irrespective of their governing law. The Model CAC will apply to both international and domestic issue. CACs in future Eurozone sovereigns are beyond the will of the issuing State. Can this excuse countries from obligations arising from instruments such as the Convention of the Specialised Agencies of 1947?

Keywords: collective action clauses, specialized agencies of the united nations, expropriation, international law, European stability mechanism, Eurozone sovereigns, Eurozone debt

1. Introduction

1.1 What Are Collective Action Clauses? - Some Basic Data

The idea behind Collective Action Clauses is to facilitate a sovereign's restructuring process in the context of a sovereign financial crisis and to enable a quick and orderly restructuring.[3]

Collective Action Clauses, hereinafter referred to as 'CACs' are contractual provisions included in the terms of bonds to

i. Limit a holdout when an issuer needs to make a proposal to bondholders to modify the terms of a bond ;
ii. Enable a smaller majority of bondholders to agree to modification; and
iii. Make modifications binding on all bondholders even where the smaller majority has agreed to the modification.

The two main provisions that may cause alarm are the lower threshold for a quorate meeting before a modification can be validly accepted, and the alternative for written resolutions rather than convening meetings for decisions on amendments.

Reserved matter modifications, which are also a major concern, i.e. a reduction in amounts payable on bonds, changes in the dates on which these are payable and the obligation to pay, may be approved by only 75% at a

[1] See http://www.european-council.europa.eu/home-page/highlights/european-stability-mechanism-treaty-signed. Accessed 10 October 2013.

[2] See http://europa.eu/efc/sub_committee/cac/cac_2012/index_en.htm. Accessed 10 October 2013.

[3] See http://europa.eu/efc/sub_committee/pdf/supplemental_explanatory_note_on_the_model_cac_-_26_march_2012.pdf. Accessed 10 October 2013.

quorum (66 2/3% of principle amount of bondholders) for a single series of bonds. Non reserved matters only require 50% by principle amount of bondholders.

A new feature of the CAC is the provision for cross series modification, which potentially lowers the voting thresholds needed from three-quarters to two-thirds for restructuring.

Another extremely important provision we find in CACs is disenfranchisement. This means that issuers that are also holders of the bonds, (any of its ministries, departments or agencies) will not be allowed to vote. The provision is designed to give comfort to investors that those that control the restructuring will not be voting for it and that only genuine investors will.

However, where the Euro is concerned, as this is not only a country's currency but the currency of many states and an international currency, considerations by bondholders may go beyond the single holding and look to the safety of the currency itself. So interests that go beyond investments are also at play – this may jeopardise the disenfranchisement provision.

It is important that we understand the implications of CACs as substantial terms may be amended by a majority even where a minority did not vote on them or where they voted against such amendments.

Furthermore and fundamentally we need to understand whether the decisions approved are binding or not on an international organisation in waiver of its privileges and immunities.

1.2 Retroactive CACs - The Case of Greece

While the ESM Treaty brings in CACs starting in 2013, any sovereign bond issued under local law may of course be amended by the sovereign to include retroactive CACs. Such was the case of Greece when it found itself in the heart of a sovereign financial crises. The Minister of Finance recommended and the Council accepted to pass an Act[4] in February 2012 for the "Commencement of the amendment procedure of eligible titles and definition of the exchange conditions" under which a procedure was established to amend eligible tiles held by bondholders of Greek bonds. Said procedure was framed in Law 4050/2012, the Greek Bondholder Act ("the Act"). The aim of the Act was to accept the consents received to amend the terms of all of its Greek law governed bonds including those not tendered for exchange. In other words the Greek government exercised the powers it granted itself under the Act[5] to activate a CAC on Greek bonds forcing holdouts to participate in the debt swap offer it launched.[6] It can legitimately be asked whether such a coerced sovereign debt restructuring could be interpreted as constituting a direct or indirect expropriation. A recent study of the validity of CACs from the international law perspective, [7] particularly in light of the European Convention on Human Rights (ECHR) and the possibilities of litigation over CACs before the European Court of Human Rights argues that a case could be made by holdout creditors for the engagement of the "peaceful enjoyment of possession", embedded in Article 1 of Protocol 1.[8] The ECHR would probably restrain the use of CACs to cases where a distressed Country needs to restructure its debt in order to avoid default, and would only allow haircuts to a proportional extent. This may prevent CACs to be used for "early restructurings". Was this the case of Greece? Nevertheless, specifying in the documentation that CACs can be triggered in situations other than default scenarios would probably enhance the chances for that "early restructuring" to be seen as Convention-compliant. This latter outcome depends on the extent to which the European Court of Human Rights would allow individuals to waive the protection granted by Article 1 Protocol 1.[9]

Much litigation is expected to ensue from the Greek restructuring which will probably materialize as this article is being published.

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[4] Act No. 5 dated 24 February 2012.Government Gazette A'37/24.02.2012 of the Hellenic Republic.

[5] No official translation is available. See unofficial translation at http://andreaskoutras.blogspot.it/2012/03/unofficial-translation-of-law-4050.html Accessed 10 October 2013.

[6] See http://blogs.reuters.com/felix-salmon/files/2012/03/Greek.Min-Fin-Press_Release_Feb.24-2012.pdf. Accessed 10 October 2013.

[7] See: Boudreau, 'Restructuring Sovereign Debt Under Local Law: Are Retrofit Collective Action Clauses Expropriatory?', 2 Harvard Business Law Review Online, 2 (2012), 164-186, Online: http://www.hblr.org/wp-content/uploads/2012/05/Boudreau_Retrofit-CAC.pdf Accessed 10 October 2013.

[8] Article 1 of Protocol 1 states that: "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

[9] Montiel, 'ECHR Litigation Over CACs: An Appraisal of Potential Obstacles Faced by the Contractual Approach to the Eurozone Debt Crisis' (April 23, 2012). Available at SSRN: http://ssrn.com/abstract=2046525 or http://dx.doi.org/10.2139/ssrn.2046525.

This paper will address only some of the many considerations deriving from the new provisions of the European Stability Mechanism (ESM). While Section 2 addresses sovereign debt restructuring in light of CACs under the Convention on the Privileges and Immunities of the Specialised Agencies and the principle of *ne impediatur officia*, Section 3 will analyse whether restructurings under CACs could be considered expropriation of assets in the case of a specialised agency of the United Nations.

2. Sovereign Debt Restructuring

2.1 The 1947 Convention on the Privileges and Immunities of the Specialised Agencies

Currently, there exists no formal legal framework establishing precise steps to be followed by a defaulting sovereign or its creditors in a debt restructuring plan. Nevertheless, it would seem that an informal regime has developed consisting of the following principles: "(i) sovereign to signal the need for debt restructure; (ii) communication between the sovereign and the creditors; (iii) consensus and consent on the terms of the restructure; and (iv) equitable burden sharing."[10] It would seem that an international organisation holding sovereign bonds on which a sovereign opens a tender process, would find itself in the same position as any other creditor. However, an international organisation is not motivated by the same intentions as the private creditor in a holdout. International organisations are mandated by the Member States they serve to accomplish the objectives for which they were established and should enjoy, to that end, a privileged creditor status. It is worth noting that the losses imposed on creditors in sovereign bond restructurings have frequently been very large. It is estimated that the average loss on sovereign bond restructurings since 1997 is 47.2%.[11]

Significant changes have been noted since the Eurozone sovereign debt crisis, forcing international organizations to countenance the same dilemma as private investors: whether to accept a haircut or hold out. The decision which international organizations need make to try and recover public funds they invest seems to be an even harder one where CACs apply. This is because CACs bind non-participating bondholders to minimize holdouts and may be used as a tool by sovereigns to exchange on terms which minority bondholders would not accept and which in extreme cases may include underrated exchanges. The latter would automatically imply the loss of public funds where international organisations are minority holders.

A first consideration that is derived from the above analysis would be that while bond-issuing countries are not bound to accord international organisations a preferred creditor status where CACs are introduced and where bonds are issued under domestic law, sovereigns members of the same organisations who have a debt with the organisation governed by international law would be required to honour the preferred creditor status.

The second consideration that arises is whether a retrofit CAC that has the effect of forcing an international organization to incur a loss on its investment is in conformity with the debtor State's conventional obligation not to interfere with the property of the organization concerned. As far as concerns the global multilateral financial institutions, one such conventional undertaking can be found in the 1947 *Convention on the Privileges and Immunities of the Specialized Agencies* ("*Specialized Agencies Convention*").

It is important to note that Section 1 (iv) of the *Specialized Agencies Convention* stipulates that "the words 'property and assets' shall also include property and funds administered by a specialized agency in furtherance of its constitutional functions".

Section 4 of the Convention states that the "specialized agencies, their property and assets, wherever located and by whomsoever held, shall enjoy immunity from every form of legal process except in so far as in any particular case they have expressly waived their immunity. It is, however, understood that no waiver of immunity shall extend to any measure of execution". More importantly, Section 5, second sentence, states that: "The property and assets of the specialized agencies, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation and any other form of interference, whether by executive, administrative, judicial or legislative action".

Whether a bond is governed by local law fully impacts the applicability of the Convention. When a bond is governed by local law, the issuing State can either change that law or pass a new law – as was the case with the Greek Bondholder's Act to unilaterally reschedule the bonds and avoid a holdout by accepting a majority bid. The impact of this is that the change is often recognised by foreign courts. As a result the bondholder is bound by a unilateral change since, presumably, if the bondholder contracts under the law of the issuing State, it must accept

[10] Rutsel Silvestre Martha, Manchester Journal of International Economic Law, Volume 10, Issue 1: 2-18, 2013.Volume 10, Issue 1: 2-18, 2013.

[11] Sturzenegger and Zettelmeyer, 'Haircuts: Estimating Investor Losses in Sovereign Debt Restructurings, 1998–2005', IMF Working Paper (2005). http://dx.doi.org/10.1016/j.jimonfin.2007.04.014 Accessed 10 October 2013.

any amendment to that law or any new law affecting the issuance. When a bond is governed by foreign law however, then a law of the debtor State cannot change the characteristics of the issuance. Hence, given that, at least in some organizations, decisions on the investment of assets is informed by the availability of a regime of privileges and immunities[12], several questions arise from the foregoing. They include, but are not limited to:

- Do claims arising from the holding of a government bond constitute a 'property" or 'asset' within the meaning of Section 1 (iv) of the Convention?
- If the answer to the foregoing question is in the affirmative, does a retrofit CAC introduced by legislation qualify as a 'legal process' within the meaning of Section 4 of the Convention?
- Separately, in so far as a retrofit CAC imposed by law can be construed as an expropriation or another form of interference with property and assets, it would follow from Section 5 of the Convention that the value of bonds held by specialized agencies cannot be affected by such an intervention.

The following sections will attempt to answer these questions as well as frame the environment within which international organisations operate.

2.2 The Principle of Ne Impediatur Officia

The questions raised above should be viewed in light of the intentions of Member States in the creation of such international organisations. As far back as during the drafting of the UN Charter, the Rappoteur of the Legal Committee IV/2 at the United Nations Conference on International Organisations held on 2 June 1945 defined the principle of *ne impediatur officia* as being the intention by members not to "hinder in any way the working of the Organisation or take measures the effect of which might increase its burdens, financial or other".[13] From a mere intention, the principle was then enshrined in the UN Charter, whereby Article 105 provides that each "Organisation shall enjoy in the territory of each of its Members such privileges and immunities as are necessary for the fulfillment of its purposes". To fulfill their purpose, their mandates being clearly defined in the constitution of each Specialised Agency, the organization may invest its funds, inter alia, in Eurozone Sovereign Bonds for the mere purpose of ensuring security and minimum returns on the funds its Member States have entrusted it with. In so doing the transfer of funds and its subsequent investment would be subject to the principle of *ne impediatur officia.* As far back as 1958, the General Assembly gave the International Law Commission (ILC) the mandate to consider the relationship between States and international organisations and in particular the status of their privileges and immunities.[14]

Among the numerous reports on the matter that the ILC published, the Fourth is of interest to us as it states, after much thorough review of the legal status and practice of international organisations, that: "international organisations should be authorized to hold and transfer funds and currencies, operate bank accounts in any currency and convert all currencies in their possession without being subjected to any form of financial control regulation or moratorium".[15] It seems that the understanding is therefore that interference with the value of a bond and the change of its fundamental terms, as would be allowed with the insertion of CACs, would fall under the ILC's definition and the principle of *ne impediatur.* Furthermore, although chronologically later, a separate opinion was presented to the 1999 ICJ Advisory Opinion of the *Difference Relating to Immunity from Legal Process of Special Rapporteur of the Commission on Human Rights* whereby Judge Rezek stated that sovereign states are under no obligation to found international organisations or to remain Members of them and that every State should, in its relation with the organization it has founded, "display an attitude at least as constructive as that which characterizes diplomatic relations between States".[16]

In light of the obligations that member states to an international organization undertake by signing the organisations' constituent documents, and additionally, following the principle of *ne impediatur officia,* those same member states should recognize the principles and immunities necessary for the exercise of the functions and the attainment of the organisations' objectives. In some cases where inconsistency derives, such as the case in question, where the operation of domestic laws – and European law - ignores these principles of international law, the organization may have to accept the consequences. Such is also the view of the International Bank for

[12] See: Interoffice memorandum to the Finance and Administration Department regarding permissibility of the investments of the Fund's resources in a non-Member State, 5 May 2010, UNJYB 2010, at 571.

[13] U.N.C.I.O., Report of the Rapporteur of Committee IV/2, Doc.933, IV/2/42, at 3.

[14] G.A.Res.1289 (XIII) of 5 December 1958.

[15] Fourth Report on relations between States and international organisations, document A/CN.4/424 and Corr.1, Yearbook of the ILC, 1989, vol. II91), §115.

[16] Difference Relating to Immunity from Legal Process of Special Rapporteur of the Commission on Human Rights, Advisory Opinion 1999 I.C.J. 62, pp.109-110.

Reconstruction and Development of the World Bank which recently presented its position in its yearly legal review.[17]

2.3 The Treaty Establishing the European Stability Mechanism – a Legal Exception?

Following the above considerations, it is interesting to delve into a specific issue which arises in relation to the European Stability Mechanism (ESM). Like the IMF, the ESM provides financial assistance to an ESM Member when its regular access to market financing is impaired. Reflecting this, at the Euro Summit of 29th June 2012, EU Heads of State stated that the ESM will enjoy preferred creditor status in a similar fashion to the IMF, although they accepted the preferred creditor status of the IMF over the ESM. The new status would become effective as of 1 July 2013[18]. It would seem therefore that the mandatory CACs starting 1 January 2013 will not affect claims of either the ESM or the IMF. The latter rationale would mean that other multilateral creditors would be excluded from exercising their preferred creditor status, when their function is also to overcome the international capital market imperfections encountered by their borrowing member States. [19]

The preferred creditor status is not only based on specific contractual provisions in the relevant loan or financing agreements, or for that matter customary international law[20], but on the status of these institutions as well as their special relationship to their Member States. One policy reason that underpins their preferred creditor status includes the fact that these institutions make loans in circumstances under which other lenders would not participate. Another such reason is that a reduction in the value of the debt to such institutions affects all members, including the Debtor State. In case of the leveraged multilateral financial institutions, there is the additional element that the preferred creditor status is critical for the credit rating needed in order for them to raise capital at affordable costs to fund their development lending.[21]

It is probably correct to state that in principle the provision in the ESM cannot have the effect of denying seniority to claims of other multilateral institutions. It is recalled in this regard that the relationship between third parties and treaties is defined by a general formula *pacta tertiis nec nocent nec prosunt.* This means that for States and international organizations non-parties to the treaty, the treaty is *res inter alios acta.* It has been reflected in numerous cases before the PCIJ. For example, in the *German Interests in Polish Upper Silesia Case,* the PCIJ observed that: "[a] treaty only creates law as be- tween States which are parties to it; in case of doubt, no rights can be deduced from it in favour of third States."[22] It follows that whatever the Eurozone parties might have agreed with respect to the seniority of ESM and IMF claims on their own claims and that of the private creditors that are subject to their jurisdiction, that cannot affect the position of other multilateral organizations nor require the latter to recognize such seniority.[23]

It might nevertheless be necessary to assess whether passiveness on the side of the other multilateral (financial) institutions may render the TESM provision of the seniority of claims of the ESM and the IMF opposable. This question is prompted by the award in the case concerning the *Preferential Treatment of Claims of Blockading Powers Against Venezuela* ("*Preferential Treatment Case*").[24] Some background on this case is useful to frame the concept of seniority of claim. Upon failure of attempts to settle by diplomatic negotiations a controversy over certain pecuniary claims of British, German, and Italian nationals against Venezuela, the British, German, and Italian Governments in 1902 declared a blockade of Venezuelan ports. The United States, Mexico, Spain, France, Belgium, the Netherlands, Sweden, and Norway also held claims against Venezuela, but these governments did

[17] The World Bank Legal Review Volume 3: International Financial Institutions and Global Legal Governance, 2012, International Bank for Reconstruction and Development.

[18] See http://www.european-council.europa.eu/council-meetings?meeting=a6ae92be-5500-4646-bcfb-c1ddb27f3036&lang=en&type=EuropeanCouncil. Accessed 10 October 2013.

[19] Yilmaz Akyüz, 'Rectifying Capital Market Imperfections -The Continuing Rationales for Multilateral Lending', Inge Kaul and Pedro Conceição (Eds.), 'The New Public Finance: Responding to Global Challenges' (Oxford, Oxford University Press, 2006), 486.

[20] Martha, 'Preferred Creditor Status under International Law: The Case of the International Monetary Fund', 39 Int'l & Comp. L.Q. 801 (1990). http://dx.doi.org/10.1093/iclqaj/39.4.801 Accessed on 10 October 2013.

[21] Morrais, 'Legal Framework for dealing with Sovereign Debt Problems', R Effort (Ed.), Current Legal Problems affecting Central Banks (IMF, 1998), 317-337, at 318.

[22] *Case Concerning certain German Interest in Polish Upper Silesia,* PCIJ Ser. A, No.7, 28; see also *Case Concerning the Factory at* Chorzow, PCIJ Ser. A, No. 17, 45 and *Customs Regime between Germany and Austria*, PCIJ Advisory Opinion No.20, 5 September 1931.

[23] Not to say the least on the question of the Eurozone members obligation pursuant to article 103 of the UN Charter to give preference to dues to the UN ex Article 17 of the Charter, irrespective of any provision of the TESM. Cf *Question of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Yamahriya v United Kingdom*), Provisional Measures, Order of 14 April 1992, ICJ Reports, 15.

[24] *Germany, Italy, and United Kingdom v. Venezuela, (1904) 9 UNRIAA 103.*

not resort to forcible measures to secure the settlement of their claims. Venezuela consented to put aside 30 per cent of the revenues of the customs of La Guayra and Puerto Cabello ports for the payment of the claims of all nations against Venezuela, the three above-named Powers have a right to preference in the payment of their claims by means of these 30 per cent of the customs receipts of these two ports. But the three blockading States maintained that their claims should be given priority of payment over the claims of the other, neutral, States. The question was submitted to arbitration, which held that, since Venezuela had in various ways acknowledged a distinction between the three blockading States and the neutral States, and since neither Venezuela nor the neutral States had protested against the pretensions of the blockading States to preferential treatment, and since the neutral States could not acquire new rights from the war-like operations in which they had not taken part, although their existing rights remained intact, Germany, Italy, and the United Kingdom had a right to preferential treatment for the payment of their claims against Venezuela.

Could we infer, therefore, from the Preferential Treatment Case that if international organisations, or in this more specific case, Specialised Agencies of the UN remain silent with regards to the infringement by CACs of their privileges and immunities as granted to them by those Eurozone Member States that are also Members of their organisation, then their rights will be overridden?

2.4 The Distinctive Nature of Investments of International Organizations

One view is that when international organizations invest in debt instruments they accept the conditions attached to them and cannot rely on their status or the nature of their resources to claim a special treatment. Obviously, that would include measures such as mandatory CACs. For instance, a decision rendered by the *Tribunal de Commerce de Paris* on 23 July 1991, stands for the view that in so far as international organizations partake in the market and perform activities common to private sector market operators, they cannot claim immunity or special treatment. This view is premised on the assumption that international organizations' activities in the capital market are fully discretionary.

The case concerned the bankruptcy proceedings regarding the Paris branch of BCCI, in which the question had to be addressed whether the position of an international development bank, namely the African Development Bank (AfDB) requires it to be placed outside insolvency proceedings in the sense that its claims ought to be paid out, separate and irrespective of the bankruptcy proceedings. The court rejected the argument relying on the nature of the assets involved as "international public funds", noting that the fact that these were funds awaiting public financing transactions to be concluded by AfDB with its members was irrelevant. It considered that by using a private channel to maximize returns, AfDB accepted the credit risk of the counterparty. [25]It is also recalled that a previous decision of the *Cour d'Appel de Paris* regarding the International Bank for Reconstruction and Development's (World Bank) claim in the bankruptcy proceedings of the Société Générale d'Entreprises Électromécaniques, held that the World Bank is a profit seeking entity whose lending operations are to be qualified as commercial for the purposes of the French Commercial Code, and that accordingly it could not claim any special treatment.[26]

If the position reflected in these two decisions is representative of the state of international law in matters of the investments of international organizations, then the outlook for those institutions is not positive. This view ignores the fact that, unlike other foreign participants in the market, in order to execute their mandates and administer their resources, international organizations—both legally and factually—cannot avoid operating in domestic markets. As Judge Ago wrote in his opinion in the *WHO/Egypt* case, an international organization is, like a state, a subject of international law, but one that enjoys limited international legal capacity and, unlike a state, a subject of law that lacks territorial basis. An international organization's "establishment" in the territory of a given state is therefore a *conditio sine qua non* of its functioning as an organization, carrying on its activities and fulfilling its objectives and purposes.[27] Both cases however concern international organizations and not sovereigns.

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[25] M Vasseur, *La Banque Africaine de Développement, organisation internationale bénéficiant de privilèges et immunités, peut-elle obtenir de distraire ses fonds du redressement judiciaire de la banque dépositaire?* Recueil Dalloz – 1992, 353.

[26] *Banque Mondiale [B.I.R.D.] c. S.A. Société Générale d'Entreprises Électromécaniques « S.G.E.E. »*, Paris, 1re Ch. A, 6 novembre 1990.

[27] *Interpretation of the Agreement of 25 March 1951 between the World Health Organization and Egypt, Advisory Op*., 1980 I.C.J. 73, 155 (Separate Opinion, Judge Ago). Cf. Felice Morgenstern*, Legal Problems of International Organizations* (Cambridge U. Press 1986). 1. According to Special Rapporteur Díaz González, this fact provides the rationale for the unrestricted immunity accorded to international organizations:"Being unable to enjoy the protection conferred by territorial sovereignty, as States can, international organizations have as their sole protection the immunities granted to them. The ample immunity afforded them is fully justified, in contrast to the increasingly restricted immunity of States, for the good reason that States are political entities pursuing their own interests while international organizations are service agencies operating on behalf of all their member States." Leonardo Díaz-González, special rapporteur, Fourth Report on Relations Between States and International Organizations (Second Part of the Topic), Y.B. Intl. L. Commn. vol. II (part 1) 153, 158

In this respect, the outlook for international organizations would be more promising if the view adopted by the Hague Tribunal in the *Bank for International Settlements (BIS) Shares Repurchase Case* were to be followed. In response to the argument that the BIS should be subject to the same rules that apply to commercial enterprises because it is a profit seeking entity and engage in the activities as commercial actors, the tribunal held as follows:

"Nor is First Eagle correct in stating that because the Bank performs some commercial activities common to private sector banks, it cannot be an international organization. Any international organization may have to engage in some private sector activities in pursuit of its public functions and does not automatically and *pro tanto* lose its public international legal character because of them. The fact that international organizations use many of the same accounting techniques as private entities tells us nothing, for these are methods for control and efficiency which are required, in one form or another, in any large scale collaboration. Nor is the Bank the only international organization that shows a profit. But even if the Bank were singular in this regard, or its profits far exceeded those of other international organizations, First Eagle itself acknowledges that there is a difference between a profitmaking and a profit-maximizing entity….The issue was not that the Bank might make profits, the possibility of which was taken for granted. It was the purpose for which the Bank was created, to which such profits had to be applied."[28]

It could be argued that the view held by the Hague Tribunal would imply that when implementing the provisions of the ESM, issuing Member States will have to recognize that due to their status and the nature of their operations, international organizations, cannot be required to accept losses that may result from the operation of a mandatory CAC.

3. Are Restructurings under CACs an Expropriation of the Assets of a Specialised Agency?

3.1 The Question of Expropriation

The question as to whether a sovereign restructuring constitutes an expropriation of assets has been at the centre of debate among scholars for some time now and what is certain and has been for a very long time indeed is that expropriation is the interference of a State with the property and the rights to property which by its actions it renders so useless that it will be deemed to have expropriated them.[29] In both Norway v. United States and the German Interests in Polish Upper Silesia cases the Courts found that even where there is no intention by the State to expropriate, if the property is rendered useless then there has been a de facto expropriation.

The use of force is another indication of expropriation. If there has been a transfer or forced sale made under threat of an expropriation then the expropriation is forced. There may be a number of ways that a State may interfere in the use and enjoyment of property. Even where a State is prepared to pay a price for the property in financial terms (but the price is equivalent to only a fraction of the market price for the property) , the State's interference will be tantamount to expropriation.[30]

What does the loss need to be for it to be considered expropriation? A total loss would of course violate international law but the law is unclear. Even where a court determines that the sovereign action had created a loss – valuation of that loss would still be a problem. See the case of Greece for example. The fact that Greek bonds were reduced to junk would not help an evaluation of the loss in the positive for any investor. The Court in *Banco Nacional de Cuba v. Chase Manhattan Bank*,[31] offers the following explanation: "There is, of course, authority, in international judicial[32] and arbitral[33] decisions, in the expressions of national governments,[34] and among

(1989).

[28] *BIS-Partial Award on the lawfulness of the recall of the privately held shares on 8 January 2001 and the applicable standards for valuation of those shares,* (22 November 2002), XXIII RIAA, 183-251, at 216, para. 117.

[29] *Norway v. United States*, The Hague Court Reports (2nd series), United Nations Arbitration Reports, I (1922), p.307 and German Interests in Polish Upper Silesia, Judgment No.7 P.C.I.J, Series A, No.7; Hudson, World Court Reports, I (25 May 1926), pp.510, 541 (merits).

[30] Professor G.C. Christie, 'What Constitutes a taking of Property under International Law', American Journal of International Law, 55 (1961), pp.558-9.

[31] 658 f.2d 875, 893 (2d Cir.1981).

[32] See *Oscar Chinn Case*, P.C.I.J., ser. A/B, No. 63 at 87 (1934); *Chorzow Factory Case*, P.C.I.J., ser. A., No. 17 at 46, 47 (1928).

[33] See, e.g., *Norway v. United States* (1922) PCA, 1 U.N.Rep.Int'l Arb.Awards 307, 334, 339 (1948), Hague Court Reports, 2d Series, 39, 69, 74 (1932); *Marguerite de Joly de Sabla, American and Panamanian General Claims Arbitration* 379, 447, 6 U.N.Rep.Int'l Arb.Awards 358, 366 (1955).

[34] See, e.g., Dispatch from Lord Palmerston to British Envoy at Athens, Aug. 7, 1846, 39 British and Foreign State Papers 1849-1850, 431-432. Note from Secretary of State Hull to Mexican Ambassador, July 21, 1938, V Foreign Relations of the United States 674 (1938); Note to the Cuban Government, July 16, 1960, 43 Dept. State Bull 171 (1960).

commentators[35] for the view that a taking is improper under international law if it is not for a public purpose, is discriminatory, or is without provision for prompt, adequate, and effective compensation."

So where there is lack of physical force, equal treatment of nationals and foreign nationals and where the status of the bonds has become junk (Greece) it is difficult to see how the courts would sway towards the investor. Greece's final defence would be compelling public need for action in light of a financial crisis. And that would justify an expropriation.

Some tribunals have recognized that an attempt to mitigate a financial crisis serves an important public purpose and is a qualifying affirmative defence.[36] In West v. Multibanco Comermex S.A. the tribunal found that although Mexico's exchange control regulations resulted in expropriation there was a strong public purpose which rendered its actions lawful.

International tribunals have also found that where extraordinary returns were associated with high risks, investors would be responsible for taking that higher risk in exchange for an extraordinarily high return.[37] Returning to the Greek example, Greek bonds governed by local law had higher returns than Greek bonds governed by UK law. The prices therefore indicated the cost that investors were willing to pay for holdout protections.

3.2 Sovereign Debtors and Sovereign Immunity

Traditionally, sovereign debtors have invoked sovereign immunity to protect them from being sued in foreign jurisdictions without their consent, a custom which derives from the Sovereign Equality Principle under International Law.[38] The interpretation of sovereign immunity has however undergone a strict test with national frameworks limiting its use and denying sovereign's immunity in particular with regard to commercial activities.[39] The test therefore should move to determining, in the context of our current analysis, whether issuance of sovereign debt constitutes a commercial activity and in so far as the US is concerned as well as other major jurisdictions, it seems that regardless of the type of issuance, international bonds and any subsequent default will be considered a commercial activity.[40]

What will be harder to attain will be attachment of a Sovereign's assets given the limited enforcement rights that creditors have due to the legal principles of sovereign immunity, the act of state doctrine and the principle of international comity (reciprocity).

What may help sovereigns is the fact that central banks may be immune from attachment although this is still not entirely uniform across Europe.[41] A common way for central banks to protect their assets has also been to place them with the Bank for International Settlements in Switzerland, outside the reach of other courts. A successful story in such an environment came with the famous victory of Elliott.[42] Here Elliott obtained an attachment order to attach Peruvian assets and bar Peru from paying interest on Brady bonds.

Later, in 2004, extensive litigation ensued following Argentina's default and both individual and class actions were successful against the sovereign, resulting in judgements in favour of the creditors although attachment proved more difficult for the plaintiffs. It is nevertheless a more complex issue than a pure sovereign default ; the case concerns a claim brought by plaintiffs – creditors to Argentina - for breach of the Equal Treatment provision in bonds held in the 2005 and 2010 restructurings of the sovereign's debt.[43] The court found that:

i. Argentina subordinated its defaulted bonds in violation of its obligations as payor under the equal-treatment provision of bond agreement's pari passu clause;
ii. The doctrine of laches did not bar defaulted bondholders' claims;

[35] See, e.g., McNair, 'The Seizure of Property and Enterprises in Indonesia', 6 Netherlands Int'l L.Rev. 218, 243-253 (1959); 'Restatement, Foreign Relations Law of the United States' (Proposed Official Draft 1962), §§ 190-195.

[36] *West v. Multibanco Comermex S.A*. 807 F.2d 820 (9th Cir. 1987).

[37] *Emilio Agustin Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7.

[38] See the GA Resolution 1883rd plenary meeting, 24 October 1970.

[39] Such is the case of the United States for example where the Foreign Sovereign Immunities Act (FSIA) of 1976 allows private parties to sue a foreign government in US courts if the complaint concerns a commercial activity. Likewise, the United Kingdom passed similar legislation with the State Immunity Act of 1978.

[40] See *Republic of Argentina v. Weltover.Inc* 504 U.S. 607 (1992).

[41] Panizza et al., 'The Economics and Law of Sovereign Debt and Default', Journal of Economic Literature 2009, 47:3, 651-698. http://dx.doi.org/10.1257/jel.47.3.651 Accessed 10 October 2013.

[42] *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.3d 363, 381 (2d Cir. 1999).

[43] *NML Capital, Ltd. v. Republic of Argentina,* 699 F.3d 246 (2012).

iii. The bond agreement's explicit provision for remedy of acceleration did not preclude a permanent injunction requiring specific performance;
iv. Monetary damages were an ineffective remedy for Argentina's breach;
v. The permanent injunction did not violate Foreign Sovereign Immunities Act's (FSIA's) prohibition against attachment, arrest, and execution of foreign state's property in United States;
vi. the district court acted within its discretion in determining that the balance of equities and the public interest tilted in favour of a permanent injunction; but
vii. remand was required to permit the district court to address application of the injunction to third parties and to address the operation of payment formula.

The court will conduct proceedings to address the payment formula, pursuant to United States v. Jacobson[44] and consider the merits of the remedy without need for a new notice of appeal.

It is particularly interesting to note that the findings included in paragraph (v) above, i.e. the findings do not violate the sovereign's immunity from attachment, and secondly the court found that the case was not relevant to other sovereign issuers because:

"In any event, it is highly unlikely that in the future sovereigns will find themselves in Argentina's predicament. Collective action clauses—which effectively eliminate the possibility of "holdout" litigation—have been included in 99% of the aggregate value of New York-law bonds issued since January 2005, including Argentina's 2005 and 2010 Exchange Bonds. Only 5 of 211 issuances under New York law during that period did not include collective action clauses, and all of those issuances came from a single nation, Jamaica. Moreover, none of the bonds issued by Greece, Portugal, or Spain—nations identified by Argentina as the next in line for restructuring—are governed by New York law." [45]

For the purposes of this paper it is furthermore of relevance to note that the Court in NML Capital, Ltd. V. Republic of Argentina stated that "…when sovereigns default they do not enter bankruptcy proceedings where the legal rank of debt determines the order in which creditors will be paid. Instead, sovereigns can choose for themselves the order in which creditors will be paid."[46] This is the difference between corporate and sovereign debt which unfortunately means there is no legal mechanism to enforce payment of sovereign debt as opposed to corporate debt and will mean that until there is, any request for payment will have to undergo a litigation process, which is unfortunate.

3.3 Sovereign Debt Mechanisms

It is the opinion of the International Monetary Fund (IMF) however that the overall number of cases against sovereign defaults and restructurings is still small. In fact, between 1980 and 2010, only 109 cases were filed against debtor governments in connection to defaults on bonds or loans.[47]

There have been many proposals and criticisms by academics and practitioners since the nineties with regard to a sovereign debt restructuring mechanism.[48] The most straight forward approach, and this is also the author's view, is a contractual approach which would only require alteration of the bond contracts to regulate the restructuring process more efficiently. This seems to have also been the view of the sub-committee of the Economic and Financial Committee on EU Sovereign Debt Markets when placing CACs as mandatory from 1 January 2013 in all Eurobonds. The EU proposal does not seem to be complete though with dispute resolution and trustee representatives for bondholders still not being mandatory.

Although there have been many proposals since as early as the eighties, the sovereign debt restructuring mechanism of the IMF (SDRM)[49] still seems to be the most well-known and provides clear indications for reform which, to date, have not been implemented. Together with the SDRM some very valid proposals have been put forward amongst which mention should be made of Bruegel's European Crisis Resolution Mechanism, [50] The

[44] 15 F.3d 19, 22 (2d Cir.1994).

[45] See Supra §39, p.11.

[46] See Supra §43.

[47] IMF Working Paper, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts*, WP/12/203, p. 51.

[48] Krueger, '*A New Approach to Sovereign Debt Restructuring*', International Monetary Fund. Available at http://ww.imf.org/external/pubs/ft/exrp/sdrm/eng/index.htm, Rieffel, Lex. 2003. '*Restructuring Sovereign Debt: The Case for Ad Hoc Machinery'* , Washington, DC: Brookings Institution Press. Accessed 10 October 2013.

[49] See http://www.imf.org/external/np/exr/facts/sdrm.htm. Accessed 10 October 2013.

[50] See http://www.bruegel.org/publications/publication-detail/publication/446-a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/. Accessed 10 October 2013.

Sovereign Debt Tribunal, [51] and a Fair and Transparent Arbitration Process.[52] For the purpose of demonstrating that there may be a viable and efficient way to address default and restructuring processes and for the purpose of this paper, only the SDRM will be detailed further as most systems have commonalities concerning the main features and are therefore all valid proposals.

The SDRM, as well as all the above mentioned systems, is characterised by the need to set up a statutory framework which includes an arbitration body to which approval powers are given for a government's restructuring plan as well as debt dispute and resolution powers. Creditor Committees are also foreseen whereby Creditors may be represented and negotiate with the debtor rejecting or accepting a restructuring plan. Financially, the system would be backed up by the IMF who is also the leading body which assesses debt sustainability and the scope of debt relief and could therefore bring in its expertise at this level. The IMF would select the membership of the arbitration body from among international organizations and professional associations. Enactment of the system would inevitably require an amendment of the IMF's Articles of Agreement but once approved, all members would be bound by its provisions. The mechanism would be activated by debtor countries that would have to prove why the debt is unsustainable and why they plan to restructure and would bear all costs associated to Creditor Committees. Voting rules would be as with CACs with the exception that interim financing would be available via IMF facilities and aggregation would occur across all creditor claims unlike CACs where restructuring must take place for each bond.

As mentioned above, it does not seem that the SDRM is on the agenda of IMF members nor is there any indication of resuming talks on the latter. Following publication of the SDRM however, the G7, G20, The World Bank and the IMF supported the Institute of International Finance's "Principles for Stable Capital Flows and Fair Debt Restructuring" the main aim of which is to establish best international practice for both debtors and creditors for a restructuring and crisis resolution process.[53] The Principles were conceived for the emerging market but it was later agreed that they should be used by all sovereign issuers on a voluntary basis.[54] The main pillars supporting the Principles are:

i. Transparency and the timely flow of information;
ii. Close debtor –creditor dialogue and cooperation;
iii. Good faith actions; and
iv. Fair treatment.[55]

4. Conclusion

The analysis provided thus far is evidence of a considerable concern with regards to the mechanism imposed on Eurozone Member States for the inclusion of CACs starting 1 January 2013 and the conflicting provisions of both the 1947 Convention and the principle of *ne impediatur officia* versus international law relating to the protection of assets of international organisations.

The new mechanism questions the recognition that the European Union makes of the status of international organisations provided for in its basic legal documents.

Specifically, Article 21 of the Consolidated Version of The Treaty on European Union[56] provides that:

"The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy , the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity , the principles of equality and solidarity , and respect for the principles of the United Nations Charter and international law.

[51] Christoph G. Paulus and Steven T. Kargman, "Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal", Prepared for Presentation to the United Nations Workshop on "Debt, Finance and Emerging Issues in Financial Integration", April 8-9, 2008 United Nations Headquarters, New York.

[52] http://probeinternational.org/library/wp-content/uploads/2011/02/FTAP_english.pdf. Accessed 10 October 2013.

[53] IIF 2006. 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets: Report on Implementation by the Principles Consultative Group'. Institute of International Finance, Washington, DC.

[54] IIF 2010. 'Principles for Stable Capital Flows and Fair Debt Restructuring: Report on Implementation by the Principles Consultative Group'. Institute of International Finance, Washington, DC.

[55] IMF Working Paper, '*Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts'*, WP/12/203, p. 93-95.

[56] Official Journal of the European Union C115/13, 9.5.2008.

The Union shall seek to develop relations and build partnerships with third countries, and international, regional or global organisations which share the principles referred to in the first subparagraph. It shall promote multilateral solutions to common problems, in particular in the framework of the United Nations. ”

The above Article clearly implies respect by the European Union of its obligations taken under international law and moreover the respect of the obligations undertaken by its members under international law. In practice this means that its member states, also members of international organisations and or members of the United Nations and its specialized agencies, would encounter a serious conflict of law being imposed on them by the European Union when forced to apply CACs and forfeit the rights of the organisations to which they belong.

Moreover, Title VI of the Treaty of Lisbon, Article 188P provides that:

“The Union shall establish all appropriate forms of cooperation with the organs of the United Nations and its specialised agencies, the Council of Europe, the Organisation for Security and Cooperation in Europe and the Organisation for Economic Cooperation and Development.”

The above mentioned provisions are clear in as much as they advocate the ‘strict observance and the development of international law, including respect for the principles of the United Nations Charter’[57] and the establishment of ‘all appropriate forms of cooperation with the organs of the United Nations and its specialised agencies’[58] but do these principles fit with the provisions of the model CAC? It seems a question is still left unanswered: do restructurings under CACs which affect holdings of international organisations that benefit from the above analysed regimes constitute an expropriation under international law?

The analysis provided shows that notwithstanding the unclear environment within which CACs have been imposed on Eurozone Member States, there is sufficient evidence that this mechanism conflicts with general principles of international law, the law of treaties and the principles and mandate of the European Union as laid out in its basic legal documents.

It is the author’s view that the imposition of CACs on specialised agencies of the United Nations as international organisations would be tantamount to an expropriation under international law. It is also noted that a sovereign debt restructuring mechanism, which is long overdue and much needed, would benefit the international community at large although it would need to reconcile the interest of regional and international players under the framework and guidance of the general principles of international law.

[57] Art. 3(5) TEU.

[58] Art. 220 TFEU.