

ADEMU WORKING PAPER SERIES

Euro CAC and the existing rules on sovereign debt restructuring in the Euro area: An appraisal four years after the Greek debt swap

Thibault Martinelli[†]

May 2016

WP 2016/043

www.ademu-project.eu/publications/working-papers

Abstract

After explaining the role of Collective Action Clauses (CAC), this paper explores how these have been developed in the 'statutory' CAC operation in Greece in 2012 and the Euro-area CAC provisions found in the ESM Treaty which apply to all Euro-area bonds issued from 2013. The paper explains the legal risks that arise and the capacity of CAC to assist in debt restructuring. Noting certain remaining weaknesses in the existing Euro CAC, the paper closes by offering some modifications as well as more long term solutions to debt restructuring.

[†] European University Institute, Florence. Email: thibault.martinelli@eui.eu

Keywords: Bank size, diversification, money market, bank solvency, liquidity

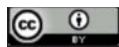
Jel codes: E4, E5, G21

Acknowledgments

The author would like to acknowledge the support of the ADEMU project, "A Dynamic Economic and Monetary Union. This project is related to the research agenda of the ADEMU project, "A Dynamic Economic and Monetary Union". ADEMU is funded by the European Union's Horizon 2020 Program under grant agreement N° 649396 (ADEMU).

The ADEMU Working Paper Series is being supported by the European Commission Horizon 2020 European Union funding for Research & Innovation, grant agreement No 649396.

This is an Open Access article distributed under the terms of the Creative Commons Attribution License Creative Commons Attribution 4.0 International, which permits unrestricted use, distribution and reproduction in any medium provided that the original work is properly attributed.



Introduction

The purpose of this paper is to explain what Collective Action Clauses (CAC) are and to provide an appraisal of the rules on CAC that were adopted as a result of the euro area crisis. CAC are provisions contained in the terms of bonds issued by states. It was a key legal mechanism used in the only sovereign debt restructuring ever carried out in the euro area: the 2012 Greek debt swap. In addition, the Treaty establishing the European Stability Mechanism (ESM Treaty),¹ the agreement between the euro area states creating a permanent bailout fund, provides for the implementation of identical CAC in all sovereign bonds issued by Eurozone states after January 2013.² Those CAC must be drafted after a model developed by a Sub-Committee of the Economic and Financial Committee, in consultation with market participants (Euro CAC or Euro area Model).³

Section 1 highlights CAC's main function. Section 2 describes how CAC were used in the Greek sovereign debt restructuring. Section 3 provides an appraisal of the main features of the Euro CAC developed pursuant to the ESM Treaty. Section 4 identifies the circumstances under which a sovereign debt restructuring could be envisaged in the future according to the

¹ Treaty establishing the European Stability Mechanism (2 February 2011) <<http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf>> accessed 15 February 2015.

² Article 12 (3) of the ESM Treaty ('Collective action clauses shall be included, as of January 2013, in all euro area government securities, with maturity above one year, in a way which ensures that their legal impact is identical').

³ For the text of the Euro CAC, see EFC Sub-Committee on EU Sovereign Debt Markets, 'Common Terms of Reference' (17 February 2012) <http://europa.eu/efc/sub_committee/pdf/cac_text_model_cac.pdf> accessed 15 February 2015 (hereinafter 'Euro CAC').

ESM Treaty. Section 5 concludes by identifying the risks under the present scheme and by considering reform paths to alleviate them.

1. What are CACs? What is their function?

A euro area state hit by a major debt crisis has essentially two main options: (a) obtain financial assistance from the IMF and the ESM and (b) negotiate a debt restructuring with its creditors. The purpose of the restructuring is to obtain - from the state's creditors - a reduction of the debt's principal or interest rate. This process entails a significant reduction of the net present value of the debt, so-called 'NPV reduction' or 'haircut'. Alternatively, a debt restructuring can signify a pushing-out of the debt maturity, usually called 'debt reprofiling'. In both instances, the transaction can either consist in a direct alteration of the debt's payment terms or a debt swap, i.e. an exchange of the outstanding debt instruments with freshly issued debt instruments with different payment terms.

A debt restructuring runs across one major legal difficulty. In principle, changes to payment terms require the consent of all contracting parties to the loan agreement (the borrower and all the lenders). Since the 1980s, states generally do not finance themselves through the conclusion of loan agreements with a few banks – i.e. syndicated loan agreements - but through the issuance of bonds. A bond issue is a loan involving potentially thousands of lenders: the bondholders, who might be banks, pension funds, investment funds or even retail investors. Obtaining the unanimous consent of all of them to a restructuring plan submitted by the state is close to impossible. There will always be recalcitrant bondholders who will refuse to agree on a 'haircut'. Some might attempt to negotiate 'on the side' with the state to obtain a more advantageous deal. Others might decide to initiate court proceedings with a view to seizing the state's assets and recovering the full face value of their bonds. Such holdout behaviors can be very disruptive for the restructuring process. As the 2001 Argentinean debt crisis illustrates, a disorderly restructuring can plague the economic recovery of a troubled State and delay the moment where it can regain market access.

The solution found to ease sovereign debt restructuring is a set of contractual provisions to be included in the bond terms: Collective Action Clauses. CAC's main provision is a supermajority amendment mechanism. Each bondholder, when buying the bonds, consents to the fact that, if a qualified majority of them - usually those holding 2/3 or 3/4 of the face value of the bonds - agree on a restructuring plan submitted by the state, the plan will be binding upon everyone, even upon those who voted against. The main virtue of this clause is to discourage holdout behavior. The non-participating bondholders are bound by the supermajority decision and are, in principle, prevented from litigating in order to obtain full repayment of their bonds.

2. 'Statutory CAC': The Greek Debt Restructuring of March/April 2011⁴

Similarly to any loan contract, the law of a given state governs the validity and performance of a bond issue.⁵ The greater proportion of debt instruments issued by euro area states is governed by the domestic law of the issuing state while the remaining part of euro area debt stock is subject to a foreign law (mainly English law because they are issued on the London bond market). Prior to the Eurozone crisis, CAC had been standard terms in bonds governed by English law for a long time. Debt instruments issued under local law, however, did not usually include such a set of contractual provisions.

When the Greek debt crisis erupted, 20 millions of bonds issued by Greece under English law were equipped with CAC and could be restructured separately according to their terms. The remaining 177.3 billions of bonds (86% of the face value of the debt targeted by the restructuring) were 'CAC less' bonds governed by Greek law.⁶ In spite of this, in April/March 2012, the Hellenic Republic restructured those bonds successfully. How did Greece succeed in implementing the largest sovereign debt restructuring ever carried out in financial history? The Greek authorities could take advantage of the fact that Greek law governed the bonds. Theoretically, by adopting a law to that effect, the Greek legislature could have directly changed the payment terms of those bonds. This confrontational strategy would have undermined market confidence even more and could have affected the borrowing

⁴ For a detailed analysis of the Greek debt restructuring, see J. Zettelmeyer, C. Trebesch & M. Gulati, 'The Greek Debt Restructuring: An Autopsy', (2013) 28 Economic Policy 513.

⁵ The bond terms designate the law governing the bonds in the so-called 'governing law clause'.

⁶ J. Zettelmeyer & al. , (no 5), 515.

costs of other troubled euro area states.⁷ Instead, a more consensual approach was followed based on a creative legal technique: a ‘statutory CAC’.⁸ Via the Bondholders Act 4050/12 adopted in February 2012, Greece incorporated retroactively a CAC with a voting threshold of 2/3 in its domestic law bonds.⁹ The restructuring took the form of a bonds swap. The Greek bonds were exchanged mainly against debt instruments with a reduced NPV governed by English law.¹⁰ Around 85 % of the creditors holding bonds governed by domestic law eventually adhered to the exchange offer and Greece activated the statutory CAC.¹¹

This strategy of retrofitting CAC in bonds governed by domestic law gave rise to litigation. A Slovakian bank challenged the lawfulness of the restructuring process before an arbitral tribunal on the basis of a bilateral investment treaty (‘BIT’) concluded by Greece with Slovakia.¹² In addition, other unsatisfied bondholders brought proceedings before the Greek Council of State based on the Greek Constitution and the European Convention of Human Rights, which protect the right to property.¹³ In both instances the purpose of the claimants was to show that, by activating a retroactive statutory CAC, Greece expropriated them unlawfully from parts of their investment and frustrated their legitimate expectations. The outcomes of the bondholders’ claims were to a certain extent uncertain. Judging the lawfulness of the legislation adopted by Greece requires appraising the foreseeability and proportionality of that measure. For doing so, many variables are to be taken into account: the economic context surrounding the restructuring, the negotiations preceding it, the purpose pursued by the State and the amount of the ‘haircut’ imposed upon recalcitrant bondholders.

⁷ L.C. Buccheit & M. Gulati, see ‘Restructuring a nation’s debt’, (2010-2011) 29 International Financial Law Review 46.

⁸ The idea of a ‘statutory CAC’ was developed by L.C. Buccheit & M. Gulati, see (no 8), 46.

⁹ An unofficial English translation of the Greek Bondholders Act 4050/12 is available at the following address: <<http://andreaskoutras.blogspot.be/2012/03/better-translation-of-bondholders-act.html>> accessed 15 February 2015.

¹⁰ Hellenic Republic, Ministry of Finance, Press Release (28 February 2012) <http://blogs.reuters.com/felix-salmon/files/2012/03/Greek.Min-Fin-Press_Release_Feb.24-2012.pdf> accessed 15 February 2015.

¹¹ Hellenic Republic, Ministry of Finance, Press Release (9 March 2012) <<http://www.pdma.gr/attachments/article/80/9%20MARCH%202012%20-%20RESULTS.pdf>> accessed 15 February 2015.

¹² This BIT is part of a network of thousands of such agreements concluded bilaterally by EU Member States among them and with third countries. By virtue of a BIT, two States grant a set of guarantees to each other’s nationals who are investing on their territory. Typically, those guarantees include a protection against unfair and inequitable treatment by the State authorities and a protection against unlawful deprivation of their investments. For the case, see *Postova Banka SA and Istrokapital SE v Hellenic Republic*, ICSID Case No ARB/13/8 <<http://www.italaw.com/sites/default/files/case-documents/italaw4238.pdf>> accessed 15 February 2015.

¹³ Note that holdout investors have also initiated litigation before multiple German courts. The German Federal Court (Bundesgerichtshof) is expected to rule on the admissibility of such claims in the course of 2016. See Bundesgerichtshof, Mitteilung der Pressestelle Nr. 159/2015, Terminhinweis in Sachen VI ZR 516/14 für den 8. März 2016 (Umschuldung griechischer Staatsanleihen).

There might also have been good reasons to differentiate the situation of each claimant depending on his degree of sophistication and the timing of the bonds' purchase. An institutional investor who bought below investment grade bonds on the secondary market should have foreseen the possibility of incurring substantial losses as a result of a restructuring. One could say that he should also have known that bonds governed by foreign law are safer investments than bonds governed by local law. On the contrary, a retroactive CAC is a legal coup that retail investors with little knowledge of the market and its practices could not have predicted.¹⁴

Eventually, both the arbitral tribunal and the Greek Council of State dismissed the proceedings, but on different grounds. The arbitral tribunal held that sovereign bonds did not qualify as a 'protected investment' under the definition given to this term by the Slovakia-Greece BIT.¹⁵ This controversial issue turned mainly on how to interpret the wording of the definition of 'investment' provided by the Slovakia-Greece BIT. In cases involving the 2005 Argentinean debt restructuring, other arbitral tribunals reached an opposite outcome on similar issues on the basis of the Argentina-Italy BIT whose wording differed.¹⁶ The Greek Council of State, for its part, ruled that the provisions of the Greek constitution enshrining the right to property were not transgressed. In its view, the constitutional protection against expropriation is limited to rights *in rem* without extending to contractual claims.¹⁷ Nor did the Greek legislation infringe upon the investors' property rights as guaranteed by the European Convention on Human Rights. Considering the compelling interest pursued, safeguarding the Greek economy, the financial losses imposed upon private bondholders were proportionate.

¹⁴ For an assessment of the compatibility of the Greek debt restructuring with the European Convention on Human Rights, see P. Wautelet, 'The Greek Debt Restructuring and Property Rights. A Greek Tragedy for Investors?', in A. Allen et al. (eds) *Liberae Cogitationes ogitatioamicorum Marc Bossuyt* (2013). See also M. Boudreau, 'Restructuring Sovereign Debt Under Local Law: Are Retrofit Collective Action Clauses Expropriatory?' (*Harvard Business Law Review Online*, 2012) <<http://www.hblr.org/?p=2283>> accessed 15 February 2015 (examining whether American courts would find the Greek Bondholders Act to be an invalid expropriation under international law).

¹⁵ See *Postova Banka*, at para. 248-324. For a case note analyzing the reasoning of the arbitral tribunal on this point, see F. Montanaro, 'Postova Banka SA and Istrokapital SE v Hellenic Republic: Sovereign Bonds and the Puzzling Definition of 'Investment' in International Investment Law', (2015) 30 ICSID Review 549.

¹⁶ See *Abaclat and others v. Argentine Republic*, ICSID Case N° ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011) <<http://www.italaw.com/sites/default/files/case-documents/ita0236.pdf>> accessed 15 February 2015; *Ambiente Ufficio S.P.A. and Others v. Argentine Republic*, ICSID Case N – ARB/08/9, Decision on Jurisdiction and Admissibility (8 February 2013) <<http://www.italaw.com/sites/default/files/case-documents/italaw1276.pdf>> accessed 15 February 2015.

¹⁷ Decision of the Greek Council of State, 23 March 2014 (*Symvoulío tis Epikrateias*, case 1116-1117/2014) (no English translation available). For a casenote in English on the case, see 'Exchange of Bonds Issued or Guaranteed by the Greek State' (*Norton Rose Fulbright*, April 2014) <<http://www.nortonrosefulbright.com/files/exchange-of-bonds-issued-or-guaranteed-by-the-greek-state-115005.PDF>> accessed 15 February 2015.

3. The Euro CAC: ‘contractual’ CAC

The ESM Treaty mandates the implementation of identical CAC in all sovereign bonds issued by Eurozone states after January 2013. In the midst of the crisis, adding a provision to the ESM Treaty mandating the inclusion of CAC conveyed an important political message directly addressed to the citizens. The ESM Treaty establishes a permanent bailout fund financed by euro area Member States’ tax revenues. However, through a sovereign debt restructuring, private creditors will also share a part of the financial burden required to restore stability in the euro area.¹⁸

Leaving aside the political function of CAC, what is the advantage of having identical CAC in all bonds issued by euro area states? What are the main features of the Euro CAC? The Euro CAC has brought three major legal changes, which are examined and assessed below.

1. *Identical CAC*

The debt of euro area states is composed of a myriad of bond issues with varying terms and possibly governed by different laws. Without identical CAC, the restructuring process could potentially vary from bond issue to bond issue. Bondholders could be treated differently depending on the terms of their bonds and the applicable law. The Euro CAC harmonizes the restructuring process to a certain extent and makes it more predictable. The voting threshold set will be identical and the mechanics of the restructuring process similar.

However, the underlying law applicable to the CAC and the other terms of the bonds remain different from euro area state to euro area state, and even from bond issue to bond issue. Further harmonization would have required subjecting all bond issues in the euro area to the law of a single commonly agreed EU Member State. Alternatively, via a mechanism of *dépeçage*, the CAC could have been separated from the other terms of the bonds. The law of a single State would govern the CAC while the issuing State could still subject the other terms of the bond to another law. Both options would have entailed a curtailment of euro area

¹⁸ A. Gelpern & M. Gulati, ‘Sovereign Snake Oli’, (2011) Washington College of Law Research Paper n° 2011-05 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1732650> accessed 15 February 2015.

states' sovereignty that was considered politically unacceptable.¹⁹ Another possibility would have been to adopt the Euro CAC as a EU legal act but no clear basis in the founding Treaties entrusts the EU with the competence to regulate such a subject matter.²⁰

2. *'An aggregate CAC with a single limb voting procedure'*

Originally, standard New York and English CAC were 'individual CAC' in that they covered solely individual bond issue. Each bond issue is restructured separately and the voting threshold is calculated for each bond issue. Holdout bondholders could therefore acquire a blocking minority in one bond issue to prevent the activation of the CAC. This weakness in the design of 'individual' CAC can be exploited by creditors and especially by the most ill intentioned of them, the infamous 'vulture funds'. The business strategy of those hedge funds consists in buying distressed sovereign bonds at a discount on the secondary market and then attempt to recover their full face value, through litigation or 'side agreements' negotiated with the state.

In contrast, 'aggregate CAC' make inter-bond issues' modifications possible. An 'aggregate CAC with a single limb voting procedure' allows a restructuring of the debt across bond series subject to a single supermajority requirement. The voting threshold required for the activation of the CAC is to be calculated at an aggregate level, for all bond issues covered by the restructuring plan. It is therefore much more difficult - if not completely impossible - for holdout creditors to resist the restructuring by acquiring a blocking minority.

The Greek debt restructuring illustrates the advantages of 'aggregate CAC with a single limb voting procedure' over 'individual CAC'. The CAC incorporated by the Hellenic Republic in the bonds governed by Greek law was inter-series. The activation of the CAC bound all bondholders across series. No bonds were left 'non-restructured'. In contrast, the bonds issued by Greece under English law included only 'individual CAC'. Holdout creditors stalled the restructuring of 16 bonds series by expressly rejecting the exchange offer made by Greece.²¹ Fearing holdout litigation, Greece repaid fully the principal of non-restructured

¹⁹ See A. Sainz de Vicuña y Barroso, 'Identical Collective Action Clauses for Different Legal Systems: a European Model', in P. Kenadijan & K.-A. Bauer (eds), *Collective Action Clauses and the Restructuring of Sovereign Debt* (2013) 15, 21

²⁰ *Ibid.*

²¹ J. Zettelmeyer *et al.*, (n 5) 527.

bonds maturing a month after the completion of the transaction.²² The payment amounted to 436 million euros, 90% of which went to a well-known vulture fund based in Cayman Islands, Dart Management. This fund made important profit on this operation since it had previously acquired those bonds on the secondary market at between 60 to 70% of their face value.²³

Compared to ‘individual CAC’ prevailing on the New York and London bond markets, the Euro CAC was a novelty at the time of its adoption in 2011. It introduces an aggregate CAC with ‘a two limb voting procedure’. The payment terms can be modified across bond series if two voting thresholds are met, one calculated in the aggregate and the other one for each bond issuance. If the restructuring proposal is submitted to creditors at a bondholders’ meeting, the CAC is activated by a positive vote of 75% of the amount of all affected bonds in the aggregate represented at the meeting and 66 2/3% of the amount of each individual bond series represented at the meeting.²⁴ The Euro CAC facilitates inter-series modifications but falls short of eliminating the risk of holdout behavior altogether. In a future euro area restructuring, minorities could still obstruct the restructuring of single bond issues. Following the example of Dart Management, vulture funds and other ill-intentioned creditors could strategically acquire, at a discount, a blocking position of 33 1/3% in a bond issue. By exerting pressure to obtain full payment, they could then attempt to make juicy profits at the expense of the distressed state and its cooperative creditors.

In order to address this problem, the International Capital Market Association (ICMA) has, since then, proposed a refined majority amendment clause: an aggregate CAC with ‘a single limb voting procedure’.²⁵ Back in 2011, the EU Sub-Committee in charge with drafting

²²*Ibid.*

²³ T. Wortswall, ‘The Value of Foreign Law Investing: Greece Pays out on English Bonds’, (*Forbes*, 16 May 2012) <<http://www.forbes.com/sites/timworstall/2012/05/16/the-value-of-foreign-law-in-investing-greece-pays-out-on-english-bonds/>> accessed 15 February 2015; T. Landon, ‘Bet on Greek Bonds Paid Off for ‘Vulture Fund’, (*New York Times*, 15 May 2012) <http://www.nytimes.com/2012/05/16/business/global/bet-on-greek-bonds-paid-off-for-vulture-fund.html?_r=0> accessed 15 February 2015.

²⁴ Section 2.2 of the Euro CAC.

²⁵ See International Market Association Standard, ‘Aggregated Collective Action Clauses (‘CAC’) for the Terms and Conditions of Sovereign Notes’ (August 2014) <<http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/>> accessed 15 February 2015. For comments on the innovative features of the new ICMA model, see A. Gelpern, ‘A Sensible Step to Mitigate Sovereign Bond Dysfunction’ (*Peterson Institute For International Economics*, 29 August 2014) <<http://blogs.piie.com/realtime/?p=4485#.VBInUiofqW8.email>> accessed 15 February 2015.

the Euro CAC rejected the idea of a truly ‘aggregate’ CAC.²⁶ It raised doubts as to its enforceability in all euro area jurisdictions as well as to its fairness. Given the absence of a supervising judicial authority, the sovereign and its largest creditors could abuse the restructuring process. The ICMA Model addresses the latter concern by providing an additional safeguard. The activation of the CAC with a single limb voting procedure is subject to the condition that all creditors be treated equally. The terms of the restructuring plan should be identical for all affected bondholders. Investors holding majorities in largest bond issues cannot coalesce with the sovereign to adopt a restructuring plan that would discriminate against majoritarian bondholders in smaller bond issues.

This innovation proposed by ICMA has been endorsed by the IMF²⁷ and is increasingly implemented, sometimes with small variations, in bond terms issued on the New York and London markets.²⁸ If those nascent contractual practices were to evolve into boilerplate bond terms, the Euro CAC, a novelty at the time of its adoption, could lie somewhat behind global developments on the major financial markets.

3. ‘Contractual’ CAC

The Greek debt restructuring gave rise to litigation mainly because it relied upon a ‘statutory CAC’. In a restructuring process carried out in accordance with a ‘contractual CAC’, each bondholder has agreed upon the CAC when buying the bonds and has acknowledged that he might be bound by a supermajority decision to alter the bonds’ terms. No claim of expropriation or of unfair and inequitable treatment could be put forward. Litigation could occur only in more marginal instances. This would be the case, for example, if the state manipulates the votes at the bondholders’ meeting,²⁹ or coerces creditors into a

²⁶ EFC Sub-Committee on EU Sovereign Debt Markets, ‘Collective Action Clause – Explanatory Note’ (26 July 2011) <http://europa.eu/efc/sub_committee/pdf/explanatory_note_draft_on_the_model_cac_-_26_july.pdf> accessed 15 February 2015.

²⁷ See IMF, ‘Strengthening the Contractual Framework to Address Collective Action Problems’ (October 2014) <<http://www.imf.org/external/np/pp/eng/2014/090214.pdf>> accessed 15 February 2015.

²⁸ See IMF, ‘Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts’ (15 September 2015) <<http://www.imf.org/external/np/pp/eng/2015/091715.pdf>> accessed 15 February 2015.

²⁹ M. Waibel, ‘Opening the Pandora Box: Sovereign Bonds in International Arbitration’, (2007) 101 *American Journal of International Law* 711,724.

restructuring offer.³⁰ As regards bonds governed by domestic law, litigation is also likely to occur if the state, via a retroactive law, lowers the voting threshold defined in a ‘contractual’ CAC or turns a ‘contractual CAC with a double limb voting procedure’ into one with a single one. Modifying *ex post* the ‘contractual’ CAC would however not violate as such the ESM Treaty. The latter only mandates the inclusion of Euro CAC in bond terms but does not require that every euro area restructuring be implemented according to its provisions.

Does it mean that litigation risks associated with the adoption of a statutory CAC have been eliminated? Has the Euro CAC rendered the Greek scenario obsolete? The Greek scenario is certainly obsolete for the Hellenic Republic itself. Through its 2012 debt swap, Greece has replaced its bonds in circulation with debt instruments governed by English law and equipped with Euro CAC. If Greece were to implement a new restructuring, it would only be playing by the contractual rules set out *ex ante* in the CAC. As the bonds exchanged include CAC drafted after the Euro area Model, the risk of blocking minorities in single bond issue remains. If Greece were to restructure its privately held debt a second time, it could still be exposed to vulture funds strategies akin to the ones adopted by Dart Management. The payment made to Dart Management in the aftermath of the debt exchange could inspire investors to follow that example.³¹

For other euro area states, depending on the composition of their debt stock and its governing law, a statutory CAC might well prove to be a useful -if not necessary- tool to implement a sovereign debt restructuring. The ESM Treaty mandates the inclusion of the Euro CAC in bonds issued after 1 January 2013 without affecting debt instruments issued prior to that date. It will still take some time before the outstanding debt stock is replaced by one equipped with majority amendment provisions. This is especially so because the implementation of contractual CAC in euro area bonds terms will be progressive. In order to preserve market liquidity, a euro area state is allowed to issue bonds without CAC as part of a reopening of an outstanding debt issuance (called ‘tapping’) up to a defined percentage of the overall face amount of the bonds issued by that euro area state in that year.³² This percentage

³⁰ K. Gallagher, ‘The New Vulture Culture, Sovereign Debt Restructuring and Trade and Investment Treaties’, The Ideas Working Paper Series n° 02/2011

<<http://www.ase.tufts.edu/gdae/publications/GallagherSovereignDebt.pdf>> accessed 15 February 2015.

³¹ J. Zettermeyer et al., (n 8) 552 (noting that the repayment of recalcitrant creditors in the aftermath of the Greek debt swap is likely to encourage holdouts in any future euro area restructuring).

³² See the conclusions of the European Council EUCO/10/1/11 (24/25 March 2011).

was set at 45% for 2013 and is decreasing periodically to reach 5% in 2023.³³ Because ‘CAC less’ bonds will remain in circulation in the coming years,³⁴ it is not excluded that a euro area state might well be left with no other choice than to restructure bonds which do not yet include a CAC. The adoption of a statutory CAC similar to the Greek Bondholders Act could be contemplated to restructure those bonds, provided that it is possible under the constitution of the euro area state concerned.³⁵ A hypothetical debt swap implemented in the near future would most likely have to rely upon two mechanisms:

- (1) A statutory CAC for all bonds governed by domestic law, which do not yet include CAC, and
- (2) A contractual CAC for the remaining of the debt stock. In the latter case, the CAC might either be drafted after the Euro area Model or ‘individual’ CAC, as they existed prior to the adoption of the Euro area Model.

Similarly to Greece, the adoption of a statutory CAC would expose the troubled state to legal challenges before domestic courts and arbitration tribunals.

4. The current framework for potential future Eurozone debt restructuring?

The political signals sent during the crisis as to when a sovereign debt restructuring would be considered have been mixed. On the one hand, the euro area Heads of state and government have insisted multiple times that the Greek scenario was ‘exceptional and unique’. They have reiterated solemnly their commitments to comply with the payment terms originally agreed with their creditors.³⁶ On the other hand, mandating CAC in bond terms constitutes in itself an acknowledgement that a restructuring in the Eurozone is not impossible. This unclear political attitude towards restructuring can be explained by the somewhat contradictory needs to reassure both the market (that a restructuring is unlikely)

³³ EFC Sub-Committee on EU Sovereign Debt Markets, Supplemental Explanatory Note on the Model Collective Action Clause’ (26 March 2012) <http://europa.eu/efc/sub_committee/pdf/supplemental_explanatory_note_on_the_model_cac_-_26_march_2012.pdf> accessed 15 February 2015.

³⁴ It is difficult to predict the precise amount of time that it will take before the entire Euro area debt stock be equipped with CAC. Two factors are to be taken into account: the maturity of the outstanding debt issued prior to 1 January 2013 and the extent to which Euro area states have made use of the possibility to ‘tap’ bond series issued prior to that date.

³⁵ Jeromin Zettelmeyer et al., (no 8) 553 (noting that, in Cyprus, the adoption of a retroactive CAC would not be constitutionally permissible).

³⁶ See Euro Summit statement (28 October 2011); Statement by the Heads of State or Government of the Euro area and EU Institutions (21 July 2011); Agreed lines of communication by euro area Member States (30 January 2012). See also Council Reply to the Question for Written Answer E-000636/12, 2 April 2012, (2013) OJ C 81 E/134.

and the taxpayers (that bailing-out distressed States with their tax money would not be the only response to the sovereign debt crisis).

In this regard, the Preamble to the ESM Treaty contains a few political indications as to the scope and content of a possible future restructuring in the euro area as well as to the circumstances under which it should be envisaged. The relevant recital of the ESM Treaty is worded as follows:

‘(12) In accordance with IMF practice, in exceptional cases, an adequate and proportionate form of private sector involvement shall be considered in cases where stability support is provided accompanied by conditionality in the form of a macro-economic adjustment programme’

It is worth analyzing this recital closely.

- *‘In exceptional cases’*

The ESM Treaty envisages sovereign debt restructuring only in relation to the system of financial assistance it establishes, and considers it as a last resort mechanism to be used ‘in exceptional circumstances’.³⁷ What do such ‘exceptional circumstances’ entail? While financial assistance by the ESM purports to address temporary liquidity crises, a restructuring is to be envisaged in the more severe situations of sovereign insolvency, when the debt of a State has reached an unsustainable level. Upon the receipt by the ESM of a request for financial assistance, the European Commission, jointly with the IMF and in liaison with the ECB, undertakes a debt sustainability analysis of the troubled state.³⁸ This analysis is the basis for distinguishing between liquidity and solvency crises. The ESM Board of Governors (and the euro area states behind the ESM) can then decide, with a wide margin of discretion, whether a ‘haircut’ should be a condition for obtaining financial assistance from the ESM. A restructuring can also be contemplated for a state already under financial assistance if its debt is later found to be unsustainable. In that case, the restructuring can be a prerequisite for obtaining further financial assistance.

³⁷ See Recital 12 of the ESM Treaty.

³⁸ Article 13 (1) (a) of the ESM Treaty. See also Article 6 of Regulation (EU) 472 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, (2013) OJ L 140/1.

As in the Greek scenario,³⁹ if it proves possible, the sovereign will then subsequently negotiate the details of the terms of the restructuring offer with a committee representing its most important private creditors. A ‘take it or leave it’ offer made by the States without prior consultation with private creditors might face opposition and encourage holdout.⁴⁰

- ‘*An adequate and proportionate restructuring*’

The restructuring should be ‘*adequate and proportionate*’. This requirement relates to the content of the restructuring deal. The proportionality requirement is to be interpreted as meaning (1) that the transaction should not unduly weaken the European banking and financial sector by asking banks and financial institutions holding sovereign debt to accept a loss they would be unable to absorb, (2) that the debt of the state facing payment difficulties should not be reduced beyond what is necessary to restore financial stability in the euro area. The restructuring also has to be adequate. This means that the debt relief obtained by the State should be sufficient to reduce its level of indebtedness to a manageable level, so that no subsequent restructuring is necessary. In this respect, CAC appears as a procedural guarantee ensuring the respect of those political requirements. Subjecting a restructuring to the approval of a majority of bondholders ensures that a certain balance between the concerns of both the debtor and its creditors is reached. It falls upon the shoulders of the troubled state to convince a supermajority of its bondholders of the necessity and fairness of the restructuring plan. A disproportionate deal would be rejected. That the transaction be proportionate and adequate is a political guidance not devoid of legal effect. A disproportionate restructuring is exposed to the risk of being successfully challenged *ex post*. In a legal challenge against a statutory CAC, proportionality will serve as a yardstick against which the lawfulness of the restructuring will be assessed.

- A ‘*Private Sector Involvement*’ transaction

³⁹ J. Zettlemeyer et al., (no 8) 533.

⁴⁰ On the advantages and drawbacks of creditor committees, see T. DeSieno, ‘Creditor Committees in Sovereign Debt Restructurings: Understanding the Benefits and Addressing Concerns’ (December 2014) <<http://www.un.org/esa/ffd///wp-content/uploads/2014/12/9Dec14-BS-statement.pdf>> accessed 15 February 2015.

Sovereign debt restructuring is conceived mainly as a ‘*Private Sector Involvement*’ transaction (‘PSI’).⁴¹ Its purpose is to ask the private sector to contribute to the restoration of the financial stability of a heavily indebted state. A restructuring plan would therefore primarily target bonds held by private bondholders. Otherwise, the ESM Treaty provides no other guidance as to the scope of the PSI. As long as it succeeds in obtaining a sufficient debt relief and in complying with the possible instructions given by the official sector, the state enjoys certain flexibility with regard to designing the scope and defining the terms of the structuring proposal.

Besides private investors, the IMF, the ESM as well as the Eurosystem (the ECB and national central banks of euro area) would also be major creditors. The IMF and the ESM could have already granted loans assistance to the troubled state. For its part, the Eurosystem has engaged in sovereign bonds buying on the secondary market within the framework of its monetary policy. Between 2010 and 2012, under the Securities Market Program (SMP), the Eurosystem purchased debt instruments issued by Italy, Spain, Ireland, Portugal and Greece, which it will hold until maturity.⁴² This programme was terminated in 2012 with the announcement of the Outright Monetary Transaction programme (OMT). The latter scheme, which has never been activated to date, would allow the Eurosystem to acquire potentially unlimited amounts of bonds issued by states benefiting from an ESM programme, as long as the conditionality attached to such a programme is complied with. In addition, in March 2015, the Governing Council of the ECB has launched a quantitative easing operation dubbed Public Sector Purchase Programme (PSPP), which cover primarily euro area governments bonds.⁴³ The PSPP and the SMP programmes have made of the Eurosystem a very large holder of euro area public debt.

In a hypothetical PSI, what would then be the fate of this sizable debt in the hands of the official sector (IMF, ESM and the Eurosystem)? The Preamble to the ESM Treaty recognizes that the ESM and the IMF are ‘preferred creditors’, which justify that their claims be exempted from a PSI transaction altogether.⁴⁴ Their privileged status is designed to protect

⁴¹ *Ibid.* (emphasis added).

⁴² ECB Decision establishing a securities markets programme (ECB/2010/5), (2010) OJ L 124/8.

⁴³ ECB Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2015/10), (2015) OJ L 212/20 (PSPP Decision)

⁴⁴ See Recitals 13-14 of the ESM Treaty.

taxpayers' money⁴⁵ and derives more generally from the role of those institutions: they provide financial assistance in circumstances where private creditors refuse to do so or only at a prohibitive price.⁴⁶

In contrast with the IMF and the ESM, neither EU law nor the Preamble to the ESM Treaty confer the status of 'preferred creditor' upon the Eurosystem. As a matter of law, the ECB and national central banks rank *pari passu* with private creditors. However, in the 2012 Greek restructuring, the debt securities bought by the Eurosystem under the SMP programme enjoyed *de facto* a seniority status.⁴⁷ Shortly before the restructuring took place, those bonds were exchanged against freshly issued bonds with identical terms, which were exempted from the debt swap.⁴⁸ In a case brought by Italian investors affected by the Greek restructuring, the General Court ruled that the preferential treatment afforded to the ECB as compared to private creditors does not breach the principle of non-discrimination enshrined in Articles 20-21 of the EU Charter of Fundamental Rights.⁴⁹ This is so because the ECB and private creditors are differently situated. A private creditor invests in sovereign bonds for its own benefit while the ECB does it as part of its monetary policy.⁵⁰ Considering the legality of this tactic, would the ECB replicate it in a hypothetical future restructuring? A definitive decision on this point would be made in the phase preceding the restructuring. The answer might depend on the bond-buying programme. The status of SMP bonds is unclear but the Greek precedent and EBC's announcements suggest that they could be exempted from the restructuring.⁵¹ In contrast, the ECB has declared that it would not claim seniority status in relation to debt securities bought under the PSPP⁵² and the OMT (should the latter ever be activated).⁵³ If the bonds on the Eurosystem's balance sheet are not exempted from the debt restructuring offer,

⁴⁵ See Statement by the Eurogroup (28 November 2010) <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/118050.pdf> accessed 15 February 2016.

⁴⁶ See conclusion of the European Council (EUCO 10/1/11) (4 April 2011).

⁴⁷ For an analysis of the considerations that led the ECB to decline participation in the Greek PSI transaction, see A. Sainz de Vicuna, 'Restructuring in a Monetary Union', in R.M. Lastra & L. Buchheit, *Sovereign Debt Management* (OUP 2014) 177,184-187.

⁴⁸ J. Black, 'ECB Said to Swap Greek Bonds for New Debt to Avoid Losses', (Bloomberg, 17 February 2012)<<http://www.bloomberg.com/news/articles/2012-02-16/ecb-said-to-swap-greek-bonds-for-new-debt-to-avoid-loss-from-restructuring>>accessed 15 February 2016; J. Zettelmeyer et al, (n 8), 524.

⁴⁹ T-79/13 *Alessandro Accorinti v. BCE* (7 October 2015) not yet reported (ECLI:EU:T:2015:756).

⁵⁰ *Ibid.*, paras. 87-91.

⁵¹ See M. Draghi, 'Introductory Statement to the Press Conference (with Q&A)' (6 September 2012) <<http://www.ecb.europa.eu/press/pressconf/2012/html/is120906.en.html>> accessed 15 February 2016 ('With regard to seniority, the statement on outright monetary purchases does not apply to SMP holdings').

⁵² Recital 8 of the PSPP Decision.

⁵³ See ECB, 'Press Release - Technical features of Outright Monetary Transactions' (6 September 2012) <http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html>accessed 15 February 2016.

the Eurosystem is likely to find itself in a cornelian dilemma: should it exercise the voting rights attached to those bonds to approve or to oppose the PSI proposal?

Voting in favor could be found incompatible with the Eurosystem mandate under the founding Treaties. Article 123 (1) TFEU prohibits the ECB and national central banks from printing money to fund euro area states' treasury. A voluntary participation in the PSI is tantamount to accepting a loss to the benefit of the troubled state. This could be read as an indirect form of financial assistance that would run afoul of the prohibition of monetary financing.⁵⁴

In order to avoid this legal controversy, the ECB intends to systematically oppose any proposed restructuring.⁵⁵ A negative vote by the Eurosystem could put the success of the whole transaction at risk, as the troubled state might not be able to gather sufficient support from the other bondholders. Aware of this danger, the ECB Governing Council has capped PSPP purchases to prevent the Eurosystem from acquiring blocking minorities capable of thwarting a restructuring based on CAC.⁵⁶ The limit set is twofold and reflects CAC's voting thresholds. Quantitative easing purchases cannot lead the overall Eurosystem's holding of sovereign debt across all its portfolios to exceed 33% per bond issuance (issue share limit) and 33% at an aggregate level, for all outstanding bonds issued by each euro area state (issuer share limit).⁵⁷ This measure constraints the duration and scale of PSPP purchases⁵⁸ without alleviating all risks of imperiling the success of a PSI. If the ECB exercises its voting rights attached to PSPP bonds to oppose a restructuring, the sovereign would still have to convince a greater proportion of its private bondholders to activate the CAC and bind recalcitrant minorities. Moreover, the twofold cap applies only to PSPP purchases. There are no *ex ante*

⁵⁴ C. Hofmann, 'Debt Restructuring in Europe Under the New Model Collective Action Clauses', 49 *Texas Journal of International Law* (2014) 383, 417

⁵⁵ In the context of the litigation over the compatibility of the OMT program with EU primary law, the ECB has stated that it would systematically vote against a proposed restructuring. See Bundesverfassungsgericht, *Order of 14 January 2014 - 2 BvR 2728/13*, para. 8; Case C-62/14 *Peter Gauweiler et al. v Deutscher Bundestag* (14 January 2014) not yet reported (ECLI EU:C:2015:7), Opinion of the AG Bot, para. 235.

⁵⁶ Thanks to Thomas Beukers for pointing this out to me.

⁵⁷ See Article 5, PSPP Decision. Note that the voting thresholds of CAC included in bond series issued prior to 1 January 2013 are not harmonized and might differ from those set out in the Euro CAC. For this reason, the issue share limit for those bonds is set, as an exception, at 25% but will be increased to 33% subject to verification on a case-by-case basis that holding 33% would not lead the Eurosystem to have a blocking minority. See ECB Decision (EU) 2015/2101 amending Decision (EU) 2015/774 on a secondary markets public sector purchase programme, (2015) OJ L 3030/106.

⁵⁸ G. Clays, A. Leandro & A. Mandra, 'European Central Bank Quantitative Easing: The Detailed Manual', Bruegel Policy Contribution 2015/02 (March 2015)

<<https://www.ecb.europa.eu/press/accounts/2015/html/mg150219.en.pdf>> accessed 15 February 2016.

quantitative limits on bond-buying under the OMT. In crisis situations, the activation of the OMT on top of the PSPP could potentially lead the Eurosystem to have blocking minorities, which would in turn further complicate, or even preclude, a sovereign debt restructuring based on CAC.

5. Conclusion and the way forward

The progressive inclusion of Euro CAC in all bonds issued in the euro area is a significant step in the improvement of the restructuring procedure. It makes it more predictable and further limits litigation risks. This does not mean that a restructuring would be free of major legal challenges.

It will still take some time before all the outstanding euro area debt stock be equipped with the Euro CAC. Pending full implementation of this harmonized set of contractual provisions, a large-scale restructuring covering the entire privately held debt stock of a euro area state would have to rely on two mechanisms: (1) a statutory CAC to restructure the ‘CAC less’ bonds governed by domestic law (if the constitution of the state so permits) and, (2) the contractual CAC already included in the bond terms for the remaining of the debt stock. Each of those parallel transactions would raise a different set of issues:

(1) *Statutory CAC*: the activation of the statutory CAC would expose the state to litigation risks akin to the ones faced by Greece in the aftermath of its 2012 debt swap. A few creditors could challenge the lawfulness of the process either before an arbitral tribunal under a BIT or before domestic courts. The outcome of such litigation would depend on the context surrounding the restructuring, the situation of the litigants and the interpretation of the applicable law.

(2) *Contractual CAC*: as it currently stands, the Euro CAC subjects a modification of bond terms to the approval a double majority, one calculated within each bond series and one calculated across bond series. Holdout creditors (and vulture funds especially) could acquire blocking minorities within bond issuances to obstruct their restructuring. How can the distressed state handle the ‘unstructured’ bonds? The magnitude of the problem and the ways to address it vary depending on the governing law:

- *Bonds governed by foreign law*: if the recalcitrant creditors hold bonds governed by foreign law, the distressed State would have to repay them in full or negotiate another arrangement to repay them partly. Alternatively, the State could repudiate them and assume the risk that those creditors initiate litigation in multiple jurisdictions to obtain full repayment.
- *Bonds governed by domestic law*: as regards domestic law bonds, it is believed that the risk of holdout behaviors would not be as acute. This is so because the state has an additional tool at its disposal to handle those recalcitrant creditors. A law could be enacted to change directly the payment terms of their bonds without their consent. While this law could be challenged under domestic and international law, the mere possibility that the terms of those bonds could be modified unilaterally by the troubled state should *ex ante* incentivize creditors to participate in the debt exchange. Theoretically, the distressed state could also prevent bonds from being left ‘unrestructured’. For doing so, the state would adopt a legislation altering the provisions of the Euro CAC. This change could, for example, provide that decisions taken by the majority of all bondholders across bond series bind the recalcitrant minorities within each single bond issuance. Such a move has very clear drawbacks: it would annihilate one of the major gain of the changes brought about by Euro CAC - a greater degree of predictability - and could be potentially the source of multiple lawsuits in domestic courts and international tribunals.

What to do with the debt instruments held by the Eurosystem would also prove delicate. If those bonds were included in the restructuring, the Eurosystem could be caught between the devil and the deep blue sea when deciding on how to exercising its voting right. Approving the restructuring offer could be found incompatible with its mandate under the founding Treaties, while rejecting it could imperil the success of the PSI transaction.

Since the 2012 Greek debt swap, how has the issue of sovereign debt restructuring been handled by EU Institutions?

In the on-going development of a European-wide investment law policy, the risk that holdouts initiate disruptive litigation before arbitral tribunals has been taken into account. The chapters on ‘investment protection’ in the recent trade deals concluded - or to be concluded - by the EU with third countries includes an annex restricting the possibility of legal challenges

against ‘negotiated’ restructurings based on contractual or statutory CAC.⁵⁹ While this measure ensures that EU investment agreements will not furnish new basis for legal challenges, it does not reduce existing litigation risks. For the time being, holdouts could still base their expropriation claims on the myriad investment agreements concluded by EU Member States, among them or with third countries.

This noticeable exception apart, while the issue of PSI has been discussed by academics, it has disappeared from the official European policy agenda on EMU reforms. The Five Presidents’ Report,⁶⁰ which sets a plan for further EMU reforms, does not mention it. In light of the difficulties that the implementation of a PSI transaction could still raise, serious considerations should be given to the available avenues to develop a more robust regime for sovereign debt workout in the euro area. Two types of reforms should be envisaged: (1) refining the Euro CAC in the short term (2) developing a statutory framework for sovereign insolvency in the medium term or long term. The precise timing and design of either reform would have to be carefully assessed in light of their potential impact on states’ borrowing costs.

1. Refining the Euro CAC

Unlike the ICMA model, the Euro CAC still allows holdouts to prevent the activation of CAC with respect to single bond issues. The growing implementation of the ICMA model in international bond contracts will in the long run create a discrepancy between the Euro CAC and the prevailing practices on the major financial markets. To avoid any such issue, the Euro CAC could be adapted to the refinements of the contractual provisions proposed by ICMA. An enhanced CAC for the euro area could be activated by one single super-majority of bondholders calculated at an aggregate level. The EFC Sub-Committee would redraft the clauses, which would then be endorsed by the euro area states meeting within Euro Group. No amendment to the ESM Treaty would be required. This avenue has however its

⁵⁹ See the Annex X (‘Public Debt’) of the Comprehensive Economic and Trade Agreement concluded by the EU with Canada; See the finalized version of the Annex X (‘Public Debt’) of the to be concluded by the EU with Vietnam. Note that the ‘investment chapter’ tabled by the EU in its negotiation with the US over the Transatlantic Trade and Investment Partnership (TTIP) also includes a similarly worded Annex on ‘Public Debt’. See <http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf> accessed 15 February 2015.

⁶⁰ Five Presidents’ Reports, ‘Completing the Europe’s Economic and Monetary Union’ (22 June 2015) <http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf> accessed 15 February 2015.

disadvantages. This mechanism might not be enforceable in all Euro area jurisdictions without more significant changes to the underlying law governing the bonds.⁶¹ The introduction of an enhanced version of the Euro CAC would only be gradual and would delay the moment where the entire euro area debt stock will be governed by a single set of clauses.⁶²

2. Developing a statutory framework for sovereign debt workout

The idea of developing a statutory insolvency procedure for sovereigns has a long history. In 2003, the IMF advocated for the establishment of the ‘Sovereign Debt Restructuring Mechanism’, which was never implemented due to a lack of political support. Recent developments in ongoing litigation related to the 2001 Argentinean debt crisis have reinvigorated this debate. In September 2015, the General Assembly of the United Nations adopted a set of non-binding principles applicable to sovereign debt restructurings,⁶³ which fell short of the original ambition to develop a fully-fledged multilateral framework.⁶⁴ Most notably, the EU Member States opposed the idea of a global statutory mechanism during the UN negotiations. In their views, the IMF should be the locus for international discussion of sovereign debt restructuring issues and a contractual approach based on CAC, at the international level at least, is to be preferred over a statutory regime.⁶⁵

At the euro area level, a similarly further-reaching option would be to adopt rules on sovereign debt restructuring, or even developing a complete statutory framework, which would replace or complement the Euro CAC.⁶⁶ In the long run, such a sovereign debt workout mechanism would ideally build upon the EU institutional framework after a revision of the founding Treaties. A more elaborate procedure and a clarification of the hierarchy of claimants and the status of official creditors would enable a timely implementation of the

⁶¹ See the EFC Sub-Committee on EU Sovereign Debt Markets, (n 30) 3.

⁶² Note that the IMF does not modifying the Euro CAC is not a priority because domestic law governs a large proportion of bonds issued in the Euro area and holdout creditors would primarily block the restructuring of bonds governed by foreign law. See IMF, (n 32) 4.

⁶³ UN General Assembly, ‘Basic Principles on Sovereign Debt Restructuring Processes’, A/69/L.84 (29 July 2015).

⁶⁴ UN General Assembly, ‘Towards the Establishment of a Multilateral Legal Framework for Sovereign Debt Processes’, A/69/L.84 (29 July 2015).

⁶⁵ See EU common position on the UN draft resolution A/69/L.84 on ‘basic principles on sovereign debt restructuring processes’ 11705/15 (7 September 2015).

⁶⁶ For proposals in this direction, see C. Fuest, F. Heinemann & C. Schröder, ‘A Viable Insolvency Procedure for Sovereigns (VIPS) in the Euro Area’ (2014) ZEW Discussion Paper No. 14-053 <<http://ftp.zew.de/pub/zew-docs/dp/dp14053.pdf>>accessed 15 February 2016 ; German Council of Economic Experts, ‘Consequences of the Greek Crisis for a More Stable Euro Area – Special Report’ (July 2015) <http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/sondergutachten/sg2015_en.pdf>accessed 15 February 2016.

transaction and provide a greater degree of legal certainty for investors in sovereign debt. The European Court of Justice would act as a supervising judicial authority; rule upon creditors' claims; and guarantee that a balance between state and investors' interests is preserved.⁶⁷

In the medium term, significant improvements of the restructuring process could be achieved by expanding upon the few provisions on PSI in the ESM Treaty. In particular, L.C Buchheit *et al.* have proposed, through an amendment to the ESM Treaty, to immunize all assets of a Eurozone state under an ESM programme from attachment by creditors refusing to participate in a debt restructuring. This immunity from attachment would reduce creditors' prospect of obtaining a preferential treatment through litigation in national courts or arbitral tribunals, thereby dissuading potential holdouts. In addition, it would minimize the risk that vulture funds and other recalcitrant bondholders be able to divert ESM financial assistance to their benefits.⁶⁸ A revised ESM Treaty could also further identify the circumstances under which a restructuring would be a prerequisite to obtain financial assistance by the ESM.⁶⁹

Modifying the ESM Treaty requires going through a lengthy process of ratification by the national parliaments of euro area states. There seems to be little political appetite for amending the ESM's founding document only a few years after its adoption although such a reform would leave the euro area better equipped to handle sovereign insolvency situations that could impact the financial stability of the currency union as whole.

⁶⁷ See A. Sainz de Vicuna, (no 55) 191 (envisioning such a mechanism in the long run).

⁶⁸ L. C. Buchheit, M. Gulati & I. Ignacio, 'The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings' (22 January 2013) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2205704> accessed 15 February 2016.

⁶⁹ Committee on International Economic Policy Reform, 'Revisiting Sovereign Bankruptcy' (October 2013), 35 <http://www.international-macro.economics.uni-mainz.de/Dateien/ciepr_2013_revisitingsovereignbankruptcyreport.pdf> accessed 15 February 2016 (suggesting that ESM lending be made automatically conditional upon a sovereign debt restructuring for states whose debt-to-GDP ratio is above a certain threshold).