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Collective Action Clauses in the Eurozone

One Step Forward, Two Steps Back

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Abstract

Amongst the measures taken inside the European Union to tackle the sovereign debt crisis, the focus of the legal scholarship has been mainly on the financial stability mechanisms and the European Central Bank's action. These initiatives constitute the liquidity assistance part of the response. Arguably, less attention has been devoted to the initiatives intended to face issues of debt sustainability. As regards the course of action to adopt in case a country cannot repay its debt, the European Union opted for collective action clauses (CACs). This paper takes a critical look at the Eurozone CACs. It aims to answer the following research question: Are the adopted CACs an efficient means to achieve their purported objective (i.e. facilitate renegotiations of sovereign bonds between creditors and the sovereign debtor)? To do so, the paper investigates the CACs' content and their historical bases. It then compares the final version with the initial draft and points to several interesting findings. The paper argues that it is likely that practical results from the use of CACs will be significantly below political leaders' expectations.

Keywords: collective action clauses (CACs), sovereign debt restructuring, Eurozone, European Stability Mechanism.

A Introduction

Amongst the measures taken inside the European Union to tackle the sovereign debt crisis, the focus of the legal scholarship has been mainly on the financial stability mechanisms and the European Central Bank's action. These initiatives constitute the liquidity assistance part of the response. Arguably, less attention has been devoted to the initiatives intended to face issues of debt sustainability. Although the economic literature has not yet reached consensus on this point, it can be fairly summarised that liquidity difficulties consist of short-term payment difficulties because of insufficient funds available to meet immediate obligations,

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whereas insolvency means the inability of a country to repay its debt since its liabilities exceed its assets.[1]

As regards the course of action to adopt in case a country cannot repay its debt, the European Union opted for collective action clauses (CACs).[2] This contractual technique consists of inserting into sovereign bonds certain clauses aimed at facilitating the renegotiation of payment and other terms. On 18 November 2011, the Economic and Financial Committee of the EU agreed on the text of identical and standardised CACs that Eurozone countries had to adopt for debt issuances starting from 1 January 2013.

This paper takes a critical look at the Eurozone CACs. It aims to answer the following research question: Are the adopted CACs efficient means to achieve their purported objective (*i.e.* facilitate renegotiations of sovereign bonds between creditors and the sovereign debtor)? To do so, the paper investigates the CACs' content and their historical bases. It then compares the final version with the initial draft and points to several interesting findings. In conclusion, the Eurozone CACs reveal few advantages and a number of inconsistencies. Thus, it is likely that their practical results will be significantly below political leaders' expectations, and a different legal solution will be needed.

B The Decision to Adopt Common CACs

In the European reaction to the sovereign debt crisis, the idea to resort to common collective action clauses for the Euro area arose at a pretty early stage. The first mention was during the negotiations envisaging the creation of the European Stability Mechanism. Eurozone finance ministers declared that "[...] standardized and identical collective action clauses (CACs) will be included, in such a way as to preserve market liquidity, in the terms and conditions of all new Euro area government bonds starting in June 2013. Those CACs would be consistent with those common under UK and US law after the G10 report on CACs, including aggregation clauses allowing all debt securities issued by a Member State to be considered together in negotiations. This would enable the creditors to pass a qualified majority decision agreeing a legally binding change to the terms of payment (standstill, extension of the maturity, interest-rate cut and/or haircut) in the event that the debtor is unable to pay".[3] This commitment was later confirmed by the Heads of Government and State of Euro area Member

1 S. Dullien & D. Schwartzer, 'Dealing with Debt Crises in the Eurozone. Evaluation and Limits of the European Stability Mechanism', *SWP Research Paper 2011/RP 11*, October 2011, pp. 5-7.

2 The International Capital Market Association and the International Monetary Fund have also recently advocated collective action clauses, *see* respectively "Standard Aggregated Collective Actionc Clauses ("CACS") for the Terms and Conditions of Sovereign Notes" (<www.icmagroup.org/assets/documents/Resources/ICMA-Standard-CACs-August-2014.pdf>) and "Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring" (<www.imf.org/external/np/pp/eng/2014/090214.pdf>).

3 'General Features of the Future Mechanism. Eurogroup Statement of 28 November 2010', annex II of the Conclusions of the European Council of 16-17 December 2010, EUCO 30/1/10, p. 9. Available at: <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/118578.pdf>.

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States at their meeting on 11 March 2011[4] and by the European Council at the summit held on 24-25 March 2011.[5] In addition, all of the Euro area Member States agreed to take all action necessary to implement standardised CACs. On 11 July 2011, the Finance Ministers of the 17 Euro area countries signed the Treaty establishing the European Stability Mechanism. Recital 9 of that version of the Treaty stipulated that "the detailed legal arrangements for including CACs in Euro area government securities will be finalised by the end of 2011", whilst Article 12(3) indicated July 2013 as the beginning of the inclusion of such clauses.

The Sub-Committee on EU Sovereign Debt Markets[6] of the Economic and Financial Committee[7] of the EU was then requested to draft the standardised CAC called for by the Euro area authorities. On 18 November 2011, it ended its works and the Economic and Financial Committee agreed on the text. On 2 February 2012, a new version of the Treaty on the ESM was signed by the Eurozone countries' ambassadors in Brussels. Its 11th Recital acknowledged the finalisation of the CACs by the Economic and Financial Committee. However, Article 12(3) now stated that 1 January 2013 would be the initial date for CACs' insertion.

The introduction of national CACs as part of the response to the European sovereign debt crisis actually preceded the insertion of identical and standardised clauses into all Eurozone bonds. In 2012 Greece initiated a voluntary restructuring of its debt, named 'private sector involvement' ('PSI'). In order to perform the swap, the government enacted Law 4050/2012[8] and added CACs to bonds issued under Greek law, which represented approximately 90% of the total (the rest being governed by different laws, mostly English law).[9]

In exchange for outstanding bonds, accepting bondholders were offered: (i) new bonds to be issued by Greece having a face amount equal to 31.5% of the face amount of the exchanged bonds, (ii) European Financial Stability Facility notes with a maturity date of two years or less and with a face amount equal to 15% of the face amount of their exchanged bonds, and (iii) detachable GDP-linked securities issued by the Greek Republic having a notional amount equal to the face amount of each holder's new bonds.[10]

4 Conclusions of the Heads of State of Government of the Euro Area of 11 March 2011. Available at: <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119809.pdf>.

5 Conclusions of the European Council, 24/25 March 2011, EUCO 10/1/11. Annex II contained the 'Term Sheet on the ESM', with a detailed §2 devoted to Collective Action Clauses. Available at: <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf>.

6 Website: <http://europa.eu/efc/sub_committee/index_en.htm>.

7 This Committee has the role to second the action of the Council of Ministers in economic and financial matters. *See* Arts. 114 (2) and (4) of the Maastricht Treaty, Council Decision 98/743/EC of 21 December 1998, OJ L 358 of 31 December 1998, pp. 109-110; Council Decision 1999/8/EC of 31 December 1998, OJ L 5 of 9 January 1999, pp. 71-73; Council Decision 2003/476/EC of 18 June 2003, OJ L 158 of 27 June 2003, pp. 58-60.

8 Law 4050/2012 (the Greek Bondholder Act) enacted by the Greek Parliament on 23 February 2012.

9 L.C. Buchheit, G.M. Gulati, 'How to Restructure Greek Debt', 7 May 2010, p. 2. Available at: <http://ssrn.com/abstract=1603304>.

10 Hellenic Republic, Ministry of Finance, Press Release, 24 February 2012, p. 1.

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On 9 March, the Ministry of Finance declared the results of the invitations and consent solicitations announced by the Republic on 24 February.[11] 85.8% (€152 billion out of €177 billion) of the outstanding bonds issued by Greece and governed by Greek law were positively involved in the exchange. The Ministerial Council, with Act No. 10 of the same day, voted the "Approval of the Bondholders' decision in the process of modification of eligible titles as certified by the Bank of Greece as Process Manager".[12] Notwithstanding the considerable participation in the bond exchange, the Greek debt to GDP ratio continues to increase, and further debt restructurings might become necessary in the near future.[13]

C The International Roots of the European Collective Action Clauses

Collective action clauses are well known on international financial markets, as "they are hardly a novel feature of international sovereign bonds".[14] Their origins can be traced back to the 'majority action clauses' suggested by the English barrister Francis Beaufort Palmer in 1879.[15] Their key feature is to require a majority of bondholders to amend a term of the debt security, instead of necessitating unanimous acceptance.[16] Collective action clauses have then traditionally featured in issues submitted to English and Japanese jurisdictions. Since 2003, they have also begun spreading in sovereign bonds governed by New York law. Even though their effectiveness has not yet been verified in a real, full-blown crisis, it is believed that CACs assist in reducing the problem of holdout creditors in sovereign debt restructurings.[17]

One of the abovementioned conditions specified by Eurozone leaders for the new CACs was their consistency with clauses issued after the G10 Report.[18] A Working Group on Contractual Clauses was formed under the auspices of G10

11 Hellenic Republic, Ministry of Finance, Press Release, 9 March 2012, p. 1.

12 Acts of the Ministerial Council, Act No. 10 dated 9.3.2012, Government Gazette of the Hellenic Republic, Vol. A, Issue 50, 9 March 2012.

13 G.M. Gulati & J. Zettelmeyer, 'Making a Voluntary Greek Debt Exchange Work', *Capital Markets Law Journal*, Draft version 31 January 2012, forthcoming 2012, p. 15.

14 O.A. Krueger & S. Hagan, 'Sovereign Workouts: An IMF Perspective', *Journal of International Law*, No. 6, 2005, pp. 203-218, at 212.

15 L.C.Buchheit & G.M. Gulati, 'Sovereign Bonds and the Collective Will', *Emory Law Journal*, No. 51, 2002, pp. 1317-1363, at 1325.

16 D. Zandstra, 'The European Sovereign Debt Crisis and Its Evolving Resolution', *Capital Markets Law Journal*, 2011, p. 309.

17 Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration', *American Journal of International Law*, Vol. 101, 2007, pp. 711-759, at 736.

18 Group of Ten, Report of the G-10 Working Group on Contractual Clauses, 26 September 2002. Available at: <www. bis. org/ publ/ gten08. pdf>. It followed an influential Group of Ten report (known as the 'Rey Report', from Jean-Jacques Rey, the Belgian chairman of the G10 Working Party), *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies*, 1996, available at: <www.bis.org/publ/gten03.pdf>.

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Ministers and Governors[19] in June 2002, in a period when this topic had drawn considerable attention on the international scene.[20] It had to deal with the issue of the growing portion of emerging countries' financial resources coming from sovereign bonds, and suggest ways forward. The mandate of the Working Group was to "to consider how sovereign debt contracts could be modified in order to make the resolution of debt crises more orderly".[21] It consulted legal practitioners from jurisdictions which more often govern sovereign bonds (England, Germany, Japan, and New York). Its recommendations were thus meant for bonds governed by a law other than that of the sovereign issuer. Moreover, the different clauses were to be seen as a single package because of their interrelatedness.

Amongst the main suggestions put forward by the Working Group, one was having a single bondholder representative for the entire bond issue, so as to facilitate routine communication between the sovereign and the group of creditors. Such a representative could be nominated within a trust in a common law jurisdiction or a comparable structure in a civil law country. Furthermore, a special bondholder representative should be elected by a meeting of the bondholders, with two thirds approval. The special bondholder would be empowered to discuss restructuring with the debtor. In addition, the Report suggested that the sovereign should be obliged by a covenant attached to its bonds to keep creditors informed about its financial situation in a timely manner.

The most significant recommendation of the G10 Working Group concerned the insertion of a collective action clause. This consists of a "majority amendment clause permitting amendments of payment terms with the approval of a supermajority of bondholders".[22] The majority wanted to modify 'reserve matters' (including payments terms, such as change in payments dates, reduction in principal or interest, change in currency, and any instruction to the representative so as to exchange or convert the bonds) which varied across jurisdictions. New York and German law, at that point however, did not allow for collective action clauses. By the same token, an exchange of old bonds for new ones could also be voted, with the same effect as an amendment of existing instruments.

Typically, under the quorum approach followed by English law bonds, 75% of the bondholders present at a meeting could amend payment terms with binding

19 The Group of Ten (G10) is composed of 11 industrialised countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the USA). Ministers of finance as well as central bank governors meet annually besides the yearly assembly of the IMF. G10 countries' Governors regularly meet at the Bank for International Settlements. Website: <www.g10.org/>.

20 Other contemporary research was performed, for instance, by the IMF: Legal Department, 'The Design and Effectiveness of Collective Action Clauses', 6 June 2002, <www.imf.org/external/np/psi/2002/eng/060602.pdf>; International Monetary Fund, Policy Development and Review, International Capital Markets, Legal Departments, 'Collective Action Clauses in Sovereign Bond Contracts—Encouraging Greater Use', 6 June 2002, <www.imf.org/external/np/psi/2002/eng/060602a.htm>.

21 Group of Ten, Report of the G-10 Working Group on Contractual Clauses, 26 September 2002, p. 1.

22 Group of Ten, Report of the G-10 Working Group on Contractual Clauses, 26 September 2002, p. 3.

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effects on all bondholders. The first meeting had to convene at least 75% of the outstanding debt; otherwise, an adjourned meeting could have a lowered quorum of 25%. This method clearly offers a considerable deal of flexibility and facilitates the agreement on a solution, especially when a section of bondholders would otherwise impede an amendment by failing to cast a vote.

Representatives from the US private sector, consulted by the G10 Working Group, suggested exchange offers instead of physical meetings to decide on restructurings. This 'outstanding principal' approach similarly required a threshold of 75%.

At any rate, the Report further envisaged the disenfranchisement of those bonds owned or controlled by the issuing State. Securities held directly by the issuer or by its instrumentalities (public sector entities) must not be counted for quorum or threshold purposes. In order to modify terms other than those concerning the payment, the Working Group suggested a majority or, at most, a supermajority not exceeding two thirds. This could be based either on the quorum or on the outstanding principal approach. The Report also dealt with the issue of aggregation amongst different bond issues. This is a very serious question, because collective action clauses usually work within the same issue of sovereign debt, and approval to an amendment by each issue's majority is thus necessary. The Working Group maintained that "'aggregation' across a range of different types of creditors for voting purposes under the majority amendment clause, while desirable, is not practicable within a contractually based mechanism".[23] It then referred to single master agreements including such a possibility, but added that the question needed further exploration.

Another question of paramount importance tackled by the Working Group was the effort to avoid disruptive legal litigation. Firstly, the Report considered acceleration. This consists of the right to demand immediate payment of principal and accrued interests in case of a default. The proposal was to include a clause which makes a vote by 25% of bondholders necessary to obtain acceleration. In addition, a majority up to two thirds of bondholders could vote to rescind acceleration, provided the event of default was cured, waived, or remedied.

Secondly, it was suggested to concentrate the power to initiate litigation onto a single bondholder representative, subject to a request by 25% of the group. In a complementary fashion, a provision was to expressly prohibit individual enforcement actions. Furthermore, recovery proceeds had to be distributed pro rata. Thus, both the acceleration and the concentration provisions effectively restrain the 'danger' of dissatisfied creditors resorting to legal actions whilst the sovereign issuer is attempting to negotiate a mutually acceptable solution with the totality of its lenders.

23 *Ibid.*, p. 5.

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D One Step Forward: The Flexibility of the Adopted CACs

The model CACs eventually adopted by the Economic and Financial Committee display flexibility as their major characteristic. This factor is intended to favour debt restructurings of Eurozone countries, which will insert this type of clauses into their debt securities, *i.e.* bonds and any other bills, debentures, notes, or other debt securities issued in one or more series with an original stated maturity of more than one year, as Section 1(a) of the Common Terms of Reference stipulates.[24]

The Eurozone CACs distinguish between a modification concerning a single series and one involving multiple issues. As regards the former, in order to modify a reserved matter, it is necessary that 75% of the bondholders present at a duly called meeting agree on it. The quorum required for such a meeting is two thirds of the outstanding principal amount of the affected bonds. This percentage applies to both the initial and adjourned meetings. If the amendment is adopted by the means of an action in writing, bondholders representing at least two thirds of the aggregate outstanding debt must agree. In the case of an amendment of a non-reserved matter, the quorum required for a meeting is 50% for the initial one and 25% for the subsequent ones.[25] The respective approval threshold is a simple majority of the present bondholders. The alternative method to modify non-reserved matters is via a written resolution signed by or on behalf of holders of more than 50% of the aggregate principal amount of the outstanding bonds, as Section 2.5(b) makes clear.

Different bond series can also be amended at the same time, through a cross-series modification. Section 2.2 stipulates that the first method is to call a bondholder meeting. Whilst the quorums are the same as for single series modifications, for cross-series amendments a double majority is needed: the first comprises all the series concerned and the second each series taken individually. Thus, the relevant majorities are 75% of the principal amount of outstanding debt of all the series concerned by the proposal, taken together, and two thirds of the principal amount for each series of bonds. In the case of an action in writing, the resolution must count on at least two thirds of the outstanding debt throughout the concerned series and 50% of the principal amount within each series.

Moreover, in case of a cross-series modification, Section 2.3 establishes that multiple options might be offered, including different combinations of modifications for each of the series involved. On those occasions, however, these alternatives must be available to bondholders of all the series concerned. Furthermore, the issuer enjoys the flexibility of designing one or several cross-series modifications and targeting different groups of bondholders. The Committee highlighted that "[t]he flexibility afforded to the issuer in grouping bonds of different series

24 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clauses. Common Terms of Reference, 17 February 2012, p. 13. Available at: <http://europa.eu/efc/sub_committee/pdf/cac_-_text_model_cac.pdf>.

25 *See* Sections 4.5 and 4.6.

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in different modification baskets is intended to minimize the likelihood of a hold-out series".[26]

The flexibility of the Eurozone CACs also emerges in connection with the case of a cross-series modification which does not succeed because of a lack of the required majority throughout all the series concerned.[27] Provided that the sovereign issuer publicises the relevant information beforehand, the amendment will be deemed to have occurred for those series where the majority has been reached. The practical effect would be identical to different single-series modifications taking place separately: the amendment will be in force for those issues wherein the majority has agreed, and not for the totality of the series originally targeted.

Disenfranchisement is another prominent feature of the model adopted by the Eurozone. It is the principle of not considering certain bonds for the purposes of calculating quorums and majorities needed for amendments. The bonds are those in the hands of the sovereign issuer or entities which are dependent on it. The reasoning is that "the losses suffered by the issuer from the modification of the bonds it holds, unlike the losses suffered by an ordinary market participant, are more than offset by the gains realised by the issuer from the resulting reduction in its debt service or debt stock or both".[28] Section 2.7(c) thus enumerates the control by the government (or one of its departments, ministries, or agencies) or its appointment of the board of directors of a corporation, trust or other legal entity, as criteria for determining bonds to be disenfranchised. Nevertheless, if these entities are characterised by a certain degree of independence from the sovereign issuer, their bonds are to be counted. This occurs under three circumstances:

a If the company cannot receive instructions from the government under national legislation
b If the entity must act "in accordance with an objective prudential standard, in the interest of all of its stakeholders (and not just its shareholders) or in its own self-interest"[29]
c If the company has a fiduciary duty to vote in the interests of a party different from the issuer or its controlled entities

Disenfranchisement does not take place where the only ground would be the predictability of the action of the bondholder. Although such ground had been proposed, it was not retained by the drafting Sub-Committee since it was not seen as adequate. As long as an investor acts in its own interest, its voting powers must not be withdrawn. The Committee held that this is the case for Euro area national

26 EFC Sub-Committee on EU Sovereign Debt Markets, 'Collective Action Clause. Supplemental Explanatory Note', 26 March 2012, p. 3. Available at: <http://europa.eu/efc/sub_committee/pdf/supplemental_explanatory_note_on_the_model_cac_-_26_march_2012.pdf>.

27 *See* Section 2.4.

28 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Explanatory Note, 26 July 2011, pp. 4-5. Available at: <http://europa.eu/efc/sub_committee/pdf/explanatory_note_draft_on_the_model_cac_-_26_july.pdf>.

29 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Explanatory Note, 26 July 2011, p. 5.

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central banks: they "have autonomy of decision in deciding how to vote on the proposed modification of any euro area government securities so acquired, and their holdings of these securities will be enfranchised under the model CAC".[30] The same reasoning can be applied to the European Central Bank (ECB).

Nevertheless, in the case of Greece in 2012, bonds held by the ECB and euro area central banks were actually shielded from the restructuring. These holders had exchanged their Greek bonds with bonds with identical structure and nominal value, but different serial numbers.[31] They were not covered by the law and thus did not have to undergo the haircut. The effort to guarantee a high level of flexibility of the Eurozone-wide CACs is strengthened by the choice not to include a provision concerning the applicable law and the forum selection. Both possibilities were examined by the Committee, yet it eventually opined that these proposals "either would not significantly enhance the uniformity of application of the CAC throughout the euro area, or that the desired uniformity could be achieved through other means more consistent with well-established market practice".[32] Consequently, CACs in debt securities are to be governed by the same law and subject to the same jurisdiction as the bonds of each issuing sovereign.

E Two Steps Back

I The All-Too-Settling Approach to Creditors

Notwithstanding the high importance attached to these CACs by Eurozone leaders and their flexibility, they do not seem capable of providing an effective solution. In this respect, it is interesting to analyse the evolution undergone by the proposal of Eurozone CACs designed by the Sub-Committee. In the passage from the first version (whose text is not available, but which can be partly reconstructed thanks to its accompanying Explanatory Note) to the finally adopted model, several modifications demonstrate a will to accommodate investors' interests much more than those of sovereign issuers.

The first change regarded the quorums and majorities necessary to enact a single-series modification. The majority needed in the first version for the approval of a reserved-matter amendment in a single series was two thirds of the outstanding bonds represented at a meeting. It rose to 75% in the final text. Initially, the quorum for such bondholder meetings was two thirds of the aggregate outstanding debt for the first meeting and 25% at adjourned meetings. Eventually, the same percentage of two thirds was retained for both initial and subsequent meetings. Similarly, if a written resolution signed by two thirds of the total principal amount was the option for the first draft, the eventual version augmented it to 75%.

30 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Supplemental Explanatory Note, 26 March 2012, pp. 6-7.

31 IMF, 'Euro Area Policies: 2012 Article IV Consultation - Selected Issues Paper', IMF Country Report No. 12/182, July 2012, p. 47.

32 *Ibid.*, p. 8.

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Therefore, the percentages of bondholders' participation and affirmative votes needed in order to perform a modification of the most important terms of a sovereign bond have been increased by the reform of the model. Consequently, those Eurozone countries which will necessitate renegotiating their debt service in the future will face further difficulties, whilst the creditors' position has been reinforced, above all by raising the quorum for adjourned meetings. This is in stark contradiction with the Committee's initial assumption that "the apparent indifference of the absent bondholders can fairly be understood as constituting their silent acquiescence to the proposed modification".[33] Now, their indifference can obstruct any attempt to reach an agreement, both at the initial and at subsequent meetings.

It is however worth noticing that the Committee resisted other even more radical changes which had been put forward by market participants. One of these was to calculate the majority of affirmative votes needed at a meeting to pass a single-series amendment for a reserved matter on the basis of the entire outstanding debt, and not on the basis of the portion represented at the meeting. The Committee saw such a suggestion as "unreasonable, [since it] would in practice make it increasingly difficult, and ultimately impossible, for a proposed modification to be approved with declining levels of bondholder-meeting participation".[34]

A trend identical to that of single-series modifications can be detected with respect to cross-series amendments. Originally, they required a two thirds affirmative vote throughout all the involved series and 50% within each individual issue, as suggested by several commentators.[35] The adopted model, instead, stipulates a cross-series acceptance of at least 75% and two thirds as the minimum at the single series level. The initial lower percentages were maintained exclusively for cross-series modifications through written resolutions. Thus, also in this case, the margin of manoeuvre for a restructuring has been limited in the definitive model. Consequently, the Committee's claim that "[c]ross-series modifications [...] are intended to facilitate the broadest possible modification of an issuer's bonds"[36] does not appear to be confirmed by the choices eventually adopted.

Seen in this light, also the lack of provisions concerning the governing law and the forum selection might be read as a further concession to creditors. The latter will be comforted by the fact that CACs will be submitted to the jurisdiction and the law to which each State's issues have traditionally been subject. The alternative option, favoured by legal scholarship,[37] of indicating a single applicable law and competent jurisdiction for all the collective action clauses inserted in Eurozone countries, would have arguably contributed to ensuring uniformity of appli-

33 *Ibid.*, p. 4.

34 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Supplemental Explanatory Note, 26 March 2012, p. 3.

35 L.C. Buchheit & G.M. Gulati, 'Drafting a Model Collective Action Clause for Eurozone Sovereign Bonds', *Capital Markets Law Journal*, Vol. 6, No. 3, 2011, pp. 317-325, at 322.

36 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Explanatory Note, 26 July 2011, p. 4.

37 Buchheit & Gulati 2011, p. 321.

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cation and interpretation of their terms and thus strengthened the collective European action.

All in all, the adopted model for CACs inside the Eurozone proves to have been designed in order to accommodate creditors to the maximum extent possible. The excessive weight and power attributed to bondholders might engender too limited a reduction when negotiating debt restructurings. Therefore, "as a result, a debt restructuring procedure that is too creditor-friendly may result in inefficiently low debt forgiveness".[38]

II Some Issues Left Wide Open by the Eurozone CACs

Besides its excessive leniency towards creditors, the final version of the model adopted by the Economic and Financial Committee fails to provide meaningful answers to questions which are key to preserving Eurozone countries' financial stability. The CACs contain too weak (or no) provisions concerning several significant threats.

First of all, collective action clauses in the international experience include some key provisions which aim at ensuring that smooth negotiations can take place in order to discuss a potential debt restructuring. This necessitates the elimination, or at least the reduction of the likelihood, of the possibility of a disgruntled creditor's resorting to litigation immediately on the occurrence of a default event. To this end, the most common means are provisions limiting acceleration and concentrating the power to litigate onto a single representative, complemented by the prohibition on single bondholders to initiate litigation. As mentioned supra, these clauses were featured in the Report of the G10 Working Group on Contractual Clauses, which was to inspire the Eurozone CACs, according to the decisions taken by European policy-makers. Indeed, some authors consider that bonds without non-acceleration provisions cannot be defined as CACs at all.[39]

Nevertheless, provisions limiting acceleration or contemplating concentration do not form part of the binding model CACs established by the Economic and Financial Committee. The latter acknowledged their frequent occurrence in foreign bonds and their usefulness to the objective of facilitating debt restructurings.[40] Yet it explained their omission in the light of their alleged inconsistency with the issuance practice or the legislation of several Eurozone governments. The Committee drafted two sections dealing with these issues in the 'Supplemental provisions', and recommended their inclusion, without however rendering them mandatory.[41]

38 P. Bolton & D.A. Jr. Skeel, 'Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?', *Emory Law Journal*, No. 53, 2004, pp. 763-822, at 774.

39 S. Häseler, 'Collective Action Clauses in International Sovereign Bond Contracts – Whence the Opposition', *European Association of Law and Economics Working Paper*, No. 007-2009, March 2009, p. 5.

40 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Supplemental Explanatory Note, 26 March 2012, p. 8.

41 EFC Sub-Committee on EU Sovereign Debt Markets, Supplemental Provisions, 17 February 2012. Available at: <http://europa.eu/efc/sub_committee/pdf/cac_-_supplemental_provisions.pdf>.

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The G10 Report also recommended the election of a bondholder representative, and a special bondholder representative, to be charged of the negotiations with the sovereign in case of a restructuring. These provisions evidently aimed at facilitating agreements between the issuer and its lenders. The Eurozone model, however, is absolutely silent on these two important matters.

Furthermore, the introduction of CACs does not provide a solution to short-term issues. The inclusion of such clauses began on 1 January 2013 for new debt securities issued by Eurozone Member States. Meanwhile, previously issued bonds which do not contain them will continue to be valid and require payment of principal and accrued interests. Thus, "it will take several years for [the whole stock of] a country's debt, domestic and foreign, to include CACs".[42] Should a State encounter difficulties in the intervening years, it would not be able to utilise collective action clauses on the totality of its bonds.

Another interesting question pertains to the 'sharing of tasks' between the EU and the new European Stability Mechanism. On the one hand, the introduction of CACs is required by the ESM Treaty. On the other hand, Eurozone countries are apparently accountable to the Economic and Financial Committee of the EU: "As part of this process and consistent with the 'identical legal impact' mandate contained in the Treaty Establishing the European Stability Mechanism, each Member State will be required to deliver a legal opinion to the Committee from the highest State authority competent for such matters, confirming that the model CAC will be legal, valid, binding and enforceable in accordance with its terms under the laws of that Member State".[43] Yet such an investigation lies outside the purposes of this paper.

Furthermore, the model CACs agreed by the Economic and Financial Committee do not cover the totality of the public bonds issued in the Eurozone. The proposal to include also debt securities of regional and local governments, actively traded syndicated loans contracted by covered borrowers, and debt securities guaranteed by covered guarantors was not accepted.[44] The reason was that this type of debt constitutes a small portion of the euro area countries' indebtedness. However, the voluntary insertion of CACs into these bonds is permissible. Thus, the adopted model does not guarantee that all Eurozone countries will have the same margin of action with respect to all the public debt for which they are ultimately responsible and whose portion is not negligible.[45]

42 Zandstra 2011, 'The European Sovereign Debt Crisis and Its Evolving Resolution', *ibid.*, p. 315.

43 EFC Sub-Committee on EU Sovereign Debt Markets, 'Collective Action Clause. Supplemental Explanatory Note', 26 March 2012, p. 10. Available at: <http://europa.eu/efc/sub_committee/pdf/supplemental_explanatory_note_on_the_model_cac_-_26_march_2012.pdf>.

44 EFC Sub-Committee on EU Sovereign Debt Markets, Collective Action Clause. Explanatory Note, 26 July 2011, p. 2.

45 For instance, in 2011, regional and local administrations' debt accounted for approximately 25% of the Spanish debt. TIRADO Ignacio, 'The Pieces on the Chessboard: Creditors in Sovereign Insolvencies - Spain. A Case Study', Presentation at the conference *A Debt Restructuring Mechanism for European Sovereigns – Do We Need a Legal Procedure*, Humboldt University, Berlin, 13-14 January 2012, pp. 1-24, at 10 (quotation authorised by the author). Available at: <www.iir-hu.de/fileadmin/Freigaben/Veranstaltungen/Tagung_Jan_2012/DRMConf-Tirado.pdf>.

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More generally, the framework provided by collective action clauses is not comprehensive. This mechanism has been tested and employed essentially by small countries, whose debt profile was fairly simple. Eurozone countries, with numerous different types of bonds, each with its own maturity and payment terms, represent a completely different situation, and the feasibility of a recourse to CACs for a debt restructuring appears much smaller. As it has been unequivocally affirmed, "CACs are only adequate to the task if the sovereign's borrowings are relatively simple; they are much less useful if the sovereign has a more complicated debt profile".[46]

Furthermore, the very international movement in favour of the introduction of collective actions clauses has been criticised as being a façade reform more than anything else. Several scholars undertook to analyse the usefulness of these clauses (which, historically, have not been key to numerous restructurings[47]) and the motives of their supporters, also from a sociological point of view. They demonstrated that "efforts on CACs had less to do with the clauses' literal purpose (facilitating future contract modification) than with their relative utility in advancing other goals, such as demonstrating commitment to a new crisis management strategy, currying political favor, or establishing reputations in the market".[48]

The incompleteness of the model CACs as a solution for debt restructurings at the Eurozone level lies with the fact that this contractual technique might not be suited for such a tightly interrelated group of sovereigns. Collective action clauses normally operate in negotiations between a sovereign debtor and its private bondholders. Nevertheless, a debt crisis in one of the Euro area countries inevitably presents concerns also for the other Member States. The latter would then step in and render the process a de facto international negotiation, towards which CACs are not geared.[49]

Probably the most important question which is not effectively tackled by the Eurozone CACs is that nowadays bondholders have a host of alternatives which could dissuade them from entering into an agreement with a sovereign in financial distress. Traditionally, in order to achieve such a result and convince a high number of bondholders to accept the borrower's proposal, it has been necessary to provide strong incentives for participating creditors and evoke a less advantageous scenario for the others: "Virtually every successful sovereign debt

46 S. Bolton & D.A. Jr. Skeel, 'Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?', *ibid.*, p. 773.

47 Talking about the 1990s and 2000s decades, "[a] few cases (e.g., Ukraine, 2000; Moldova, 2002) were resolved with the help of collective action clauses but, for the most part, collective action clauses played little or no role". U. Panizza, F. Sturzenegger & J. Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default', *Journal of Economic Literature*, Vol. 47, No. 3, 2009, pp. 651–698, at 672, footnote No. 35.

48 A. Gelpern & G.M. Gulati, 'Public Symbol in Private Contract: A Case Study', *Washington University Law Review*, No. 84, 2006, pp. 1627-1715, at 1631.

49 F. Gianviti, A.O. Krueger, J. Pisani-Ferry, A. Sapir & J. Von Hagen, 'A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal', *Bruegel Blueprint Series*, 9 November 2010, p. 26. Available at: <www.bruegel.org/publications/publication-detail/publication/446-a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/>.

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restructuring involves an implicit threat of a worse outcome for creditors who choose not to participate in the restructuring, especially an implicit threat that non-participating creditors will not be paid in full".[50]

This holds true for Eurozone CACs, where quorums and majorities were increased between the initial draft and the final version, at the request of market actors. Sovereigns will therefore need to find more significant incentives to offer, and "[t]he result is that power shifts significantly from the state to bondholders in settlement negotiations".[51]

In particular, the situation is made worse by three factors. Firstly, the model adopted by the Economic and Financial Committee does not mandate limits on acceleration and litigation powers. Thus, the recourse to the courts of the chosen national jurisdiction might not be prevented during negotiations. Secondly, the room for reaching a cross-series amendment has been seriously diminished by the augmentation of the relevant thresholds. Although a cross-series modification is the most efficient way to achieve a comprehensive debt restructuring, this opportunity will be extremely rare (because of the majorities required). Thirdly, and finally, the possibility to resort to international investment tribunals will constitute a powerful alternative for concerned creditors. In the light of the *Abaclat* case, lenders know that they will always have a forum where they could attempt to recover the full amount of principal and interests due.[52] In such a context, the chance to attain a wide acceptance of the proposed amendment shrinks dramatically.

What is more perplexing is that even in case a supermajority votes in favour of a modification and the amendment is adopted, sovereign issuers might still be faced with legal claims: "the sovereign debtor must worry about maverick creditor litigation both before and after completion of a restructuring with the other bondholders".[53] There could be room for a suit before international arbitral tribunals. This is because lenders could invoke the violation of treaty claims despite the legitimate exercise of CACs, which would then no longer effectively bind holdout creditors.[54] Theoretically, arbitrators ought not to interfere with the correct use of contractual clauses. They could only deal with autonomous treaty breaches, which would arise, for instance, if the State treats nonparticipating creditors in a manifestly discriminatory manner with respect to those who accept the restructuring. Thus, an infringement of the fair and equitable treatment might materialise.[55] Conversely, it has also been suggested that disgruntled bondholders could exploit an umbrella clause contained in a BIT to present a claim before an arbitral

50 Waibel, 'Steering Greece's Debt Restructuring Through the CDS Quicksand', *ibid.*, p. 14.

51 R.M. Ziff, 'The Sovereign Debtor's Prison: Analysis of the Argentine Crisis Arbitrations and the Implications for Investment Treaty Law', *Richmond Journal of Global Law and Business*, No. 10, 2011, pp. 345-386, at 377-378.

52 *Abaclat and Others (Case formerly known as Giovanna a Beccara and Others) v. Argentine Republic*, ICSID Case No. ARB/07/5 (Italy/Argentina BIT). *Abaclat, Decision on Jurisdiction and Admissibility, 4 August 2011*.

53 Buchheit & Gulati, 'Sovereign Bonds and the Collective Will', *ibid.*, p. 1347.

54 Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration', *ibid.*, p. 736.

55 *Ibid.*, p. 737.

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tribunal.[56] In this case, the balance struck in the contract would be broken, since the investor would lament the violation of the payment terms whilst disregarding the collective action clause of the very same contract.

F Conclusion

In sum, the adoption of standardised and identical collective action clauses by the EU Economic and Financial Committee can be appreciated as the first sign of awareness by the Eurozone of the need to act in the debt restructuring field. The Committee could take inspiration from previous experience at the international level, especially with bonds governed by English law, and the G-10 Working Group. The Eurozone model CACs thus essentially included provisions on single-series and cross-series majority amendment, as well as disenfranchisement. These are meant to provide greater flexibility to assist in reaching an agreement between private creditors and sovereign issuers.

However, the final version adopted bespeaks an approach which accommodates bondholders to an excessive extent. Majority and quorum increases and other modifications from the original draft render the successful utilisation of CACs an unlikely event. Furthermore, limitations on acceleration and litigation, the election of a bondholder representative, and the risk of a resort to international arbitral tribunals even in case a supermajority is attained all constitute issues which have been disregarded. Thus, Eurozone CACs do not provide a firm comprehensive answer to the need for a framework for debt restructuring in the EU, and further, braver steps are necessary.

56 Gallagher, 'The New Vulture Culture: Sovereign debt restructuring and trade and investment treaties', *ibid.*, p. 17.