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Digging Up the Past: Can Greece Handle Another PSI Challenge?

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While everyone has been watching with fascination the ups and downs of the Greek crisis, colleagues have been busy in the background trying to unravel some core components of the Greek Bailouts. The PSI deal, which is largely responsible for passing the burden of any potential Greek default from private hands onto public coffers, has been the central target of litigators. The PSI deal, as discussed previously in the blog accessible here, offered a bond swap in early 2012 resulting in a haircut of 53.5%. It worked in a way that the sovereign enacted retrospective legislation inserting what are known as Collective Action Clauses (CACs) in the bond contracts. Unsurprisingly, a significant number of bondholders, roped into this deal through the operation of CACs, sought legal redress arguing that their investments had been forcefully expropriated.

The Greek government had some justification for optimism recently, as it survived the challenges of the PSI both in domestic courts and at ICSID. A class suit in national administrative courts arguing expropriation under the Greek Constitution and the violations of the European Convention of Human Rights [ECHR] failed. The Greek Council of State, in March 2013, found for the government, stating that losses were caused by the activation of the CACs, and not by the state act that retrospectively adopted them. The court did not find violations of Article 1 of the Protocol to the ECHR either. ICSID arbitrators also proved kind to the Greeks. The Slovakian bank Poštová Banka and its Cypriot subsidiary Istrokapital argued that under the Greece-Slovak Republic and the Cyprus-Greece Bilateral Investment Treaties (BITs), they were entitled to compensation for losses they suffered due to the PSI, amounting roughly to half the invested amount of €504m. Poštová's claim was the first challenge under BITs to land on Greece's door. The Tribunal found that it did not have jurisdiction to hear Poštová's claim. This was primarily because Poštová was not the holder of the bonds, but a participant in an investment fund with indirect claims to the bonds.

One could think, therefore, that this puts an end to challenges? Actually, no. Smallholders lost because a national court which needed to consider public interests would find it extremely difficult to disallow deviations from contractual and proprietary rights due to the 'emergency' situation the Greek government claimed to be operating under. Indeed, the Greek Court had announced the outcome of the trial a whole year in advance before the full text of the decision being made available. However, investment arbitration is an entirely different environment. Poštová lost on jurisdiction because of the exact wording of the Greek-Slovakia BIT it was relying on (Istrokapital had no standing as a subsidiary). Poštová filed a request for the partial annulment of this decision in August 2015, but has questionable chances of success. Investors from one of the other states

Greece holds BITs with may indeed have better luck.

One of those other states is Cyprus, the home of the departed (the bank ended operations in March 2013) yet litigious Cyprus Popular Bank (Laiki). Laiki is already involved in an action against Greece, this time for the provision (or lack thereof) of Emergency Liquidity Assistance (ELA) to its Greek subsidiaries that led to the resolution of Cyprus' two biggest banks. The PSI challenge of Laiki was filed late September 2015, claiming billions of euros in compensation for losses suffered in 2012 when Laiki's 2.8 billion portfolio of Greek bonds was subjected to the haircut. Adding this claim to the ELA action where Laiki claims that the assistance to which its Greek-registered branches were entitled to was not received, leads to a claim totalling 4 billion Euros.

Does Laiki have any chance of success? Firstly, the claimant is unlikely to face the same jurisdictional hurdles as Poštová. If Laiki did not hold the bonds directly (regardless of whether they were purchased in primary, or secondary market transactions), it is improbable that their advisors would have proceeded to file at ICSID. A key question to be answered by the Tribunal will be whether the introduction of the CACs was an exercise of sovereign power, and whether financial investments in Greek sovereign bonds can still be considered purely contractual, and consequently outside the jurisdiction of investment tribunals. Also, it remains to be determined whether investors can complain regarding treaty violations solely due to the retrospective introduction of CACs, and in the absence of concurrent violations of MFN clauses or other Treaty rights. Further, is it still appropriate to consider that BITs are unlikely to cover financial instruments? After the Abaclat case, where a number of Italian bondholders sued Argentina, it is unlikely that this will be an impediment. In that case, the Tribunal ruled that the financial nature of the investment did not preclude it from being a protected investment. Abaclat has proceeded to a consideration of substantive issues, joining a long line of cases in various fora against Argentina. There is a real possibility, therefore, that Laiki will overcome jurisdictional hurdles, and have its case heard on the merits.

But can the PSI deal violate BIT standards of investor protection? The most likely claims by Laiki will be that of expropriation and discriminatory treatment. Expropriation under BITs can occur only in accordance with international law standards, and they need to be non-discriminatory and followed by a payment of prompt, adequate and effective compensation. Modern BITs place emphasis on safeguarding the sanctity of a contract by protecting it against regulatory and other governmental action that thwarts the normal legitimate expectations of the investor. The key issue will be, therefore, whether a reduction of the face value of a sovereign bond is an exercise of legitimate state powers, or a form of expropriation that gives rise to a claim for compensation under international law.

Laiki would most likely claim that the introduction of the CACs by legislation constitutes a sovereign act which resulted in the diminution in value of their investment. Such investment would arguably fall under the 1992 Greece-Cyprus BIT as a contract of financial value. The loss sustained could be treated as an expropriation warranting compensation. The allegation of unlawful expropriation would be based upon the lack of compensation for the losses suffered by the investor (diminution of value of the bonds), and potentially discriminatory treatment as the haircut did not extend to the institutional holdings of Greek bonds (eg. ECB held bonds), nor to those Greek bonds denominated in foreign currencies. Under an MFN clause such discrimination would be considered a violation of the Treaty standards. On the assumption therefore that investors convince the tribunal to proceed (overcoming jurisdictional challenges), and win on the substantive grounds (expropriation), they would claim restitution to the face value of the pre-haircut bonds.

Could this argument work, considering that Greece was responding to an emergency? A necessity defence as a matter of customary international law is unlikely to work for Greece. In its recent ICSID cases, Argentina reportedly is invoking the argument that due to the severe economic emergency it faced in 2001-2002, it was left with no choice but to adopt the measures it did. The argument presumably relies on concepts such as the impossibility of performance or the fundamental change of circumstances, as set forth in Articles 61 and 62, respectively, of the Vienna Convention on the Law of Treaties of 1969. Argentina (same as Greece) faces the problem that even if we accept that economic emergency allows a state to claim necessity or force majeure as a defence to the claims of wrongfulness, the threshold as set by tribunals seems insurmountable.

Greece then might lose, but will this mean that it will have to pay billions in compensation? It could be argued that the bondholders got a better deal with the PSI than what was an offer in the markets. Before the International Swaps and Derivatives Association (ISDA), which manages Credit Default Swap (CDS) rules, declared that a Restructuring Credit Event had occurred with respect to the PSI, old Greek bonds were trading at a significant discount, factoring the chances of a disorderly default (21.5% of their face value). Even after the swap, new bonds were quoted at around 24% to 25% of face value. Greece could, therefore, argue that purchasers in the secondary market have not suffered losses, if they obtained their bonds after the onset of the Greek crisis in 2010, unless they intended to keep them till maturity.

Greece has no choice but to fight this case. While it may find it expensive to defend (Greece spent in excess of €4,650,000 in legal fees, with the arbitration cost adding US$300,000 defending against Poštová) it cannot afford to lose. Losing will mean not only many more claims by those affected by the 2012 haircut, but will also have a catastrophic budgetary impact in an already difficult period.

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