Scrutinising the resolution of European Union banks through the looking glass of investment treaty arbitration

Georges Affaki*
RVLJ, N.º 13, 2020, pp. 43-53.

1. Over the past two decades, I have had the pleasure of discussing regularly with my colleague and friend Professor James Otis Rodner S. issues relating to international banking and to international arbitration. His multilingual skills, openness to comparative law and sheer curiosity about international practice has always yielded most interesting intellectual exchanges. The topic that I chose to contribute to the essays in his honor attempts to span some of the issues that we used to discuss.

2. Illustrating the challenges raised by the resolution of banks in the European Union (EU) with a case involving the liquidation of a Peruvian bank may seem a bold introduction. However, the lessons to be learned from this case may be of guidance to many a national resolution authority when exercising their powers under Directive 2014/59/EU[1] (BRRD) on the recovery and resolution of credit institutions.

* **University of Paris II**, Professor of Law. Avocat à la Cour, Paris, member of the ICC International Court of Arbitration and of the ICSID Panels of Arbitrators and Mediators.

1 Directive 2014/59/EU of the European Parliament and of the Council of 15-05-14 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) N.º 648/2012, of the European Parliament and of the Council (*OJ* L 173, 12-06-14, p. 190).

3. Banco Nuevo Mundo (BNM) was incorporated in Peru in 1992. It soon became the country's sixth largest bank[2]. Like a number of other Peruvian banks, BNM was negatively impacted by the Russian financial crisis in 1998. Through successive on-site reviews that extended through 2000, the Peruvian bank superintendent found several failures in BNM's safety and soundness tests, which triggered the imposition of fines. Around that period, state entities began to withdraw their deposits from BNM. This was followed by a massive withdrawal of private deposits. The bank's liquidity ratio fell below the required 8 % threshold. The Central Bank of Peru refused to provide an emergency loan to BNM and, soon after, excluded the bank from its automated clearing house after it failed to settle its multilateral liability. Ultimately, BNM was dissolved and liquidated with a negative balance of USD 222,517,000. A French shareholder of the bank brought an action against Peru before ICSID under the France-Peru bilateral investment treaty for infringement of the standards of fair and equitable treatment, national treatment and full protection and security, alleging that the Peruvian banking authorities' actions amounted to an indirect expropriation.

4. The final award rendered by the arbitral tribunal in 2014 totals over 180 pages and merits attentive reading on the part of banks and their regulators. In brief, the majority of the members of the arbitral tribunal declined to consider that the Central Bank of Peru's refusal to grant an emergency loan to the failing BNM amounted to an infringement of Peru's international law obligation to protect an investment. While the Central Bank was the «lender of last resort» in Peru and was therefore required to contribute to the stability of the banking system, the applicable banking law required it to demand collateral before granting a loan. BNM did not offer collateral. The tribunal therefore found that the Central Bank did not act arbitrarily in denying the loan[3]. Similarly, the majority of the tribunal rejected the claimant's argument that discriminatory treatment had resulted from the Central Bank bailing out certain Peruvian banks, but allowing BNM to fail, and from the state's

---

2 All the facts are taken from the final award in Renée Rose Levy de Levi *v.* Republic of Peru, ICSID Case N.º ARB/10/17.

3 Renée Rose Levy de Levi *v.* Republic of Peru, pp. 338 and 367.

triggering that failure by withdrawing deposits with BNM. Like any depositor, the tribunal ruled, the state could remove sight deposits when deemed expedient. The tribunal added that the Central Bank has no obligation to act in any specific way to mitigate a potential run on the banks since it owed its duties to the public, not to a specific bank or to its shareholders.

5. The tribunal concluded that it was the bank's own bad business decisions, which entailed taking risks in times of liquidity crisis, that had led to its liquidation, not any expropriation by the state. Importantly, the tribunal added:

> No investment treaty is an insurance or guarantee of investment success, especially when the investor makes bad business decisions[4].

6. The failed claim against the Peruvian bank authorities is mirrored in subsequent investment treaty claims brought by bank shareholders against EU Member States for alleged misuse by the national bank regulators of their regulatory powers or by the national resolution authority of its resolution powers. They likewise failed on the merits[5]. Beyond the difference in the terms of the heads of claim, the question of law is almost identical: is a state liable if its central bank does not fulfil its duty as the lender of last resort in aiding banks that face liquidity crises? A creditor, or a shareholder, of a regulated bank in the EU might argue that it legitimately expected, and reasonably relied upon, the central bank fulfilling its role as lender of last resort if the regulated bank were to face a liquidity crisis. And a claimant would argue that beyond liquidity assistance, the bank regulator should be expected to provide other

[4] Award in Renée Rose Levy de Levi *v.* Republic of Peru, p. 478. Previous awards holding the same include Emilio Agustín Maffezini *v.* Kingdom of Spain, ICSID Case N.º ARB/97/7, award, 13-11-00, p. 64; MTD Equity Sdn. Bhd. and MTD Chile S.A. *v.* Republic of Chile, ICSID Case N.º ARB/01/7, award, 25-03-04, p. 178; CMS Gas Transmission Company *v.* Republic of Argentina, ICSID Case N.º ARB/01/8, decision on jurisdiction, 17-07-2003, p. 29; and Eudoro Olguín *v.* Republic of Paraguay, ICSID Case N.º ARB/98/5, award, 26-07-00, p. 73.

[5] Marfin Investment Group Holdings S.A., Alexandros Bakatselos and others *v.* Republic of Cyprus, ICSID Case N.º ARB/13/27 (the Laiki Bank case); GBM Global, S.A. de C.V., Fondo de Inversión de Renta Variable and others *v.* Kingdom of Spain, ICSID Case N.º ARB/18/33; and ICC case 20588 (award of 15-01-19, unpublished).

forms of support, in terms of supportive public statements of the «whatever it takes»[6] kind to reassure depositors and mitigate a run. In turn, regulators targeted by such a claim would likely respond by calling that moral hazard.

7. How can a creditor or a shareholder of a failing bank who claims to have suffered a loss as a result of the resolution of the bank require the state to which the acts of the resolution authority are attributed to submit to arbitration? In considering that question, it is critically important to remember that the arbitral process contemplated by the putative claimant is not an ordinary commercial arbitration arising out of a provision of a contract. Rather, that arbitral process arises out of one of more than 3,000 investment protection treaties or free trade agreements concluded between sovereign states. In a treaty of this kind, the host state will make a unilateral public offer to investors from the other contracting state to have eligible disputes relating to their investments submitted to international arbitration. When an investor submits a notice of dispute, it is deemed to have accepted that offer. The treaty, which is itself a contract between the two contracting states, thus functions as the equivalent to an arbitration agreement between claimants and respondents in commercial contracts, and offers a contractual basis for the arbitrators' jurisdiction.

8. For the arbitral tribunal to claim jurisdiction based on the host state's consent to arbitration expressed in the treaty, the investment in relation to which the loss is claimed needs to qualify as a «protected investment». The treaty can exclude certain sectors, or certain types of government measures. After the Argentinian bonds cases[7], some states took the initiative of excluding sovereign debt rescheduling from the scope of treaties[8]. The now defunct

---

6 See speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London, 26-07-12.

7 Abaclat *v.* Argentine Republic (ICSID Case N.º ARB/07/5); Ambiente Ufficio S.P.A. and others *v.* Argentine Republic (ICSID Case N.º ARB/08/9); and Giovanni Alemanni and others *v.* Argentine Republic, ICSID Case N.º ARB/07/8.

8 See, *e.g.*, the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part (*OJ* L 11, 14-01-17, p. 23), which is a free-trade agreement between Canada, the EU and its Member States, signed on 30-10-16.

Trans-Pacific Partnership excluded measures adopted for prudential reasons[9]. That aside, the majority of investment treaties adopt a broad asset-based approach to defining qualifying investments. «Claims to money» are generally listed in treaties as an example of qualifying investments. There are numerous reported cases where providing financing, investing in bonds, purchasing an equity stake in the capital of a bank, issuing or benefiting of a guarantee or a derivative have been held by arbitral tribunals as being qualifying investments absent exclusion in the relevant treaty[10].

9. In addition, the investment has to be made in the territory of the host state for jurisdictional purposes. Whilst it may be straightforward to determine the location of a dam, a highway, or a mine, tabilizezed securities and derivatives may be more challenging to situate for legal nexus purposes. Arbitral tribunals have accepted in a number of cases that if the funds ultimately benefit the host state, the jurisdictional nexus condition is fulfilled, regardless of where those funds are paid[11]. However, that consensus, which was established in the Argentine bonds cases, was broken in a Greek bonds case, Poštová banka, where the majority of the tribunal refused to take the view that there was sufficient territorial nexus in relation to the host state where

---

[9] Trans-Pacific Partnership, Article 11.11, text released on 05-11-15: «For greater certainty, if a measure challenged under Section B of Chapter 9 (Investment) is determined to have been adopted or maintained by a Party for prudential reasons in accordance with procedures in Article 11.22 (Investment Disputes in Financial Services), a tribunal shall find that the measure is not inconsistent with the Party's obligations in the Agreement and accordingly shall not award any damages with respect to that measure».

[10] See, e.g., Fedax *v.* Venezuela, ICSID Case N.º ARB/96/3; British Caribbean Bank *v.* Belize (Uncitral); Ceskoslovenka Obchodni Banka, A.S. *v.* Slovak Republic, ICSID Case N.º ARB/97/4; Deutsche Bank AG *v.* Sri Lanka, ICSID Case N.º ARB/09/2; Abaclat and Others *v.* Argentine Republic; Ambiente Ufficio S.P.A and Others *v.* Argentine Republic; and Giovanni Alemanni and Others *v.* Argentine Republic.

[11] Decision on jurisdiction of 04-08-11, Abaclat and Others *v.* Argentine Republic, para. 374 («With regard to an investment of a purely financial nature, the relevant criteria cannot be the same as those applying to an investment consisting of business operations and/or involving manpower and property»).

the tabilizezed securities were purchased by the investors on the secondary market, as opposed to directly from the issuer state itself[12].

10. As concerns the specific topic of this paper, that of resolution; in order to place an entity into resolution, the resolution authority must ascertain that all of the following conditions are met[13]:

i. the bank is failing or likely to fail;
ii. there are no supervisory or private sector measures that can restore the bank to viability within a reasonable timeframe; and
iii. resolution is necessary in the public interest, i.e. resolution is preferable to normal insolvency proceedings, with the corollary no creditor worse off (NCWO) principle also being applicable[14].

11. Once the resolution authority has determined that a resolution is warranted, there are four possible resolution tools to choose from:

i. the sale of business tool, involving the total or partial disposal of an entity's assets, liabilities and/or shares to a private purchaser;
ii. the bridge institution tool, involving the transfer of part or all of the assets, liabilities and/or shares to a controlled temporary entity;
iii. the asset separation tool, involving the transfer of assets to an asset management vehicle; and
iv. the bail-in tool, involving the write-down or conversion of equity and debt, placing the burden on the shareholders and creditors of a bank, rather than on the public[15].

---

12 Poštová banka, a.s. and ISTROKAPITAL SE *v.* Hellenic Republic, ICSID Case N.º ARB/13/8.

13 Article 32 of the BRRD.

14 Under the NCWO principle, no creditor or shareholder shall incur greater losses than they would have incurred if the institution had been wound up under normal insolvency proceedings. The application of the NCWO principle is carried out under Article 74 of the BRRD.

15 Article 37 of the BRRD.

12. The conditions and circumstances in which the resolution authority may determine the fulfilment of the required prerequisites for a resolution, or its use of any of the four resolution tools listed in the BRRD, may potentially offer grounds to bring a treaty-based claim for misuse of powers or for misfeasance in public office. To date, treaty-based claims have been exclusively directed against the national resolution authority, but not against the European banking regulator. However, in the case of a bank that is considered a globally systemically important bank, and is therefore supervised by the ECB and falls within the jurisdiction of the Single Resolution Board (SRB), would the conditions of its resolution, however contestable, exclude the investment treaty-based liability of the national resolution authority of the Member State where the bank is located? Some investors might consider relying on the following Commission statement in an attempt to bring a claim against the national resolution authority to take advantage of the investment treaty with the relevant Member State, given the rarity of treaties of which the EU itself is a ratifying member[16]:

> National resolution authorities are closely involved in the resolution process. They assist the Board in preparing its actions (…) Crucially, national authorities are also in charge of implementing the resolution decisions in line with national company and insolvency law. Member States are thus integrated into the mechanism in the preparatory and implementation stage regarding banks in their jurisdiction[17].

13. That argument led Mexican shareholders of Banco Popular to bring a claim under the Mexico-Spain Treaty against Banco España, not against the ECB or the SRB, although Banco Popular was supervised by the ECB[18].

[16] Such as the Energy Charter Treaty. After the Lisbon Treaty came into effect, future investment treaties with third countries are expected to be concluded by the EU, but no longer by its Member States.

[17] European Commission, Memo, A Single Resolution Mechanism for the Banking Union - frequently asked questions, Brussels, 15-04-14.

[18] GBM Global, S.A. de C.V., Fondo de Inversión de Renta Variable and others *v.* Kingdom of Spain.

14. On what legal ground can an investor bring a treaty claim for misuse of resolution powers by the competent authority? Almost all investment protection treaties guarantee investors treatment in accordance with international customary law, including fair and equitable treatment (FET), as well as full protection and security, in connection with their investments. The requirement to provide FET is generally interpreted as protecting foreign investors against arbitrary and discriminatory treatment. Investors argue that FET, an international law obligation of the host state, requires that state to provide a stable and predictable legal and regulatory environment, and act in a consistent and even-handed way in accordance with applicable laws and regulations. Investors may also argue that FET also includes the state's obligation to act with transparency in enacting measures that affect protected investments.

15. The above might lead investors to argue that a state has breached its FET obligation if it takes any or all of the following acts or measures:

i. Withdrawal, by the state or its agencies and other entities it controls of deposits from the failing bank, thus aggravating its liquidity crisis[19].
ii. The making of alarming public announcements that damage the reputation of the bank, leading to a run; or, alternatively, the failure to make reassuring announcements to mitigate a bank run[20].
iii. Discrimination against the failing bank by denying it liquidity tabilizez measures that the state may have approved for other banks. For instance, the investors in the Laiki Bank[21] case argued that the Bank of Cyprus was offered state support, but not Laiki Bank. Eventually, the Bank of Cyprus was tabilizezed and took Laiki Bank's viable assets.
iv. Discrimination amongst the creditors by choosing (arbitrarily, as the investor may contend) which debts are to be transferred to the bridge bank and which will stay in the failing bank. That argument was made in relation to the setting up of Novo Banco and the transfer to it of

19 Renée Rose Levy de Levi *v.* Republic of Peru; GBM Global, S.A. de C.V., Fondo de Inversión de Renta Variable and others *v.* Kingdom of Spain.

20 *Ibid*.

21 Laiki Bank case.

selected assets from Banco Espirito Santo. It could be argued that the very concept of resolution seeking to avoid bankruptcy by selecting viable assets is antinomical to the principle of equal treatment of creditors. Recital 13 of the BRRD should be kept in mind as a useful guidance for resolution authorities:

> The use of resolution tools and powers provided for in this Directive may disrupt the rights of shareholders and creditors. In particular, the power of the authorities to transfer the shares or all or part of the assets of an institution to a private purchaser without the consent of shareholders affects the property rights of shareholders. In addition, the power to decide which liabilities to transfer out of a failing institution based upon the objectives of ensuring the continuity of services and avoiding adverse effects on financial stability may affect the equal treatment of creditors. Accordingly, resolution action should be taken only where necessary in the public interest and any interference with rights of shareholders and creditors which results from resolution action should be compatible with the Charter of Fundamental Rights of the European Union (the Charter). In particular, where creditors within the same class are treated differently in the context of resolution action, such distinctions should be justified in the public interest and proportionate to the risks being addressed and should be neither directly nor indirectly discriminatory on the grounds of nationality.

v. The bailing in of creditors without first determining whether there were private sector alternatives to resolution[22].
vi. Deprivation of shareholders and creditors of the opportunity to be heard before the resolution, including discussion of possible private initiatives to tabilize the bank's financial condition[23].
vii. The conditions in which the resolution authority implements a sale-of-business resolution tool, including, in particular, how expert valuation is conducted and a bidding process is organized. In the sale of Banco

[22] GBM Global, S.A. de C.V., Fondo de Inversión de Renta Variable and others *v.* Kingdom of Spain (ICSID Case N.º ARB/18/33).
[23] Ibíd., ICC Case 20588 (2019), unpublished.

> Popular Español in 2017, the Spanish resolution authority is reported to have only invited five Spanish banks to bid and gave prospective buyers less than 24 hours to review the documents uploaded in the virtual data room and submit their offers. Only Banco Santander was able to meet that deadline. It submitted its offer for EUR 1 which was accepted by the resolution authority. The exclusion of foreign bidders and the short timeframe were grounds for the claim brought by Mexican shareholders of the failing bank against Spain claiming the violation of their rights under the Treaty to fair and equitable treatment and full protection and security, national treatment and most favored nation treatment, and protection against expropriation without due process and just compensation[24].

16. To date, investment tribunals have generally shown deference towards the actions of national resolution authorities. In the Laiki Bank case, the tribunal held that the decisions of the banking regulator were entitled to be treated with some deference, opining that:

> a central bank acts as a regulator of a highly technical and sophisticated economic sector, that it has intimate knowledge of the underlying data and is best placed to assess whether one course of action is preferable to another[25].

17. However, this affords only limited comfort to resolution authorities. A breach of international law would be found, according to the tribunal in the Laiki Bank case, «If there is any evidence that a decision taken by a regulator was abusive, did not afford due process or was a pretense of form designed to conceal improper ends». Where the regulator misuses its powers, or uses them disproportionately or discriminatorily, tribunals have found a breach of international law and awarded damages[26].

---

24 GBM Global, S.A. de C.V., Fondo de Inversión de Renta Variable and others *v.* Kingdom of Spain, *op. cit.*, foonote 24 above, Request for Arbitration, 23-08-18, at ¶ 90 *et seq.*

25 Laiki Bank case.

26 PL Holdings *v.* Poland (SCC case N.º V 2014/163 –suspension of voting rights and required sale of shares held in the bank); Deutsche Bank AG *v.* Democratic Socialist Republic of Sri Lanka.

* * *

Resumen: El autor reflexiona sobre el tema de la «resolución» de las entidades bancarias de la Unión Europea y el sometimiento a arbitraje al Estado de la autoridad que la acuerde. Para tal fin, comenta varios casos que se han sometido a arbitraje y los argumentos que han alegados los inversores para reclamar responsabilidad de los Estados. **Palabras clave**: Resolución, entidad bancaria, arbitraje. Recibido: 11-11-19. Aprobado: 23-12-19.