

Fordham Journal of Corporate & Financial Law

Volume 18, Number 3

2013

Article 5

A Legal Analysis Of The Euro Zone Crisis

Dr. Christian Hofmann*

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Dr. Christian Hofmann

Abstract

While the sovereign debt crisis of the Euro zone raises numerous economic issues that are broadly discussed in public, it also involves a large number of legal questions that are, in contrast, rarely talked about. This is surprising, as the relevant legal implications may predetermine the outcome of the economic discussions by precluding certain options. The seventeen member states of the Euro zone and the European Central Bank are struggling to stabilize the financial situation of the currency union's highly indebted members. Legal challenges result from the fact that the Euro zone is not identical to the European Union, which is comprised of ten more members than the Euro zone. Additionally, Euro zone members do not constitute an institution with legal competencies that would enable them to enforce emergency measures, as is the case with the European Union. Instead, the Euro zone's only modus operandi is intergovernmental cooperation. However, the European Union's legal framework draws limits on cooperation that could conflict with the rescue funds established by Euro zone members. Furthermore, the European Central Bank has gradually become the main provider of emergency assistance to indebted countries. It has enacted a number of non-standard measures whose volume has constantly been growing. Thus, the increasingly drastic nature of the European Central Bank's actions raises the question of whether these emergency measures infringe upon the Bank's own mandate. Finally, the restructuring of Greek sovereign debt in early 2012 has raised a number of legal issues. The focus of this analysis will be the legal challenges posed by retroactive Collective Action Clauses, in particular those presented by the Bilateral Investment Treaties that Greece has previously signed

KEYWORDS: Debt, Banking, Euro zone, Investing

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VOLUME XVIII

2013

NUMBER 3



FORDHAM

JOURNAL OF
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ABSTRACT

While the sovereign debt crisis of the Euro zone raises numerous economic issues that are broadly discussed in public, it also involves a large number of legal questions that are, in contrast, rarely talked about. This is surprising, as the relevant legal implications may predetermine the outcome of the economic discussions by precluding certain options. The seventeen member states of the Euro zone and the European Central Bank are struggling to stabilize the financial situation of the currency union's highly indebted members. Legal challenges result from the fact that the Euro zone is not identical to the European Union, which is comprised of ten more members than the Euro zone. Additionally, Euro zone members do not constitute an institution with legal competencies that would enable them to enforce emergency measures, as is the case with the European Union. Instead, the Euro zone's only modus operandi is inter-governmental cooperation. However, the European Union's legal framework draws limits on cooperation that could conflict with the rescue funds established by Euro zone members. Furthermore, the European Central Bank has gradually become the main provider of emergency assistance to indebted countries. It has enacted a number of non-standard measures whose volume has constantly been growing. Thus, the increasingly drastic nature of the European Central Bank's actions raises the question of whether these emergency measures infringe upon the Bank's own mandate. Finally, the restructuring of Greek sovereign debt in early 2012 has raised a number of legal issues. The focus of this analysis will be the legal challenges posed by retroactive Collective Action Clauses, in particular those presented by the Bilateral Investment Treaties that Greece has previously signed.

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I. UNIQUE SOVEREIGN DEBT CRISIS

A. A CRISIS OF TRUST

The Euro currency union (“Euro zone”) crisis is one of sovereign debt. It implicates the members of the currency union, seventeen out of twenty-seven European Union (“EU” or “Union”) member states, though it is not a currency crisis as of yet. Since its introduction, the Euro has been a rather stable currency. In the course of the last three years, however, its exchange rate to other major currencies has depreciated, though not drastically enough to amount to a currency crisis. In addition, the inflation rate surpassed the target set by the European Central Bank (“ECB”) of “below, but close to, 2%” in 2012 and has dropped below it in the first half of 2013.¹

This crisis is a result of enormous amounts of debt that have been accumulated by a number of currency union member states. Investors question the sustainability of these states’ debt and suspect default, and as a result require high-risk yields or abstain altogether from investing in sovereign bonds from those countries. A number of countries have been cut off from market financing due to this issue. It started with Greece in May 2010, followed by Ireland later that year and then Portugal in early 2011.² More recently, Cyprus has joined the group of recipients of financial aid, and Spain has requested help for its financial sector.³ Italy is still able to receive market funding but risk premiums have gone up significantly, prompting the ECB to intervene heavily in the sovereign bond markets.⁴

B. THE UNIQUENESS OF THE ISSUE

The current crisis is unique in several respects. For the first time in post-war history, highly developed countries are on the verge of

1. On Euro area inflation data from April 2012 to April 2013, see News Release, Eurostat, Euro area annual inflation down to 1.2% (Apr. 30, 2013), *available at* http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-30042013-AP/EN/2-30042013-AP-EN.PDF.

2. *See infra* Part II.A.

3. *See infra* Part II.A.

4. *See infra* Part II.A.

defaulting. In addition, this crisis affects an entire region comprised of several countries whose future prospects could hardly diverge more. Four of the currency union members have kept their top ratings (Germany, Netherlands, Finland and Luxembourg), but the sovereign debts of the other members have been downgraded, some so significantly that their sovereign bonds have been referred to as “junk bonds.”⁵

In the post-war era, the rules of the Paris and London Club were sufficient to find solutions for the effects of unsustainable debt and sovereign defaults on underdeveloped or emerging economies.⁶ By assembling the major creditors who would agree on a debt restructuring, uncontrolled defaults could be avoided. These principles prevailed even during the Latin American crises of the 1980s and 1990s, though further

5. The lowest ratings were Greece's CCC, which was lowered to selective default in early 2012 until the sudden raise to B- on Dec 19, 2012, as well as Portugal's BB. See *Sovereigns Rating List*, STANDARD AND POOR'S RATINGS SERVICES, [\(http://www.standardandpoors.com/ratings/sovereigns/ratings-list/en/eu/?subSectorCode=39&start=100&range=50_\(last visited Apr. 9, 2013\)\)](http://www.standardandpoors.com/ratings/sovereigns/ratings-list/en/eu/?subSectorCode=39&start=100&range=50_(last%20visited%20Apr.%209,%202013)) (providing an updated list of sovereign ratings by Standard & Poor's). On the credit rating system in general, see Roberto A. De Santis, *The Euro Area Sovereign Debt Crisis – Safe Haven, Credit Rating Agencies and the Spread of the Fever from Greece, Ireland and Portugal* 55 tbl.A1 (European Cent. Bank, Working Paper No. 1419, 2012), available at <http://www.ecb.int/pub/pdf/scpwps/ecbwp1419.pdf>. The EU is currently reforming its regulation on credit rating agencies. See Christian Hofmann, *Stabilizing the Financial Sector: EU Financial Services 2010–2012*, 8 EUROPEAN REV. CONT. L. [ERCL] 426 (2012) (Ger.).

6. See PARIS CLUB, <http://www.clubdeparis.org/en> (last visited Apr. 10, 2013) (“The Paris Club is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. As debtor countries undertake reforms to stabilize and restore their macroeconomic and financial situation, Paris Club creditors provide an appropriate debt treatment. Paris Club creditors provide debt treatments to debtor countries in the form of rescheduling, which is debt relief by postponement or, in the case of concessional rescheduling, reduction in debt service obligations during a defined period (flow treatment) or as of a set date (stock treatment).”). The London Club is less institutionalized. The term stands for a forum of commercial banks in which they negotiated haircuts for sovereign debtors. On both the Paris and London Clubs, see Antonio Sáinz de Vicuña y Barroso, *Identical Collective Action Clauses for Different Legal Systems: A European Model*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT 15, 15, 18 (Klaus-Albert Bauer, Andreas Cahn & Patrick S. Kenadjian eds., 2013).

efforts were also needed, such as with the introduction of Brady bonds.⁷ The Argentine crisis marked the beginning of a new level of sovereign default, as it illustrated that the amount of debt that had been accumulated by highly industrialized nations eclipsed traditional methods of managing the default. The discourse that followed did not produce practical results,⁸ which is why there are no ready solutions for responding to the current Euro zone crisis.

This situation is further complicated by the fact that the highly indebted countries of the EU are part of a currency union. Thus, they are no longer in control of the policies governing their currency. The monetary policy is set by the Council of the ECB that consists of seventeen governors, the heads of the National Central Banks (“NCBs”) of the member states, and the directorate of the ECB.⁹ This Council decides the currency policy of the union by majority vote, with binding effect on all impacted member states.¹⁰ This policy is executed jointly by the ECB as well as the NCBs that are subject to the ECB’s instructions.¹¹ As a result, the Euro zone countries are limited in their responses to the crisis; in addition, the current crisis raises issues that have never before occurred.

Traditionally, a country with unsustainable debt implements emergency measures to regain sustainability. The ultimate goal—notably, economic growth—requires drastic measures to increase a country’s competitiveness. Such measures include austerity, default, and restructuring, as well as inflation coupled with depreciation of the

7. See Lee C. Buchheit, *How Ecuador Escaped the Brady Bond Trap*, INT’L FIN. L. REV., Dec. 2000, at 17. See also *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 15 (Aug. 4, 2011), available at <http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf> (on the Brady bond concept).

8. See *infra* Part III.A. on the plans to establish a resolution regime for sovereigns.

9. See Consolidated Version of the Treaty of the Functioning of the European Union art. 129(1), Oct 26, 2012, 2012 O.J. (C 326) 103 [hereinafter TFEU]; Protocol on the Statute of the European System of Central Banks and of the European Central Bank Article 9(3), 10(1), March 30, 2010, 2010 O.J. (C 83) 230, 233 [hereinafter Protocol on the ESCB and the ECB].

10. See Protocol on the ESCB and the ECB, *supra* note 9, Article 10(2), O.J. (C 83) 233; *id.* Article 14(3), at 237.

11. See *id.* Article 7, O.J. (C 83) 232; *id.* Article 12(1), O.J. (C 83) 236 (on the independence of the national central banks in national matters). See also TFEU Article 130, 2008 O.J. (C 115) at 106.

currency.¹² Austerity efforts are limited by their recessive effects on the economy and may even prompt social unrest. Both default and restructuring send out negative signals to the markets and discourage potential investors.¹³ Therefore, monetary depreciation caused by expansionary monetary policy, potentially coupled with “quantitative easing,” seems like the most feasible solution. It may raise the country’s competitiveness, since low production costs could attract foreign investments and a weak currency generally boosts exports. These benefits come with the unavoidable side effect of high inflation, but any negative effects are mitigated if the debt is denominated in the local currency.¹⁴

Since monetary policy is decided by the ECB, a currency union member could not enforce such measures on its own. The ECB’s most efficient instrument to steer inflation and manage the exchange value of the Euro is its power over the money supply.¹⁵ Even if the ECB decided to depreciate the Euro, it would hardly help the struggling union members. Most members trade predominantly with other member countries, leaving their export industry in practically the same position.¹⁶ For a member of the currency union, debt within the union is therefore comparable to debt denominated in a foreign currency (foreign debt).

12. On measures taken by governments in situations of financial distress, see SOVEREIGN INSOLVENCY STUDY GRP., INT’L LAW ASS’N, STATE INSOLVENCY: OPTIONS FOR THE WAY FORWARD, THE HAGUE CONFERENCE REPORT 1 (2010). *See also* Richard Herring, in: Allen/Gelper/Mooney/Skeel, *Is U.S. Government Debt Different?*, 2012, p. 21, 22.

13. *See* Adrian Blundell-Wignall, *Solving the Financial and Sovereign Debt Crisis in Europe*, OECD JOURNAL: FINANCIAL MARKET TRENDS, no. 2, 2011, at 201–05, available at <http://www.oecd.org/finance/financial-markets/49481502.pdf> (discussing potential rescue measures for the highly indebted Euro zone countries and their advantages and disadvantages).

14. *See* SOVEREIGN INSOLVENCY STUDY GRP., INT’L LAW ASS’N, STATE INSOLVENCY: OPTIONS FOR THE WAY FORWARD, THE HAGUE CONFERENCE REPORT 1 (2010).

15. *See* Protocol on the ESCB and ECB, *supra* note 9, art. 12, 2010 O.J. (C 83) at 5 (decisions regarding the money supply in the union are made by the ECB); Joseph de Wolf & Dominique Servais, *Objectives and Tasks of the Eurosystem and of the National Central Banks*, 2009 EUR. BANKING & FIN. L.J. [EUREEDIA] 441, 448 (Belg.) (discussing the monetary policy and competences of the ECB).

16. *See* *EU Merchandise Trade with Non-EU Countries: Monthly Growth*, EUROPEAN COMM’N, <http://ec.europa.eu/trade/statistics/> (last updated Feb. 18, 2013) (presenting EU trade statistics).

The measures that can be taken autonomously are drastically limited; they include default and the search for external help.

II. RESCUE AND STABILIZATION EFFORTS

In response to the limited options of a currency union member state, the union itself has provided emergency help to ease the pressure on indebted countries and to protect the interests of the union as whole.

A. INTER-GOVERNMENTAL FINANCIAL FACILITIES

Financial support for Euro zone members faces several legal obstacles. The most obvious is that it is the EU, not the Euro zone, which has a legal personality and related organs and institutions.¹⁷ The legal framework of the EU generally does not differentiate between currency union members and other EU countries.¹⁸ The EU is more factually than legally divided into a group of seventeen currency union members and ten countries that either chose to keep their national currencies or have not yet fulfilled the criteria necessary to join the currency union. Even the ECB is an institution of the EU, and the European System of Central Banks (“ESCB”) includes the central banks of all twenty-seven EU Member countries and the ECB.¹⁹

The sovereign debt crisis predominantly affects the countries of the currency union. All highly indebted countries whose debts have been downgraded and who face serious obstacles to receiving market financing under sustainable conditions are Euro countries. Furthermore, the currency union fears for the stability of the Euro, and as a result its more stable members are also affected. This creates a serious dilemma for the EU. Drastic emergency measures on the EU level are impeded

17. See Consolidated Version of the Treaty on European Union art. 47, May 9, 2008, 2008 O.J. (C 115) 13, 41 [hereinafter TEU].

18. A recent exception is Article 136(3) of the Treaty on the Functioning of the EU (“TFEU”), which addresses only the members of the currency union. See *infra* Part II.A.1.c.

19. On the principals of the European System of Central Banks, see generally Bernd Krauskopf & Christine Steven, *The Institutional Framework of the European System of Central Banks: Legal Issues in the Practice of the First Ten Years of its Existence*, 46 COMMON MKT. L. REV. 1143, 1143–75 (2009); see also Francisco Javier Priego & Fernando Conlledo, *The Role of the Decentralisation Principle in the Legal Construction of the European System of Central Banks*, in LEGAL ASPECTS OF THE EUROPEAN SYSTEM OF CENTRAL BANKS 189, 190 (European Central Bank 2005). For more detail on the ESCB, see *infra* Part II.A.

by the reluctance of non-Euro members to participate.²⁰ The Euro zone has reacted by cooperating on an inter-governmental level,²¹ which creates serious legal complications. Whereas the actions of the EU institutions can only be challenged by other EU institutions, member states, or in few exceptional cases by individuals who are directly affected, a much wider circle of involved parties can take action against the acts of national governments, such as members of national parliaments and individuals.²² Germany provides a striking example. The German Constitutional Court has repeatedly ruled on the constitutionality of the Euro zone rescue measures provided by Germany because citizens and members of parliaments are entitled to turn to that court for a decision on the constitutionality of government acts.²³ Further legal implications of this shift to the intergovernmental level are discussed in the following paragraphs.

20. See, e.g., *Sweden's Borg Dismisses EU Bank Supervision Plan*, THE LOCAL, <http://www.thelocal.se/43258/20120916> (Sept. 16, 2012) (Swed.) (on the Swedish resistance to the planned Banking Union). See also *infra* Part II.C.2.

21. See *infra* Part II.A.–B.

22. See TFEU arts. 251–81, 2012 O.J. (C 263) at 157–67 (determining the competences of the European Court of Justice). Actions are generally limited to Union institutions and member states with few exceptions. *Id.* art. 263. Article 263 enables individuals to take action against Union measures, but requires that these measures affect the individual directly. *Id.* Article 265 enables individuals to demand actions from Union institutions that are directly addressed to the individual. *Id.* art. 265.

23. See, e.g., Press Release, German Constitutional Court, Applications for the Issue of Temporary Injunctions, (Sept. 12, 2012) (Ger.), available at <http://www.bundesverfassungsgericht.de/pressemitteilungen/bvg12-067en.html>.

Recently, the German Constitutional Court conducted a preliminary hearing on the compatibility of the obligations arising from the European Stability Mechanism (ESM) with the German constitution. See *id.* For more on the ESM, see *infra* Part II.A.1.c. The court first articulated that, under the standard by which it would review the matter, the imposition of an incalculable financial obligation on Germany under the ESM Treaty would violate the budget autonomy of the federal parliament. Press Release, German Constitutional Court, *supra*. It ruled that Article 8(5) of the ESM Treaty had to be understood as limiting the total amount of Germany's payment obligations to € 190,024,800,000, and stated that no provision of the ESM treaty "may be interpreted in a way that establishes higher payment obligations for the Federal Republic of Germany without the agreement of the German representative . . ." *Id.* Furthermore, the court obligated Germany to "express that it does not wish to be bound by the ESM Treaty in its entirety if the reservations made by it should prove to be ineffective." *Id.*

1. Direct Financial Aid

The highly indebted member states receive funding from member states of the currency union and international organizations. The tools applied are similar to a corporate restructuring. The indebted country leaves the markets for a limited time, while public financing helps to break the vicious cycle of downgrades and higher financing costs.

To date, five countries have profited from direct financial assistance. In May 2010, Greece became the first country to receive help from the European Financial Stability Mechanism (“EFSM”), the IMF, and bilateral loans from currency union member states.²⁴ The European Financial Stability Facility (“EFSF”) was established shortly afterwards to help Ireland, Portugal, and later on, Greece.²⁵ In June 2012, Spain joined the group as the fourth recipient of Euro zone financial aid from the EFSF.²⁶ The fifth beneficiary shortly followed; Cyprus submitted an official request for financial assistance to the Euro group on June 25, 2012.²⁷

a. European Financial Stability Mechanism (EFSM)

The EU established the EFSM in May 2010. An EU regulation based on TFEU Article 122(2) provides the legal framework.²⁸ TFEU Article 122(2) regulates the procedure under which the Union can

24. On the financial aid to Greece by the EFSM, see Council Regulation 407/2010, Establishing a European Financial Stabilisation Mechanism, 2010 O.J. (L 118) 1 (EU). On the EFSM, see Jean-Victor Louis, *The No-Bailout Clause and Rescue Packages*, 47 COMMON MKT. L. REV. 971, 986 (2010); Deborah Zandstra, *The European Sovereign Debt Crisis and Its Evolving Resolution*, 6 CAPITAL MARKETS L.J., 285, 288 (2011). On the financial aid by the IMF and other Euro member states, see EC Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Greece*, Occasional Papers 61 (May 2010), available at http://ec.europa.eu/economy_finance/publications/occasional_paper/2010/pdf/ocp61_en.pdf.

25. For an up-to-date summary of the lending operations of the EFSF, see *Lending Operations*, EFSF, <http://www.efsf.europa.eu/about/operations/index.htm> (last updated Feb. 28, 2013).

26. See Spain: Memorandum of Understanding on Financial-Sector Policy Conditionality (July 20, 2012), available at http://ec.europa.eu/economy_finance/eu_borrower/mou/2012-07-20-spain-mou_en.pdf.

27. See *Frequently Asked Questions*, EFSF, § J, http://www.efsf.europa.eu/attachments/faq_en.pdf (information on future aid can be retrieved from the up-to-date summary of the lending operations of the EFSF).

28. Council Regulation 407/2010, Establishing a European Financial Stabilisation Mechanism, 2010 O.J. (L 118) 1 (EU).

financially assist a member: “[w]here a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned.”²⁹ Thus, the regulation authorizes the EU Commission to collect money from credit institutions or the financial markets in the name of the Union and to provide that money to member states that fulfill the regulation’s requirements.

b. European Financial Stability Facility (EFSF)

The financial resources provided by the EFSM are rather insignificant as compared to the volume of the second source of financial aid, the EFSF. The EFSF is not a Union facility, and therefore not based on TFEU Article 122(2). Euro zone member countries established the EFSF on the basis of an inter-governmental treaty outside of the EU in June 2010,³⁰ as a corporation established under the laws of the Grand Duchy of Luxembourg. It cooperates with the Union institutions, above all the Commission, which negotiates the financial aid conditions with the intended recipient in the name of the Euro zone member states. These member states are also the shareholders of the corporation.³¹

According to its articles of incorporation, the EFSF was founded to “facilitate or provide financing to Member States of the European Union in financial difficulties whose currency is the Euro and which have entered into a memorandum of understanding with the European

29. TFEU art. 122.

30. See European Financial Stability Facility Framework Agreement (June 7, 2010), available at http://www.efsf.europa.eu/attachments/20111019_efsf_framework_agreement_en.pdf [hereinafter Framework Agreement]; European Financial Stability Facility, Statuts Coordonnés Suite à un Constat D'Augmentation de Capital [Articles of Association Following a Finding of an Increase in Capital] (Dec. 6, 2011), available at www.efsf.europa.eu/attachments/efsf_articles_of_incorporation_en.pdf [hereinafter Articles of Incorporation]; see also Zandstra, *supra* note 24, at 288–90; Sideek M. Seyad, *A Legal Analysis of the European Financial Stability Mechanism*, 26 J. INT’L BANKING L. & REG. 421, 424–26 (2011) (U.K.).

31. See Framework Agreement, *supra* note 30; Articles of Incorporation, *supra* note 30.

Commission containing policy conditionality.”³² To pursue this purpose, the EFSF issues bonds with underlying claims that are guaranteed by the Euro zone member states.³³ The individual share in the guarantees corresponds to the share in the paid-up capital of the European Central Bank.³⁴ As of May 2013, Germany’s share, about twenty-nine percent of the debt, is the highest of the member states.³⁵

c. European Stability Mechanism (ESM)

The Euro zone has established a permanent funding scheme called the European Stability Mechanism (“ESM”). It was supposed to be effective on July 1, 2012, but the German president delayed its ratification in Germany to await the German Constitutional Court’s decision in a preliminary hearing on the compatibility of the obligations arising from the ESM with the German Constitution. In September 2012, the court decided that allowing Germany to have an incalculable financial obligation to the ESM would be in violation of the budget autonomy of the German federal parliament. It ruled that Article 8(5) of the ESM treaty had to be understood as limiting Germany’s total payment obligations to € 190,024,800,000 and that no provision of the ESM treaty “may be interpreted in a way that establishes higher payment obligations for the Federal Republic of Germany without the agreement of the German representative”³⁶ Furthermore, the court obligated Germany to “express that it does not wish to be bound by the ESM Treaty in its entirety if the reservations made by it should prove to be ineffective.”³⁷ The ESM became the EU’s permanent bailout fund after Germany ratified it on September 27, 2012 and deposited its instrument of ratification that same day.³⁸

32. Articles of Incorporation, *supra* note 30, at ch. 1, § 3. The language is originally from the EFSF Prospectus: EUR 55,000,000,000 Guaranteed Debt Issuance Programme (Feb. 13, 2012), at 57, available at http://www.efsf.europa.eu/attachments/efsf_prospectus_dip_55bn_20120213_en.pdf.

33. See Framework Agreement, *supra* note 30, pmb., ¶ 2, at 2.

34. However, in October, 2011, Greece, Ireland and Portugal were exempted from contributing, and, as a result, the shares of the remaining members went up, Germany’s from 27% to 29%. See *Frequently Asked Questions*, EFSF, *supra* note 27, § A3.

35. *Id.*

36. See Press Release, German Constitutional Court, *supra* note 23.

37. *Id.*

38. See *Factsheet: European Stability Mechanism*, COUNCIL OF THE EUROPEAN UNION (Oct. 4, 2012), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/132734.pdf.

TFEU Article 136 was amended to establish the ESM in paragraph 3, which provides that “[t]he member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the Euro area as a whole.”³⁹ The legal framework of the ESM is provided in the “Treaty Establishing the European Stability Mechanism.”⁴⁰ Like the EFSF, the ESM is established by an intergovernmental treaty and run by a corporation whose shareholders are the Euro zone member states, incorporated in the Grand-duchy of Luxembourg.⁴¹

2. Indirect Financial Aid

The EFSF may also provide indirect financial aid, as may the ESM. The EFSF is entitled to buy sovereign bonds of Euro zone countries for the purpose of avoiding soaring yields on those bonds, thereby ultimately preventing default. These purchases may take place in the secondary and, on an exceptional basis as stated in the EFSF Guideline on Primary Market Purchases of November 29, 2011, the primary market.⁴²

In addition, the EFSF can recapitalize credit institutions when a foreseeable crisis predominantly originates in the financial sector. The intention of this aid mechanism is reflected in the wording of the guidelines that explain, “[e]xperience has shown that some governments may not have large enough resources, especially where the size of the financial sector is large relative to the size of the economy. In these cases, the EFSF may serve as the last-resort instrument to preserve

39. For more detail on this amendment, see Seyad, *supra* note 30, at 427.

40. See Treaty Establishing the European Stability Mechanism, Feb. 2, 2012 [hereinafter ESM Treaty], available at <http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf> (detailing the ESM); EUROPEAN CENT. BANK, MONTHLY BULLETIN: JULY 2011, at 71-84 (2011) [hereinafter ECB JULY BULLETIN], available at <http://www.ecb.int/pub/pdf/mobu/mb201107en.pdf>; Zandstra, *supra* note 24, at 300; Seyad, *supra* note 30, at 428.

41. See ESM Treaty, *supra* note 40, art. 1.

42. See *Maximising the Capacity of the EFSF: Terms and Conditions*, EFSF (Nov. 29, 2011), http://www.efsf.europa.eu/attachments/efsf_terms_of_reference_maximising_the_capacity.pdf. See also *EFSF Guideline on Primary Market Purchases*, EFSF (Nov. 29, 2011), http://www.efsf.europa.eu/attachments/efsf_guideline_on_primary_market_purchases.pdf; *EFSF Guideline on Interventions in the Secondary Market*, EFSF (Nov. 29, 2011), http://www.efsf.europa.eu/attachments/efsf_guideline_on_interventions_in_the_secondary_market.pdf.

financial stability.”⁴³ As a prerequisite for financial aid, the guidelines require that “[a] beneficiary country will have to demonstrate that it has a sound fiscal policy record . . . and sufficient capacity to reimburse the EFSF loan”⁴⁴

In the future, a “banking union” may replace EFSF assistance in national financial sectors. Under these EU plans, supervision over financial institutions would be transferred from the national authorities to the European Supervisory Authorities and the ECB.⁴⁵ The ESM would gain the necessary power and tools to provide loans to recapitalize financial institutions throughout the EU.⁴⁶

These plans are part of the broader agenda to complement the monetary union with a thorough banking and fiscal union.⁴⁷ The risks to individual nations resulting from huge financial institutions operating from their territories would be eased by the currency union’s joint liability for the soundness of these institutions.

However, these plans include the entire EU, and therefore the ten member states that are not part of the Euro zone. Some of these non-Euro zone countries have already voiced their objections to these plans.⁴⁸ Furthermore, even the support of the currency union members seems doubtful. Opposition parties, backbenchers of government

43. See *EFSF Guideline on Recapitalisation of Financial Institutions (FIs) via Loans to Non-programme Countries*, EFSF, 2, http://www.efsf.europa.eu/attachments/efsf_guideline_on_recapitalisation_of_financial_institutions.pdf.

44. *Id.*

45. See Press Release, European Comm’n, Update – The Banking Union (June 22, 2012), available at europa.eu/rapid/press-release_MEMO-12-478_en.pdf (discussing the informal European Council of May 23, 2012, where the Commission presented the idea of a banking union.).

46. For this purpose, the ESM Treaty, *supra* note 40, art. 3, excerpted below, will have to be amended:

The purpose of the ESM shall be to mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. For this purpose, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties.

47. On the informal European Council of May 23, 2012, the Commission presented the idea of a banking union. See Press Release, European Comm’n, Update – The Banking Union (June 22, 2012), available at europa.eu/rapid/press-release_MEMO-12-478_en.pdf.

48. See *Sweden’s Borg Dismisses EU’s Bank Supervision Plan*, *supra* note 20 (referring to the Swedish resistance to the planned Banking Union).

parties, and, above all, voters in the member countries seem increasingly worried, if not alienated, by the crisis and “crisis management.”⁴⁹

3. The “No Bail Out” Clause

Apart from the question of political will, there is the legal issue of whether the current rescue measures violate EU law. These legal questions have caused much controversy, not only among academics, but also among the central banks of the ESCB and national politicians in Euro zone member states. The controversy revolves around the wording of TFEU Article 125, which may prohibit the EFSF and ESM rescue measures. TFEU Article 122(2) does not cover the EFSF and ESM because under the EFSF and ESM agreements, financial aid is not provided by the EU, but by Euro zone governments, and Article 122(2) only refers to financial assistance by the EU.⁵⁰

The text of TFEU Article 125 provides:

(1) The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

(2) The Council, on a proposal from the Commission and after consulting the European Parliament, may, as required, specify definitions for the application of the prohibitions referred to in Articles 123 and 124 and in this Article.⁵¹

The key legal issue is whether this ban is limited to the exact wording of the provision and therefore restricted to the assumption of commitments, or if a broader reading is required. The latter

49. *See supra* Part II.A. The most obvious example seems to be the continuous efforts of German members of Parliament and other citizens to stop further transfers of liabilities by appealing to the Federal Constitutional Court.

50. TFEU art. 122(2).

51. TFEU art. 125.

interpretation would prohibit any measure by the EU or a member state that provides financial help to another member state.

A contextual interpretation of Article 125 supports the prohibition of any form of member state bailout. TFEU Arts. 120–126, which discuss the economic policy of the Union, reflect the market approach pursued by the TFEU. TFEU Arts. 122(2), 125, and 143 demonstrate that the Union pursues an approach of independent market financing for each member state, while TFEU Article 126 further provides strict rules on fiscal discipline. Financial support for member states is limited to exceptional cases, which are explicitly regulated in these provisions.⁵²

The counter-argument to this is that the Treaty provides for emergency measures in general, and an emergency situation such as the sovereign debt crisis requires adequate measures even if the Treaty did not foresee them.⁵³ This is certainly true, yet it calls for amendments to the fundamental principles establishing the currency union. The current framework may be flawed, but clearly seems to prohibit any form of financial assistance provided by the union or the member states to other member states. Long-term financing provided by the EFSF and ESM as a response to a lack of fiscal discipline undermines the imperatives of TFEU Article 126, which call for disciplinary measures for member states that infringe upon the rules, and not financial assistance.⁵⁴

52. On all of the above, see Ulrich Häde, *Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise* [Budgetary Discipline and Solidarity in the Financial Crisis], 20 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [EUZW] 399, 403 (2009) (Ger.); Lothar Knopp, *Griechenland-Nothilfe auf dem verfassungsrechtlichen Prüfstand* [Constitutional Scrutiny of the Financial Aid for Greece], 63 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1777, 1779 (2010) (Ger.); Kurt Faßbender, *Der europäische “Stabilisierungsmechanismus” im Lichte von Unionsrecht und deutschem Verfassungsrecht* [The European “Stabilization Mechanism” in the Light of EU Law and German Constitutional Law], 29 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT [NVWZ] 799, 800 (2010) (Ger.); Ulrich Jan Schröder, *Die Griechenlandhilfen im Falle ihrer Unionsrechtswidrigkeit* [The Greek Financial Aid in Case of its Infringement of Union Law], 64 DIE ÖFFENTLICHE VERWALTUNG [DÖV] 61, 62–63 (2011) (Ger.) (a more expansive reading is mainly taken by German scholars).

53. See Louis, *supra* note 24, at 985; Christoph Herrmann, *Griechische Tragödie – der währungsverfassungsrechtliche Rahmen für die Rettung, den Austritt oder den Ausschluss von überschuldeten Staaten aus der Eurozone* [Greek Tragedy - The Currency Constitutional Framework for the Rescue, the Withdrawal or Removal of Over-Indebted Countries in the Euro zone], 21 EUZW 413, 415 (2010) (Ger.).

54. See *infra* Part II.C. (discussing similar legal issues resulting from the central bank measures).

B. NON-STANDARD CENTRAL BANK MEASURES

The ECB has enacted a number of non-standard monetary operations in order to support indebted countries and the financial sector, some in addition to the funding provided by the inter-governmental financial facilities, and some which occurred prior.

1. Liquidity Provided by the Euro System

The Euro system (“System”) consists of the ECB and the NCBs of the member states, whose currency is the Euro (TFEU Article 282 §§ 1–2).⁵⁵ The ECB determines the monetary policy of the currency union, and the NCBs implement this policy by *inter alia* providing liquidity to credit institutions. The NCBs engage with credit institutions in “open-market operations” that are part of the tasks defined by TFEU Article 127.⁵⁶ Liquidity is granted in exchange for adequate security as required by Article 18.1 of the Protocol on the ESCB and the ECB Statute.⁵⁷

Via a repurchase agreement, ownership of an asset is transferred to the NCB in exchange for liquidity in the amount of the asset’s current market price (minus a haircut reflecting potential difficulties in realizing the asset). The parties agree to reverse the transaction through a re-transfer of the asset to the counterparty on the repurchase day, which coincides with the maturity date of the typically short-termed lending operation. Such repurchase agreements are collateralized *per se* because they require a transfer of the ownership of the asset that underlies the agreement.

Loans, on the other hand, require separate collateral. In exchange for liquidity, the NCBs become creditors of the borrowing institutions and holders of security rights in full title to any assets offered as collateral.⁵⁸ The security rights remain with the NCB at least until

55. See sources cited *supra* note 19 (on the principles of the European System of Central Banks).

56. See Jean-Victor Louis, *The Monetary Authority of the Euro Area*, 2 EUR. BANKING & FIN. L.J. [EUREEDIA] 277 (2009) (illustrating the full range of the competences shared by the ECB and the NCBs); Christian Hofmann, *Central Bank Collateral and the Lehman Collapse*, 6 CAPITAL MARKETS L.J. 456, 460–64 (2011) (detailing the open market operations of the NCBs).

57. See Protocol on the ESCB and the ECB, *supra* note 9.

58. See, e.g., GENERAL TERMS AND CONDITIONS OF THE DEUTSCHE BUNDESBANK: BANKING REGULATIONS, ch. V, nos. 1(1), 2(1), 3, 13, 23(1) (2011), available at

maturity of the loan, and usually longer as the assets frequently serve as collateral for future operations.⁵⁹

2. *Inflated Money Supply*

In reaction to the crisis, the Euro system began expanding its supply of liquidity to the banking sector on August 8, 2007 by providing unlimited liquidity to banks in the Euro area on an overnight basis.⁶⁰ In the following months, it provided liquidity for periods of several months to facilitate planning for those same banks. The System also introduced the practice of “front loading”;⁶¹ during the first half of the month, liquidity was distributed without limits. This had the intended effect of providing security for the banks. In the second half of the month, when banks were able to assess their actual demand, liquidity could gradually be reduced. Liquidity was thereby granted for longer periods than usual, yet due to the reduction in the second half of the month, the overall amount of liquidity did not increase.⁶² The outbreak of the Lehman crisis on September 15, 2008 required further measures. In October 2008, the Council of the ECB decided to provide unlimited liquidity to all admitted credit institutions. Since then, credit institutions in the Euro zone have had unlimited access to liquidity with fixed interest rates. The ordinary process of tendering has been suspended.⁶³

http://www.bundesbank.de/Navigation/EN/Service/Services_for_banks_and_companies/OMTOS/General_information/Terms_and_conditions/terms_and_conditions.html.

59. See Hofmann, *supra* note 56, at 460–64.

60. See *id.* at 462–67 (discussing the collateral requirements in detail).

61. See *The ECB’s Response to the Financial Crisis*, in EUROPEAN CENT. BANK, MONTHLY BULLETIN: OCTOBER 2010, at 59, 64 (2010), available at www.ecb.int/pub/pdf/mobu/mb201010en.pdf.

62. See *id.* at 64.

63. See *id.* at 66. See generally EUROPEAN CENTRAL BANK, THE IMPLEMENTATION OF MONETARY POLICY IN THE EURO AREA—GENERAL DOCUMENTATION ON EUROSISTEM MONETARY POLICY INSTRUMENTS AND PROCEDURES: FEBRUARY 2011, 31–41 (2011) [hereinafter GenDoc], available at <http://www.ecb.int/pub/pdf/other/gendoc2011en.pdf> (describing the ordinary tender procedure). The GenDoc is a consolidated (yet unofficial) booklet that includes all amendments and therefore represents an up-to-date version of the seven chapters of the annex to Guideline ECB/2000/7 of the European Central Bank of 31 August 2000 on Monetary Policy Instruments and Procedures of the Eurosystem, 2000 O.J. (L 310) 1.

3. Eased Security Standards

Expanded or even unlimited liquidity only creates trust when it is easily accessible for banks. The Euro zone central banks, however, require adequate collateral in exchange for loans provided to banks.⁶⁴ The high requirements for collateral became a serious obstacle for the credit institutions during the crisis. Consequently, the requirements were lowered significantly.

The Euro system applies uniform standards for eligible security assets to all Euro system credit operations. This harmonized standard applied to collateral is called the “single list.”⁶⁵ As a general rule to limit the central banks’ exposure to risk, the list requires that the title of the asset used for collateral is easily transferable and that the value of the asset is easily realizable.⁶⁶ Furthermore, external ratings of the assets are mandatory, and the Euro zone applies haircuts to the estimated value of the assets.⁶⁷ The general rule is that longer residual maturities of debt instruments result in higher haircuts than shorter ones.⁶⁸

These requirements were generally relaxed after Lehman collapsed and the financial crisis began to develop. The minimum rating requirement for central government debt instruments (sovereign bonds) was reduced to “BBB–” from A–; at the same time the haircut was raised by 5%, at first temporarily.⁶⁹ On January 1, 2011, these temporary changes became permanent.⁷⁰ Furthermore, the Governing Council of

64. See *supra* Part II.B.1. (liquidity provided by the Euro system).

65. See GenDoc, *supra* note 63, at 45 (describing how this new legal framework entered into effect on January 1, 2007 and replaced the former two leveled system).

66. The requirements for adequate collateral are set out in Guideline ECB/2000/7 of the European Central Bank of 31 August 2000 on Monetary Policy Instruments and Procedures of the Eurosystem, 2000 O.J. (L 310) 1, *amended by* Guideline ECB/2010/13 of the European Central Bank of 16 September 2010, 2010 O.J. (L 267) 21 [hereinafter Guideline ECB/2010/13], which came into effect on October 10, 2010.

67. See GenDoc, *supra* note 63, at 61; see also Hofmann, *supra* note 56, at 463–65.

68. See generally GenDoc, *supra* note 63, at 72–73 (detailing a full classification).

69. See Guideline ECB/2008/18 of the European Central Bank of 21 November 2008 on Temporary Changes to the Rules Relating to Eligibility of Collateral, 2008 O.J. (L 314) 14, *amended by* Guideline ECB/2009/24 of the European Central Bank of 10 December 2009, 2009 O.J. (L 330) 95. See also Press Release, ECB, Measures to Further Expand the Collateral Framework and Enhance the Provision of Liquidity (Oct. 15, 2008), available at <http://www.ecb.europa.eu/press/pr/date/2008/html/pr081015.en.html>.

70. See Guideline ECB/2010/13, *supra* note 66.

the ECB granted additional exceptions to these rules starting in May 2010. Through decisions on May 6, 2010, March 31, 2011, and July 7, 2011, the general requirements have been abandoned for Greek, Portuguese and Irish sovereign bonds that are now eligible regardless of their actual ratings.⁷¹ In February 2012, seven national central banks of the Euro zone decided to further ease the collateral requirements to encourage additional lending to banks.⁷² In September 2012, the ECB expanded the list of eligible assets. Marketable debt instruments denominated in currencies other than the Euro and issued and held in the Euro area were declared eligible to be used as collateral. This measure comes with the suspension of the minimum credit rating threshold for all debt granted to or guaranteed by the countries participating in the Euro zone's bond purchasing programs.⁷³

4. Covered Bond Purchase Programs

In order to provide liquidity for the market in covered bonds, the Euro system purchased covered bonds in primary and secondary markets for € 60 billion based on a June 6, 2009 decision. The program expired in June 2010, but on October 6, 2011 the ECB announced a further purchase program under which eligible covered bonds for a total

71. See Decision of the European Central Bank of 6 May 2010 on Temporary Measures Relating to the Eligibility of Marketable Debt Instruments Issued or Guaranteed by the Greek Government, 2010 O.J. (L 117) 102; Decision of the European Central Bank of 31 March 2011 on Temporary Measures Relating to the Eligibility of Marketable Debt Instruments Issued or Guaranteed by the Irish Government, 2011 O.J. (L 94) 33; Decision of the European Central Bank of 7 July 2011 on Temporary Measures Relating to the Eligibility of Marketable Debt Instruments Issued or Guaranteed by the Portuguese Government, O.J. (L 182) 31.

72. The seven central banks are the Central Bank of Ireland, Bank of Spain, Banque de France, Bank of Italy, Central Bank of Cyprus, National Bank of Austria and the Bank of Portugal. See EUROPEAN CENT. BANK, MONTHLY BULLETIN: FEBRUARY 2012, 29, available at <http://www.ecb.int/pub/pdf/mobu/mb201202en.pdf>. See also *ECB Approves Collateral Eligibility Criteria of Seven Eurosystem Central Banks*, CENTRALBANKING.COM (Feb. 9, 2012), <http://www.centralbanking.com/central-banking/news/2145263/ecb-approves-collateral-eligibility-criteria-seven-eurosystem-central-banks>.

73. See Press Release, European Cent. Bank, Measures to Preserve Collateral Availability (Sept. 6, 2012), available at http://www.ecb.int/press/pr/date/2012/html/pr120906_2.en.html; see also *infra* Part II.B.4.

nominal amount of € 40 billion would be purchased through October 2012.⁷⁴

5. Sovereign Bond Purchasing Programs

In its short history, the most drastic and criticized measure of the Euro system has been its program for the purchase of sovereign bonds of Euro zone members. The program started as a Securities Markets Program (“SMP”) in May 2010 and authorized the Euro system to purchase sovereign bonds denominated in Euro.⁷⁵ Five countries benefited from the program. In addition to bonds issued by the beneficiaries of direct funding, which include Greece, Ireland, Portugal, and most recently Spain, the central banks of the Euro zone have also purchased Italian and Spanish bonds (in the case of Spain, prior to its application for direct EFSF funding).⁷⁶

In September 2012, the Euro system made the decision to start the “Outright Monetary Transactions” program to replace the SMP.⁷⁷ This program allows the Euro zone to purchase sovereign bonds of Euro zone member states that receive financial help from the EFSF or ESM.⁷⁸

6. Emergency Liquidity Assistance (ELA)

The aforementioned measures of the Euro system, which are determined by the ECB council and predominantly carried out by the NCBs, are supplemented by measures of the NCBs to provide further liquidity to financial institutions in need. The NCBs’ Emergency

74. See Press Release, European Cent. Bank, Covered Bond Purchase Programme Completed (June 30, 2010), available at <http://www.ecb.int/press/pr/date/2010/html/pr100630.en.html>. See also Press Release, European Cent. Bank, ECB Announced Details of Its New Covered Bond Purchase Programme (CBPP2) (Nov. 3, 2011), available at http://www.ecb.int/press/pr/date/2011/html/pr111103_1.en.html.

75. See Decision of the European Central Bank of 14 May 2010 Establishing a Securities Markets Programme, 2010 O.J. (L 124) 8.

76. See *Liquidity Analysis: Monetary Policy Portfolios*, EUROPEAN CENT. BANK, <http://www.ecb.int/mopo/liq/html/index.en.html#portfolios> (last visited Apr. 15, 2013) (detailing the updated volumes of all the covered and sovereign bond purchase programs).

77. See Press Release, European Cent. Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012), available at http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html.

78. See *id.*

Liquidity Assistance (“ELA”) is a more modern term for the traditional concept of “lender of last resort.” The ELA provides liquidity to an individual or group of credit institutions, as opposed to liquidity supplied via monetary policy operations addressed to all market participants and the money market as a whole.⁷⁹

Recapitalization efforts such as by EFSF or ESM funding take time, whereas ELA assistance is more immediate. Several Euro zone banks, especially in Greece, are deeply troubled by the financial crisis and the bleak prospects in some local EU economies. They have been further weakened by massive withdrawals of depositors. As a result, their equity capital is negative and there exist no assets that might serve as collateral for central bank loans. Thus, ELA by the NCBs, e.g., the Greek central bank, is the major source of liquidity still available, as well as the ultimate emergency measure keeping these banks from collapsing.⁸⁰

C. LEGAL ISSUES OF NON-STANDARD EURO ZONE MEASURES

1. Justification by the ECB

Non-standard measures call for justification. These measures are unorthodox because they are outside the catalog of conventional monetary measures that central banks in the ESCB ordinarily apply.⁸¹ The ECB argues that these measures are justified by a need to “address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism” and are therefore covered by its mandate in Article 18 of the Protocol.⁸² The ECB has applied this

79. See EUROPEAN CENT. BANK, MONTHLY BULLETIN: 10TH ANNIVERSARY OF THE ECB 123–24 (2008), available at <http://www.ecb.int/pub/pdf/other/10thanniversaryoftheecbmb200806en.pdf>.

80. See Annika Breidhardt & Andreas Framke, *ECB Stops Operation with Some Greek Banks*, REUTERS (May 16, 2012, 5:39 PM), <http://www.reuters.com/article/2012/05/16/us-ecb-greece-banks-idUSBRE84F0SN20120516> (discussing the precarious situation of Greek central banks).

81. On the differences between conventional and non-standard (unconventional) central bank measures, see Lorenzo Bini Smaghi, Member, Exec. Bd. of the ECB, Keynote Lecture at the Int’l Ctr. for Monetary and Banking Studies: Conventional and Unconventional Monetary Policy (Apr. 28, 2009), available at <http://www.bis.org/review/r090429e.pdf>. For typical conventional measures, see *id.* at 2.

82. For its justification of the SMP, see the Decision of the European Central Bank of 14 May 2010 Establishing a Securities Markets Programme, *supra* note 75, 2010 O.J. (L 124) 8, Preamble (3). See also Press Release, European Cent. Bank, ECB Decides on

line of justification to its new purchasing program called “Outright Monetary Transactions” (“OMTs”).⁸³

The ECB thereby expresses its concern that uncertainty in the markets may hinder the ECB from achieving its monetary goals in conventional ways. In ordinary times, central banks issue liquidity and leave further steps to the markets.⁸⁴ Before the crisis, the ECB similarly relied on the assumption that the provided capital would circulate in the markets and be allocated efficiently.⁸⁵ In this situation, banks serve as intermediaries and pass on the liquidity. However, these ordinary mechanisms fail in situations of uncertainty or even distrust in the markets. Institutions store and accumulate liquidity instead of circulating and distributing it. Banks take loans from the NCBs and instead of passing on the capital in the form of loans to their customers, they deposit it with the NCBs. The banks thereby accept losses from the spread between their financing costs and the lower interest yield on deposits, instead of generating profits from forwarding the capital to the markets. In ordinary times, tendering restricts the money supply since the tendered amount is fixed in advance and bids will only be satisfied pro rata if the sum of bids exceeds the total amount of liquidity the central banks intend to distribute.⁸⁶ If stockpiling and general distrust coincide with restrictions on the money supply, massive shortages of capital occur in the markets. The central banks are advised to provide unlimited capital in an attempt to reestablish trust and achieve an efficient allocation of liquidity.⁸⁷ The bond purchase programs pursue a similar agenda. These programs are also based on the assumption that

Measures to Address Severe Tensions in Financial Market (May 10, 2010), *available at* <http://www.ecb.int/press/pr/date/2010/html/pr100510.en.html>.

83. See *supra* notes 77–78 and accompanying text. In its press release, dated September 6, 2012, the ECB holds that its bond purchase under the OMTs “aim[s] at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy.” Press Release, Technical Features of Outright Monetary Transactions, *supra* note 77.

84. See Keynote Lecture by Bini Smaghi, *supra* note 81, at 2.

85. See Protocol on the ESCB and the ECB, *supra* note 9, art. 2.

86. See GenDoc, *supra* note 63, at 36–37, ch. 5.1 (describing that in a tender procedure bids can only be satisfied up to the total amount of liquidity the central bank decides to allot).

87. See Laurent Le Maux & Laurence Scialom, *Central Banks and Financial Stability: Rediscovering the Lender-of-Last-Resort Practice in a Finance Economy*, 37 CAMBRIDGE J. ECON. 1, 1 (2013) (discusses the central bank measures taken during the crisis years and their deviation from common practices).

providing central bank liquidity will benefit the whole range of market participants, including governments that raise capital on the sovereign bond markets. When the bond markets dry up because investors withdraw over concerns about the sustainability of sovereign debt, monetary policy is imperiled.

The solution of the central banks in the Euro zone sovereign debt crisis has been to replace the investors in the secondary bond markets. The sovereigns still need to find buyers in the primary markets, but the intervention in the secondary markets by the Euro system sends out a strong signal to investors in the primary markets. Primary market investors need not fear to find themselves left with valueless sovereign bond investments since the Euro system will buy them up on the secondary markets.

For justification, the ECB emphasizes that it applies non-standard measures to pursue its main monetary goal of price stability in the Euro zone.⁸⁸ Factually, however, the ECB has given in to the demands for generous monetary support for frail countries and weak economies. From a US perspective, this may sound persuasive. The Federal Reserve System (“Fed”) traditionally acquires large amounts of US Treasury Bills.⁸⁹ The Euro system, however, does not have the double mandate that has been entrusted to the Fed (and other central banks like the Bank of Japan).⁹⁰ TFEU Article 127 provides that “[t]he primary objective of the European System of Central Banks . . . shall be to maintain price stability.”⁹¹ Any additional monetary goal is clearly

88. *See supra* notes 75, 77.

89. *See* Terence P. Jeffrey, *Fed Now Largest Owner of U.S. Gov’t Debt – Surpassing China*, CNSNEWS.COM (Nov. 16, 2011), <http://cnsnews.com/news/article/fed-now-largest-owner-us-gov-t-debt-surpassing-china>.

90. *See* 12 U.S.C. § 225a (2006) (“The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.”). On the Bank of England, that also subordinates any other objectives to price stability, see Bank of England Act, 1998, c. 11, § 11 (“In relation to monetary policy, the objectives of the Bank of England shall be: (a) to maintain price stability, and (b) subject to that, to support the economic policy of Her Majesty’s Government, including its objectives for growth and employment.”). *See also* GUILLERMO DE LA DEHESA, MONETARY POLICY RESPONSES TO THE CRISIS BY ECB, FED, AND BOE 5–6 (2012), *available at* <http://www.europarl.europa.eu/document/activities/cont/201208/20120820ATT49767/20120820ATT49767EN.pdf> (manuscript) (discussing the different mandates).

91. TFEU art. 127.

subordinate: “Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union.”⁹²

2. Legal Issues

The purchase of sovereign bonds has been received with much praise in the media.⁹³ However, such voices focus entirely upon the immediate effects on the markets and ignore the deeper implications. The purchase programs are questionable with respect to the single mandate of the ESCB and raise further serious legal issues. At first glance, the ECB’s line of argumentation may seem consistent with TFEU Article 127, which provides that “[t]he ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources”⁹⁴ However, TFEU Article 123 reads:

(1) Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.

(2) Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions.⁹⁵

This requires clarification of which central bank measures are affected by this ban on monetary financing. The ECB argues that the prohibition is limited to the direct wording of Article 123 and therefore only prevents the central banks from purchasing sovereign debt on the

92. *Id.*

93. See Gideon Rachman, *Five Events That Stood Out in 2012*, THE STRAITS TIMES (Sing.), Dec. 19, 2012 (referring to the OMT program as “one of the five most important events” of the year 2012).

94. TFEU art. 127.

95. *Id.* art. 123.

primary markets. The ECB considers purchases on the secondary markets to be outside of the wording of the ban. It has further been argued that the central banks only engage in ordinary market transactions as typically carried out by commercial banks. These transactions should be qualified as non-monetary as they are not based on any commercial relationships between the central banks and the governments.⁹⁶

Critics—including a minority of the central banks of the Euro zone, especially the German *Bundesbank*—argue that secondary market purchases are covered by the broader scope of the provision that banishes any attempt to finance sovereign debt by inflating liquidity.⁹⁷ This opinion relies on reasoning 7 of Regulation (EC) Nr. 3603/93, which prohibits central banks from circumventing the provisions of TFEU Article 123 through secondary market purchases.⁹⁸ It also corresponds to the design of the disciplinary principles of the currency union. They were critically summarized by Bini Smaghi, member of the ECB directorate until the end of 2011, in three principles: (1) the duty to discipline the governments falls upon the markets; (2) further discipline is forced upon the governments by the Stability and Growth Pact, if necessary by way of sanctions; and (3) the monetary union has been

96. On these arguments, see Phoebus Athanassiou, *Of Past Measures and Future Plans for Europe's Exit from the Sovereign Debt Crisis: What is Legally Possible (And What is Not)*, 36 EUR. L. REV. 558, 561–67 (2011); Louis, *supra* note 24, at 975. See also Häde, *supra* note 52, at 400 (2009) (Ger.); Christoph Herrmann, *EZB-Programm für die Kapitalmärkte verstößt nicht gegen die Verträge – Erwiderung auf Martin Seidel*, 21 EuZW 645, 646 (2010) (Ger.).

97. Senior representatives of the Bundesbank have expressed their objections in numerous interviews. Its former president, Axel Weber, criticized the measures harshly. See, e.g., *Bond Purchase Frictions Convinced Weber to Drop Out of ECB Race*, CENTRALBANKING.COM (Feb. 14, 2011), <http://www.centralbanking.com/central-banking/news/2026150/bond-purchase-frictions-convinced-weber-drop-ecb-race>. For more on Weber's view and the opinion of the current president, Jens Weidmann, see Paul Carrel & Sakari Suoninen, *ECB Growing More Skeptical of Bond-Buys: Weidmann*, REUTERS (Dec. 14, 2011, 9:40 AM), <http://www.reuters.com/article/2011/12/14/us-ecb-bundesbank-weidmann-idUSTRE7BD14X20111214>. Juergen Stark, former chief economist of the ECB, resigned in protest against the SMP. See Gabi Thesing & Jana Randow, *ECB Seen Favoring Bond Buying Over Bank Loans*, BLOOMBERG (Apr. 13, 2013, 10:21 AM), <http://www.bloomberg.com/news/2012-04-12/ecb-seen-favoring-bond-buying-over-bank-loans-as-crisis-deepens.html>.

98. Council Regulation 3603/93 of 13 December 1993 Specifying Definitions for the Application of the Prohibitions Referred to in Articles 104 and 104b (1) of the Treaty, 1993 O.J. (L 332) 1 (EC).

built upon the principle that every member state should be forced to cope with the consequences of its fiscal policy individually.⁹⁹

Bini Smaghi has joined a large group of critics who conclude that at least the last principle has turned out to be illusory.¹⁰⁰ As already described above,¹⁰¹ it is certainly true that the latest developments have shown the shortcomings of the Euro system architecture. However, the legal provisions of the TFEU as well as of the Protocol on the ESCB and the ECB still form the basis on which the monetary union is based. If the provisions and assumptions of the treaty are circumvented by ECB measures as well as rescue measures outside the union, it may be seen as an attempt to circumvent the democratic basis of the union. This may further erode trust in the union and raise doubts about whether the legal framework of the union is being accepted and followed by governments and central banks.

The strongest argument against bond purchases is that the ECB has converted them into a regular mechanism to influence the markets through its September 2012 decision. Initially, the argument that the bond purchases were merely a short-lived stability measure to overcome temporary failures in the transmission mechanisms of monetary policy was persuasive. However, these measures have been extended to sovereign bonds of five Euro countries (with the potential of more to come) and have been said to be without “quantitative limits” unless termination is decided upon by the ECB Council.¹⁰²

Returning to the US perspective, these arguments against the non-standard measures may seem exaggerated, as the Fed has frequently applied similar measures.¹⁰³ However, the situation in the Euro zone is by no means comparable to the situation in the US, neither from a legal nor economic perspective. It cannot be sufficiently emphasized that the EU (as well as the Euro zone) seems further from becoming a federal union than ever. The member states have been, and still are, sovereign

99. See Lorenzo Bini Smaghi, Exec. Bd. Member, ECB, Address at “The Group of Thirty,” 63rd Plenary Session, Session I: The Crisis of the Eurosystem (May 28, 2010), available at <http://www.ecb.int/press/key/date/2010/html/sp100528.en.html>.

100. See Louis, *supra* note 24, at 979–81.

101. See *supra* Part II.A.3.

102. See Press Release, Technical Features of Outright Monetary Transactions, *supra* note 77.

103. See DE LA DEHESA, *supra* note 90, at 5, 8 (discussing the recent, non-standard measures of the Fed and the BoE, as well as the differences between the challenges for the ECB as compared to the Fed and the BoE).

countries. The EU institutions and several heads of state and government have discussed plans to move on to the next step of a fiscal union, which transfers money from the richer to the poorer member states, collectivizes sovereign debt (and potentially private debt as in the case of financial institutions), and creates new competencies for the European Commission and the ECB—such as deciding the amount of transfers and debt for the individual member state.¹⁰⁴

However, discontent among voters in the member states is growing. As of now, the only unifying element throughout the EU seems to be general discontent regarding the current situation. These circumstances are predominantly blamed upon too much power over domestic policy in the hands of the supranational organs. Furthermore, such plans need the approval of the ten non-members of the EU, among them Sweden and the UK. It seems unlikely that these countries will support further transfers of powers to Brussels. This opposition became apparent at the ECOFIN meeting of the EU finance ministers in September 2012.¹⁰⁵

As of May 2013, the Euro zone is more comparable to a random group of seventeen of the fifty US states than to the US as a whole. Imagine a monetary union of seventeen randomly picked states including some with entirely different profiles, such as New York or California, as opposed to Montana or Kansas. Now imagine further that there was no political union and that the economic ties were limited to free trade and a common monetary policy.¹⁰⁶ The states would share a central bank, which would purchase a large number of the states'

104. Such political ambitions have culminated in the September 12, 2012 speech by the President of the European Commission, José Manuel Barroso, in which he called for a “federation of nation states.” See José Manuel Barroso, President, European Comm’n, 2012 State of the Union Address at the Plenary Session of the European Parliament (Sept. 12, 2012), available at http://europa.eu/rapid/press-release_SPEECH-12-596_en.htm. On the plans for a “banking union” see Press Release, European Comm’n, Update - Banking Union (June 22, 2012), available at europa.eu/rapid/press-release_MEMO-12-478_en.pdf. On further developments, see Christian Hofmann, *Stabilizing the Financial Sector: EU Financial Services 2010–2012*, 8 EUROPEAN REV. CONT. L. [ERCL] 426 (2012) (Ger.).

105. On the Swedish resistance to the planned Banking Union, see *Sweden’s Borg Dismisses EU’s Bank Supervision Plan*, *supra* note 20. On recent reservations from the government of the UK, see *David Cameron Says UK Should “Ask for Change on Europe,”* BBC NEWS (Jan 6, 2013, 11:27 AM), <http://www.bbc.co.uk/news/uk-politics-20926563>.

106. The ties among the Euro zone countries are certainly stronger than the hypothetical I describe, but the illustrated facts are the relevant factors for the coordination of the monetary union.

sovereign bonds. However, each of the states would still pursue its own political and economic agendas. The money supply of this currency union would be expanded constantly, thus raising fears of inflation. The question is merely rhetorical: would such a construction create trust and confidence in the markets?

The European monetary union has been established based on the assumption that the ECB would pursue one goal alone: price stability.¹⁰⁷ Financing of member states was meant to be left to the markets, which would base investments on their assessment of a state's fiscal situation. The markets were meant to punish any failure in discipline by the member states. As mentioned above, these concepts proved illusory. The markets overestimated the potential of a common currency; they made refinancing significantly cheaper for the currency union member states than before under their individual currencies.¹⁰⁸

In addition, it seems questionable to burden the central banks with duties that truly should be imposed on the governments. At the same pace that the central banks step up their efforts to replace the disappearing investors, the governments reduce their efforts to improve the attractiveness of their bonds with a combination of austerity measures (in ineffective fields) and stimulus measures (in fields which show potential). This may result in negative incentives or, put differently, in moral hazards.¹⁰⁹

III. SOVEREIGN DEFAULT AND RESTRUCTURING

The bitter lesson to be learned from the Euro zone crisis is that highly developed countries are not immune from crises that were in the past more common to developing countries.¹¹⁰ It has become evident that even highly developed countries can encounter serious difficulties when trying to refinance their sovereign debt, and that they may even

107. On the single mandate of the ECB, see discussion *supra* Part II.C.1.

108. For information on Greek lending yields, see *Government Benchmark Bond Prices and Yields*, BANK OF GREECE, http://www.bankofgreece.gr/Pages/en/Statistics/rates_markets/titloiildimosiou/titloiildimosiou.aspx (last visited Apr. 15, 2013).

109. On this moral hazard, see ECB JULY BULLETIN, *supra* note 40, at 78.

110. See GERARD CAPRIO ET AL., FINANCIAL CRISES: LESSONS FROM THE PAST, PREPARATION FOR THE FUTURE 87–117 (2005) (discussing sovereign defaults in the recent past); GRP. OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES: A REPORT TO THE MINISTERS AND GOVERNORS PREPARED UNDER THE AUSPICES OF THE DEPUTIES 7 (1996), available at www.bis.org/publ/gten03.pdf.

default. The Euro zone, therefore, requires measures that have long-term stabilizing effects. For the banking sector, the EU is planning a refinancing and restructuring regime.¹¹¹ On the sovereign level, solutions are more difficult to find, though the Euro zone pursues two approaches. A permanent fund is intended to provide financial emergency assistance to member countries,¹¹² while a restructuring regime is meant to prevent or deal with sovereign default.

A. SOVEREIGN DEBT RESOLUTION MECHANISM (SDRM)

The idea of a restructuring regime for sovereign debtors is not new. It has not only been a topic in academic circles, but was also discussed by the G10 in 2002.¹¹³ Since insolvency principles do not apply to sovereign debtors, there have been plans to establish an internationally recognized restructuring procedure, the basic principles of which would be similar to the Chapter 11 framework under US bankruptcy law.¹¹⁴ Such a procedure would lead to a moratorium of sovereign debt and implement a restructuring plan effective to all creditors of a sovereign. The major advantage of such an approach is its comprehensive effect: all claims against the sovereign can be treated equally; the haircut is paramount.¹¹⁵

111. See Commission Proposal for a Directive of the European Parliament and of the Council: Establishing A Framework for the Recovery and Resolution of Credit Institutions and Investment Firms, COM (2012) 280 final (June 6, 2012).

112. See discussion *supra* Part II.A.1.c (on the ESM).

113. GRP. OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES 1 (2002), available at <http://www.bis.org/publ/gten08.pdf>. On sovereign debt restructurings in the past, see Antonio Sáinz de Vicuña y Barroso, *Identical Collective Action Clauses for Different Legal Systems: A European Model*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT, *supra* note 6, at 15, 17–18. See also Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* (IMF, Working Paper No. 12/203, 2012), available at <http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>.

114. Chapter 11 allows a majority of creditors to adopt a plan of restructuring with binding effect on all creditors. This requires creditors who hold at least two-thirds of the debt, as well as a majority of all creditor claimants, to accept the plan. See 11 U.S.C. §§ 1126(c), 1129(a)(8) (2006).

115. See Christoph G. Paulus, *A Resolvency Proceeding for Default Sovereigns*, 3 INT'L INSOLVENCY L. REV. [IILR] 1 (2012) (Ger.) (discussing SDRM concepts); FRANÇOIS GIANVITI ET AL., A EUROPEAN MECHANISM FOR SOVEREIGN DEBT CRISIS RESOLUTION: A PROPOSAL (2010), available at <http://www.bruegel.org/publications/>

The disadvantages are similarly striking: both the sovereign and the debtors become subject to the decision of a third party that forces its rules upon them. This raises the question of within which institution such powers could be vested—potentially the IMF, a UN institution, or a yet-to-be-created international court.¹¹⁶ In the absence of a sovereign restructuring regime, arbitration tribunals hold an important role in state-investor disputes.¹¹⁷

In the EU, it seems more feasible to overcome reservations against a Sovereign Debt Resolution Mechanism (“SDRM”). The EU could establish general binding rules for the restructuring of sovereign debt and create an institution to execute the restructuring, namely, create a chamber for restructuring at the ECJ.¹¹⁸ For the time being, however, such approaches are not being pursued. However, more Euro zone defaults, such as the Greek default of March 2012,¹¹⁹ could revive the idea of a European SDRM.

B. COLLECTIVE ACTION CLAUSES

Compared to an SDRM, collective action clauses pursue a modest approach. They also enable the restructuring of a sovereign’s debt in bonds, but contrary to an SDRM, they rely entirely on the principle of consent. This is why, for the time being, the Euro zone favors them over an SDRM.

1. Nature and Effects of Collective Action Clauses

Collective action clauses in sovereign bond issues can be defined as a compendium of standardized provisions within sovereign bond

publication-detail/publication/446-a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal; Beatrice Weder di Mauro & Jeromin Zettelmeyer, *European Debt Restructuring Mechanism as a Tool for Crisis Prevention*, VOX (Nov. 26, 2010), <http://www.voxeu.org/index.php?q=node/5845>.

116. GIANVITI ET AL., *supra* note 115, at 28–29.

117. See discussion *infra* Part IV. It should be added, however, that there is no generally approved regime for state-investor arbitration either. See JOSÉ E. ALVAREZ, *THE PUBLIC INTERNATIONAL LAW REGIME GOVERNING INTERNATIONAL INVESTMENT* 257–61 (2011).

118. GIANVITI ET AL., *supra* note 115, at 28–29.

119. See *infra* Part IV.

contracts.¹²⁰ Their major purpose is to introduce a principle of majority voting into the bond terms. If a qualified majority of bondholders agrees to a proposed restructuring of the bond obligations, all bonds are modified.¹²¹ Majority provisions in collective action clauses thereby deviate from one of the most basic principles of contract law, as the contractual claims of the dissenting minority are modified without their consent.¹²² This mechanism is designed to overcome the so-called holdout problem—the phenomenon that bondholders will wait for their peers to give in to the demands of the creditor in order to profit from the compromise and get paid in full.¹²³

120. On the terminology, see Frank Elderson & Marino Perassi, *Collective Action Clauses in Sovereign Foreign Bonds, Towards a More Harmonised Approach*, 4 EUREDIA 239, 241 (2003) (Belg.) (“Collective action clauses (CACs) are the denominator usually given to a number of different clauses found in various forms and to a varying degree in bond contracts under the laws of various jurisdictions which have in common, principally, that they enable a majority of bondholders to bind a minority against their will to the amendment of the terms of the contract and to a number of other actions in relation to the bonds (such as acceleration and de-acceleration)”). See also GRP. OF TEN, *THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES*, *supra* note 110, at 16.

121. On majority provisions in Collective Action Clauses following the English law model, see Lachlan Burn, *Bond Issues Under U.K. Law: How the Proposed German Legislation Compares*, in DIE REFORM DES SCHULDVERSCHREIBUNGSRECHTS 219, 238 (Theodor Baums & Andreas Cahn eds., 2004) (Ger.). On American law style collective action clauses, see Lee C. Buchheit & Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1329 (2002). On the impediments for collective action clauses resulting from the Trust Indenture Act (“TIA”), which has been applied beyond its limited scope to sovereign bonds, see George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431 (2006). On an international approach to majority provisions, see GRP. OF TEN, *REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES*, *supra* note 113, at 3.

122. On the principle that modifications to contract terms require the approval of each party to the contract, see 1 JOSEPH CHITTY, *CHITTY ON CONTRACTS: GENERAL PRINCIPLES* (Hugh Beale ed., 2004); EWAN MCKENDRICK, *CONTRACT LAW: TEXT, CASES AND MATERIALS* 939–40 (3d ed. 2008); G. H. TREITEL & EDWIN PEEL, *THE LAW OF CONTRACT* 312 (6th ed. 2004).

123. On the holdout problem, see Lee C. Buchheit & Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 65–66 (2000); Laura Alfaro, Noel Maurer, & Faisal Ahmed, *Gunboats and Vultures: Market Reaction to the ‘Enforcement’ of Sovereign Debt* 4 (Apr. 2010) (unpublished manuscript), available at <http://www.econ.ucla.edu/workshops/papers/History/Maurer,%20Gunboats%20and%20Vultures,%20version%205.2.pdf>; Patrick Kenadjian, *Bond Issues under New York and U.S. Law: Considerations for the German Law Maker from a U.S. Perspective*, in DIE REFORM DES SCHULDVERSCHREIBUNGSRECHTS, *supra* note 121, at 245, 263. See also Stephen J. Choi, Mitu Gulati & Eric A. Posner, *Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution*

The discussion about harmonized standards for collective action clauses in sovereign bond contracts emerged before the Euro zone sovereign debt crisis. The G10 in 1996 and the G20 in 2002 recommended them and drafted rudimentary model clauses,¹²⁴ but these proposals have not found broad approval. Highly developed countries in particular have not made use of these bond terms in their domestic issues (designating issues under domestic law). Only international issues under foreign law commonly include collective action clauses,¹²⁵ but highly developed countries issue the vast majority of bonds domestically.¹²⁶

One way of looking at the March 2012 restructuring of Greek debt¹²⁷ is that it is indicative of the need for collective action clauses.

Mechanism, 6 CAPITAL MARKETS L.J. 163 (2011) (concluding that Collective Action Clauses should create creditor confidence and potentially lower the cost of financing, at least for financially stable sovereigns). See also Elderson & Perassi, *supra* note 120, at 262; Liz Dixon & David Wall, *Collective Action Problems and Collective Action Clauses*, FIN. STABILITY REV. 142, 148 (2000) (U.K.).

124. See GRP. OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES, *supra* note 110, at 16, available at <http://www.bis.org/publ/gten03.pdf>; GRP. OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 113, at 3.

125. See David G. Sabel, *An Introduction to the Euro Area's Model Collective Action Clause*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT, *supra* note 6, at 29, 31; Klaus-Albert Bauer, *The Euro Area's Collective Action Clause – Some Questions and Answers*, in: COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT, *supra* note 6, at 3, 4.

126. See IULIA STANISLAV EMINESCU, EUROSTAT, STRUCTURE OF GOVERNMENT DEBT IN EUROPE IN 2011: UPWARD TREND IN THE EU GOVERNMENT DEBT LEVEL CONTINUED IN 2011, at 4 fig.6 (2012), available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-12-034/EN/KS-SF-12-034-EN.PDF. See also Patrick Kenadjian, *The Aggregation Clause in Euro Area Government Securities: Game Changer or Flavor of the Month? – Background and the Greek Experience*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT, *supra* note 6, at 113, 121; Lee C. Buchheit & Mitu Gulati, *Restructuring a Nation's Debt*, 29 INT'L FIN. L. REV. 46–49 (2010), reprinted in, MANAGING RISK IN THE FINANCIAL SYSTEM 168–78 (John Raymond LaBrosse, Rodrigo Olivares-Caminal, Dalvinder Singh, eds., 2010), available at http://scholarship.law.duke.edu/faculty_scholarship/2336 (discussing Greek sovereign debt). Detailed legal provisions are included in the terms of corporate, but not sovereign bond issues. Statutes on corporate bonds exist in practically all Euro zone countries, e.g., in Germany, see the codification in the Gesetz über Schuldverschreibungen aus Gesamtemissionen [SchVG] [Act on Notes from Issues of Identical Debt Securities], July 31, 2009, BGBl. I at 2512, and in France, Art. L 228-38 to L 228-90 of the Code de Commerce.

127. See discussion *supra* Part IV.

Back in the 1980s, restructurings could be worked out on a multilateral basis by bringing major creditors together to negotiate a deal with the sovereign debtor, for example, according to the principals of the Paris and London Club.¹²⁸ This procedure seems to have worked for several sovereign debt crises in Central America in the 1980s.¹²⁹ The number of creditors however was more limited than it is today, as funding came predominantly from American, European, and Japanese banks.¹³⁰

In contrast, the Argentine crisis escalated because it involved a vast number of foreign investors.¹³¹ The situation in the Euro zone is equally complex; the sovereign debt of the larger Euro zone economies is held by large numbers of investors throughout the world.¹³²

2. The Euro Zone Standardization of Collective Action Clauses

The Euro zone has agreed on a project of revolutionary magnitude: all seventeen Euro zone countries will use standardized collective action clauses.¹³³ This will catapult collective action clauses in sovereign bond issues from a marginal position to one of core significance. So far there have been a number of frequently used terms in international issues of sovereign bonds that commonly underlie English or New York state law, but there is no set of rules that could be considered a common standard.¹³⁴ The purpose of introducing standardized collective action clauses is to establish equal standards for all Euro zone bonds, thus creating transparency and market confidence. Since all countries will

128. On the principles of the Paris Club, see discussion *supra* Part I.B.

129. On these crises, see CAPRIO ET AL., *supra* note 110, at 87–117.

130. See Nancy Neiman Auerbach, *Latin American Debt Crisis*, in 2 THE PRINCETON ENCYCLOPEDIA OF THE WORLD ECONOMY 727, 728 (Kenneth A. Reinert et al. eds., 2009).

131. See, e.g., *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶¶ 316–18 (Aug. 4, 2011), available at <http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf>. See also discussion *supra* Part IV.

132. See EMINESCU, *supra* note 126. See also Buchheit & Gulati, *supra* note 126 (discussing Greek sovereign debt).

133. See *Collective Action Clause: Common Terms of Reference*, EUROPA ECON. & FIN. COMM., http://europa.eu/efc/sub_committee/pdf/cac_-_text_model_cac.pdf; *Collective Action Clause: Supplemental Provisions*, EUROPA ECON. & FIN. COMM., http://europa.eu/efc/sub_committee/pdf/cac_-_supplemental_provisions.pdf. On the drafting process, see Sabel, *supra* note 125, at 29.

134. On the dominance of the law of New York and England, see Kenadjian, *supra* note 123, at 246.

use the same provisions, it can be assumed that the Euro zone politicians hope that collective action clauses will be regarded as a common and neutral element of sovereign bond issues, and not an indicator of a potential sovereign default.

Yet, from a legal perspective, another element is even more fascinating: the enormous volume of sovereign bonds in the Euro zone promises to set a worldwide standard for the first time in the history of sovereign bonds.¹³⁵

IV. RESTRUCTURING OF GREEK DEBT

Sovereign bonds are the major source of finance for modern industrialized nations, which rely on a system of revolving debt. The current sovereign debt crisis in the Euro zone illustrates that once markets lose confidence in the sustainability of a country's debt, market refinancing becomes unaffordable.

Greek debt was restructured in March 2012, when private creditors of the Hellenic Republic accepted an exchange offer that led to a haircut on their debt. Greek domestic bonds were exchanged for new bonds with lower principal, lower interest rates, and longer maturity.

A. PRIVATE SECTOR INVOLVEMENT

The Greek restructuring took place in the form of a so-called Private Sector Involvement—a voluntary haircut accepted by the private holders of Greek bond debt. Over ninety percent of Greece's private creditors participated. The remaining holders of Greek bonds withstood political pressure and did not participate in what was called a “voluntary” bond restructuring. In particular, some hedge funds did not trade in their old bonds. As a result, the restructuring was accompanied by Greece's announcement that all remaining old bonds would never be paid. The remaining creditors who defied the exchange would either lose everything or be forced into an exchange. Greece threatened to

135. It should, however, be mentioned that the standardized set of rules does not address all legal issues, on this in detail. See Christian Hofmann, *Sovereign Debt Restructuring in Europe under the new model Collective Action Clauses*, 49 TEX. INT'L L.J. (forthcoming 2014).

compel this exchange by the introduction of retroactive (also called retrofit) collective action clauses.¹³⁶

Under the current situation in the Euro zone where sovereign restructurings seem far from impossible, it seems worth analyzing whether legal obstacles would impede the introduction of such retroactive collective action clauses.

B. RETROACTIVE COLLECTIVE ACTION CLAUSES

1. Greek Constitution, ECHR and BITs

Prior to the haircut, domestic bonds were issued under Greek law and the underlying issuance contract did not contain terms to protect the investors from negative changes of the legal framework (for example, in the form of a “stabilization” or “freezing” clause).¹³⁷ Taking advantage of this fact, Greece announced plans to enact a law that would automatically amend all domestic bonds if a set majority of bondholders accepted the voluntary exchange offer.¹³⁸ What sounded like a legislative measure that left the decision about the amendment to the private sector was actually a mere paltry excuse: the decision by the

136. On all of these events and the threat to introduce Collective Action Clauses retroactively, see Kenadjian, *supra* note 123, at 126–28; Klaus-Albert Bauer, *supra* note 125 at 8–9; Landon Thomas, Jr., *Bond Deal Narrows Options For Greece*, N.Y. TIMES, Mar. 10, 2012, at B1, available at http://www.nytimes.com/2012/03/10/business/global/greece-debt-restructuring-deal-private-lenders.html?pagewanted=all&_r=0; Melissa A. Boudreau, *Restructuring Sovereign Debt Under Local Law: Are Retrofit Collective Action Clauses Expropriatory?*, 2 HARV. BUS. L. REV. ONLINE 164, 166–67 (2012). On the effect of the Greek restructuring on credit default swaps for Greek sovereign debt, see Richard Squire, *A Market for End-of-the-World Insurance? Credit Default Swaps on US Government Debt*, in IS U.S. GOVERNMENT DEBT DIFFERENT? 69, 73–77 (Franklin Allen, Anna Gelper, Charles Mooney & David Skeel eds., 2012).

137. This can be considered common practice for domestic issues of sovereign bonds, a practice that will change with the introduction of collective action clauses. See discussion *supra* Part III.B.

138. For some of the facts of the Greek restructuring, see ‘Historic Opportunity’: Greece Pulls Off Debt Restructuring Deal, SPIEGEL ONLINE (Mar. 9, 2012, 12:51 PM), <http://www.spiegel.de/international/europe/historic-opportunity-greece-pulls-off-debt-restructuring-deal-a-820343.html>. On the negative effect of a restructuring on the markets, see Choi, Gulati & Posner, *supra* note 123, at 175. However, restructuring of domestic bonds by legislative means did happen in the past. See Buchheit & Gulati, *supra* note 126 (discussing the dangers involved).

qualified majority of bondholders had already been taken before the potential enactment of the law.

Therefore, the question arises whether such a procedure leads to an expropriation of the bondholders' property. Article 17(2) of the Greek constitution provides that "[n]o one shall be deprived of his property except for public benefit which must be duly proven, when and as specified by statute and always following full compensation corresponding to the value of the expropriated property at the time of the court hearing on the provisional determination of compensation."¹³⁹ To similar effect, Article 1 of the Protocol to the European Convention on Human Rights ("ECHR") guarantees that "[e]very 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." Finally, the Bilateral Investment Treaties ("BITs") that Greece entered into could become relevant. BITs generally contain rules on the expropriation of foreign investments and provide that expropriation measures must generally be non-discriminatory, for a public purpose, accompanied by prompt, adequate and effective compensation and in accordance with due process of law.¹⁴⁰

2. Expropriation of Bondholders

Bondholders' protection under these provisions is dependent on whether the exchange of bond debt by way of retroactive collective action clauses qualifies as an expropriation, and in the case of BITs, on the controversial preliminary question of whether sovereign bond debt is covered by BITs.¹⁴¹ It could be argued that the actual haircut follows from the voluntary decision taken by a qualified majority of the

139. 1975 SYNTAGMA [SYN.] [CONSTITUTION] 17(2) (Greece).

140. See 2012 U.S. Model Bilateral Investment Treaty art. 6, Apr. 2012. See also JEFFREY DUNOFF ET AL., INTERNATIONAL LAW NORMS, ACTORS, PROCESS: A PROBLEM ORIENTED APPROACH 87–92 (2d ed. 2006).

141. See U.N. CONFERENCE ON TRADE & DEV., INVESTOR-STATE DISPUTE SETTLEMENT AND IMPACT ON INVESTMENT RULEMAKING, at 9–17, U.N. Sales No. E.07.II.D.10 (2007) (discussing the approach to covered debt, the investors entitled to claims, and the changing opinion on minority shareholders).

bondholders, not by the legislative act.¹⁴² However, in the current scenario, this line of argumentation must fail. It is merely formalistic and ignores the predetermined outcome of the law as well as the obvious intentions of the legislator. The Greek scenario is incomparable to the general exercise of standard collective action clauses. The necessary number of bondholders gave its consent prior to the enactment of the law. Furthermore, this law does not define or amend the legal situation in a general way or for an indefinite number of cases. It is meant for exactly one case, and the beneficiary is the country itself. These benefits are not merely incidental, but are the very purpose for which the law is being enacted. In contrast, a typical legislative measure regulates legal relationships in a general way and with no regard to a specific case. If, for example, the legislator changes the laws on rental property, the government may well benefit as part of a multitude of affected landlords. However, this effect is merely incidental and not the pursued legislative purpose. It should follow that when a sovereign chooses to deal with investors on a contractual basis, this method of legal action implies a waiver for any recourse to sovereign powers. It seems contradictory to turn to sovereign powers when conflicts arise in order to avoid being held to contractual promises.

However, some jurisdictions sanction the use of retroactive action clauses. Germany is an example for such jurisdictions as the German statutes on corporate bonds in the *Schuldverschreibungsgesetz* allow the introduction of retroactive majority provisions into existing bond terms by majority vote.¹⁴³ Yet, this possibility under German law is incomparable to the Greek scenario. The *Schuldverschreibungsgesetz* does not apply to German sovereign bonds; by enacting this law, the German legislator acted in its general legislative capacity and regulated the contractual relationship of third parties in an abstract and general way, not the contractual relationship of the Federal Republic of Germany to investors in its bonds.

142. For this line of argumentation, see Buchheit & Gulati, *supra* note 126 (considering Greek retroactive Collective Action Clauses in a less drastic scenario).

143. See Gesetz über Schuldverschreibungen aus Gesamtemissionen [SchVG] [Act on Notes from Issues of Identical Debt Securities], July 31, 2009, BGBl. I at 2512, § 24(2) (Ger.).

3. *Inequality of Treatment*

In addition, issues of unequal treatment arise because the restructuring only affects the private sector. All public debt is exempted, including all bonds held by the European financial facilities and especially the large number of Greek bonds owned by the central banks. This does not necessarily indicate a breach of the principle of equal treatment, which is open to justification. In this case, justification could lie in the fact that the public sector provided and continues to provide the liquidity necessary to guarantee the future sustainability of Greek debt. In the words of the ECB, the Euro system has purchased the bonds as part of their Securities Markets Program in order to implement its monetary policy in times of perturbed transposition mechanisms.¹⁴⁴ However, a proper assessment of such justification would require that these reasons be communicated clearly by the legislator.

C. BILATERAL INVESTMENT TREATIES (BITs)

BITs seem to be bondholders' best chance at arguing their case for expropriation compensation. BITs are bilateral treaties between two governments created with the goal of mutually protecting private foreign investment. BITs give rise to individual claims and remedies. They generally protect foreign investment from expropriation by requiring strict conditions before these takings can arise, and appropriate compensation once the expropriation occurs. They further provide for non-discrimination and fair and equitable treatment clauses, which ensure that foreign investors are not discriminated against relative to nationals or third parties.¹⁴⁵

1. *Application of BITs to Investments in Bonds*

The typical investment protected by BITs is a direct investment in the host's territory, including the acquisition of assets held in the host country or the acquisition of a majority shareholding position. It is, on the other hand, an unresolved issue whether indirect investments also benefit from the protection, especially investments in sovereign bonds.

144. See discussion *supra* Part II.C.

145. See ALVAREZ, *supra* note 117, at 30–33.

a. The Argentine Default

A recent arbitration decision, however, helps to shed light on this issue. The Arbitral Tribunal at the International Centre for Settlement of Investment Disputes (“ICSID”) in Washington, D.C., delivered a decision in *Abaclat et al. and the Argentine Republic* on various claims against Argentina resulting from a default of their sovereign bonds. It was decided on the basis of the Argentina-Italy BIT, which went into effect on October 14, 1990. This decision affects the claims of over 180,000 individuals and corporations. In this case, Argentina defaulted on its sovereign bonds in December 2001 and in the following years extended exchange offers to the investors. In 2005, Argentina enacted a law (the “Cram Down” or “Emergency” Law), which provided that the exchange procedure would not reopen for bonds that had not been exchanged.¹⁴⁶

b. Exercise of Sovereign Powers

One of the essential issues in *Abaclat* concerned the tribunal’s jurisdiction in light of the contractual nature of the investors’ claims against Argentina, a matter of equal importance in the Greek scenario. The tribunal held that “[w]ith respect to a BIT claim an arbitral tribunal has no jurisdiction where the claim at stake is a pure contract claim . . . because a BIT is not meant to correct or replace contractual remedies . . .”¹⁴⁷ But it added that “[w]here the equilibrium of the contract and the provisions contained therein” were “unilaterally altered by a sovereign act of the Host State” the claim could not be considered a pure contract claim.¹⁴⁸ The tribunal decided to apply this exception where “[t]he circumstances and/or the behavior of the Host State appear to derive from its exercise of sovereign State power. Whilst the exercise of such power may have an impact on the contract and its equilibrium, its origin and nature are totally foreign to the contract.”¹⁴⁹

The tribunal saw these circumstances in the Argentine Emergency Law of 2005.¹⁵⁰ In the case of Greece, the retroactive collective action

146. See *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶¶ 10–50 (Aug. 4, 2011), available at <http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf>.

147. *Id.* ¶ 316.

148. *Id.* ¶ 318.

149. *Id.*

150. *Id.* ¶¶ 321–26.

clauses enacted by a Greek law fulfill these exceptional requirements. By passing such a law, Greece applies means that have no basis in the bond contracts and do not stem from its rights as a party to the contract, but instead are wholly based on its sovereign powers.

c. Qualification of Investment

A further issue in the Argentine situation that is applicable to the Greek scenario is the meaning of “investment.” The BIT was only relevant insofar as the bond claims could be qualified as investment claims under the scope of the BIT. In determining the matter, the tribunal interpreted the wording of the BIT and decided that the BIT pursued a wide approach. Article 1 of the unofficial English translation provides that:

“[i]nvestment shall mean, in compliance with the legislation of the receiving State and independent of the legal form adopted or of any other legislation of reference, any conferment or asset invested or reinvested by an individual or corporation of one Contracting Party in the territory of the other Contracting Party, in compliance with the laws and regulations of the latter party.”¹⁵¹

Article 1 names further examples of investments, including “bonds, private or public financial instruments or any other right to performances or services having economic value, including capitalized revenues.”¹⁵² The tribunal started its analysis by looking for “[r]ights and values which may be endangered by measures of the Host State, such as an expropriation, and therefore deserve protection.”¹⁵³ It came to the conclusion that with respect to the protective purpose of the BIT and in light of the wording of Article 1, the Argentine sovereign bonds were a form of investment covered by the protection under the BIT.¹⁵⁴

A further issue was whether the bond purchases constituted an investment “in the territory of the other Contracting Party,” which is a common requirement in BITs. Argentina argued that the bondholders’ purchases did not qualify as such an investment since the investment had taken place between investors and banks as intermediaries.¹⁵⁵

151. *Id.* ¶ 336.

152. *Id.*

153. *Id.* ¶ 347.

154. *Id.* ¶¶ 360–61.

155. *Id.* ¶ 373.

Therefore, no actual transfer of money from the investors to Argentina had taken place. In response to these objections, the tribunal defined the criteria that are relevant to investments of a purely financial nature. It held that it was essential “[w]here and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred.”¹⁵⁶ The tribunal dismissed the argument that the intermediaries, as primary underwriters, extended the principal to Argentina, and only afterwards received payments from their customers. For the tribunal, the only relevant point was the fact that the underwriters extended their lump payment because they would “[b]e able to collect sufficient funds from the individual purchasers of security entitlements . . .” and that “[t]he funds generated through the bonds issuance process were ultimately made available to Argentina”¹⁵⁷

All of these holdings by the tribunal support the qualification of Greek sovereign debt as “investments” under the BITs entered into by Greece.

d. Dissenting Opinions

Though a majority of tribunal members made the *Abaclat* decision, there is a dissenting opinion that argues for a more limited definition of investments.¹⁵⁸ Argentina has filed for an annulment of the decision and the result of the annulment procedure seems unpredictable. This is due to the fact that there is no established opinion on the definition of an investment, and other ICSID tribunals have come to different conclusions. Whereas the majority in *Abaclat* held that the definition of investment should be decided independently based on the provisions of the individual BIT, other tribunals favor a more general approach and base their definition of investments on the wording of the ICSID Convention. Article 25(1) of the Convention provides that “[t]he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State . . . and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.”¹⁵⁹ Some tribunals have

156. *Id.* ¶ 374.

157. *Id.* ¶¶ 376–78.

158. *See* *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Oct. 28, 2011) (Abi-Saab, Arb., dissenting), available at http://italaw.com/documents/Abaclat_Dissenting_Opinion.pdf.

159. *See, e.g.,* *Joy Mining Mach. Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction (Aug. 6, 2004), 19 ICSID Rev. 486, 499 (2004);

decided that this provision of the Convention contained an objective standard from which the parties to a treaty could not deviate.¹⁶⁰

However, even the supporters of such an “objective standard theory” have not agreed on a uniform definition of investment. Whereas one tribunal excluded contingent liabilities from the scope of an investment, another required that the investor participate in the risks of the transaction.¹⁶¹ The latter approach could exclude sovereign bonds from the definition of an investment since the bondholders do not bear typical business risks. Their risks are limited to a sovereign default and therefore to the precise situation that gives rise to the dispute.

However, such a limited interpretation of the term “investment” seems unfounded. Bondholders are as exposed to arbitrary sovereign measures as other investors. Furthermore, the purpose of BITs and other treaties on the protection of Foreign Direct Investment should be considered. The amount of money invested in sovereign bonds is enormous, and the events in both Argentina and Greece illustrate the vulnerability of these investments. Low levels of protection cause insecurities in the markets for foreign investments, and other sovereigns feel the negative impact. In the absence of sovereign debt restructuring regimes,¹⁶² arbitration promises to reestablish market confidence. In light of that, it is neither helpful nor required to limit the scope of arbitration within BITs to non-securitized forms of investment. Therefore, in agreement with the majority in *Abaclat*, the issue of whether sovereign bond debt qualifies as an investment should be decided by interpreting the wording of the individual BIT.

2. The Greek BITs

Greece has entered into BITs with countries world-wide.¹⁶³ Some of these BITs define the term “investment” in a very similar way to the Argentine-Italian treaty in the *Abaclat* decision. A randomly picked BIT, such as that between Greece and Bosnia and Herzegovina, defines “investment” as “[e]very kind of asset by an investor of one Contracting

Salini Costruttori S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 50 (July 23, 2001), *reprinted in* 42 ILM 609, 621–22 (2003).

160. *Joy Mining Mach. Ltd.*, 19 ICSID Rev. at 499.

161. *Salini Costruttori S.p.A.*, 42 ILM at 622.

162. *See* discussion *supra* Part III.

163. *See* Database of Bilateral Investment Treaties, UNCTAD, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (last visited May 20, 2013).

Party invested in the territory of the other Contracting Party, and in particular, though not exclusively includes . . . claims to money or any performance having economic value, as well as loans connected to an investment”¹⁶⁴ An expropriation is deemed lawful in this BIT if it takes place in the public interest, under due process of law, on a non-discriminatory basis and against prompt, adequate, and effective compensation.¹⁶⁵

Similar provisions can be found in other BITs that Greece has signed.¹⁶⁶ If the *Abaclat* interpretation is applied to these BITs, it could well follow that the investment in Greek sovereign bonds is protected by the BITs and that Greece infringed upon its obligations regarding equal treatment because the entire public sector—Greek and foreign—had been spared by the latest restructuring.¹⁶⁷ In any case, Greece would owe prompt, adequate, and effective compensation. The Greek scenario is comparable to the findings in *Abaclat* in that “[i]t may . . . constitute an act of expropriation where the new regulations and/or laws deprive an investor from the value of its investment or from the returns thereof.”¹⁶⁸

Another problematic matter is determining the amount of compensation that would have to be granted to bondholders due to expropriation. Are bondholders entitled to full compensation for the principal and interest even if they purchased their bonds on secondary markets and paid significantly less than what they would have bought them for in the primary markets, or should this reduce their claims to the market value of the bonds? If the market value is the appropriate measure, how should it be determined?

Purchases in the secondary market are problematic for another reason. Can they be considered investments in the territory of Greece given that the purchase price may flow from one foreign investor to another? This issue is not explicitly addressed in the *Abaclat* decision. However, this line of argumentation helps. The tribunal emphasizes the fact that in transactions involving intermediaries, the ultimate

164. Agreement for the Reciprocal Promotion and Protection of Investments, The Hellenic Republic-Bosn. & Herz., May 1, 2002, A: 1, 5.

165. *Id.*

166. See Database of Bilateral Investment Treaties, UNCTAD, *supra* note 163.

167. On fair and equitable treatment, see, e.g., *Enron Corp. v. Argentine Republic*, ICSID Case No. ARB/01/3, 257–68 (May 22, 2007); *DUNOFF ET AL.*, *supra* note 140, at 814–15.

168. *Abaclat*, ICSID Case No. ARB/07/5, ¶ 314.

beneficiary is the issuer of sovereign bonds.¹⁶⁹ From this it can be derived that transactions in the secondary market are a consequence of the issuance of sovereign bonds and, therefore, indirectly benefit the sovereign. Investors in the primary market may be willing to buy sovereign bonds only because the bonds are transferable and, therefore, tradable on secondary markets. A different line of argumentation might simply posit that all secondary investors merely succeed into the legal position that the primary purchaser acquired.

The amount of compensation depends on the approach taken. If the rights of the bondholders are seen as derived from the primary purchasers, compensation should cover the full amount promised by the issuer at the time of the underwriting. The alternative approach, which emphasizes the fact that every transfer of title is part of the bond scheme approved by the issuer, would lead to the more satisfactory result that compensation would have to reflect the market value of the bond. The market value could be determined according to what can be considered a recognized standard for BITs. The 2012 U.S. Model BIT provides that the value of the investment is decided by the price paid prior to the act of expropriation and may not reflect any change in value due to the fact that the intended expropriation had become known earlier.¹⁷⁰ This corresponds to the findings of international arbitrators who applied customary international law to determine the standard of compensation for expropriation.¹⁷¹

169. See discussion *supra* Part II.A.1.c.

170. The 2012 U.S. Model Bilateral Investment Treaty provides that “[t]he compensation referred to in paragraph 1(c) shall . . . be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (“the date of expropriation”) [and] not reflect any change in value occurring because the intended expropriation had become known earlier” 2012 U.S. Model Bilateral Investment Treaty art. 6, Apr. 2012. See also *World Bank Guidelines on the Treatment of Foreign Direct Investment*, in 2 WORLD BANK, LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT (1992), available at <http://italaw.com/documents/WorldBank.pdf>; *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 122 (Aug. 30, 2000), 16 ICSID Rev. 168 (2001) (“[A]ny award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed (the *status quo ante*).”).

171. See *SEDCO, Inc. v. Nat’l Iranian Oil Co.*, 10 Iran-U.S. Cl. Trib. Rep. 180 (1986).

3. New Challenges to Arbitration

With respect to BITs, there is a dimension to the inter-governmental financial facilities (EFSF and ESM) described above that seems unique.¹⁷² The traditional wording of BITs seems ill-prepared for the new approaches taken by the Euro zone governments. Generally speaking, BITs include most favorable nation clauses as well as fair and equitable treatment (“FET”) clauses. These clauses guarantee that all investors will enjoy equal treatment, regardless of their nationality or affiliation with the public or private sector. In the event of a sovereign default, these clauses are designed to prevent investors from losses resulting from the preferential treatment of a third party.¹⁷³ The new Euro zone financial facilities, however, create a category of investors for which the BITs seem ill-prepared to deal with. The ESM claims preferential creditor status,¹⁷⁴ which is not unheard of. The IMF enjoys this status, which is not explicitly granted by international law, but exists due to customs and general recognition.¹⁷⁵ However, with increased emergency funding pouring into troubled Euro zone countries, coupled with these investors enjoying preferred creditor status, it seems that the BITs’ intent to guarantee investor protection in the situation of sovereign default is challenged.

CONCLUSIONS

The financial aid provided to Euro zone member states infringes on the “no bail out” clause in TFEU Article 125. Furthermore, the current non-standard central bank measures have now been applied for more than five years, and there are no signs to indicate that the central banks would be able to terminate their non-standard commitments in the near future. This raises the issue of whether such a broad commitment of the central banks is compatible with its single mandate following from TFEU Article 127. This article has also taken the position that the purchase of sovereign bonds by the Euro system, unlimited in volume and duration, is incompatible with the ban on monetary financing in TFEU Article 123.

172. See discussion *supra* Part II.A.1.

173. See ALVAREZ, *supra* note 117, at 177–90.

174. See ESM Treaty, *supra* note 40.

175. On the preferred creditor status of the IMF, see ECB JULY BULLETIN, *supra* note 40, at 80.

These findings call for preventive mechanisms that provide for instances of sovereign default. It is unfortunate that hardly any attempts are made to establish a Sovereign Debt Restructuring Mechanism in the EU. The imminent introduction of mandatory collective action clauses in sovereign debt contracts of Euro zone member states will only provide a solution limited to sovereign bond debt.

The first restructuring in the Euro zone took place in March of 2012 when Greece offered a voluntary exchange of its sovereign bonds, simultaneously announcing that obstinate bondholders would be forced to comply. This event is remarkable since the imminent legal issues have yet to be addressed and could potentially lead to a number of bondholder lawsuits against the Hellenic Republic. It has been argued that an involuntary restructuring could not only be challenged in Greek courts for infringements of the Greek constitution, but could also find its way to arbitral tribunals for potential breaches of BIT clauses.