New Financing, Market Stabilization, and Debt-Cutting Techniques in Sovereign Debt Restructurings: The European Perspective

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I. The Main Issues in Sovereign Debt Restructurings: General Remarks

1. Actual or Imminent Insolvency of a Sovereign Debtor: the Notion

Sovereign States may become insolvent—or may come dangerously close to insolvency—much in the same way as business entities or individuals. They may become insolvent in the bankruptcy sense under the U.S. meaning of this expression, i.e. that is, their indebtedness may become larger than the aggregate amount that may be extracted from the assets realistically available for the payment of creditors, including, among these assets, for instance, from the present or future taxation proceeds from taxation that may be allocated to the repayment of the debt. In this sense, if the imbalance between the debt and these realistically available assets is structural and irreversible, then the State is insolvent.

More frequently, however, sovereign States may become insolvent or may approach insolvency in the equity sense (again under the U.S. meaning of this expression), which means that they may become unable to honor their financial obligations as they become due and payable. As a practical matter, this inability to pay is often due to the impossibility of refinancing—at affordable interest rates—the tranches of outstanding debt on the date of a particular tranche’s maturity.

As long as the financial markets are willing to let the sovereign debtor continue rolling over its debt through refinancing at affordable rates of the consecutive tranches coming to maturity, there is, at least in practical terms, no financial insolvency (or, in market terms, no default) on the part of the sovereign debtor. This holds irrespective of whether or not its structural indebtedness is sustainable in the long run and whether or not the imbalance between its level of debt and

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2 In the past, the view was sometimes expressed that sovereign States cannot become insolvent in the bankruptcy sense, since they can always obtain through taxation the necessary resources for matching their liabilities; however, this is clearly a non-persuasive view as it is self-evident that in reality there are political limitations to the fiscal burden that a State may impose upon its citizens. When the maximum politically feasible burden is reached, a State is certainly entitled to declare a moratorium under the state of necessity theory; the ensuing default is legitimate for as long as the state of necessity continues. See infra note 18 and corresponding text.
3 COLLIER ON BANKRUPTCY, supra note 1.
realistically available assets is reversible.

In other words, as long as refinancing at affordable rates is feasible, there is arguably no insolvency on the ground that the markets—whether rightly or wrongly—have not ceased to consider the sovereign debtor to be a creditworthy borrower. However, when the rollover becomes impossible in terms of market conditions, or is possible only at unaffordable rates, then the State can no longer postpone the acknowledgment of actual or imminent insolvency. The question then becomes one of how the law can handle the problems associated with the insolvency or pre-insolvency of a sovereign State debtor.

2. Insolvency of a Sovereign Debtor Between a Necessarily International Dimension and the Lack of an Adequate International Law Solution

The analysis must begin by focusing on two basic considerations.

First, the domestic law and jurisdiction of the sovereign debtor do not provide—subject to certain qualifications—to adequate tools for the satisfactory handling of the grave problems associated with a sovereign insolvency or default. Intuitively, States are unlikely to be tempted by the idea of legislating or adjudicating with regards to their own insolvency. Moreover, even assuming ex arguendo that this might be politically feasible, the real obstacle to be surmounted would persist. An entirely domestic solution (i.e., a solution governed by domestic law and administered by the domestic courts of the insolvent or defaulting State) would be adequate only if substantially all, or at least an overwhelming majority, of the State’s creditors were citizens of that State and subject as such to the recognized international law competence of any State to make laws and exercise jurisdiction with respect to its own citizens. However, in the real world this situation (i.e., that the entire sovereign debt is held by that State’s nationals) has likely never been the case and will probably never be the case.

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4 See infra, notes 18-23 and accompanying text.
Inevitably, the indebtedness of an insolvent or pre-insolvent sovereign (i) involves foreign creditors (public or private), (ii) includes monetary obligations governed by international law or by a State law other than the law of the debtor, (iii) interferes or may interfere with obligations set out in international treaties (such as BITs) or deriving from membership in international or regional organizations (such as the IMF or the EU), or (iv) ultimately poses a fundamental problem of credibility: a unilateral attempt to absolve itself of the burden of insolvency without coming to terms with the international dimension of the problem may make it extremely difficult for the insolvent or pre-insolvent sovereign to subsequently obtain or re-gain access to the international financial markets on financially feasible terms.5

In short, the insolvency or pre-insolvency status of a sovereign State raises unavoidable issues of international law that cannot be satisfactorily solved using the tools offered by the debtor’s domestic law.

Second, although, as stated above, the insolvency or pre-insolvency of a sovereign State requires an approach that respects the international law dimension and concomitant relevance, international law is neither adequate nor able to provide a satisfactory legal framework for this problem.

The rule of customary international law whereby a State cannot exercise jurisdiction over another State6 would apply a fortiori to any attempt to exercise bankruptcy jurisdiction over a creditor who ex hypothesi is, like the debtor, a sovereign State.7 A multilateral Convention


6 In the United States the rule is part of the Act of State Doctrine, whose elaboration started with Underhill v. Hernandez, 168 U.S. 250 (1897).

providing for the regulation—preferably in an orderly manner—of the actual or imminent insolvency of any Member State is not in sight and is probably a completely unrealistic proposition. Alternative ideas that could have attracted more serious consideration in the light of their *prima facie* compatibility with the present status of international law—in particular, entrusting the IMF with the task of acting as a sort of arbitral forum providing substantive and/or procedural rules for the governance of an orderly default process of any of its Member States—have been rejected after being strongly objected to by many members of the international community (the most prominent example being the United States). Even more recently, less ambitious proposals to promote a merely voluntary and procedural framework for governing sovereign defaults received no better treatment, and such proposals have remained on paper as mere scholarly suggestions.

The combination of these two factors (namely, the impracticability of domestic law solutions and the unavailability of specific and adequate international law solutions) is the

bankruptcy jurisdiction over a foreign state was declined on the ground that “[a]cceptance of jurisdiction would imply that a trustee in bankruptcy with extensive powers would have to undertake the management and the liquidation of the assets of a foreign power under the supervision of a Dutch public office” and that “[a]ll this would make an inadmissible encroachment under international law upon the sovereignty of the foreign State concerned”).


The United States was apparently convinced to reject the SDRM proposal because of the strong opposition of the market. What was frightening to the private sector was the prospect of an IMF bankruptcy “court” intervening directly as an arbiter of sovereign debt workouts, thus weakening creditors’ power and the role of negotiators. See Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1652 (2006).

conceptual motif providing the proper perspective for the main issues being dealt with in this paper.

Since a sovereign State, even if it becomes irreversibly insolvent, cannot be wound up and liquidated piece by piece as could be done, at least in theory, with an ordinary business entity, and since there is no generally recognized and accepted international law procedure for dealing with the problem when the insolvent debtor is a State, the unavoidable conclusion is that in the case of a sovereign insolvency or pre-insolvency there cannot be any way out other than a reorganization process\(^\text{12}\) that must ensure, on the one hand, the preservation of the essential functions of the sovereign State and, on the other hand, some form of acceptable legal treatment of the rights of the State’s creditors.

3. Reorganization of a Sovereign Debtor Through Restructuring of its Debt: the Main Problems

It would be wrong, however, to assume that the “necessary” reorganization of a sovereign debtor may proceed along the same paths as the models that may be found in the domestic laws dealing with the reorganization of insolvent business entities. There are indeed similarities with these models but, on the whole, the differences and the peculiarities of the reorganization or debt restructuring of a sovereign State largely prevail over the commonality of certain underlying basic problems and needs.

Essentially, this is so since, in the case of a sovereign debtor, the reorganization or debt restructuring is inevitably a process to be carried out \((i)\) in the open arena of global financial markets and \((ii)\) without the support of the regulating and supervisory powers of a court exerting jurisdiction over the debtor and the debtor’s assets and obligations.

Perhaps the most relevant and visible consequence of the absence of a judicially administered insolvency procedure is the impossibility of structuring the reorganization process by

\(^{12}\) Schwarcz, \textit{supra} note 5, at 959 (“States are not liquidated. Reorganization is therefore the goal of any sovereign debt restructuring.”); see also William W. Bratton & G. Mitu Gulati, \textit{Sovereign Debt Reform and the Best Interest of Creditors}, 57 VAND. L. REV. 1, 14, 23 (2004).
imposing, first of all, a clear-cut distinction between the pre-commencement phase and the post-commencement phase of the process; consequently, unlike in ordinary insolvency procedures, there is a sort of unnatural coexistence under the same legal regime of old claims deriving from the past failure to properly administer the indebtedness and of new claims deriving from the fresh financing of the restructuring efforts.

In other words, in a sovereign debt restructuring there cannot be, by definition, a court order by which the old indebtedness (as existing on the effective date of such order) is crystallized and thereafter administered in accordance with certain judicially supervised rules, while in parallel the new indebtedness, that is, the new financing that is required as a conditio sine qua non of the functional continuity of the entity, is granted a different treatment by giving it priority over the crystallized old claims in future payments or distributions.

The unavailability (with regards to sovereign debt restructuring) of this clear-cut divide between pre-commencement and post-commencement indebtedness has a number of consequences, major and minor, of which at least three deserve to be singled out and emphasized for the purposes of this paper.

First, in the absence of a system of ex ante legal priority rules assisting the supply of new financing under judicial supervision, it is both clear and imperative that an alternative and roughly equivalent solution in legal and practical terms must be found. In fact, in the absence of an alternative and equally protective solution it would be unreasonable for the potential providers of new financing to make it available to the debtor: the result would simply be the use of the new funds for the repayment of the old debt, thus causing the new funds to simply benefit the old claimants without offering the new financiers fair protection in exchange for their engaging with a new, and quite high, set of risks.\footnote{See infra Chapter II, para. 7.}
Secondly, since the old indebtedness (pre-commencement outstanding claims) cannot be simply wiped out, financial instruments evidencing such claims (e.g., sovereign bonds) will preserve some measure of market value and will therefore be traded at a fluctuating discount on the international financial markets. Inevitably, then, the reorganization or debt restructuring process aimed at rescuing (i.e., rehabilitating) the insolvent or pre-insolvent sovereign cannot ignore market solutions and market opportunities that may arise from the continuing existence of a market in which pre-commencement sovereign bonds can be traded jointly with the new instruments that may be issued in exchange for the fresh money supplied by the participants in the fund-raising rescue attempts. Thus, and without delving into unnecessary details, it is sufficient for the purposes of these general and introductory remarks to point out that the possibility for the sovereign debtor to regain access to the international financial markets at affordable refinancing rates may be greatly increased or facilitated by appropriate market transactions whose primary aim is the stabilization of the price of both the old and new sovereign bonds. The most basic examples of such transactions purchases in the secondary market of outstanding bonds; however, many alternative schemes do exist, such as voluntary swap proposals or substantial quantitative increases of liquidity made available to the market by one or more central banks. These may result in the ultimate availability—to market makers and interested players of a certain caliber—of the funding through which stabilizing transactions may be executed.

Third, notwithstanding the fact that the drawing of a clear-cut distinction between the treatment of pre-commencement and post-commencement claims is impossible for the fundamental reason that has already been stated (i.e., lack of an internationally recognized insolvency procedure

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14 The rule in international law is that while a State is entitled to modify the terms of the indebtedness governed by its law through legislative changes affecting its currency, no State is allowed to merely disregard its monetary obligations by unilaterally deciding to cancel them. What is prohibited by international law is “the situation in which the state exercises its executive or legislative authority to destroy the contractual rights as an asset.” IAN BRONLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 550 (5th ed. 1998) (emphasis added). If the State’s actions fall short of this destruction, they “may affect foreign interests considerably without amounting to expropriation.” Id. at 535.

15 See infra Chapter II, para. 6.
for sovereign debtors), it is still true that there are sound economic as well as equitable reasons for seeking to achieve the imposing of a “haircut” upon the holders of pre-commencement claims, meaning a more or less “voluntary” reduction of the value of their claims. The rationale behind this solution is to prevent such parties from “unfairly” reaping the benefits of stabilization and consequent protection of the market value of their claims without requiring them to make a contribution by way of a loss-sharing scheme such as will result from a negotiated or self-imposed “haircut.” Typically, for the purpose of practically imposing such a “haircut,” the supply of new financing or the implementation of a market stabilization program may be conditioned upon prior consummation of an adequate sacrifice by some or all classes of holders of pre-commencement claims.\(^{16}\)

Thus, even in sovereign debt restructurings it is often the case that the result is the “classic” outcome of satisfying pre-commencement claims at less (and often at much less) than par. However, while this outcome is viewed as normal and non-problematic in national insolvency procedures that are applicable to ordinary business entities, the same cannot be said in sovereign debt restructurings where, as will be more fully discussed below,\(^ {17}\) “haircuts” are at the same time a realistic necessity and simultaneously a source of difficult political and legal issues.


Having thus identified in general terms the main issues to be tackled in sovereign debt restructurings, a few additional remarks must now be made with regards to the methods or approaches that may be adopted in order to effectively carry out such restructurings.

The first possible approach is wholly unilateral. A sovereign debtor may react to its insolvency (or to a difficult situation that is equally threatening to its ability to fulfill its essential

\(^ {16}\) See infra Chapter III, para. 2.

\(^ {17}\) See infra Chapter III.
functions) by invoking a “state of necessity” as the basis for declaring a moratorium on the payment of all or part of its debt obligations. Under established principles of international law it is unquestioned that the State’s necessity to preserve the continuity of its essential functions weighs more than the duty to honor debt obligations towards financial creditors, whether domestic or foreign. Once the moratorium is declared—and during its pendency—the defaulting State, having decided to follow the purely unilateral approach, will usually seek to unilaterally cut its indebtedness by resorting to a full array of direct or indirect measures, which may include currency devaluation or adoption of a new currency, introduction of severe exchange control restrictions, enactment of internal deflationary legislation, direct reclassification or restructuring of outstanding indebtedness through more or less voluntary swaps, reschedulings, or issuance of new preferred instruments. These measures may all ultimately result in an “indirect” or “creeping” “regulatory expropriation” as opposed to a “direct expropriation,” which would consist of acts of state characterized by the direct taking by the defaulting sovereign State of any form of wealth which is present on its territory, including properties and assets belonging to foreign investors, so as to carry out nationalizations. Although direct expropriations have become less frequent, under international law a general consensus exists that in cases of indirect expropriation as well as direct expropriation,

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18 The doctrine of the state of necessity as a justification for non-compliance by a sovereign with its financial obligations can be traced to the Russian Indemnity Case (Russia v. Turkey), award rendered on November 11, 1912. Tanzi, supra note 7, at 69-70. The most authoritative recent restatement of the doctrine may be found in Article 25 of the Draft Articles on State Responsibility in international law: “1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole. – 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if: (a) The international obligation in question excludes the possibility of invoking necessity; or (b) The State has contributed to the situation of necessity”. Notoriously, in the application of this doctrine there have been conflicting holdings on substantially the same facts in the investment treaty arbitrations relating to the Argentina crisis of 2001-2003. Compare LG&E Energy Corp., LG&E Capital Corp. and LG&E Int’l Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, par. 257 (Oct. 3, 2006) (recognizing that the state of necessity of Argentina precluded wrongfulness), with CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, par. 329 (May 12, 2005) (finding that the doctrine was inapplicable owing to Argentina’s contribution in creating the conditions for the crisis).
“just compensation” is due to the investor.\textsuperscript{19} However, determining what is “just compensation” and how to calculate it raises difficulties for two reasons.

The first reason is that the relevant jurisprudence has interpreted the notion of “just compensation” by applying different standards: in some cases, these standards benefit the investors (e.g., the standard of full compensation\textsuperscript{20} or the standard of fair market value\textsuperscript{21}), while in other cases the standard imposed is more pro-state (e.g., the standard of equivalent of national treatment,\textsuperscript{22} which typically warrants a lower level of compensation than that which may be expected from the application of the former two formulas).

The second reason is that the courts have found the standard of fair market value to be difficult to apply in cases of indirect or creeping expropriations, especially when it becomes time to calculate the damages to be awarded (courts have used numerous valuation formulas when calculating fair market value). This means that sovereign states may sometimes expropriate at a cost (payment of an indemnity) that is actually likely to be substantially lower than the real value.\textsuperscript{23}

For the reasons already mentioned above, however, the unilateral approach, while conceivably open to adoption in the abstract, is wholly unrealistic in the contemporary context of strong international links among the vast majority of nations. Moreover, for the purposes of this paper, which intends to focus its analysis on the European experience, the unilateral approach or method may be disregarded without hesitation, since the European examples have followed a

\begin{itemize}
  \item\textsuperscript{19} See Restatement (Third) of Foreign Relations Law of the United States § 712(1)(c) (1987).
  \item\textsuperscript{20} Factory at Chorzów (Germany v. Poland) 1928 P.C.I.J. (ser. A) No. 17, at 47 (holding that “reparation must, as far as 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”).
  \item\textsuperscript{22} Id. (recalling the Calvo Doctrine, according to which international law only requires a State to give aliens rights that are equal to those given to its citizens).
  \item\textsuperscript{23} Thomas Merrill, Incomplete Compensations for Takings, 11 N.Y.U. ENVTL. L.J. 110, 111 (2002); see also Micheal Reisman & Rocio Digon, Eclipse of Expropriation?, in CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION 27 (Arthur W. Rovine ed., 2008).
\end{itemize}
completely different path.

Realistically, therefore, the reorganization of an insolvent sovereign, that is, the restructuring of its indebtedness, will not be a unilateral process but will rather take a cooperative form, typically in the context of an IMF-sponsored or co-sponsored program of economic and financial rehabilitation.

As of today there are two major models of cooperative restructuring.

The first model is offered by the experiences of the Paris Club and the London Club.24 This model is characterized by negotiated, voluntary debt reductions and reschedulings that are granted by consenting creditors (and by them only) to the sovereign debtor, typically an emerging country.

The process is inherently flexible and based on practice more than on binding legal rules. However, it is a process that does not take place in a political or institutional vacuum: procedures have been developed and, more importantly, every restructuring of this type occurs within the context of a readjustment program approved or sponsored by the IMF.25

The second model is based on the active intervention, leadership, and financial support of international institutions, such as—typically but not exclusively—the IMF, and is characterized by a high level of de jure or de facto constraints that must be accepted by the restructuring sovereign debtor in exchange for the granting of external help.

The recent experiences of sovereign debt restructurings in the Eurozone follow the second, and strongly institutional, model. However, the first model has also been a source of inspiration. In particular, recourse to the practice of seeking solutions through negotiations has been made in the


area of debt-cutting (haircuts) required from the private sector’s bondholders.\textsuperscript{26}

\textsuperscript{26} The Greek debt restructuring (\textit{infra} Chapter III, para. 3) was executed pursuant to laborious negotiations that took place between the Greek government and the representative bodies (Steering Committee and Creditor Committee) of the major holders of Greek bonds. “The restructuring process combined features of the «London Club» process of the 1980s (bargaining with Creditor Committee) with a take-it-or-leave-it exchange offer familiar from emerging market restructurings since the mid 1990s”. Jeronim Zettelmeyer et. al., \textsc{The Greek Debt Exchange: An Autopsy} 3 (2012), \textit{available at} http://scholarship.law.duke.edu/ \textit{(on file with Duke Law Scholarship Repository); see also Allen & Overy, How the Greek Debt Reorganization of 2012 Changed the Rules of Sovereign Insolvency} 9-10 (2012), \textit{available at} http://www.alenover.com/SiteCollectionDocuments/AO\%20-%20Greek\%20debt\%20reorganisation\%20of\%202012.pdf; Videotape: The Restructuring and Resolution of Sovereign External Debt (2012) \textit{(on file with the World Bank).}
II. The European Perspective: Institutional Cooperation, New Finance, and Market Stabilization – The Coordinated Role of the IMF, the EU, and the ECB

1. The European Framework: the Need for Interventions and the Reasons behind Coordination

Professor Rosa Lastra once compared the daunting effects of financial instability to a tsunami.\(^{27}\) The idea is intuitive, and its visualization leaves a mark: both phenomena, once underway, dash relentlessly—and equally careless of what they might come across—along their respective ways, disregarding even national boundaries.\(^{28}\) This may suggest one conclusion, which Lastra has phrased as follows: “Episodes of financial instability have a trans-national dimension, thus requiring a trans-national solution”.\(^{29}\) Although her words refer on their face solely to financial crises, the same conclusion—that is, when we are dealing with potentially boundary-less economic woes, containment has to be secured multilaterally—shall apply to sovereign debt crises as well, given the tightly intertwined nature of these two types of distress.\(^{30}\)

That said, the picture must now be narrowed from the foregoing general perspective to the actual scope of analysis of this paper, which is specifically circumscribed to the economically


\(^{28}\) One may agree that this is a well-fitting description by recalling, for example, the financial and debt crises of the 1990s and 2000s. This refers specifically on the one hand to the Mexican (1994), Asian (1997), and Russian (1998) crises and, on the other hand, to the USA (2008) mortgage crisis. For a concise but clarifying overview on the first set of crises, see Andreas F. Lowenfeld, *International Economic Law* 667-718 (2nd ed. 2008). With respect to the US crisis and its spillover effects with regards to Europe, see European Commission, *Economic Crisis in Europe: Causes, Consequences and Responses* 8-13 (2009), available at [http://ec.europa.eu/economy_finance/publications/publication_15887_en.pdf](http://ec.europa.eu/economy_finance/publications/publication_15887_en.pdf).

\(^{29}\) Lastra, *supra* note 27.

\(^{30}\) Carmen M. Reinhardt & Kenneth S. Rogoff, From Financial to Debt Crisis 25-26, (Nat’l Bureau of Econ. Research, Working Paper No 15795, 2010), [http://www.nber.org/papers/w15795](http://www.nber.org/papers/w15795). According to these economists, financial crises – either in the form of banking illiquidity or currency crashes – and sovereign debt crises break out, if not exactly, almost simultaneously. *Id.*, at 25. The temporal sequence according to which one event follows the other is reversible and this is possible due to the existing interconnection between the two forms of crises. An explanation is provided for each temporal sequence; if it is the financial crisis to hit first, that is usually because the government had profusely lent to private banks that later find themselves with an unbearable debt, which irrevocably undermined their own solvency and consequently the sovereign’s solvency. Vice-versa, the sovereign debt may trigger financial instability because the government is probably imposing to its otherwise reluctant national banks considerable purchases of public debt. *Id.*, at 26.
troubled European Union (EU). In doing so, a few words on the structure of this Chapter provide some useful guidance to the reader.

At the outset I will endeavor to highlight the main legal and practical reasons underpinning the multilateral approach that has been adopted for the purpose of tackling sovereign debt crises in Europe. Subsequently, a description will be offered of the coordinated roles played by the institutional members of the so-called Troika – that is, the International Monetary Fund (IMF), the European Union (EU) acting through the European Commission (EC), and the European Central Bank (ECB) – in the practical implementation of the plans put in place to heal some EU Member States’ economies. In this regard, consideration will be given to the mechanisms through which new financing is provided, the conditionality rules that are typically imposed, the market interventions that have been and may be made for stabilization purposes, and the main legal problems arising in connection with all these interwoven measures. Subsequently, in the following Chapter, I deal with the issue of debt-cutting techniques by which a forced contribution to the sovereign debt restructuring is sought from the creditors (and, in particular, from the private sector bondholders) and offer conclusions regarding whether the European perspective and experience, as hitherto structured and developed, is entirely consistent with general principles of international law.

In Europe, the first symptoms of the debt crisis first raised their ugly head in 2009, when a small number of peripheral European countries—mainly from the former Eastern Bloc and USSR—suddenly found themselves in urgent financial need and consequently applied for

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32 Between 2008 and 2009, the following countries applied for financial assistance: from the ex-Eastern Bloc, Hungary, Romania, and Poland, and from the ex-USSR, Latvia. The first EU Member States that requested, and subsequently received, financial assistance from the EU were Hungary and Latvia in late 2008, swiftly followed by Romania in 2009. EUROPEAN COMMISSION, Economic and Financial Affairs, http://ec.europa.eu/economy_finance/assistance_eu_ms/index_en.htm. As for Poland, that is, the only country that applied for assistance directly to the IMF rather than to the EU, see IMF SURVEY ONLINE, Poland Seeks $20.5 Billion Credit Line From IMF (Apr. 14,
outsourced financial assistance. An important caveat is that the countries at stake, while Member States of the EU, were and are all “Member States with a derogation” within the meaning of Article 139.1 of the TFEU – that is, Member States allowed to maintain their own national currencies throughout the period needed to fulfill the obligations regarding the attainment of the level required for admission to the economic and monetary union. But the ripple effect did not end there, and the crisis quickly spread – not without some surprise – from “Member States with a

2009); IMF SURVEY ONLINE, IMF Provides Poland $20.6 Billion Credit Line (May 6, 2009).

Interestingly, on multiple occasions the EU has refrained or at least displayed some uncertainty with regards to having the IMF involved in addressing the financial difficulties of EU Member States. The most blatant example in this regard is the Greece case. Here, the EU institutions have long pushed back against the IMF’s stepping into the assistance program as they hoped that the mere implied promise of regional support would be sufficient on its face to reassure the markets regarding Greece’s capacity to sort out its problems. In December 2009, the newly elected Greek government announced Greece had accumulated €300 billion in debts, yet the first bailout agreement between the IMF and the Eurozone Members was not reached until May 2, 2010. Antonis Antoniadis, Debt Crisis as a Global Emergency: The European Economic Constitution and other Greek Fables 5 (2010), available at: http://ssrn.com/abstract=1699082 (quoting Éditorial, L’Union économique et monétaire dans la tourmente de déficits publics, 46 Revue Trimestrielle de Droit Européen 1, 6 (2010)). See Timeline: The Unfolding Eurozone Crisis, BBC.CO.UK, http://www.bbc.co.uk/news/business-13856580 (last visited Mar. 28, 2013). History is repeating itself with another and even more current example: Cyprus. Even as of this writing in April 2013 we are witnessing the tension between the different views of the IMF and the EU on how the island’s financial distress should be tackled. Essentially, there is a clear division regarding the speed at which the debt should be reduced to manageable levels and how such a goal should be achieved. While the IMF is calling for a faster and tougher solution that would reduce the sovereign debt to 100 per cent of the GDP by 2016 through forced losses on depositors – mainly Russian – in Cypriot banks, the European Commission is suggesting a gradual—and slower—alternative aimed at meeting the 100 percent threshold by 2020 through increased fiscal pressure on depositors and the forced purchase of sovereign debt by Cypriot banks and pension funds. See Peter Spiegel, Finance Ministers seek Cyprus Bailout, FIN. TIMES (Mar. 13, 2013, 7:31 PM), http://www.ft.com/intl/cms/s/0/3db65908-8bfc-11e2-b00100144feabd0.html#axzz2Nie_YhsxU.


The entry into the single currency is subject to the conditions originally set forth in the Maastricht Treaty (e.g., Articles 121.1, 122.2, second sentence, and 123.5 TEC), currently reproduced under Article 140.1 of the TFEU. To adopt the euro as its own currency, the Member State with a derogation has to prove “a high degree of sustainable convergence” with specific regard to price stability, government budgetary position, exchange rate fluctuations, and long-term interest-rate levels. Id.

E.g., Spain and Ireland had both registered substantial capital inflows until the sudden burst of the crisis. The trend started in the last decade in connection with both countries' commitment to convergence; capital flows were channelled towards these countries because of the implied assumption that the euro's stability would be a strong guarantee against market speculation. Edgardo Favaro et al., Europe's Crisis: Origins and Policy Challenges, in SOVEREIGN DEBT AND THE FINANCIAL CRISIS: WILL THIS TIME BE DIFFERENT? 221, 236 (Carlos A. Primo Braga et al. eds., 2011).
derogation” to other peripheral EU Member States that are part of the Eurozone, thereby creating a situation where, with more and bigger Member States' economies struggling with their balance sheets, the future of the EU appears all but rosy.

As mentioned above, the surfacing—the first outside and then inside the Eurozone—of great budget imbalances sparked by the 2007-2008 credit crunch is the essential fact pattern that explains a second key point. To wit, the insolvency or pre-insolvency status of a Member State of the EU is never a problem affecting only that Member in isolation. The political and institutional framework created by the existence of the EU and the potential disruption of the EU objectives that may be caused by the disorderly default of any Member State are inherent factors necessarily entailing

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38 Starting May 2010 a worrisome series of EU Member States joined the list; the EU Member States currently under financial assistance programs include Greece, Ireland, Portugal, Spain, and Cyprus (Members of the Eurozone), and Hungary and Romania (Members with a derogation). EUROPEAN COMMISSION, Financial Assistance in EU Member States, http://ec.europa.eu/economy_finance/assistance_eu_ms/index_en.htm (last visited Mar. 28, 2013).


41 First, the creation of an internal market characterized by four fundamental freedoms: free movement of goods (Arts. 28-32 TFEU), persons (Arts. 45-48 TFEU), services (Arts. 56-62 TFEU), and capitals (Arts. 63-66 TFEU). Second, the adoption of a single currency as a subsequent and completing step of the first objective. (Arts. 139-143). author, supra note 9 (Treaties). Regarding the division of competences between the Union and Members States, under the TFEU there are four main categories of Union competence: (i) exclusive, (ii) shared, (iii) special, and (iv) supporting. To give a very general idea, the first category is ensured in the fields of customs union, competition rules for internal market, external trade policy, and, above all, monetary policy and, above all, monetary policy for Member States whose currency is the euro (Art. 3.1); the second, being the default rule, encompasses many areas (Art. 4 TFEU); the third is very specific: it concerns the economic and employment policy (Art. 5 TFEU) and the Common Foreign and Security Policy (CFSP) (Art. 2.4 TFEU); finally, the fourth includes, inter alia, areas such as health, industry, culture, tourism, and education (Art. 6 TFEU). It is relevant to stress that the above characterization matters as to the legally binding effect of an act. In short—and again very roughly—within the scope of its exclusive competence the Union can enact with binding effects while Member States cannot; they may do so only if empowered by the EU (Art. 2.1 TFEU). Within the shared area, both the EU and Member States can legislate with binding effect, however, Members’ legislative power is withheld when the EU has exercised its competence (Art. 2.2 TFEU). With regard to the supporting category, the EU can take legally binding actions, but their effects are limited; in fact, here, the EU cannot harmonize the law (Art. 2.5 TFEU). Lastly and unlike the foregoing, the legal consequences of an act falling within the economic and employment policy category are somewhat less straightforward: Art. 2.3 TFEU, which sets out the category's definition, is silent on this very issue. Thus, to infer the legal consequences of an act characterized under the special category, one is left only with Art. 5 TFEU, which unfortunately does not provide any clearer guidance than simply calling for Member States’ coordination. PAUL CRAIG, THE LISBON TREATY: LAW, POLITICS, AND TREATY REFORM 156-182 (2010); 2 KENNETH DYSON & LUCIA QUAGLIA, EUROPEAN ECONOMIC GOVERNANCE AND POLICIES 843 (2010) (maintaining that the economic and employment policy category—concerning core fiscal, economic, and labour matters—ought to be considered soft-law).
direct involvement of the European institutions in the debt-restructuring process or, more generally, in the rehabilitation efforts relating to any Member State threatened by insolvency or plagued by serious difficulties. This is certainly true whenever a situation of serious difficulty occurs in one or more of the seventeen Member States that are also members of the European Monetary Union (EMU). But it is also true in cases of insolvency, pre-insolvency or serious difficulties of Member States not belonging to the Eurozone. In fact, both legally and practically it would be wrong to assume that the involvement of the EU institutions is only warranted when one or more Members of the Eurozone is/are in trouble.

Legally, all the EU Member States are subject to a common regime on fiscal and monetary policy, as shown, inter alia, by the powers granted to the European System of Central Banks (ESCB) and, conversely, all EU Member States are entitled to receive what may be roughly described as institutional European solidarity in crisis situations.

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42 Of the 27 countries belonging to the EU, 17 Member States agreed to bound themselves to the euro, namely Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, Malta, Netherlands, Portugal, Slovakia, Slovenia, Spain. For a historical overview from the European Monetary System to the adoption of the single currency, see Lowenfeld, supra note 29, at 771-802.


44 Supra note 41.

45 Protocol (No 4) on the Statute of the European System of Central Banks and the ECB, Mar. 30, 2010, O.J. (C 83) [hereinafter ESCB]. Article 127.1 TFEU (Article 2 ESCB) pleads the objectives of the ESCB which are price stability, support of the general economic policies of the Union and financial stability. Article 127.2 TFEU (Article 3.1 ESCB) lists “the basic tasks to be carried out through the ESCB” which are four: (i) to define and implement the monetary policy of the Community, (ii) to conduct foreign exchange operation consistent with the provisions of Article 219, (iii) to hold and manage the official foreign reserves of the Member States; (iv) to promote the smooth operation of payment system. Article 219.1 TFEU, gives the Council the power to conclude formal agreements on the exchange-rate between the euro and the currency of third States; unanimity of action is required, also, the Council is allowed to adopt, adjust or abandon the central rates of the euro. Although not included in the letter of Article 127.2 TFEU, there are other “non-basic” tasks: (I) issue of banknotes (128.1 TFEU; 16 ESCB), (ii) contribution to financial stability (Art. 127.5-6 TFEU; Art. 25 ESCB), (iii) advisory functions and collection of statistical information (Articles 127.4 and 132.1 third indent TFEU; Article 4 ESCB), and (iv) international cooperation and “external operations” (Articles 6 and 23 ESCB).

46 Article 122.2 TFEU allows the Council to “grant, under certain conditions, Union financial assistance” to a Member State when such Member “is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control”. Article 122.1 allows the Council to adopt “in a spirit of solidarity between Member States” a decision by which the supply of certain products will be offered by Members
Furthermore—and more importantly—it would be disruptive of the fundamental objectives of the EU to let any Member State, whether or not it belongs to the EMU, seek in insolation a readjustment of its ruined economic and financial status by adopting policies or negotiating solutions that may have a very serious “beggar-thy-neighbour” effect within the boundaries of a strongly integrated customs union, as the EU is (at the very least) as of today. This is clearly the underlying rationale of Articles 143 and 144 of the TFEU, which provide for emergency measures that are applicable to Member States “with derogation” (i.e., whose national currency is not the euro) if they are hit by a crisis. In brief, these provisions make clear that even if the Member States “with derogation” have not formally relinquished monetary sovereignty over their national currency, such sovereignty is in any case severely limited by the TFEU in that it is exercisable only within the boundaries of the Treaty and subject to the power of recommendation and enforcement of concerted actions, which are granted to the Commission and the Council, respectively.

In short, a sovereign debt crisis of an EU Member State necessarily triggers an institutional European reaction. This paper will expend no additional attention to sovereign crises outside the Eurozone. Intuitively, crises within the Eurozone may endanger the very survival of the euro, thus threatening consequences that could be devastating across the Union. This is why these crises draw so much attention and why my analysis will consequently focus only on such crises.

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Art. 143 TFEU sets out the “mutual assistance” to EU Members whose currency is not the euro. Consider, in particular, the role of the Council and the protective measures the actual or prospective beneficiary can take under Articles 143.3 and 144.1.
2. Institutional Cooperation Between the IMF, the EU, and the ECB: the Model of the IMF's Conditionality

Each sovereign crisis has its own features, both in terms of its trigger or catalyst and in terms of measures that must be identified as especially suitable for its resolution. Within the Eurozone, however, coordination among three particular institutions has developed into a repeating, institutional pattern—or model—for the co-management of the efforts aimed at the rehabilitation of the sovereign debtor at issue.

The three institutions that have shaped this model are the International Monetary Fund (IMF), the European Union (EU)—acting through the European Commission (EC)—and the European Central Bank (ECB). When they coordinate their actions, they are collectively called the “Troika,” which is probably colored with somewhat disparaging intent. At this point, however, this informal nomenclature has become so popular that it would be senseless to expend resources in an effort to promote a different, more formal name.

Essentially what the members of the Troika “do” is make available financial help that is conditioned upon compliance with required infrastructural changes that impact upon the economic, financial, and social conditions of the sovereign debtor.

This is what the IMF has been doing for many years on the international scene: initially, in compliance with its institutional mission of helping its Member States to cure structural balance-of-payment problems; and subsequently, in a broader capacity as a promoter of economic development and/or as “fireman” entrusted with the task of avoiding the conversion of local crises into explosive regional or universal crashes.50

In 2009, when the first signals of the crisis made their appearance, the European institutions

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did not have (and perhaps still do not have) significant experience in handling sovereign debt crises and, after initial hesitation (not to say hostility), they requested IMF intervention; this has led to the placing of the IMF’s fingerprints on the nature, structure, and techniques that have since characterized the financial assistance given to the Eurozone Member States that have asked for it.

Thus, in order to quickly understand the main features of the sovereign debt restructuring and rescue programs that have been launched within the Eurozone, the best way to start is by looking back at the IMF practice that has been the main source of inspiration in shaping the “special” European variants.

Generally speaking, the main feature of the IMF’s lending operations is conditionality, whereby the institution aims (i) to “educate” the member State benefiting from the new financing on how it should redress its macroeconomic flaws, and (ii) to improve, in the interest of the other member States, the chances of repayment of the funds that have been or will be disbursed under the relevant rescue program. This repayment is crucial for the “revolving” character of the funding that will then be available for all other, present or future, financial assistance programs.

Since its inception the IMF has always attached policy conditions to its financings. That

51 Antoniadis, supra note 33.
54 Vreeland, supra note 52, at 20-21. Implicitly, there has always been conditionality. During the first decade of operations conditionality was developed outside an explicit legal framework, even if it was not mentioned in the Articles of Agreement of the IMF. Id. at 29-30. It was first included in the text in 1952 in parallel with the SBA. In the early 1960s SBA was characterized by some relevant elements that have fashioned the Arrangement the way we know it today, including periodic reviews by the Staff and “phased” drawings. Later the EFF supplied the limits shown by the short-term-oriented SBA. An Analysis of IMF Conditionality, in Challenge to the World Bank and IMF – Developing Country Perspectives 83 (Ariel Buira ed., 2003). It was ultimately inserted in the Articles by the First Amendment in 1969 at Article V(3)(a), which was entitled “conditions governing use of the Fund's general resources”. During the first years of operations, in fact, the borrowing country simply had to satisfy
does not mean that conditionality has remained the same throughout the almost seven decades of operations. On the contrary, the IMF has carefully adjusted its lending policies according to the course of history and the kinds of needs the upcoming “clientele” brought when knocking at its doors. In short, conditionality has gradually developed from macro-conditions into micro-conditions. That is, while in the early days the IMF allowed members to withdraw resources as long as their request was in compliance with the IMF’s Articles of Agreement, it later started to attach to disbursements more and more complex and thorough structural conditions. By the 1990s the number of structural conditions applied to a program had increased greatly.

Conditionality has gone through two important phases: a first version, which covers the period 1979-2002, and a second version, which encompasses the period 2002-today.

The first period is important because in 1979 the IMF reviewed its policy conditions for the first time and, through a Decision of the Executive Board, released the first comprehensive set of the consistency of its request with the Articles of Agreement and—in particular—language stating “without resorting to measures destructive of national or international prosperity.”

LOWENFELD, supra note 1, at 645.

VREELAND, supra note 52, at 23. In the aftermath of the Second World War the IMF was mostly concerned with preventing the larger economies—now impoverished—from availing themselves of measures that could impair national or international prosperity. JAMES M. BOUGHTON, SILENT REVOLUTION – THE INTERNATIONAL MONETARY FUND 1979-1989, Ch. 13 (2001) (surveying conditionality attached to adjustment and growth program).

VREELAND, supra note 52, at 24 (noting how the number of structural detailed micro-conditions soared in the 1980s, that is, when the IMF started to get progressively more involved in the assistance of developing countries and conditionality started to urge, e.g., privatization operations and deregulation measures rather than a generic reduction of the public deficit). Boughton, supra note 56, Ch 14. In this context (the 1980s and the IMF’s pivot to the developing world), some have argued that the IMF encroached into the World Bank’s exclusive operational area, that is, development. See, e.g., Lex Rieffel, The International Monetary Fund and the World Bank: A Case for Separating the Conjoined Twins (Brookings, Policy Brief, 2008), available at http://www.brookings.edu/research/papers/2008/10/global-governance-rieffel. Others maintain the contrary by underscoring that the IMF was not doing project financing and thus directly addressing development issues, but rather it was pursuing its institutional role as catalyst for lending from other sources. ASIF H. QURESHI & ANDREAS R ZIEGLER, INTERNATIONAL ECONOMIC LAW 239-40 (3rd ed. 2011)

Initially, the sole legal requirement conditioning the use of the resources of the Fund was that such use had to be consistent with the provisions of the Agreement. Conditionality was formalized in 1952, when the SBA was first launched. Lowenfeld reproduces at 612 the text of a Decision of the Executive Board in 1948 that he considers the “birth certificate” (my words) of conditionality: “If the Fund concludes that a particular declaration is not correct, the Fund may postpone or reject the request, or accept it subject to conditions”. LOWENFELD, supra note 28, at 612.

VREELAND, supra note 52, at 24 provides interesting data about the average number of conditions per program; from the 1960's to the late 1990s, the average increased from six to sixteen.

LOWENFELD, supra note 28, at 647.
Guidelines on Conditionality, which are considered the basic document of reference required to obtain stand-by or extended arrangements. Performance clauses were set forth under these Guidelines (e.g., specified targets on inflation rates, minimum levels of reserves and liquidity, attainment of certain levels of GNP increases) and strict observance was required. Although the Guidelines presumed “macroeconomic” performance criteria (in fact, other variables were considered exceptional), in the late 1990s the IMF had to respond to regional crises with programs that went far beyond the earlier Guidelines (e.g., governance structure, enactment of competition law, anti-corruption measures, tax collection, regulation and deregulation of industries, foreign investment law). “Structural adjustment” was born, and the inadequacy of the 1979 Guidelines was subjected to intensified scrutiny.

After a period of debate and negotiations, a new set of Guidelines was released in 2002.

Pursuant to the 2002 Guidelines the IMF has re-shaped its structural conditionality with a more flexible approach to—and inclusion of the national authorities in designing—assistance programs. In accordance with the spirit of the Streamline Initiative, the paramount principles that

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61 Id. at 648. “[S]tand-by arrangements were in fact suspended more often than is made public”; however, he specifies that in similar situations, usually “an emergency consultation would be held, the targets would be adjusted somewhat, and a supplemental or amended Letter of Intent would be submitted to the Fund, or a short-term waiver granted” (citing RICHARD W. EDWARDS, INTERNATIONAL MONETARY COLLABORATION 268 (1985)).
62 Id. at 649.
63 Mexico and East-Asia.
64 Id. at 649.
65 Id.
66 Id.
67 In 1999 the Poverty Reduction and Growth Facility (PRGF) was established to replace the Enhanced Structural Adjustment Facility of 1989. This facility operates under the PRGF Trust, the channel through which the IMF provides concessional lending - as opposed to the General Resources Account (GRA) operations, which instead is non-concessional, that is, subject to market interest rates, charges, and surcharges. Id. at 657. Also introduced are the problems of “moral hazard” of both debtor and creditor, and “ex ante” and “ex post” conditionality. Olivier Jeanne et al., A Theory of International Crisis Lending and IMF Conditionality 5 (IMF Working Paper No. 08/236, 2008), available at http://www.imf.org/external/pubs/ft/wp/2008/wp08236.pdf).
69 The Guidelines on Conditionality were first issued in 1979, but they were never actually implemented; they were later harshly criticized by the IEO, which in essence noted that the conditions had a highly technical aspect and were
should guide the IMF staff in crafting conditions to be attached to each program are: ownership
(i.e., causing the beneficiary State to perceive the IMF’s proposed program as if it had been
conceived and launched by the State itself), parsimony, tailoring, and clarity. In very simple
words, conditionality is what needs to be accomplished under the IMF-supported program as well
as how the IMF staff will assess the progress made by the beneficiary. With regard to the substance,
conditionality on the whole must be “macro-critical”, that is, the modern approach to
conditionality is to focus only on structural conditions so as to avoid the imposition of unnecessary
sacrifices and to require only those that are essential to the achieving of the macroeconomic
standards set by the program or to the implementation of the IMF’s institutional goals.

In the process of determining the overarching features of the conditionality attached to its
program, the requesting Member's role is required to submit a letter of intent along with a
memorandum of economic and financial policies outlining the objectives to be pursued under the
program.

As regards the assessment procedure, program reviews are two-fold, comprised of a
backward-looking evaluation as well as a forward-looking one. In fact, the IMF's Executive Board
not only checks whether previously set targets are satisfied according to the agreed schedule, but it
also verifies whether such targets remain feasible in the development of the program, in the course

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71 IMF, 2011 REVIEW OF CONDITIONALITY—OVERVIEW PAPER 9 (June 19, 2012) (defining macro-critical as
“conditions [that] should be of critical importance for achieving the goals of the member’s program or for
monitoring program implementation [that] should be limited to the minimum necessary”).
72 VREELAND, supra note 52, at 20-21 (arguing agreements are generated by Executive Board decisions, not
international treaties). Also, it is conceded that the Letter Of Intent might be purportedly written by the IMF Staff
with national authorities behind closed doors during the Staff’s first visit to the prospective borrower State. Id. 32-33
(describing the whole process).
of which new issues not contemplated at the time of negotiations might arise. Hence, only in the case of a positive appraisal from both standpoints will the Executive Board approve or complete the review and therefore grant the installment's disbursement.

Policy commitments are extremely important and are divided in different categories, namely: prior actions, quantitative performance criteria (QPCs), indicative targets, and structural benchmarks.

Prior actions, as the name suggests, are a sort of pre-condition (ex ante) as they entail measures to be effected by the requesting country before any subsequent review takes place (e.g., approval of a budget consistent with the program's fiscal goals).

The QPCs are specific and measurable conditions that deal with factors under the direct control of the national authorities (e.g., certain minimum level of international reserves or government borrowing).

Indicative targets serve as temporary indicators that come into play when QPCs cannot be sufficiently specific, which could be due to data uncertainty enshrined in various economic trends; these are turned into QPCs once the uncertainty has faded.

Lastly, structural benchmarks, although often non-quantifiable, measure the quality of the critical reforms to be accomplished under the program (e.g., the building-up of social nets or strengthening of public financial management).

If the satisfying of prior actions is mandatory before a given disbursement, the other criteria may benefit from a waiver (i.e., a minor or belated deviation from the program's goals and schedule). To be more precise, waivers are possible with regards to QPCs as long as it is proven that

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73 Jeanne et al., supra note 67, at 6-7. Prior notice clauses empowered the IMF to rescind agreement with a borrower at any time if the sovereign debtor is not implementing the program in accordance with the agreed terms. Although included in more than 30 programs between 1954 and 1960, the IMF has only invoked the prior notice once (Bolivia in 1958). The high degree of discretion allocated to the IMF pursuant to these clauses remained controversial until they were replaced by performance criteria clauses. *Id.* at 5.
the program will be successfully implemented anyway; in contrast, no waiver is foreseen in respect of structural benchmarks or indicative targets as the failure to meet one of these measures is assessed from an overall performance perspective.74

Typically, a sovereign State finds itself compelled to seek financial assistance from external institutional sources75 when its debt and deficit levels become unsustainable due to a lack of trust on the part of the creditors with regard to the debtor's capacity to service its debt. In such instances the sovereign debtor's options are quite few: launch a debt reduction strategy, apply for financial assistance to the international financial institutions, or both. The request of outsourced institutional financings is sought not with the ultimate intent of obtaining funds for rollover purposes (i.e., payment of outstanding indebtedness and replacement of the old paid debt with new debt) but rather to show the sovereign's willingness to undertake the necessary measures and reforms that should help them avoid needing to request further financial assistance in the future.

This is the core rationale behind the IMF's conditionality (and the same generally holds true for the conditionality required by all the major international financial institutions): the beneficiary obtains monies merely to the extent that is deemed sufficient to restore creditors' trust, and nothing more; these monies are then contingent on the beneficiary's commitment to a rigid plan of reforms expected to put it back on the right track.

In other words, the IMF76 (and, similarly, the other major international financial institutions) only provides a cushion that easies the adjustment of the balance of payments so that the borrower

74 IMF, GRA LENDING TOOLKIT AND CONDITIONALITY: REFORM PROPOSALS 6-7 (March 13, 2009).
75 From an overall perspective, it has been argued that rather than a balance of payments problem, what really urges a country to seek financial assistance is its low reserves level. VREELAND, supra note 52, at 51-72 (discussing the various reasons behind a request for financial relief)
76 Article I(v) of the Articles of Agreement. Along with other institutional purposes, the IMF is “To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity” (emphasis added). This is the current amended version.
will then be able, by its own means, to resume economic growth and access new financing from the markets. More precisely, the monies are gradually released, against a backdrop of strict scrutiny, under observance of the conditions imposed by the involved financial institution. In this way, two objectives are pursued: on the one hand, the beneficiary is helped to back onto its feet and, on the other hand, the reimbursement of the funds provided by the institution will make it possible to use them for providing financial assistance to other potential sovereigns in need.

3. (sequitur): The Respective Roles of the IMF, the EU (EC) and the ECB

While every program of financial assistance within the Eurozone has been conducted so far as an ad hoc exercise with its own peculiar features, there is by now a well established practice of cooperation among the members of the Troika, a process that deserves to be underpinned. This is in particular so with respect to the distribution of the roles and the sharing of the financial burdens and responsibilities that are associated with each program of rescue or assistance.

The EC’s role, as the operating representative of the EU, has typically been that of the main collector of the funds as well as of the main official negotiator with the Member State in need.

Initially, that is, in the context of the first financial assistance program concerning Greece, the EC acted as a sort of broker, first procuring and then pooling together the granting (to Greece) of bilateral loans provided by other Member States of the EU.77

Subsequently, the EC assumed a different role: it became the promoter of financial vehicles, whereby the necessary funding for each financial assistance program could be typically sought in the market.78 In practical terms, however, the responsibility for organizing the collection of the largest share of the funding required for each financial assistance program has always been—and

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78 Infra, para. 5.
still is—incumbent upon the EC in its capacity as the political and institutional representative of the European Union and the Member States.

Coupled with the fact that the EC is the institution that must combine the objective of European solidarity with that of European financial stability, the status of the EC as the largest provider of funds is an understandable reason for giving it the official role of main negotiator of the terms upon which the requested financial help may be granted. In other words, rather than due to superior technical expertise, the role of main negotiator is allocated to the EC as a matter of political necessity as well as due to its importance as the collector of the largest contribution.

In contrast, the role of the IMF has been financially and formally less important, if in substance not less relevant, than that of the EC in determining the outcome of the negotiations with the Member State in need of help.

In parallel with its subsidiary participation in the supply of new financing, the IMF has typically contributed its experience and know-how in suggesting the type of conditionality to be imposed. In particular, the language and technicalities of the IMF's conditions—such as the requirements of prior actions, QPCs (quantitative performance criteria), indicative targets and structural benchmarks—have been adopted as part of the process of economic and financial rehabilitation required to be complied with by the Member State in need of help.

As will be shown with more detail later in this paper, the financial contribution of the IMF has in all cases been substantially lower than the strictly “European” share and has typically been characterized by two favorable features, namely the IMF's claimed prerogative to subordinate the

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79 Art. 13.4 of the ESM Treaty (providing that the EC has the right to sign on the behalf of the ESM the MoU with the ESM Member requesting financial assistance, notwithstanding the fact that the ESM is legally a separate entity with respect to the Union).

80 Infra, para. 4. By contrast, the IMF’s share has been substantially higher than the “European” share regarding the programs for the non-EMU Member States. EUROPEAN COMMISSION, supra note 32.
payment of its commitments to the prior payment of the other contributions, and the right to be repaid with priority over the other creditors. On the whole (and this is a point to which I will return), the IMF has been recognized, in all rescue programs in which it has participated, as playing an overall role and exerting more influence than would be proportional with respect to the weight of its financial contribution.

The underlying reason for granting the IMF this very special status in all the European Adjustment Programs is comprised of two factors.

First, the IMF had—and still has—accumulated experience in assisting financially troubled states, experience the EU lacked at the outset of the Eurozone crisis and that the EU is still in the process of acquiring. It is only natural and reasonable that a recognized level of higher expertise carries with it the enhanced possibility of influencing the shaping of the rehabilitation process.

Second, it may have been politically attractive for the EU to let the IMF take the helm as the severe expert imposing the harsh rules politically difficult to cram down (from the standpoint of the EU) and to swallow (from the standpoint of the ailing Member State). In other words, giving the IMF more space and visibility than the size and conditions of its contribution would seem to have demanded was both per se warranted and may have even been politically desirable rather than an unwillingly granted concession.

In more specific terms, the EC would be typically responsible for designing the conditionality and the program review to be inserted in the Memorandum of Understanding (MoU), while the IMF prefers to take care of the matters covered in the Memorandum of Economic and

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81 EUROPEAN COMMISSION, supra note 77.
82 See infra, para. 7.
83 A significant confirmation of the special role of the IMF is set out in the ESM Treaty. The 13th Whereas Clause grants the IMF’s loans a super-priority over the loans of the ESM itself. See infra para. 7.
Financial Policies (MEFP).  

Generally the MoU is a document containing a wider and more detailed set of structural measures, promoting required changes in macro-social conditions, while the MEFP usually focuses on a smaller number of priority actions that are seen as macro-critical.  

There are certain areas where the relationship is characterized by the complementary contributions of both institutions (e.g., fiscal policy, where the EC has often focused on health care and pension reforms and the IMF on reforms of the tax system) as well as areas in which the special expertise of one of the members of the Troika has resulted in the de facto primacy of that institution in outlining the program and monitoring its implementation. In this way the IMF has brought special expertise from its involvement in numerous banking crises, while the ECB has claimed a special role regarding the providing of liquidity and the EC in promoting an increase of competitiveness and, generally, a better application of competition rules and internal market rules.  

On the whole, the monitoring of conditionality and the conduct of the review programs have relied “on the principles of mutual trust and reciprocal evaluation rather than a strict division of labor within teams.” It would therefore seem that the lack of clarity and of a rigid distinction between the tasks of each member of the Troika has not resulted in conflicts or significant inconveniences owing to a spirit of collaboration, which has prevailed despite the intrinsic difficulties that have certainly been present in the light of an unprecedented experience.  

Turning now in particular to the ECB, it might seem at first glance that its role within the Troika has been closer to that an observer than to that of an active participant. Very recently, there have also been rumors that members of the ECB board and governors of national central banks have

84 IMF, 2011 REVIEW ON CONDITIONALITY—BACKGROUND PAPER 4: TECHNICAL APPENDICES 11 (June 18, 2012).
86 Id.
87 IMF, supra note 84, at 12.
been insisting behind the scenes for a slow phasing out of the ECB’s role within the Troika, to be followed eventually by a formal exit, presumably on the ground that it is not appropriate for the ECB to be exposed to the political criticism of what policies that appear to be jointly decided by the Troika in the implementation of each rescue program.\textsuperscript{88}

It would be wrong, however, to assume that the role of the ECB is minor in the overall picture. It is true that the ECB appears to be less interested than the EC and the IMF in getting involved at the level of the \textit{internal} relationship between the Troika and the Member State receiving financial assistance. The ECB, however, is fully conscious of (and fully determined to play) a fundamental role in preserving the \textit{external} conditions of market stability on which the success or failure of the rescue efforts ultimately depends.

In substance, as will be shown below, the real role of the ECB consists in avoiding turmoils and discouraging speculative attacks in the Eurozone sovereign bond market. Without the ECB’s market interventions, it is highly doubtful whether the individual programs of financial assistance would or could have been capable \textit{per se} of delivering the results that have been so far achieved.

\textbf{4. Overview of the European Adjustment Programs: Greece, Ireland, Portugal, and Spain}

A quick factual overview of the main experiences in granting help to Eurozone Member States is necessary to comprehend the scope and dimension of the efforts taken and the variations in technical approaches that have been developed. This overview is presented country-by-country.

\textbf{Greece}: Greece has gone through two subsequent programs of financial assistance. The first covered the period from May 2010 to December 2011, while the second started in March 2012 and is expected to continue until the end of 2014.

Under the First Economic Adjustment Program, Greece was slated to receive an aggregate

\textsuperscript{88} Marika de Feo, \textit{Stop della BCE—Fuori dalla Troika sugli Aiuti} [\textit{Halt from the ECB—Exit the Troika on Assistance}], \textit{Corriere della Sera} 13, Mar. 6, 2013.
loan amount of €110 billion, of which €80 billion was to flow from the Greek Loan Facility (i.e., a pool of bilateral loans granted by the European Member States and coordinated by the EC acting as a lending manager or administrator); the other €30 billion was to be provided by the IMF under a typical IMF Stand-by Arrangement (SBA).\(^89\)

Eventually, only €73 billion were disbursed under this Program. In March 2012 a new, broader Program was launched to provide additional financial support in the aggregate amount of €164.5 billion.

Specifically, in addition to the undisbursed portion of the GLF, €144.7 billion were committed to Greece on the basis of funding to be obtained through the European Financial Stability Facility (EFSF), that had become operational in August 2010.\(^90\) The remainder, €19.8 billion, would come from the IMF as part of a €28 billion arrangement under the Extended Fund Facility (EFF). It should be noted in this connection that the short-term SBA approved under the First Economic Adjustment Program had been canceled on the grounds that financing under the EFF, that is, financing designed to help countries with medium- and long-term balance of payments problems “reflecting extensive distortions that require fundamental economic reform”,\(^91\) was more appropriate for a country like Greece.\(^92\)

Prior to the approval of the Second Economic Adjustment Program, the Troika jointly found that all of the prior actions required for its start-up had been taken.\(^93\) Moreover, as a condition precedent to the disbursement under the Second Program, the EC and the EU Member States, led by

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91 IMF, supra note 69.
93 European Commission, supra note 81.
Germany and France, obtained from Greece the enactment of new legislation that would facilitate “haircuts” of the Greek bonds held by the private sector. As a result of this legislation—as well as of a parallel debt exchange offer—97.5% of the outstanding Greek bonds held by the private sector were successfully restructured.94

Starting in Spring 2012, Greece went through a period of political instability (two election rounds) that culminated in frightening capital outflows and widespread uncertainty over Greece’s capacity to implement the sacrifices imposed by the Second Program.

In response to these problems, in late November 2012 the Finance Ministers of the Eurozone and the IMF agreed to (i) extend the fiscal adjustment path by two years; (ii) lower the interest rate on the GLF; (iii) lower the costs of the EFSF’s guarantee fee; (iv) extend maturity on loans (bilateral and EFSF) by 15 years; and (v) defer interest payments on EFSF by 10 years.95

In December 2012, after a substantial buyback of the outstanding Greek debt, the second installment under the Second Program was released.96

**Ireland:** The financial assistance to Ireland was granted under an Economic Adjustment Program stipulated in December 2010 and providing for coverage until 2013.

The total financing of the Program comprises €85 billion, of which two-thirds will be covered by the EFSF, bilateral loans from other EU Member States and the Irish Treasury, while the remaining one-third will come from the IMF. In exchange for the help, Ireland undertook to carry out a thorough overhaul and restructuring of its banking sector, a drastic cleaning of the inflated values of real estate assets, and severe reforms of the taxation system and labor costs.97 Ireland

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94 See infra, Chapter III, para. 3.
95 Press Release, EFSF, EFSF Places €1.5 Billion 20 Year Bond (Mar. 19, 2012).
recently regained access to the international bond market, where it was able to place new bonds at affordable interest rates.98

**Portugal:** The financial assistance to Portugal was granted under an Economic Adjustment Program that started in May 2011 and will expire in mid-2014.

The total financing of the Program is €78 billion, of which two-thirds will be covered by European sources or mechanisms (EFSM and EFSF) and the remaining one-third by the IMF.99

The conditionality accepted by Portugal includes growth-enhancing reforms (in particular, in the areas of labor and competitiveness), public debt reduction, fiscal system reform, and financial sector stabilization through recapitalization and deleveraging pursued through market-based mechanisms supported by backstop facilities.100

**Spain:** In July 2012 Spain reached a comprehensive and articulated agreement with the EC, acting cooperatively with the ECB and the European Banking Authority (EBA) as well as with the technical (but not financial) assistance of the IMF.

Again in conformity with the IMF’s practice, an MoU was issued and a Financial Assistance Facility Agreement was stipulated.

The Spanish Program aims to address the greatest issues of the banking sector, in particular its long-term resilience, market access and the legacy stock of the real estate basis. This explains the peculiar feature of the Spanish Program: the direct aim of supporting the banking sector. The recipient of the funds under the Agreement is the Fondo de Restructuración Ordenada Bancaria

98 Micheal Steen, *Glimmer of Hope in the Europe Debt’s Tale*, FT.COM (Nov. 29, 2012, 3:48 PM), [http://www.ft.com/intl/cms/s/0/7e5cd158-3a28-11e2-a00d-00144feabdec0.html#axzz2QgY4IXVS](http://www.ft.com/intl/cms/s/0/7e5cd158-3a28-11e2-a00d-00144feabdec0.html#axzz2QgY4IXVS).


(FROB), which acts on behalf of the Spanish government and is responsible for channeling the funds to the financial institutions concerned.\textsuperscript{101}

The conditionality laid down in the Memorandum of Understanding is particularly detailed and sophisticated. There are rules on bank-specific conditionality and on horizontal conditionality: the latter applies to the entire banking sector, while the former seeks to impose rules on a bank-by-bank ratio.\textsuperscript{102}

The aggregate financial package is geared to provide up to €100 billion via the EFSF (which will be replaced by the ESM\textsuperscript{103}). In December 2012 the Spanish government formally requested a crucial disbursement (almost €40 billion), and the funding was made through the ESM, which issued notes that were subsequently transferred to the FROB.\textsuperscript{104}

Compliance with the disbursement schedule and with the conditionality rules in the Memorandum of Understanding is monitored and scrutinized on a regular basis by the EC acting in concert with the ECB and the EBA. The IMF provides technical assistance to the Spanish authorities throughout the implementation and monitoring of the program of financial assistance to the Spanish banks. Its role and involvement are described in a separate deed known as the Terms of Reference (TOR).\textsuperscript{105}

5. The European Financial Stability Mechanism (EFSM), the European Financial Stability Facility (EFSF), and the European Stability Mechanism (ESM)

Even though the disclosure of the gravity of the Greek situation occurred in October 2009, when, after the elections, Greece reported that its annual budget deficit was much larger than the

\textsuperscript{102} Id.
\textsuperscript{103} See infra, para. 6.
\textsuperscript{104} Id.
previously disclosed official figures (three times the amount stated at the beginning of 2009 and
twice the amount stated before the elections), the first formal request for European financial
assistance was not made by Greece until April 23, 2010.\textsuperscript{106}

As described above, the EU and the IMF reacted by offering a €110 billion emergency
package, of which €80 billion was in the form of bilateral loans coming directly from other Member
States and €30 billion from the IMF.

Shortly thereafter, on May 10, 2010, the European Council issued Regulation 407/10,
whereby a European Financial Stabilization Mechanism (EFSM) was established.\textsuperscript{107}

The EFSM was conceived under pressure with the aim of providing an institutional relief
mechanism by replacing the direct loans from the Member States of the kind exemplified by the
Greek Loan Facility (GLF).

Although prompted by the Greek crisis, the EFSM was established as a mechanism that
would also be available to any other requesting Member State in difficulty, provided that a qualified
majority of the Council had previously approved the offering to such a State of financial assistance
through the EFSM.\textsuperscript{108} Approval of the request would require a prior assessment by the Council of
an application to be made by the Member State to the EC and the EU Economic and Financial
Committee (ECOFIN)\textsuperscript{109} and would further require acceptance by the Member State of strict
conditions whose terms would be determined in consultation between the EC and the ECB.\textsuperscript{110}

The financial technique characterizing the EFSM was the granting to the EC of the
authorization to borrow up to €60 billion on the financial markets and to make available the raised

\begin{footnotesize}
\begin{enumerate}
\item[106] EUROPEAN COMMISSION, supra note 82.
\item[108] Id., Art. 3.2.
\item[109] Id., Art. 3.1.
\item[110] Id., Whereas Clause (7) and Arts. 3(b), 4(b).
\end{enumerate}
\end{footnotesize}
funds to the requesting State as loans.\textsuperscript{111}

Clearly, the most important legal and political effect of the EC acting as a borrower was to place the burden and the risk of fundraising on the EU's budget. The legal basis that was invoked for justifying the assumption by the Union of this burden was Article 122.2 of the TFEU, providing for the possibility of EU financial assistance under certain conditions, such as “where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional circumstances beyond its control” (emphasis added).\textsuperscript{112}

Whether in strictly legal terms Regulation 407/10 establishing the EFSM could rely on Art. 122.2 as its proper legal basis for tackling situations such as those of Greece and Ireland is a proposition that has been strongly criticized, particularly on the ground that Art. 122.2 was not designed to apply to situations where the severe difficulties of the requesting Member States were not the consequence of a sudden occurrence beyond the control of such a State, but rather the result of many years of mismanagement of the State's fiscal policy and financial affairs.\textsuperscript{113}

The EFSM, however, played a relatively minor role in the evolution of the process leading to the creation of relief mechanisms designed to help troubled Eurozone Member States (and, by the same token, to protect more generally the Eurozone and the euro from the risks of country-to-country contagion).

Instead, and almost contemporaneously with the EFSM, an additional and more important mechanism was created: the European Financial Stability Facility (EFSF).\textsuperscript{114}

\textsuperscript{111} Id., Arts. 2.1, 2.2. See also EUROPEAN COMMISSION, European Financial Stabilization Mechanism (EFSM), \url{http://ec.europa.eu/economy_finance/eu_borrower/efsm/} (last visited Apr. 3, 2013).

\textsuperscript{112} EUROPEAN COMMISSION, supra note 111.


\textsuperscript{114} European Financial Stability Facility Framework Agreement, C-No 1189 Journal Officiel Grand-Duch´e de Luxembourg (June 7, 2010), available at \url{http://www.efs.f.europa.eu/attachments/20111019_efs.f_framework_agreement_en.pdf}. 
The legal format of this additional mechanism was no longer the granting of borrowing power (authorization) to the EC, but rather the formation of a separate legal entity. This new entity was a Luxembourg company endowed with robust capitalization provided by the Eurozone Member States and acting as a special purpose vehicle to raise funds in the markets for each rescue program through the sales of bonds guaranteed by participating Member States. The funds raised would then be loaned to the Member State under a strict conditionality program.\textsuperscript{115}

Thus, in legal terms the primary liability for repayment to the holders of bonds issued by the EFSF would fall upon the EFSF itself; the exposure of the guarantor Member States to subsidiary liability is subject, however, for each guarantor to a limitation of that guarantor's liability to a maximum aggregate amount of exposure.\textsuperscript{116} No risk of liability would be borne by the Union nor by the non-guarantor Member States. In the event of failure by a guarantor Member State to honor its guarantee obligation, all of the other guarantor Member States would have to absorb \textit{pro rata} their share of the shortfall, but this share will always be limited by the aggregate maximum exposure of such guarantor under its own guarantee.\textsuperscript{117}

The EFSF had a maximum authorized capital of €440 million.\textsuperscript{118} As in the case of the EFSM, the Member State requesting assistance was required to agree with the EC on the observance of an MoU containing an economic reform program characterized, as already mentioned, by a strict conditionality.\textsuperscript{119} These two elements (i.e., robust capitalization of the EFSF and financial assistance granted only upon terms of strict conditionality) in conjunction with the subsidiary liability undertaken by the guarantor Member States ultimately made it possible to achieve the desired goal, namely the granting of an AAA rating to the EFSF bonds by the three

\textsuperscript{115} \textit{Id.}, Arts. 2-3.
\textsuperscript{116} \textit{Id.}, Art. 2(10).
\textsuperscript{117} \textit{Id.}, Art. 2(2).
\textsuperscript{118} While the maximum lending capacity is €440 billion. \textit{Id.}, Whereas Clause (2).
\textsuperscript{119} \textit{Id.}, Whereas Clause (2), Arts. 2(1)(a), 2(1)(b).
major rating agencies.120

Thus, in addition to insulating the EU and the Member States from exposure to direct liability in the event of failure by the recipient State to honor its reimbursement commitments, the EFSF mechanism eventually succeeded in delivering a politically very important result, namely the result of keeping the cost of borrowing funds on behalf of the assisted Member State at a much lower level (AAA rates) than the one that such Member States would have paid had they tried to borrow on a stand-alone basis.

Unlike the EFSM, whose legal basis was stated to be Article 122.2 TFEU, the EFSF's legal basis is couched in Article 124 TFEU, which restricts privileged access by EU bodies or public undertakings of Member States to financial institutions, save for situations where the measure determining privileged access is based “on prudential considerations”.121

Arguably, a mechanism such as the EFSF—which succeeds in the task of issuing AAA securities thanks to its capitalization and enhancement of the bonds through sovereign guarantees— not only facilitates an ailing Member State’s access to borrowing but also, and ultimately more importantly, makes a significant contribution to controlling the systemic risks of the entire Eurozone area, risks that might otherwise be triggered by the default of that Member State. Accordingly, regarding the wording of Art. 124 TFEU, the EFSF may persuasively claim to be a measure based “on prudential considerations” in terms of both external legal structure and underlying purpose.

Both the EFSM and the EFSF, however, could be described as ephemeral experiences in that they have only represented the initial steps of an evolution that had already started to become manifest shortly after their respective creation.

120 Id., Art. 2(3).
121 Ryvkin, supra note 113, at 240.
On July 11, 2011 the Eurozone finance ministers signed a first version of a treaty establishing a permanent European Stability Mechanism (ESM). Its mission was, *inter alia*, to replace the EFSM and the EFSF, which were set to expire in June 2013.\(^{122}\) A second and final version of the ESM treaty was signed on February 2, 2012.\(^{123}\) It was initially foreseen that the treaty would enter into force in July 2012, but due to delays in the national ratification procedures this deadline was not met.

In particular, strong opposition to the treaty were raised in Germany, which led to the treaty being challenged before the German Federal Constitutional Court regarding its constitutionality.\(^ {124}\) On September 11, 2012 the German Federal Constitutional Court held that ratification by Germany of the ESM treaty would be constitutional only if two conditions were met, namely that all payment obligation of Germany under such treaty would in no event exceed its maximum subscription to the authorized capital stock of the ESM and that no protection of secrecy or confidentiality of documents concerning the functioning of the ESM could be opposed to the German Parliament and Senate.\(^ {125}\) After an interpretative declaration issued by the other Member States of the Eurozone, in which the two conditions posed by the German Federal Constitutional Court were met, Germany ratified the ESM Treaty on September 27, 2012; the treaty entered into force on the same day.\(^ {126}\)

Two months later, on November 27, 2012, the European Court of Justice issued a decision upholding the legitimacy of the ESM treaty from the standpoint of European law.\(^ {127}\)

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\(^ {122}\) Treaty Establishing the European Stability Mechanism, Apr. 6, 2011, O.J. (L 91) [hereinafter ESM].  
\(^ {126}\) Borger, *supra* note 124, at 113.  
Although these decisions have not ended the academic debate surrounding the ESM, it is nevertheless clear that at this point the ESM has become an established pillar of the structure designed to shelter and promote the development of the Economic and Monetary Union (EMU). In other words, the ESM is more than just an institution entrusted with the task of providing financial assistance to troubled Member States of the Eurozone. Rather, it is a permanent structure whose mission is to provide and administer the legal framework that the EU Member States have decided to accept in order to comply with the objectives of the Stability and Growth Pact (SGP) (essentially, sound public finances) and of monetary integration (for EMU Member States) or convergence (for non-EMU Member States).

For the purposes of this paper, it is unnecessary (and would exceed my time constraints and capabilities) to delve into an analysis of the numerous complexities and details of the ESM institutional structure. Although it is much more than this, the angle from which the ESM deserves to be considered is from the point-of-view of its mission as provider of financial assistance to troubled Eurozone Member States. As will be shown in the following, considering this mission necessarily entails an analysis through which the paths of the ESM and the ECB must converge.

6. Market Stabilization and the Key Role of the ECB – The Future Complementarity Between the ECB and the ESM

There is a common rationale behind the almost contemporaneous creation of the EFSM and the EFSF and the recent incorporation by treaty of the ESM.

Although distinguishable technically, legally, and in terms of financial magnitude, all of these mechanisms have been conceived and implemented with the aim, and under the assumption, that they would fulfill two functions: (i) to relieve the general body of EU Member States from being subjected to the pressure of direct demands to directly intervene as providers of emergency funding to ailing individual Member States; and (ii) to organize, in advance, techniques, resources,
and commitments capable of tackling crisis situations within the Eurozone, thereby discouraging potential speculative attacks against the Euro.

The first function can be easily recognized by merely looking at the sequence of the First and the Second Economic Adjustment Programs for Greece.

While most of the funds to be provided to Greece under the First Program (€80 billion out of a total of €110 billion) were collected directly from bilateral loans granted by the other Member States and pooled by the EC into the GLF, most of the additional funds to be provided under the Second Program (€144.7 billion out of a total of €164.5 billion) were committed through the EFSF, which had become operational in the meantime.\(^{128}\)

It is true that behind the separate legal personality of the EFSF there was still the financial and legal support of the Member States standing as guarantors of the bonds issued and sold by the EFSF for the purpose of collecting the funds.\(^{129}\) However, the legal and technical differences “matter”; in other words, it is not insignificant that through the recourse to the EFSF the direct financing of the rescue efforts was shifted from the Member States to the market (while not ignoring the intermediation of the EFSF as a special purpose vehicle and the continuing support of most, if not all, Member States as guarantors of the financial instruments issued).

The subsequent replacement of the EFSF by the ESM completed the evolutionary process of progressive detachment of the Member States from responsibility as direct providers of emergency funds to any ailing individual Member State. In addition, it constitutes the most ambitious move thus far undertaken by the EU with a view to arming itself with an ostensibly self-sufficient weapon for resisting speculative attacks against the Euro.

\(^{128}\) Supra note 90.

\(^{129}\) Supra note 115.
As pointed out above,\textsuperscript{130} the ESM is not just a special purpose vehicle relying on the support of guarantors to enhance the credibility (and ratings) of the financial instruments that it may issue. Rather, the ESM is a treaty-created entity conspicuously and directly capitalized by the Member States (the authorized capital is €700 billion: Art. 8 of the ESM Treaty), and it is striving for stand-alone financial credibility with the markets.\textsuperscript{131}

Conceptually, the ESM aims to become a European variant of the IMF,\textsuperscript{132} as shown by the complexity of its institutional structure\textsuperscript{133} and the size of its actual and potential firepower in terms of its own funds and fundraising capacity.\textsuperscript{134} The larger point, however, is whether its underlying political aspiration, which cannot be overlooked, is matched by a realistic capability to achieve its institutional goals, which at this point seems highly doubtful.

There are two main sets of reasons to doubt the ESM’s capability to achieve its institutional goals. First, the complexity of its institutional structure and the carefully constructed architecture of its decision-making process are likely to prevent (or to create in the markets the impression of preventing) it from reacting quickly to acute emergencies—in other words, precisely in those situations in which that ability is most needed.

Second, and most importantly, the level of debt carried by certain crucial Member States

\textsuperscript{130} \textit{Supra}, para. 4.

\textsuperscript{131} In addition to the paid-in capital, the ESM, like the EFSF, is authorized to borrow on the capital markets without any predetermined limitation (Art. 21 of the ESM Treaty); however, unlike the EFSF, it can do so without the supporting guarantees of any Euroarea Member State. Pursuant to Art. 8.5 of the ESM Treaty “The liability of each ESM Member shall be limited, in all circumstances, to its portion of the authorized capital stock at its issue price. No ESM Member shall be liable, by reason of its membership, for obligations of the ESM”. \textit{Supra} note 121.

\textsuperscript{132} Matthias Ruffert, \textit{The European Debt Crisis and European Union Law}, 48 COMMON Mkt. L. Rev. 1777, 1789 (2011). It is to be noted, however, that cooperation with the IMF is favored and expressly provided for in the ESM Treaty: see the 8th Whereas (“The ESM will cooperate very closely with the International Monetary Fund (“IMF”) in providing stability support. The active participation of the IMF will be sought, both at technical and financial level. A euro area Member State requesting financial assistance from the ESM is expected to address, whenever possible, a similar request to the IMF”).

\textsuperscript{133} The governance and organization of the ESM rest on three institutions: the Board of Governors (Art. 5 ESM), the Board of Directors (Art. 6 ESM), and the Managing Director (Art. 7 ESM).

\textsuperscript{134} The final amount could easily exceed €1 trillion. The math is simple: €700 billion of capital stock (Art. 21 ESM), plus €500 billion of maximum lending capacity (Art. 39 ESM).
who might become the target of market attacks owing to the intrinsic flaws of their economic and financial structures (this goes mainly to Spain and Italy, but France is also not immune from risks) is so gigantic as to cast serious doubts (to put it mildly) on the ability of the ESM to, on a stand-alone basis (or even with the cooperation and support of the IMF), effectively stop a general crisis of the euro that might be triggered by spillover effects of a crisis of any of these major countries.

The crucial issue comes up at this point. In order to discourage from the outset the convenience—in market terms—of betting on the plummeting of the stock market quotations of the above mentioned “weak” giants’ sovereign bonds, the most effective and least costly method is not to create an ad hoc rescuing institution, however generously capitalized: the better answer is instead to inform the markets that such bets will lose due to the existence of a central bank that is willing to act as a lender of last resort, providing “whatever it takes” to supply the market with the required liquidity.\(^{135}\)

However, as paradoxical it may sound or appear, the EU does not have—and yet has—an institution fulfilling this function: the ECB. On the one hand, the ECB is prohibited under the TFEU to act as if it were a lender of last resort in the sense described above; on the other hand, the ECB, again under the TFEU, has certain powers, whose firm exercise under the circumstances has enabled it—at least so far—to stabilize the market for certain sovereign bonds that would have otherwise been exposed to dramatic falls in value, much in the same way as if it had been the kind of lender of last resort that it cannot be.

In strict legal terms, Article 123 of the TFEU prohibits the ECB from acting as lender of last resort in support of any ailing Member State:

1. Overdraft facilities or any other type of credit facility with the European Central Bank or with the central bank 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.

The prohibition specifically imposed upon the ECB by Article 123 of the TFEU must be read in conjunction with the prohibitions promulgated in Articles 124 and 125 of the TFEU. The former prevents any Union institution and any public authorities of the Member States (including the Member States themselves and the regional and local authorities within each of them) from gaining privileged access to any financial institution. The latter, known also as the “no bail-out clause,” prohibits the Union from assuming or accepting liability for Member States’ commitments or any of their agencies or instrumentalities and, in turn, prohibits Member States from assuming or accepting liability for commitments made by central governments or of any public authority of any other Member State—save for a limited exception concerning “mutual financial guarantees for the joint execution of a specific project”.

The overall picture that emerges from the combination of these prohibitions reflects a rigid hostility towards the conversion of the EU into a community authorizing excessive public spending and/or permitting in general terms a solidarity mechanism whereby the indebtedness of any public authority at any level could be passed to, or shared with, another Member State (or any public authority at any level of any other Member State).

136 Art. 124 TFEU: Any measure, not based on prudential considerations, establishing privileged access by 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 to financial institutions, shall be prohibited.

137 Art. 125.1 TFEU: 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. For a critical appreciation of Art. 125, see Jean-Victor Louis, The No-Bailout Clause and Rescue Packages, 47 COMMON MKT. L. REV. 971, 981-88 (2010).
In the area of economic policy, intra-European solidarity is not the rule but rather the exception, as can be clearly inferred from the wording of Article 122 of the TFEU as well as from the final part of Article 125.1 of the TFEU, which refers to the exceptional possibility of “mutual financial guarantees for the joint execution of a specific project”.

With regard to all of these provisions and their interconnections, the conclusion is unavoidable that the ECB is not permitted to make direct loans to an ailing Member State; nor is it permitted to purchase directly from any such Member State debt instruments (sovereign bonds) issued by that Member State (see last part of Article 123). Equally, by virtue of the independence of the ECB from the political power of the EU and the Member States, the ECB can under no circumstances ever be mandated to do so by the EU or any one or more Member States.

However, the ECB is obviously granted specific powers for the pursuit of its institutional tasks, among which special mention must be made of those that are set out in Article 18 of the Statute of the ESCB and the ECB. In substance, pursuant to this provision the ECB and the national central banks are authorized to engage in open market transactions and to lend against adequate collateral with no specific limits being imposed on either type of transactions and subject only to the general institutional duty to act “in order to achieve the objectives of the ESCB and to carry out its tasks” (cfr. incipit of Art. 18 of the ECB Statute).

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138 Art. 122.1 TFEU: Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy. Art. 122.2 TFEU: Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional circumstances beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken.

139 Art. 18.1 ECB: In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may: operate in the financial markets by bringing and selling outright (spot or forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as unions metals; conduct credit operations with credit institutions and other market participations, with lending being based on adequate collateral. Art. 18.2: The ECB shall establish general principles for open market and credit operations carried out by itself or the national central banks, including from announcement of conditions under which they stand ready to enter into such transactions. Supra note 45.
Whether the prohibitions and the exceptions laid down in the above-cited provisions of the TFEU (i.e., Articles 122-125) should or should not be construed as imposing a very narrow interpretation of the extent to which the ECB may exercise its Article 18 powers is a legally and politically sensitive open question, as to which it is difficult (and probably not very useful) to attempt to give an answer in the abstract.

In practice, however, what counts is that the ECB has decided to give a very broad interpretation of its Art. 18 powers. In May 2010, a few weeks after the March 2010 launching of the First Program of Economic Adjustment for Greece, the ECB decided to intervene in the open market by announcing that it would engage in a Securities Market Program (SMP) for the purchase of financial instruments issued by certain Member States of the Eurozone.140

In so doing the ECB was launching a self-evident signal to the markets: the programs of financial assistance led and supported by the Troika would not be left without protection against speculative attacks that could otherwise undermine the rehabilitation process by causing the market value of the outstanding bonds to plummet and the cost of any refinancing to skyrocket.

The formal decisions taken by the ECB and published in the Official Journal of the EU were per se important; but even more important was an additional factor: that Governor Draghi succeeded in passing to the markets the credible warning that the ECB would do whatever could or would be necessary under the circumstances to avoid speculative de-stabilizations of the European sovereign bond market.141

140 ECB Decision ECB/2010/5, 2010 O.J. (L124) 8 (initially the SMP was limited to the purchase of sovereign bonds issued by Greece, Ireland and Portugal; starting in August 2011, the interventions under the SMP have been extended also to bonds issued by Italy and Spain). Subsequent decisions under the SMP were taken by the ECB in connection with more focused national needs. ECB Decision ECB/2011/4, 2011 O.J. (L 44/33) (concerning Irish bonds); ECB Decision ECB/2011/10, 2011 O.J. (L 88/31) (concerning Portuguese bonds); ECB Decision ECB/2012/2), 2012 O.J. (L59/36) (concerning a change of policy in respect of Greek bonds).

This was achieved by announcing in early August 2011 a number of non-standard monetary policy measures, including on August 4, 2011, the announcement of a supply of substantially unlimited liquidity to European banks\textsuperscript{142} and, on August 7, a vigorous re-activation of the SMP\textsuperscript{143}.

From those announcements onwards, the market for European government bonds first improved and thereafter remained stable, notwithstanding the fact that during the same time span the overall economic and financial status of the “weak” members of the Eurozone has not substantially improved.

The short but important lesson to be drawn from this story is that the single biggest factor that has allowed the mitigation of the Eurozone crisis has been and remains the market stabilization policy conducted by the ECB and the strong stance personally taken by Governor Draghi. By comparison, the institutional engineering conceived and implemented under the various Economic Adjustment Programs, including the sequence of the European vehicles designed to finance such Programs (i.e., the EFSM, the EFSF, and the ESM), has played a much lesser role.

There are clear signs, however, of a strengthened future convergence between the respective missions of the ESM and that of the ECB. For instance, on September 6, 2012 the ECB adopted a decision establishing a new program of purchases of sovereign bonds of relatively short maturity (one to three years). This program was called the OMT (Outright Monetary Transactions).\textsuperscript{144}

This decision was adopted by the ECB’s Board with the sole dissenting vote of the President of the German Bundesbank. It is based on the same philosophy and goals underlying the SMP, but it is also characterized by different ways and means to pursue the same objectives and by a clear intent to require complementarity between the role of the ESM and that of the ECB.


\textsuperscript{143} Id. at 53.

\textsuperscript{144} Ewing & Erlanger, supra note 141.
A first important difference with respect to the SMP interventions is that the ECB will no longer claim under the OMT the status of preferred creditor that had been consistently claimed under the SMP. I will return to this issue in the next paragraph.\footnote{See infra, para. 6} It is intuitively clear, however, why the ECB has accepted this change: it wishes to eliminate a disincentive for the private sector in subscribing for the new short-term bonds. Should a restructuring occur, the loss for the private sector, at least, would not be increased by the presence of prioritization in favor of the ECB.

A second important difference is the increased transparency of the transactions done under the OMT: the decision provides for the publishing of a weekly report of the quantities and worth of all purchases made under the OMT and for the publishing of a weekly report on the average expiry dates of the securities and the aggregate quantities for each Member State.

The third and most important novelty (from the standpoint of my analysis) is the introduction of the rule conditioning the exercise of the ECB’s open market powers on compliance by the beneficiary Member State with a strict conditionality. In substance, the OMT cannot be activated in respect of formally eligible bonds issued by a Member State unless such State has lodged an official request of assistance, accompanied by an executed Memorandum of Understanding specifying the conditionality agreed with (not to say imposed by) the ESM. Moreover, the ECB may purchase on the open secondary market only State bonds that had been originally subscribed for by the ESM in the primary market (i.e., at the time of their issuance).

The implications of this necessary convergence between the role of the ESM and that of the ECB in providing financial assistance to an ailing Member State are far reaching. For instance, the protective umbrella of the ECB open market interventions will no longer be available with respect to the (one to three year-) bonds issued by a Member State, unless such State
has previously accepted the guardianship of the new rescue system, including *inter alia* the opening of either of the two *ad hoc* credit lines that are made accessible by the ESM, depending on the peculiar circumstances of each case—namely either the Precautionary Conditioned Credit Line (PCCL)\(^{146}\) or the Enhanced Conditions Credit Line (ECCL)\(^{147}\)—each of which, however, entails subjection to a very strict conditionality.

Finally, the SMP has been entirely replaced by the OMT. On the same day of the OMT’s entry into force, September 6, 2012 the ECB formally announced the termination of the SMP.\(^{148}\) The sovereign bonds that were purchased by the ECB under the SMP will remain in the ECB’s portfolio, but the criteria (and the limitations) for future intervention in the open market will be limited to those that are consistent with the new program.

Two main conclusions may be drawn from the above outline of the latest developments.

On the one hand, it has become ever more evident that the evolution of the European experience in sovereign rescue efforts will increasingly resemble the model developed over the years by the IMF; on the other hand, the complementarity between the roles of the ESM and that of the ECB enhances the possibility of combining and reconciling the somewhat divergent interpretations that, at least prior to the ESM Treaty and the ECB Decision of 6 September, 2012, could be advocated with respect to provisions such as Article 122.2 TFEU (possibility of

\(^{146}\) In a nutshell, subject to compliance with the stability and growth pact, the PCCL addresses ESM Members’ difficulties in raising funds in the capital markets so as to prevent future crisis situations. Here, the foreseen conditionality simply requires continuous respect for the conditions set for accessing the ESM. ESM, *European Stability Mechanism Guideline on Precautionary Financial Assistance*, http://www.esm.europa.eu/pdf/ESM%20Guideline%20on%20precautionary%20financial%20assistance.pdf. Among its financial vehicles, the IMF offers two credit lines that are similar to the ones provided within ESM support, namely, the Flexible Credit Line (FCL) and the Precautionary and Liquidity Line (PLL). IMF, *supra* note 69.

\(^{147}\) The ECCL pursues the same goal as the PCCL (i.e., timely crisis prevention), but differs from such credit lines in terms of conditionality. The ECCL is designed for ESM Members that do not qualify for access to a PCCL. This is reflected in the ECCL's conditionality, which, unlike the PCCL, is twofold: it entails ex ante and ex post facets. In consultation with the EC and the ECB, the requesting ESM Member States must undertake corrective measures ex ante; once the requirements to access the ESM are met and financial support is granted, the beneficiary is subject to ex post conditionality. ESM, *supra* note 146.

interventions by the EU on grounds of solidarity), Article 123 TFEU (prohibition against the ECB acting as lender of last resort), Article 125 TFEU (no-bail out), and Article 18 of the Statute (granting the ECB power to make open-market interventions and lend against adequate collateral).

While the overall legal clarity of the picture has certainly improved, it is to be hoped that this improvement will not be followed by a collapse of the effectiveness of the umbrella protection that has so far been provided by the ECB.

7. The Preferred Creditor Status: a Privilege of the IMF or a Model to Be Extended?

The final remarks in this Chapter will deal with the issue of the entitlement to receive the status of preferred creditor in a sovereign debt restructuring, an old yet contentious debate. The rationale for the granting of such preferred status has already been presented in the general remarks contained in Chapter I.

To identify the rationale, however, is only the beginning of the problem, not a final answer.

The starting point of the analysis may be the long-standing position taken by the IMF, according to which any and all credit facilities that are granted under the IMF's programs of financial assistance must be deemed to be assisted by the IMF's entitlement to receive preferred creditor status. To put this another way, is this a claim with a clear, solid legal foundation or rather a self-serving assessment that is made in the hope that it will become self-fulfilling?

Until very recently, it would have been fair to say that the basis for the IMF's position was consensus rather than legislative or treaty provisions or judicial precedents squarely on point.

The strongest evidence of the existence of this entitlement was the fact that nobody dared to deny it or to object to it. In particular, a *de facto* confirmation of this consensus was offered by the experience of the Paris Club: the IMF, unlike the other (public) creditors, was never asked or
invited to “spontaneously” reduce its right to be fully reimbursed. Understandably, States that are recipients of IMF funds under programs of financial assistance have always had good reasons to abstain from challenging the IMF’s position. However, even though the same reason does not apply to them, scholars have also refrained from raising the issue, yet this is somehow surprising, since it should be natural for scholars to inquire as to why total silence has always been maintained on this point in IMF loan agreements and other documents evidencing the opening of an IMF’s credit facility line.

Arguably, rather than a priority within the meaning of this notion in ordinary bankruptcy, what the IMF may have in reality claimed all along is nothing other the recognition of the impossibility for the debtor State and the IMF to “modify” (i.e., to cut or subordinate) the monetary obligations undertaken by the former vis-à-vis the latter. Viewed from this standpoint, the strength of the IMF’s claimed priority would merely be the consequence of the rigidity of the international law obligation that debtors State assume with the IMF: unlike other sovereign monetary obligations, which are “commercial obligations” governed by only by a State's law and whose breach does not give rise to a breach of international law—and which are thus subject to “haircuts”150—the IMF obligations would be entitled to escape this treatment by virtue of their superior international law ranking, and in this sense they may be viewed as entitled to a preferred status.

Support for this view may be found in a broad reading of Article V(7)(g) of the IMF’s Articles. This provision permits only a postponement of the date of discharge of the repurchase (i.e., reimbursement) obligation that is incumbent upon a Member State and does not even contemplate the possibility of cancelling or reducing the obligation to repurchase (reimburse).151

149 Videotape, supra note 26.
150 See infra Chapter III.
151 The view has been authoritatively expressed that in order to make it make it possible to restructure sovereign debt towards the IMF, it would be necessary to amend the present text of the Articles of Agreement of the IMF.
Last but not least, there is also an important case that lends indirect support to the IMF’s claim on the entitlement to priority treatment. In *EM LTD v. Republic of Argentina* the plaintiff appellant sought to obtain reversal of the district court judgment, that had denied denying the plaintiff the right to attach funds held in New York in the name of and on behalf of the central bank of Argentina. The plaintiff’s argument was that those funds should be treated as if they belonged to the Republic of Argentina, against which the plaintiff had obtained a judgment for damages in a holdout litigation relating to a bond-restructuring unilaterally imposed by that State. Since Argentina had provided, by an executive decree of the President of Argentina, that assets—defined as unrestricted reserves and including also reserves of the Argentinian central bank—could be used to repay Argentina’s obligations owed to the IMF, the submission of the plaintiff appellant was that those assets were attachable in the U.S. pursuant to the FSIA provisions allowing such a result with respect to a foreign state’s “property in the United States used for a commercial activity in the United States.”

The Second Circuit rejected the appeal, firstly on the ground that the internal Argentinian decree had not transferred the property of the assets from the central bank to the State of Argentina and further on the ground that even if the property had been transferred, the FSIA exception allowing attachment would not be applicable in the case. In reaching the second conclusion, the reasoning of the court lays down a detailed analysis of the non-commercial and public international law nature of the obligations undertaken by a sovereign State towards the IMF. By virtue of a number of important *obiter dicta* on the nature of the IMF’s right to be

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152 EM Ltd. v. Republic of Argentina, 473 F.3d 463 (2d Cir. 2007).
153 *Id.* at 466.
154 *Id.* at 476.
155 *Id.* at 480.
156 *Id.* at 481-85.
repaid, this case may be considered as an authority, providing support—at least indirectly—to the special, international public law nature of the IMF’s claims and, consequentially, to the IMF’s right to escape subjection to the same treatment as is applicable to other ordinary “state law” creditors of the sovereign.\textsuperscript{157}

On the whole, the legal bases on which the IMF appears to vindicate its entitlement to receive preferred creditor status are not overly persuasive and, above all, do not lend themselves to be equally applicable to any other contributor of funds within the context of a sovereign debt reorganization or restructuring.

All of the arguments that have been referred to (e.g., de facto recognition of the preferred status based on consensus, rigidity of the monetary obligations under IMF’s Articles, the non-commercial nature of the IMF’s activity of financial assistance to States) are not supported by a legal rationale with regards to the function fulfilled through the supply of emergency finance, but rather with regards to the nature of the particularly strict and severe international law obligations, that are undertaken by the recipient of the IMF’s financial help.

Ultimately, therefore, it is the status of the IMF and its role within the international community that comprise the most powerful reasons for recognizing its entitlement to be treated as a preferred creditor.

This conclusion, however, greatly affects the persuasiveness of the proposition that the same rationale should apply to other institutions.

In other words, if the IMF’s privilege is linked to what the IMF is, there is no longer a strong logical argument for claiming that the same privilege should be extended to others.

The result is that granting the status of preferred creditors to the providers of new financing

\footnote{\textsuperscript{157} Videotape, supra note 27.}
in a sovereign rescue program or debt restructuring is more a political decision that depends on the will and the prestige of the institution claiming it than a necessarily implied legal rule whose observance is required by the logic of the reorganization process that the ailing sovereign must undergo.

If this analysis is applied to the European experiences, then a plausible explanation may be offered by an apparent contradiction, namely, the granting of preferred creditor status to the ESM and the “voluntary” waiver (or abstention from claiming) such status by the ECB.

The 13th Whereas Clause of the ESM Treaty provides that:

Like the IMF, the ESM will provide stability support to an ESM Member when its regular access to market financing is impaired or is at risk of being impaired. Reflecting this, Heads of States or Government have stated that the ESM loans will enjoy preferred creditor status in a similar fashion to those of the IMF, while accepting preferred creditor status of the IMF over the ESM.

Moreover, the following Whereas Clause (14th Whereas) specifies that:

The euro area Member States will support equivalent creditor status of the ESM and that of other States lending bilaterally in coordination with the ESM.

By virtue of these statements, therefore, the ESM Treaty (admittedly in its Preamble and not in its strictly prescriptive provisions) has become the first international instrument openly recognizing (i) the legitimacy of the preferred creditor status long claimed by the IMF and (ii) the commonality of the rationale for extending the same treatment to the emergency financing supplied by the ESM and by other States, if any, that is meant to co-finance (with the ESM) the rehabilitation of the requesting ESM Member.

In light of the strongly emphasized complementarity between the ESM and the ECB, one

158 The recognition of preferred status for the ESM, subject to the “super-priority” in favor of the IMF, is stated to be effective from the entry into force of the ESM Treaty (i.e., September 28, 2012). With respect to loans that may be made under programs of financial assistance already existing at the time of entry into force of the ESM Treaty, no preferred status shall be claimed by the ESM, without prejudice, however, of the preferred status of the IMF’s loans. (See the remainder of Whereas Clause 13). Supra note 122.
could have expected that the privilege of the preferred creditor status would also be confirmed to the benefit of the ECB.

But the ECB, in the same announcement in which it disclosed the OMT program that would supplant the SMP, made clear that for transactions under the new program it would not claim preferred creditor status.\textsuperscript{159} The rationale for this decision might be traced in part to considerations of a strictly legal nature and in part to considerations of economic opportunity.

At the time when the ECB purchased, in the open market, the Greek bonds with regards to which it subsequently claimed preferred creditor status,\textsuperscript{160} the ECB certainly did something beneficial to the Economic Adjustment Programs for Greece. But, and equally certainly, the benefit was not conveyed in the form of new financing transferred to Greece (incidentally, Article 123 would strictly prohibit this kind of financial help); it was the result of programmed market actions that avoided a worsening of the Greek crisis and presumably diminished the cost of other mechanisms that were used to refinance Greece’s depleted treasury.

To argue, however, that this provided an impeccable and irresistible legal basis (at least in the context of the restructuring of the Greek debt) for claiming that the ECB was entitled to escape the “haircut” that was being imposed upon all other bondholders,\textsuperscript{161} has in the opinion of this author never been a convincing proposition.

The priority that was at that time claimed and obtained by the ECB was and remains discriminatory vis-à-vis all other market actors who had purchase, in the open market, low-priced Greek bonds exactly in the same way and at the same conditions as the ECB.

It is true that, at least according to the prevailing view, discrimination is not \textit{per se} unlawful

\textsuperscript{159} Supra note 141.
\textsuperscript{160} \textit{Infra} Chapter III, para. 3.
in international law, insofar as the necessity of protecting the public interest is invoked by the discriminating sovereign as the ground for selectively awarding a preferred treatment to certain creditors only.\footnote{Peter Charles Choharis, \textit{U.S. Courts and the International Law of Expropriation: Toward A New Model for Breach of Contract}, 80 S. CAL. L. REV. 1, 29 (2006) ("although discrimination is a strong indicium of a violation of international law, it alone does not establish such a violation under current U.S. case law").}

However, international law on this point is far from clear, so the need for legal prudence in the future would \textit{per se} provide a reasonable justification in support of this change in policy by the ECB.

As already mentioned, however, other factors may have come into play: in particular, two potential economic arguments are likely to have had an influence on the ECB's decision.

First, any priority that is obtained by a given creditor over the others is an additional risk and a potentially additional cost that they may have to bear generally. Thus, it is inevitable that granting someone a benefit to be enjoyed \textit{ex post} tends to be paid through a higher cost of financing \textit{ex ante}. While this argument does carry some value, in the case of rescue programs it may prove too much, since it would ultimately lead to the conclusion that no priority of any kind should ever be granted, not even to the IMF or the other public entities such as the ESM (the providers of the new finance). Since the “zero priority approach” is unrealistic, the argument is relevant but not decisive.

The second argument is somewhat more convincing. Certainty that the ECB will not claim priority is a convincing signal for the future private operators in the secondary market that the ECB will “believe” in the market price of the bonds it will buy, as opposed to impliedly relying on the possibility of obtaining a protective floor (or a guaranteed profit) for its purchases at the expense of the other market participants thanks to the recognition of its preferred creditor status in the event of a future debt restructuring. This should reduce the likelihood of panic selling by the other market participants—even if the market seriously deteriorates—for as long as the ECB is seen occupying a
position on equal footing with the rest of the players.

In other words, the beneficial effect of the ECB’s waiver of the preferred creditor status in respect of open market transactions (OMT) is probably more significant in terms of reducing the risk of future liquidity interventions seeking to tackle future sale rushes than in terms of obtaining—at the time of the issuance of the sovereign bonds—significantly lower borrowing costs.
III. The European Perspective: Private Sector, Haircuts and the Statutory Introduction of Retroactive Collective Action Clauses (CACs)

1. Who Pays the Bill? The Doubtful Privilege of Private Holders of Sovereign Bonds

Sovereign debt restructurings are, after all, bailouts. Irrespective of their specific legal, political, or geographic context, they all pose a fundamental question: at the end of the day, who pays the bill?

It is obvious that the bill should not be paid by the providers of the new finance, whose intervention is requested by the sovereign debtor and whose supply of badly needed funds is presumed to protect the best interests of both the sovereign debtor and its outstanding creditors by at least preventing the crisis from worsening and by keeping the gate open to recovery. Of course, the actual results will not always align with the theory.

Arguably, an ex post analysis may find that a non-assisted sovereign default might have been a better solution, both for the sovereign debtor and its creditors, than a rescue attempt linked to the wrong conditionality (e.g., a conditionality imposing a combination of overly high tax increases and overly harsh deflationary measures), which could trigger more severe “real” losses—for both the sovereign debtor and its creditors—than those that would have occurred in a situation of straight formal default.

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163 Supra Chapter II.
Similarly, notwithstanding the preferred status granted by contract or *de facto* to the new financing, it may well be that a subsequent crisis (or the unexpected longer duration or worsening of the original crisis) makes it unrealistic for the new financiers to obtain recovery of their funds as planned; in such a case, they would also become involuntary payors of the final rescue bill.

However, whatever “wrong” evolutions a rescue attempt may have, it is unquestionable that the logic of sovereign debt restructurings should not be based on the *ex ante* assumption that the providers of new finance will also be called or required to lose their new, rehabilitating money to the benefit of the other stakeholders involved. Thus, one must look elsewhere for the proper candidate payors of the final bill.

At first blush, there are typically two categories of candidate payors, namely, the taxpayers of the sovereign debtor\textsuperscript{166} and/or its creditors.

The tension between these two categories of candidate payors is self-explanatory: the more the sovereign debtor will accept to honor its commitments by putting the burden on its taxpayers, the less the creditors will suffer losses on their claims. However, owing to the primacy, which is recognized in international law, of the preservation of the essential functions of any sovereign debtor over the claims of its creditors,\textsuperscript{167} it is hardly conceivable that a sovereign debt restructuring could be implemented by placing the entire burden on the taxpayers without substantial losses ultimately being also imposed upon the creditors of the sovereign.

\textsuperscript{166} In the Eurozone, Member States with significant financial strains (Greece, Ireland, Portugal, Cyprus but also Spain and Italy) have in substance advocated a supranational notion of solidarity among all Member States (or all Member States of the Eurozone) as the basis for claiming the legitimacy of the proposed issuance of the so-called “Eurobonds”, *i.e.* the technique whereby national bonds issued in euro by the individual Member States would be replaced by new bonds assisted by the guarantee of all Member States. The financially stronger Member States (among which, in a position of prominence, Germany) have so far strenuously (and successfully) opposed this solution, whose adoption would in substance spread the cost of the debt restructuring of the financially weaker Member States on all the other Member States, thus ultimately substituting for the taxpayers of each sovereign debtor in difficulty the broader constituency of the taxpayers of the entire European Union or Eurozone (with the highest burden to be borne *pro rata* by German taxpayers).

\textsuperscript{167} *Supra*, note 12.
The real question, therefore, is to find out whether all creditors of the sovereign debtor are equally exposed to the risk of suffering significant losses or if there are classes or groups of creditors more exposed than others to such risk; in the affirmative, we must then ask which are the groups or classes that are more exposed and whether or not they may find ways or chances to pass onto others, in whole or in part, the burden of the losses or threat of losses.

The traditional rule in ordinary bankruptcy is equality of treatment among all unsecured creditors, irrespective of the legal source of their claim (whether voluntary or involuntary) and irrespective of whether a given claim is identical in law with many others similarly situated within a defined class created by one collective deed or whether a given claim is, on the contrary, a “pièce unique”, stemming from a specific, stand-alone relationship.

In practice, however, not even in cases of ordinary bankruptcy is equality of treatment the “real” rule. This is due to the accumulation of various exceptions, whether created by contract and recognized by law or simply imposed by law on various policy grounds.\(^{168}\) Finally, equality of treatment is even less relevant—and less often applied—in the context of a sovereign debt restructuring.

It is true that clearly discriminatory treatment (e.g., confiscating the property of a specific foreign creditor without applying the same treatment to others in the absence of reasonable grounds for differentiation) may be a ground for a national court’s finding of a taking (of property) in breach of international law.\(^{169}\) However, in order to successfully invoke a claim involving a breach of international law, relevant and unreasonable discrimination must be established on a case-by-case

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basis. For instance, nobody seriously doubts that an insolvent sovereign is ultimately entitled to continue to pay, say, commercial suppliers and holders of short-term treasury bills while suspending service on the interest accrued on long-term bonds.

This is just to point out that while there is no clear legal principle affirmatively establishing that sovereign States may expose certain categories of claimants to deeper losses than others in cases of restructuring, the selecting of certain categories of “better” loss-bearers by an insolvent or quasi-insolvent sovereign is neither unusual nor unlawful; it is generally protected by the Act of State Doctrine (or similar doctrines) deferring to the inherent powers of the insolvent or quasi-insolvent sovereign to make discretionary choices on public policy grounds. Thus, as a practical matter, the typical candidate payors in a sovereign debt restructuring are the holders of medium-term or long-term financial instruments placed on the international markets, that is, the various classes of holders of medium or long-term sovereign bonds.

Having so identified the most likely eligible candidates, it would be wrong to assume that there is no room for further distinctions or for the possibility of involving other groups or classes. First, even if there is no legal difference ex ante between foreign and local bondholders or between those bondholders who are private entities, those who are public entities, and those who are mere “retail investors” (including families and individuals), political and social considerations and the perceived necessity of being realistic suggest that the de facto differences existing among these groups may prompt ex post (i.e., post-insolvency) considerations resulting in an uneven allocation of the burden as a condition for the palatability of the restructuring effort.

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170 Id. at 852.
171 “Short-term Treasury bills have been excluded from a number of recent sovereign debt restructurings in order to keep that market sweet for the government's emergency financing needs” Lee C. Buchelt & Mitu Gulati, How to Restructure Greek Debt 8 (Duke Law Working Paper, Paper No. 47, 2010), available at http://scholarship.law.duke.edu/.
172 Infra notes 218-225 and accompanying text.
In particular, there may be irresistible political pressures for imposing higher losses on foreign bondholders and, within that group or class, on private bondholders as opposed to public bondholders. Foreign bondholders, who are often perceived as typically coming from rich capital-exporting countries, may be seen as better loss-bearers as compared with national bondholders, who are also exposed to the further deprivations that are expected to derive from higher taxes and drastic deflationary measures. In parallel, a better treatment for public bondholders may be prompted by the fact they may be able to more actively contribute to the restructuring efforts (e.g., by making stabilizing purchases on the market or by subscribing for new bonds), thus benefitting from leverage which private bondholders may simply not have.\textsuperscript{173}

Second, as certain recent crises have shown,\textsuperscript{174} the insolvency or pre-insolvency of a sovereign debtor may be generated by or associated with the insolvency or pre-insolvency of its banking system, which may broaden or modify the constituency of the ultimate candidate payors. Consider, for instance, the case of a national banking system that is exposed to a systemic risk of collapse either because its assets are too heavily invested in a real estate bubble (which was apparently the case in Ireland and Spain) or in large amounts of sovereign bonds whose value is sinking since they are involved—or threatened to be involved—in the debt restructuring of the issuer (whether the issuer is the State to which that banking system belongs or a different State whose debt is equally in need of restructuring).

If by refinancing its banking system in order to avoid a collapse a sovereign debtor should become pre-insolvent or insolvent and as a result must restructure its own debt, the question arises of whether it is fair and/or reasonable to inflict the losses of such restructuring more on the holders

\textsuperscript{173} Infra note 192 and accompanying text.

\textsuperscript{174} In the Eurozone Ireland, Greece, Spain and, most recently, Cyprus are good examples of sovereign crises triggered or worsened by the troubles of their banking system and the necessity of re-financing the respective systems.
of the sovereign bonds (i.e., the direct creditors of the State rescuing its banks) than on the creditors of the banks that would have become insolvent in the absence of refinancing by the State.\(^{175}\)

If the latter solution appears to be preferable both on grounds of fairness and feasibility, then the subsequent question arises of whether the more eligible candidate payors are (i) the holders of the corporate bonds issued by the banks or (ii) the banks’ depositors and, in the latter case, whether (iii) all the depositors pari passu, (iv) the larger depositors only, or (v) the larger depositors at higher rates of contribution than the smaller depositors.

The most recent sovereign crisis triggered by a banking bubble, Cyprus, is a perfect example (fear-instilling or instructive, depending on your perspective) of the potentially far reaching effects of the process that may be triggered when the selecting the most “suitable” candidates for the payment of the final bill of a sovereign debt restructuring is clearly a “political” decision.

2. Haircuts and the Private Sector: the Voluntary Models of the Paris Club and the London Club

Although, as explained above, the constituency of the candidate payors in a sovereign debt restructuring may include stakeholders other than the holders of medium-term or long-term sovereign bonds, this latter category has the doubtful privilege of being the most likely candidate for picking up the largest share of the bill to be presented to the sovereign’s creditors.

Thus, the subsequent discussion in this paper will focus exclusively on the treatment of these bondholders and, in particular, on the conceivable legal techniques of debt-cutting that may be applied to them in the case of a sovereign debt restructuring within the legal framework of the Eurozone.

Over the last hundred years, there have been numerous examples bankrupt sovereign States in Europe (as well as in the rest of the world). According to a study conducted by a prestigious

\(^{175}\) Porzecanski, *supra* note 161, at 12 (evidencing contradictory choices in the solutions adopted for Greece, Ireland and Spain).
international law firm and purporting to offer a worldwide picture: “If we took the (world) map back for a century, it would be found that virtually no sovereign state escaped bankruptcy in that period, except perhaps three” \(^{176}\)

Although a historical perspective is important for the purpose of understanding the context in which those cases were decided, cases whose holdings continue to constitute the landmarks of international law on sovereign defaults or insolvencies, \(^{177}\) my analysis below will not indulge in a retrospective look at what happened in previous sovereign default cases; rather, I will immediately focus on today’s problems, and in particular on the approach or approaches that prevail today in the Eurozone on the issue of how bondholders should be called to take “their” share of losses in the debt restructuring of a Member State.

The word which is commonly used to describe the bondholders’ unavoidable contribution is “haircuts” \(^{178}\).

The first experiences using “haircuts” in a way similar to what has now become an established practice came at a time when the Eurozone did not yet exist. These first “haircuts” were sovereign debt restructuring procedures that, from 1956 onwards, were privately administered on a “voluntary” basis by the Paris Club and the London Club. \(^{179}\) The mission of the Paris Club was to promote the sovereign debt restructuring of emerging countries, whose main creditors were public creditors (other States or foreign public entities). \(^{180}\) The mission of the London Club was roughly

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\(^{177}\) See **Michael Waibel, Sovereign Defaults Before International Courts and Tribunals** 58-98 (2011).


\(^{180}\) Alexis Rieffel, **The Role of the Paris Club in Managing Debt Problems** (Essays in International Finance No. 161, 1985); **Elisabetta Cassese, Diritto del Commercio Internazionale** 591 (2002).
the same but for situations where the main creditors of the insolvent or pre-insolvent emerging country were private creditors, typically commercial banks or private financial institutions.\footnote{Oluwole Akanle, Rescheduling of the External Debt: London Club 12, UNITAR Document Series No. 1 (1992), available at http://www2.unitar.org/dfm/Resource_Center/Document_Series/Document1/C_Akanle.htm.}

In the practice of both Clubs, “haircuts” were voluntarily accepted by creditors at the end of long and laborious negotiations, conducted in each case within the framework of an IMF-promoted program; the aggregate debt restructuring was always accompanied with the conditionality standards required by the IMF in a particular case.\footnote{Karen Hudes, Coordination of Paris and London Club Reschedulings, 17 N.Y.U. J. INTL. L. & POL. 553 (1984-85); Enrique Cosio-Pascal, The Emerging of a Multilateral Forum for Debt Restructuring: The Paris Club, UNCTAD Discussion Paper no. 192 (2008), available at: http://unctad.org/en/Docs/osgdp20087_en.pdf.}

The most evident feature of the “haircuts” accepted within these contexts was the absence of any legally binding effect on non-consenting creditors of the will or consensus expressed by the creditors accepting a reduction in their claims. While the Paris Club has until now mostly succeeded in fulfilling its mission quite effectively (notwithstanding the non-binding and strictly voluntary nature of its procedures),\footnote{“To date, the Paris Club has reached 405 agreements, with 84 debtor countries. Since 1983, the total amount of the debt covered in Paris Club agreements – rescheduled or reduced – is approximately $505 billion”. Weiss, supra note 179, at 1.} the London Club has been much less effective, although indeed capable of promoting the acceptance of significant haircuts.\footnote{Huden, supra note 182, at 560-61.}

When the first signals of the Eurozone crisis were observed in the last months of 2009 and the first quarter of 2010, the private sector was probably tempted by the idea of replicating, if necessary (in the Greek case as well as in other similar cases) the same voluntary model of negotiated “haircuts” as had been tested within the contexts of the Paris Club or the London Club. However, things have developed a long a different path.

The debate that soon took centerstage and has remained there ever since has been dominated by the issue of collective action clauses (“CACs”) and, in particular, by the issue of whether it is
compatible with international law to enact new legislation providing for what may be roughly described as a retroactive application by law of a CAC-equivalent regime to sovereign bonds that were issued without the inclusion of a CAC in their contractual terms.

The following paragraphs are devoted to the analysis and discussion of this issue and its relevance for the European perspective.

3. Collective Action Clauses (CACs), the Greek Bondholder Act, and the Greek Debt Restructuring

There are three main types of collective action clauses that may be found in the contractual conditions governing bond issues: (i) modification clauses; (ii) acceleration clauses, and (iii) reverse acceleration clauses.185

For the purposes of this paper, it is sufficient to focus the attention on modification clauses, which provide that the affirmative vote of a majority or supermajority of bondholders (typically, 66% or 75%, but sometimes even just a bare absolute majority) may modify the contractual rights of the entire class, for instance by accepting a reduction of the outstanding capital amount of the loan or by accepting a reduction of the rate of interest and/or a postponement of the expiry date, coupled with either or both of the preceding features. Subject to the adoption in the CAC of an additional, appropriate sub-clause, the vote approving the modification may also be given the effect of authorizing the acceptance of a swap offer (i.e., the acceptance of a new bond with different rights and features in exchange for an old one, or a specified number of old ones).186

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185 “After a default, many sovereign bonds allow each bondholder to accelerate all future payments due under their bonds. This complicates restructuring, for it allows holdout creditors to demand payment in full immediately instead of suing only to recover missed coupon payments. As noted previously, acceleration clauses make the decision to accelerate a collective one by requiring the approval of a certain percentage of bondholders (typically, twenty-five percent). Some modern clauses go a step further and allow a majority of bondholders to reverse a decision to accelerate. Thus, even if a holdout creditor obtained a twenty-five percent stake, the majority could override its decision to accelerate the loan.” W. Mark C. Weidemaier, Reform Sovereign Lending Practices: Modern Initiatives in Historical Context 5-6 (2012), available at http://works.bepress.com/mark_weidemaier/9.

186 Buchheit, supra note 171, at 9 (describing the wording and the mechanics that were subsequently used in the structuring of the Greek offer: see infra note 189 and accompanying text); see also Zettelmeyer, supra note 26 (describing the actual features of the Greek offer).
Without delving into details and technicalities that are unnecessary for the purposes of this paper, the result permitted by the presence of these clauses in the original contractual terms of a sovereign bond issue is the possibility of resorting to a majority vote (that is binding on the dissenting bondholders) when it appears that a modification (reduction) of the rights attached to the bonds is necessary and/or reasonable in order to make it possible for the restructuring to succeed. In substance, by virtue of the CACs, the majority bondholders (and the sovereign debtor) are protected against the risk of opportunistic holdouts by the minority bondholders. In parallel, the new bonds (whether swapped or modified) that will emerge from the restructuring will presumably have such new or modified features as will be necessary in order to cause their real economic value, calculated at a proper rate of discount (technically, their present net value) to be in line with the planned reduction of the pre-existing indebtedness.

Whether a haircut of, for example, 40% of the original face value of the bonds is achieved on a purely voluntary basis in the absence of any CAC in the bond issue (as was typically the case for sovereign debt restructurings administered by the Paris or London Club) or whether an equally sizable haircut may be achieved by a binding majority vote pursuant to a CAC expressly stipulated in the bond issue, the end result is substantially the same—not only in terms of relief for the debtor, but also, at least in principle, in terms of the ultimate legal justification given for the reduction.

In both cases the legitimacy of each individually suffered reduction can be considered to be based on consent, although at two different stages or levels. In the case of a purely spontaneous reduction carried out in the absence of a CAC, this is self-evident, as no bondholders other than the expressly consenting bondholders are bound by the self-inflicted haircut. But this is also true, if less obvious, in the case of a reduction pursuant to a majority vote under a CAC: here the dissenting or non-voting bondholders are bound by virtue of the exercise of a majority power, the source of
which is the consent that was given by them or their predecessors with regards to the insertion of the CAC in the original terms of the bond issue.

The Greek crisis, however, triggered the awareness that within the Eurozone the basic problem of how to achieve the necessary “haircuts” could not be satisfactorily solved by relying solely or mainly on either negotiated self-reduction (as with the London Club) or reduction by majority vote under a contractual CAC.

In the case of Greece, more than 90% of the outstanding sovereign bonds had been issued under terms and conditions governed by Greek law and not contemplating any CAC. Only the remainder of outstanding bonds, roughly €25 billion (less than 10% of the aggregate indebtedness) had been issued under English law and therefore “assisted” by the presence of CACs, consistent with a long-established practice developed with regards to English-law bond issues in the London market.\(^{187}\)

Other countries of the Eurozone had and still maintain a structure of sovereign indebtedness that is characterized, as in the case of Greece, by the choice of the national law as the governing law of most issues as well as by the absence of CACs in the contractual terms of such issues. This is the case in Spain, Portugal, Ireland, and Italy; in fact, local law governs 88%-100% of the outstanding sovereign debt of eleven Eurozone Member States.\(^{188}\)

In the second half of 2010, as European leaders began considering and discussing the measures to be taken as conditions for the creation of stronger European financial stability mechanisms, Germany and France in particular (but not in isolation) pushed the idea that more teeth should be given to the principle that no new public finance should be made available to Member


\(^{188}\) Boudreau, \textit{supra} note 187, at 2, n.5 (with reference to information given by Moody’s Investors Service, London on February 6, 2012).
States in difficulty without being certain of their ability to use effective legal tools for the enforcement of “haircuts” on bondholders and, in particular, on private bondholders. In short, the message was: no more public funds for bailouts without the legal certainty of the enforceability of substantial haircuts on the private sector.

Politically this was reflected in the statement issued by the Eurogroup on November 28, 2010, according to which “In order to ... [prevent future crisis], standardized and identical collective action clauses (CACs) will be included ... in the terms and conditions of all new euro area government bonds”.189

On its face, this statement indicated a principle or rule to be applied to future issues of bonds. Since, however, the statement was also (and still is) a public announcement of a clear policy choice, it was (and still is) only natural to wonder if the same policy choice might also be applied to outstanding issues that are not “assisted” by CACs. In particular, would it be possible for any Member State of the Eurozone to cure the lack of CACs in its outstanding issues by enacting a new law whereby a supermajority of bondholders would be granted the power to pass a resolution, binding on all other bondholders, whose effect would be to modify the class rights of all bondholders, just as if a CAC had been inserted in the original terms?

On February 23, 2012 Greece enacted a law of this nature (Greek Bondholder Act no. 4050/12). The next day it launched two invitations (public offers) adhering to its official restructuring program.190

The first invitation was addressed to the holders of bonds issued by the Greek Republic and

governed by Greek law. The principal amount of these bonds was approximately €178bn.\textsuperscript{191}

Importantly, the bond holdings of the ECB and other central banks were excluded from the invitation: shortly before the launching of the invitation, these holdings had been swapped into a new series with identical payment and maturity dates. In practical terms, Greece did not receive any substantial debt relief with respect to these bonds, resulting in the \textit{de facto} granting of a sort of preferred or preferential status to these “special” bondholders.\textsuperscript{192}

The second invitation was addressed to the holders of bonds issued by the Greek Republic but governed by a law other than Greek law (actually, English law).\textsuperscript{193}

Both invitations were very successful. Two months later, on April 25, 2012, Greece announced that about 97% of the bonds that were targeted in the exchange offer had been restructured.

The practical success of the Greek restructuring offer does not eliminate \textit{per se} the importance of the following query: were the Greek legislation and the Greek offer consistent with all applicable principles of law? Moreover, can the Greek example be treated as a legally acceptable model for future sovereign debt restructurings in the Eurozone?

\textbf{4. Statutory Introduction of Retroactive CACs: Issues of Constitutionality and/or Consistency with Treaty Obligations}

The Greek Bondholder Act applied only to the Greek law bonds that were tendered under the first invitation. It is submitted that, in principle at least, neither the internal legal order of a sovereign issuer nor international law would be violated by the enactment of a statute having in substance the same purpose, structure, and content as the Greek Bondholder Act.

\textsuperscript{191} Zettelmeyer, \textit{supra} note 26, at 8.

\textsuperscript{192} \textit{Id.} at 34, 5, n.4 where it is stated that “[a]s part of this swap arrangement, the ECB committed to return any profits made through its Greek government bond holdings to its shareholders. Hence, Greece received virtually no debt relief on these bonds […] because of its small share in the ECB (about 2 per cent)”. In light of these remarks, it can likely be inferred that the French and German private sector benefitted the most from the ECB's profits return.

\textsuperscript{193} \textit{Id.} at 6.
For the sake of clarity, it is helpful to analyze separately these two aspects (i.e., consistency with the internal legal order and consistency with international law), even if a number of considerations relating to the first are also very relevant for the analysis of the second.

From the standpoint of the internal legal order of the sovereign issuer, the crucial issue is whether a statute like the Greek Bondholder Act may be found to be unconstitutional on the ground that it permits interference with existing vested rights by virtue of provisions enacted with retroactive effect.

The constitutional law approach that prevails in the European legal systems and, in particular, in the legal systems of the Member States of the Eurozone, is that laws generally do not have retroactive effect. However, save only for the strict prohibition on retroactivity in criminal law, exceptions to the general rule are permitted in a vast variety of cases, provided that the exception is justified under the circumstances and does not violate other constitutional principles.

In general terms, interfering with certain creditors’ rights by virtue of a change enacted in the bankruptcy law after the perfected acquisition of such rights is one of the most largely, while not universally, admitted exceptions to the said rule.\(^{194}\)

If this is so, the same rationale that normally justifies broad (including retroactive) interference with creditors’ rights in ordinary bankruptcy appears to be equally applicable in cases where the insolvent or pre-insolvent debtor is a sovereign. It would be an untenable proposition to hold that when the insolvency or pre-insolvency concerns a sovereign, the same rationale should not apply on the ground that there is no articulated and comprehensive procedure applicable to such

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\(^{194}\) In a bankruptcy context, retroactivity is constitutionally permitted in the United States. Hanover National Bank v. Moyses, 186 U.S. 181 (1902) (holding that Congress has power under the Bankruptcy Clause of the U.S. Constitution to retroactively impair contractual obligations); James Steven Rogers, *The Impairment of Secured Creditors’ Rights in Reorganization: A Study on the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 Harv. L. Rev., 973, 987 (1983) (arguing that secured creditors know, or should know, of US bankruptcy law’s restrictions on their rights, and therefore take their rights subject to those restrictions).
insolvency or pre-insolvency. Clearly, the admissibility of the exception finds its rational basis in the relevance that each legal system attributes to the objective situation of insolvency or pre-insolvency, not in the applicability to the “special” debtor of an insolvency procedure characterized by generality and comprehensiveness of scope. Whether the law or laws enacted with respect to insolvency or pre-insolvency of certain entities are general or special is a choice which clearly falls within the universally accepted discretion of the national legislatures; this view is confirmed by the frequency in most legal systems of special insolvency rules that are applicable only when the insolvent or pre-insolvent entity is a public entity of systemic relevance.\(^\text{195}\)

Additional *a fortiori* arguments may be brought in support of the conclusion that has just been expressed.

Strictly speaking, a statute like the Greek Bondholder Act does not entitle the sovereign issuer to unilaterally reduce, through its own decision, the amount and the ancillary features of the individual rights of each bondholder. As one scholar\(^\text{196}\) has put it, granting the majority by statute the power to cram down a restructuring on the minority implies that the “dirty work” is left to the consenting bondholders\(^\text{197}\): the sovereign, as such, does not directly take any asset or property (in the broad sense) from the investors as a general body.

Furthermore, the fact that (for the reason just stated) there is no direct statutory taking by the

\(^{195}\) An outstanding example of ad hoc legislation for systemically important entities is offered by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Title II, H.R. 4173, 111th Cong. (2010) (introducing the Orderly Liquidation Authority (“OLA”) with special insolvency powers to assist financial institutions facing imminent bankruptcy and granting federal regulators with the authority (and discretion) of liquidating particular institutions, such as banking holding companies and companies identified for heightened systemic risk regulation). *INST. OF INT’L FINANCE, ADDRESSING PRIORITY ISSUES IN CROSS-BORDER RESOLUTION* 19-20 (Report, May 2011), *available at* www.iif.com/download.php?id=615ZrRHRb+E= (emphasizing the need for bank to provide for the maintenance of “critical function” in order to avoid the unexpected interruption of services which cannot be readily substituted or whose termination would have substantial spillover effects on the economy); *IMF & WB, AN OVERVIEW OF THE LEGAL, INSTITUTIONAL AND REGULATORY FRAMEWORK FOR BANK INSOLVENCY* 23 (2009), *available at* www.imf.org/external/np/pp/eng/2009/041709.pdf (stressing the need for restricted judicial review to ensure that an ex post facto judicial reanalysis of the resolution will not undermine the effectiveness of the transaction sought).

\(^{196}\) Boudreau, *supra* note 186.

\(^{197}\) *Id.* at 6.
sovereign of any asset or property of the investors has another important implication.

The statute, as such, essentially lays down procedural or organizational rules as opposed to substantive rules. This is extremely relevant from the standpoint of an assessment in terms of the rule against legislative retroactivity: procedural laws typically apply upon their coming into force, irrespective of whether their immediate application interferes with substantive situations having arisen prior to the enactment of the new procedural law.¹⁹⁸

Finally, it may also be argued that since ex hypothesi a statute like the Greek Bondholder Act could have been validly enacted under the local law even if the sovereign issuer had not been insolvent or in difficulty, a fortiori its consistency with the internal legal order cannot be challenged, due to the additional factor of legitimacy that comes into play when enactment occurs in response to the need of protecting the public interest in the context of a dramatic crisis.

The very first step of this argument is, however, the conceptual acceptance of a characterization. Specifically, the reasoning moves from characterizing the right held by each individual bondholder not as a monetary claim equivalent in law to a chattel pertaining on a stand-alone basis to a “solitary” owner, but rather as a contractual claim, representing a fraction of a loan co-held by a plurality of similarly situated co-lenders.

The national law that proceeds from the characterization of the bond issue as a co-holding will assumedly be entitled to maintain at all times the prerogative of regulating the organization of the co-holding. Otherwise stated, the individual right of each bondholder never acquires, from this standpoint, a total independence from the parallel right of all other similarly situated bondholders: if it is true that by contract each bondholder has an individual right, it is equally true that by virtue of the same contract each bondholder holds his right not in isolation but as a member of a community.

¹⁹⁸ Landgraf v. USI Film Prods., 511 U.S. 244, 271-75 (1994) (holding that the presumption against statutory retroactivity is limited to statutes altering substantive rights and does not apply to changes characterized as procedural, jurisdictional, or remedial).
of similarly situated co-holders.

Thus, if the governing law recognizes the inherent applicability of a majority rule to any homogeneous collectivity of similarly situated members, a statute may at any time expressly provide for the adoption of a decision-making mechanism based on a majority rule, even if no clause to that effect had been in the contract or deed by which the community was created.

_A fortiori_, this conclusion must be drawn with regard to a context, such as a situation of insolvency or pre-insolvency, where the need to make a collective decision by majority rule in the best interests of the community as a whole is coupled with the justification that even if there is insolvency, there is also a need to enforce the old maxim “equality is equity” regarding the distribution of the debtor’s assets among the creditors (or, more accurately in modern times, among all the members of the same class of creditors).

On the whole, from the standpoint of legal traditions that do not share the fears underlying the prohibition set out in the U.S. Trust Indenture Act of 1939,199 it is extremely difficult (which is not to say impossible) to identify a convincing line of reasoning whereby statutes like the Greek Bondholders Act may be disqualified as unconstitutional or otherwise incompatible with the legal order of the enacting Member State of the Eurozone.

The next step of the analysis concerns the issue of whether a statute like the Greek Bondholder Act, while _ex hypothesi_ consistent with the constitutional framework of the enacting State, may be found to be in breach of international law in _fora_ other than the courts of the enacting State.

Here again it is appropriate to start by drawing some preliminary distinctions.

199 The U.S. Trust Indenture Act of 1939 (15 U.S.C. § 77) introduced the rule that bondholders could not by majority resolution change the terms of payment, although they could change other clauses. For more on the rationale of the provision, see Mark Roe, _The Voting Prohibition in Bond Workouts_, 97 _Yale L.Y._ 232, 256 (1987) (expressing the view that the prohibition was imposed in order to favor the bankruptcy outcome).
A hypothetical statute, similar to the Greek Bondholder Act and enacted by another Member State of the Eurozone, may trigger doubts of consistency with international law obligations of such State at two different levels: first, on the ground of alleged breaches of obligations undertaken by treaty, and second, on the ground of breaches of rules and principles of (general) customary international law.

At the first level, three possibilities deserve to be briefly considered.

First, the question may be posed of whether the statute may constitute a breach by the enacting State of the obligations undertaken vis-à-vis the IMF in its capacity as member of that institution. In theory, the possibility cannot be ruled out: a particularly aggressive, unilateral, and non-negotiated debt restructuring launched by a hypothetical Member State of both the Eurozone and the IMF could violate one or more provision of the IMF Articles. In practice, however, this is extremely unlikely and, on the contrary, the IMF Articles are likely to support the opposite stance. In other words, the IMF Articles may turn out to provide a strong support to the legitimacy of a plan of restructuring agreed with the IMF by that Member State.

Consider, in particular, the hypothetical case in which—as a part of the restructuring process—the sovereign debtor with the assistance of the Troika (IMF, EU, and ECB) would propose an offer for reducing and swapping its external indebtedness, denominated in a foreign currency but governed by the local law. Arguably, a moratorium on the payments in the denominated foreign currency coupled with a payment offered in the form of new swapped bonds, denominated in local currency, might be entitled to receive the protection afforded by Article VIII(2)(b). All other Member States of the IMF could be bound to deny enforcement to claims against the restructuring sovereign that might brought in their courts by non-consenting

200 Christopher Greenwood & Hugh Mercer, Considerations of International Law, in CRISIS? WHAT CRISIS?, supra note 5, at 103; id. at 111-12 (noting, however, that courts might continue to take a restrictive view of Art. VIII(2)(b) of the Articles).
There are two other possibilities of conflict between a statute like the Greek Bondholder Act and an international treaty.

One of these possibilities is offered by the European Convention on Human Rights (ECHR) and Protocol No. 1 to the ECHR. Indeed, this is not just a theoretical possibility but something that has in some sense already happened in the real world.

According to one press release (the sole source of information on this subject):

[a] group of investors of Italian and Greek nationality, assisted by a pool of domestic and international lawyers, lodged the first application with the European Court of Human Rights against the decision of the Greek government to unilaterally extend, by applying the collective action clauses, the conditions of the swap offer on Greek government bonds also to those investors who did not voluntarily accept them.\footnote{What Bondholders Claim Before the Court, Greekbond-legalactions, \url{http://greekbond-legalactions.eu/collective-complaint-to-the-european-court-of-human-rights/}.}

According, again, to the same source, the applicants have alleged that by discretionarily activating the CACs the Greek government violated Article 1 of Protocol No. 1 to the ECHR (the right to protection of property), Article 14 of the ECHR (prohibiting discrimination), Article 13 of the ECHR (the right to an effective remedy before the national courts), and Article 15 of the ECHR (violation of the procedural and substantive conditions to be observed in order to lawfully resort to the exercise of emergency powers).\footnote{Id.}

At first glance, while the attacks are brought under the ECHR and Protocol No. 1, the grounds alleged by the applicants raise basic issues that courts have already dealt with in cases involving claims against sovereigns based on alleged violations of international law principles regarding expropriatory measures. For this reason, rather than expressing an inevitably premature view on this pending suit, it would be more appropriate to make \textit{renvoi} to the analysis presented

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below on the principles of international law relevant to expropriations.\textsuperscript{203}

The third relevant possibility of conflict with treaty obligations stems from the increasingly liberal approach that has crept into the interpretation of International Investment Agreements (IIA) or Bilateral Investment Treaties (BIT), particularly with regards to whether publicly traded bonds in general—and sovereign bonds in particular—fall within the definition of “foreign investments” entitled to treaty protection.\textsuperscript{204}

While the prevailing view in the past was against treating bonds and sovereign bonds as foreign investments, a drastic change in approach occurred after Abaclat v. Argentine Republic.\textsuperscript{205}

In substance, given the variety of the IIAs or BITs and given the impossibility of figuring out in detail \textit{ex ante} the precise contents of national statutes on sovereign debt restructurings, it would be both imprudent and misleading to state in absolute terms that sovereign bonds are always “in” or always “out” regarding the scope of application of IIAs or BITs.

A serious answer can only be given \textit{ad hoc} by analyzing the relevant treaty and the relevant national statute allegedly infringing upon such treaty. Clearly, however, a general reminder is in order: IIAs and BITs, depending on their specific content and wording, may provide the legal basis for international law claims brought by non-consenting bondholders before the courts of a State other than the sovereign issuer.

5. (sequitur): Issues of Consistency with the International Law Principles on Unlawful Expropriations

The final part of this analysis will move from the visual angle of customary international law.

\textsuperscript{203} See \textit{infra} notes 208-225 and accompanying text.


\textsuperscript{205} Abaclat and Others v. Argentine Republic (formerly Beccara and Others v Argentine Republic), ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 4, 2011).
To avoid developing a largely abstract argument, let us look to the jurisprudence of the United States, a county traditionally more inclined to protect basic, well known values as the “right to property” and “sanctity of contract”. In this regard, previous writers have promulgated the view that claims that could not succeed before U.S. courts are very unlikely to fare better before the national courts of any other State—a view that seems quite likely to be correct.

A claim seeking to establish in a U.S. court the liability of a foreign sovereign for the loss suffered as a result of a restructuring carried out under a statute like the Greek Bondholder Act would face a number of serious hurdles. First, the plaintiff would have to establish jurisdiction by proving that the case falls within one of the exceptions permitted by the Foreign Sovereign Immunities Act of 1976 (“FSIA”). Assuming that at the time of the original issuance of the bonds the restructuring sovereign had waived immunity with respect to suits for enforcement, the first serious obstacle likely to arise would be when the court would required to interpret the meaning of “property” under the expropriation exception.

For this exception to apply, the sovereign must have (1) taken “rights in property . . . in violation of international law” and (2) the property must be related to “commercial activity” conducted in the United States by the sovereign. Here, as noted above, the major difficulty for the plaintiff may come from the interpretation of “property”. The prevailing view among U.S. courts

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206 Boudreau, supra note 187, at 7.
208 FSIA, 28 U.S.C. § 1605(a)(3)(2000) (“A foreign state shall not be immune from the jurisdiction of the courts of the United States or of the States in any case in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state”).
209 For the sake of the argument that I am submitting here (namely, whether or not a sovereign debt restructuring of the kind carried out by Greece is compatible with general principles of international law on expropriation) it is unnecessary to delve into a specific analysis of the second requirement of the FSIA exception dealing with the “taking of property”, namely the requirement that the property taken or exchanged must be in the United States in connection with “a commercial activity carried on in the U.S. by the foreign State”. Among the largest holders of the Greek bonds that were restructured, there were certainly some U.S. financial institutions, as evidenced by the fact that Greylock Capital was a member of the Steering Committee and Marathon and Metlife were members of the
is that for the purposes of the expropriation exceptions of the FSIA, “property” means tangible property only, not including contractual rights.\textsuperscript{210} However, in at least one case a U.S. court expressly took the opposite view and held that even the taking of contract rights constitutes \textit{per se} an expropriation.\textsuperscript{211}

Broadly speaking, and even in the jurisprudence of national courts outside the U.S., the issue of whether tangible property and contractual rights should be afforded an equal or different level of protection by international law is not well established, but the restrictive view clearly prevails at least with respect to certain categories of contracts or assets (e.g., financial instruments).

Particularly when contractual financial instruments are involved, there seems to be a consensus around the notion that the law governing the contract plays a major role in determining to which extent that law may interfere with that contract without violating international law: one of the reasons typically given in support of this view is that the investor knew or ought to have known from the outset that the risks of investment included the risk of subsequent changes in the law

\footnotetext[210]{See, e.g., Peterson v. Royal Kingdom of Saudi Arabia, 416 F. 3rd 83, 85 (D.C. Cir. 2005) (“an expectation interest in payments [...] does not qualify as a right in tangible property and the [FSIA] expropriation exception does not apply ...”); Davantree Ltd. v. Republic of Azerbaijan, 349 F. Supp. 2d 736, 749-50 (S.D.N.Y. 2004) (“As numerous courts have held, for purpose of the expropriations exception to the FSIA, the property taken ... means physical property and not the right to receive payment”).}

\footnotetext[211]{West v. Multibanco Comerňex, S.A., 807 F.2d 820, 830 (9th Cir. 1987) (“although the certificates of deposit may be characterized as intangible property or contracts, they are “property interests” that are protected under international law from expropriation”); see also the outcome in \textit{Allied Bank, infra} note 218.}
governing the investment contract.\textsuperscript{212}

Assuming, however, that the first obstacle stemming from the prevailing restrictive construction of the expropriation exception in the FSIA can be overcome, the plaintiff in a U.S. court would still have to face at least two additional levels of difficulties, namely (i) whether the interference with the plaintiff’s rights as non-consenting bondholder reaches expropriation, and (ii) assuming that this threshold can be met, whether deference must nevertheless be paid by the court to the exercise of legislative discretion by the restructuring sovereign.

As noted above in the context of the analysis conducted from the standpoint of the local law,\textsuperscript{213} the introduction by statute of a CAC-equivalent regime leaves the implementation of the “dirty work” in the hands of the consenting bondholders and does not, therefore, constitute \textit{per se} an act of spoliation directly imputable to the sovereign. Furthermore, depending on how the actual provisions of the statute tackle the treatment of non-consenting bondholders, those non-consenting bondholders may face a choice designed to put pressure on them, even if that framework does not reach the level of being expropriatory. Intuitively, a choice between something or nothing is inherently different from a choice between something more and something less (even if the “something more” is obviously less than the face value of the original claim; however, the appropriate “comparable” in judging whether there is expropriation should be the normally depressed market value of the bond, as opposed to its face value). While the first choice is a pseudo-alternative which, depending on the circumstances, may well be inexcusably expropriatory, the second choice may perhaps be indirectly coercive and \textit{prima facie} disadvantageous while not being necessarily expropriatory within the extreme meaning that is relevant for the purposes of

\textsuperscript{212} See, e.g., ALLEN & OVERY, \textit{supra} note 176, at 3-4; Schwarcz, \textit{supra} note 5, at 1013 (“The rationale excusing compensation appears to be that contracting private parties should be aware of the possibility that a State may retroactively alter its contracts by changing its national law, and therefore the private party should assume the risk of such changes occurring.”).

\textsuperscript{213} \textit{Supra} notes 194-199 and accompanying text.
establishing a violation of international law.

Briefly restated, the manner and the intensity by which coercion is or may be exercised as a result of the enactment of a statute designed to facilitate the restructuring may be significantly relevant in determining whether or not the test of expropriation is met.\textsuperscript{214}

Interestingly, expropriation in some cases has been found to subsist solely or essentially on the ground that the measures taken by the restructuring sovereign were discriminatory.\textsuperscript{215} Here again, the holdings in the cases do not permit clear identification of which levels of discrimination will generally be deemed relevant and sufficient in order to warrant a finding of expropriation.

As previously mentioned,\textsuperscript{216} equality of treatment is no longer the “real” rule in ordinary bankruptcy and even less so in sovereign debt restructurings. In the case of the two parallel offers in the Greek restructuring, there was no difference of treatment between foreign bondholders and Greek bondholders. However, the ECB and the other central banks were granted \textit{de facto} preferred status, as shortly before the offer they were permitted to swap their old bonds in exchange for new bonds not subject to the haircut.\textsuperscript{217} If the initial assumptions are (1) the impossibility of applying strict equality of treatment in sovereign debt restructuring and (2) the recognition of the benefit that all stakeholders in the restructuring may gain from the stabilizing roles of the ECB and the Central Bank, it is reasonable to conclude that the discrimination in the Greek case was not expropriatory. However, if a strict notion of the “necessity” of discrimination is used as the test for assessing consistency with international law principles, then discrimination might well have been considered

\textsuperscript{214} \textit{BRONLIE}, supra note 14, at 535. The view has been expressed that, by comparison with other sovereign debt restructurings, the Greek debt restructuring was characterized by a relatively low degree of coercion. Zittelmeyer, \textit{supra} note 26, at 28-30.

\textsuperscript{215} \textit{See, e.g.}, Banco Nacional de Cuba v. Sabbatino, 307 F.2d 845, 867 (2d Cir. 1962), \textit{rev'd on other grounds}, 367 U.S. 398 (1964) (“[P]erhaps, international law is not violated when equal treatment is accorded to aliens and natives, regardless of the quality of the treatment or the motives behind that treatment.”).

\textsuperscript{216} \textit{Supra} notes 168, 171 and accompanying text.

\textsuperscript{217} \textit{See supra} note 192 and accompanying text.
unnecessary under the circumstances and thus expropriatory vis-à-vis the “ordinary” bondholders.

Ultimately, therefore, the issue remains open and uncertain, and this uncertainty is likely to be an additional factor pushing for a resolution in favor of the sovereign defendant, a resolution based primarily on policy grounds that will be further exemplified below.

The last and most effective obstacle that holdout litigants are unlikely to surmount in U.S. courts is the deference that these courts show for the legislative or regulatory choice of a sovereign defendant on grounds of international comity and, even more, on grounds of consistency with U.S. foreign policy.

This is well illustrated by the final outcomes in Allied Bank International v. Banco Credito Agricolode Cartago\textsuperscript{218} and West v. Multibanco Comermex S.A.\textsuperscript{219}

In Allied Bank the judgment below had rejected a claim brought by some investors against Costa Rica, which had issued regulations suspending all external debt payment owing to a serious economic and financial crisis. The reasoning of the district court was based on the Act of State Doctrine: to hold against Costa Rica would “put [ ] the judicial branch of the United States at odds with policies laid down by a foreign government on an issue deemed by that government to be of central importance.”\textsuperscript{220}

On appeal, the Second Circuit first found that the district court had correctly applied the Act of State Doctrine,\textsuperscript{221} but subsequently, on rehearing \textit{en banc}, the decision was reversed on policy grounds. An \textit{amicus curiae} brief filed by the government had indicated that in this case, the application of the Act of State Doctrine would not be consistent with the U.S. policy. According to the government, Costa Rica should have restructured its debt under an IMF-approved rehabilitation

\textsuperscript{218} Allied Bank Int'l v. Banco Credito Agricolo de Cartago, 757 F.2d 516 (2d Cir. 1985) \textit{(en banc)}.
\textsuperscript{219} Supra note 211.
\textsuperscript{221} Allied Bank, 757 F.2nd at 519.
program; Costa Rica had not done so, thus deciding to proceed unilaterally. Accordingly, the Second Circuit found that the Act of State Doctrine was inapplicable and that in the absence of such a defense, the rights of the investors should be treated as having been taken in violation of international law.\textsuperscript{222}

The comparison of \textit{Allied Bank} with \textit{Comermex}\textsuperscript{223} is very instructive. In \textit{Comermex} the Ninth Circuit first found that certificates of deposit, in spite of their characterization as intangible property or contracts, were “property interests” protected under international law from expropriation; it also found that the measures taken by the Mexican government and complained of in the case were in principle expropriatory. However, in adjudicating the case on its merits, the court held that when exercising its basic authority to regulate its economic affairs and to institute exchange control regulation, Mexico’s actions were not in violation of international law.\textsuperscript{224}

Thus, in \textit{Comermex} the Act of State Doctrine was applied, as it was equally applied on similar grounds in \textit{Braka v. Bancomer S.A.}\textsuperscript{225}

The common denominator between these cases and \textit{Allied Bank}, which at first blush stands for the opposite proposition, is that U.S. courts, while deeply inspired by a culture that is most sensitive towards the international law protection of values such as rights to property and sanctity of contract, continue to give decisive weight, as an argument of last resort, to the Act of State Doctrine, as interpreted and adapted from time to time by the U.S. government.

Thus, on the assumption that sovereign debt restructurings in the Eurozone would continue to be prepared, negotiated, and carried out under programs led or supervised by the Troika (IMF,

\textsuperscript{222} \textit{Id.} at 520-522.
\textsuperscript{223} \textit{West}, 807 F.2d at 820.
\textsuperscript{224} \textit{Id.} at 830-32.
\textsuperscript{225} \textit{Braka v. Bancomer, S.N.C.}, 762 F.2nd 222 (2nd Cir. 1985).
EU, and ECB),²²⁶ the decision in *Allied Bank* is a strong indication of the likelihood that statutes like the Greek Bondholder Act would not be treated in a U.S. court as sanctionable acts in the form of an expropriatory taking of property in violation of international law. *A fortiori*, the same outcome may be expected to occur with respect to holdout suits that are *ex hypothesi* brought before the national courts of any Member State of the Eurozone. Furthermore, it is certain that great weight would be given to the IMF position, which is clearly favorable to—and has advocated—the introduction by statute of CACs with retroactive effects.²²⁷

Coupled with the tradition of a sovereign-oriented jurisprudence in international law,²²⁸ I submit that holdout litigation seeking to establish sovereign liability for violations of international law on the basis of measures taken under restructuring statutes enjoy only a very small chance of success (unless this were to occur in arbitration under an IIA or BIT that is particularly protective of its private beneficiaries—that is, those investors who are nationals of the other Contracting Party).


There was no need to enact a statute providing for a CAC-equivalent regime with respect to the Greek sovereign bonds that had been issued under a law other than Greek law. As mentioned above,²²⁹ all of these bonds were subject to English law and, as all sovereign bond issues governed by English law, the Greek issues were also assisted by the presence of CACs in the original terms of the issue. Thus, the restructuring of these bonds was facilitated by the presence of this structural feature, although this did not *per se* eliminate all implementing difficulties.²³⁰

However, the fact that the presence of CACs in the English law bond issues made moot the

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²²⁶ Supra Chapter II, paras. 2, 3.
²³⁰ For a detailed description of the various aspects, see Porzecanski, * supra* note 161.
question of whether the Greek Bondholder Act should also cover these issues does not per se eliminate the value of such a theoretical inquiry. Assuming that a sovereign member of the Eurozone issued bonds under a foreign law without the insertion of any CAC in the original contractual terms, would it be possible for that sovereign (i.e., consistent with international law) to restructure those bonds by enacting a statute like the Greek Bondholder Act?

The answer is much more uncertain than in the case of sovereign bond issues governed by the local law. I believe, however, that it should still be in the affirmative.

Although it is clear that the restructuring sovereign has no power to modify the foreign law governing the bonds, the result of this impossibility of modification is the total rigidity of the bundle of rights and obligations stemming from the contract, not the lack of the sovereign power to make laws in respect of the issue of how payments to be made by the sovereign itself or its agencies or nationals will be regulated.

If the bond issues at stake are not only governed by a foreign law but are also denominated in a foreign currency, the sovereign’s power to make (and/or modify) exchange control regulations in respect of payments in foreign currency comes into play, and the exercise of such power does not violate international law, at least if the exercise is consistent with the obligations imposed by the IMF Articles (all members of the Eurozone are members of the IMF). A fortiori, this is true, regardless of whether the restructuring occurs under the umbrella of an IMF-approved program or a Troika-approved program.231

If, however, the bond issue were governed by a foreign law but denominated in euros, could the preceding reasoning relating to sovereign issues in foreign currency apply also to a bond issue of this kind (i.e., an issuance denominated in euros)? The uncertainty here is a direct consequence

231 See supra note 200 and accompanying text.
of the fact that, as of today, the euro is a “strange” currency. It is the national currency of 17 sovereign states, in that in each of them it is the legal tender currency. But none of these States exercises monetary sovereignty over the euro: thus, each State’s indebtedness with respect to the euro is similar to an indebtedness denominated in foreign currency.

The consequences of these special features of the euro on the question raised above are, I repeat, far from immediately evident. It would seem awkward to argue that in the absence of monetary sovereignty over the euro each Eurozone member is entitled to treat its indebtedness in euro as if it were external debt. To argue that a Eurozone member is entitled to enact exchange control regulations with respect to a currency over which it has no sovereignty is equally awkward.

Perhaps the only convincing answer is that a debt restructuring of a foreign law, euro-denominated sovereign issue is still possible with the assistance of appropriate exchange control regulations adopted *ad hoc* by that sovereign—provided, however, that these exchange control regulations are adopted in coordination with the EU and the ECB—in other words, with the entities to which monetary sovereignty over the euro may be imputed.
Conclusions

The main conclusions that can be drawn from my analysis may be restated as follows.

First, the IMF’s experience and techniques, developed over the years in the course of promoting and guiding financial aid programs to troubled States throughout the world, have been largely used as models—or at least as sources of inspiration—in the shaping of the European Adjustment Programmes. Thus, technically these programs carry a noticeable IMF imprint. As such, they may attract the same kind of criticism that has been addressed in recent years to the IMF’s approach in promoting rescue programs subject to strict conditionality.

Second, the most important structural feature of the European experiences is the tripartite institutional framework, namely the coordination of roles among the IMF, EU (acting through the EC), and the ECB. Here, the role of the ECB should receive particular emphasis. The Eurozone crisis has, at least thus far, been mitigated not because of the good quality and timeliness of the rescue programs accepted by Greece, Ireland, Portugal, Spain, and Cyprus, but rather because of the protective umbrella displayed by the ECB through the unlimited liquidity supplied to European banks and open market purchases of sovereign bonds under the SMP program. In strict legal terms, it is not entirely certain that the ECB has always acted within the boundaries of its powers under its Statute and the TFEU. As of today, the uncertainties of these boundaries have been removed as a result of the mandatory complementarity provided with regards to the roles of the ESM and the ECB. However, while the legal picture is clearer, the open question is whether the ECB’s umbrella protection is still available to the Member States of the Eurozone, and whether it could continue with the same effectiveness as during the SMP interventions from May 2010 to September 2012.

Third, notwithstanding the absence ex ante of a largely accepted uniform procedure as a framework for sovereign debt restructuring, the Greek debt was actually restructured without
causing the levels of chaos or disruption that had been feared. More than 97 percent of the privately held Greek bonds targeted by the Greek government’s offer accepted the terms as put forward. Of course, this high level of acceptance may be due to the fact that 90 percent of the targeted bonds were Greek-law bonds directly exposed to the pressure exerted by the change of the law under the Greek Bondholder Act (and its insertion of CACs with substantially retroactive effect). But since many Eurozone states have a sovereign indebtedness structure similar to the one prior to the restructuring (i.e., where the majority of sovereign debt was local-law debt), the Greek experience cannot be considered to be peculiar or marginal; rather, it may be a precedent that cannot be easily dismissed if the need for additional sovereign debt restructuring were to arise again in the Eurozone.

Fourth, the fact that the Greek debt restructuring was not a disaster and may indeed constitute (or appear to constitute) a precedent does not per se imply that the manner in which it was conducted was legally impeccable.

My conclusions in these regards are as follows: (i) the enactment of laws introducing CACs with retroactive effect is likely to be constitutional in those European States—likely the majority—where the rights of bondholders are legally viewed as the rights of co-holders of a collective loan; in such states, the law may well allow for retroactive subjection to a majority rule; (ii) a different conclusion could hold if we consider whether the statutory introduction of retroactive CACs is compatible with the international obligations that the enacting State has undertaken under an international treaty (e.g., in particular, a bilateral investment treaty (BIT) or an international investment treaty (IIT) if such a treaty considered sovereign bonds an “investment” and if the protection accorded by that treaty were capacious enough to cover such investments); (iii) from the standpoint of the general principles of international law (i.e., in situations where no treaty protection is or may be sought), a sovereign debt restructuring such that in Greece is unlikely to be
characterized in national courts (other than the courts of the restructuring sovereign) as a taking of property in violation of international law, a finding that might allow a holdout creditor to enforce her right to be paid the face amount or to claim an indemnity higher than the market value of the post-restructuring securities; and (iv) even if the restructuring were characterized as expropriatory on grounds of discrimination or gross unfairness to certain creditors, holdout creditors may still have to face a difficult obstacle: the deference that sovereign States are paid by foreign courts due to theories such as the Act of State Doctrine or its functional equivalents in international law.

Finally, the European experiences have offered interesting insights into the issue of whether preferred creditor status should be granted to the public entities making a financial contribution to the rescue program of an ailing State. While the IMF's right to receive such status has been not only recognized by the ESM Treaty but also emphasized by the recognition of a super-priority whenever preferred creditor status is claimed by other public entities that also provided new financing, a significant change of approach has been adopted by the ECB. Under the new OMT programme, in accordance with the policy that the ECB has now undertaken to follow in open market transactions, the preferred creditor status left unclaimed by the ECB in connection with the Greek debt restructuring will no longer be claimed. This underlines the soundness of the proposition that the recognition of preferred creditor status is more a discretionary political decision than a necessarily implied legal rule, a choice perhaps dictated by the logic of a sovereign debt restructuring.