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CURRENT LEGAL DEVELOPMENTS

The Unique Legal Status of the Bank for International Settlements Comes into Focus

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Abstract

The Bank for International Settlements (BIS), created in 1930 to handle German reparations from the First World War, has enjoyed a unique international legal position. This status was questioned when the Bank, in 2001, recalled its shares held by private parties. The resulting arbitral award settled the BIS's *sui generis* legal status, as well as making some important rulings about the application of state responsibility rules to international institutions in cases of expropriation. Additionally, the award provided needed insight as to the use of various methods of valuation of corporate assets in shareholder claims.

Key words

Bank for International Settlements; international institutions; international legal personality; state responsibility; stock valuation

The outcomes of international legal disputes often turn on historical serendipity, and one of the pleasures of international legal practice is the historic sleuthing that is part and parcel of these controversies. A recent arbitration,[1] conducted under the auspices of the Permanent Court of Arbitration and pursuant to a 1930 Agreement,[2] is a prime example of this phenomenon. In addition, the award has much to say about the nature of international institutions as well as certain aspects of the valuation of shareholder interests in particular sorts of entities.

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1. *Dr Horst Reineccius, et al. v. Bank for International Settlements*, Partial Award of the Lawfulness of the Recall of Privately Held Shares on 8 Jan. 2001 and the Applicable Standards for Valuation of those Shares, Arbitration Tribunal Established Pursuant to Art. XV of the Agreement Signed at The Hague on 20 January 1930 (partial award issued 22 Nov. 2002), available at <www.pca-cpa.org> (hereinafter cited as 'Award', with the relevant paragraph numbers).
2. This Agreement was constituted by a number of elements. For the purposes of this casenote the primary instruments are (i) the Convention respecting the Bank for International Settlements, Ger.–Bel.–Gr.Brit.–It.–Japan–Switz., 20 Jan. 1930, 104 LNTS 441, reprinted in (1930) 24 AJIL Supp. 323 (BIS Convention); (ii) the annexed Constituent Charter of the Bank for International Settlements, 104 LNTS 445, reprinted in (1930) 24 AJIL Supp. 324 (BIS Charter); (iii) the annexed Statutes of the Bank for International Settlements, 104 LNTS 449, reprinted in (1930) 24 AJIL Supp. 326 (BIS Statutes). The primary document of the set was the actual Reparations Agreement with Germany, also known as the Young Plan, 104 LNTS 244, reprinted in (1930) 24 AJIL Supp. 262, of which Art. XV provided for a dispute settlement mechanism and arbitration of any disputes arising from under any of the elements or instruments of the Agreement.

The story begins with the creation of the Bank for International Settlements (BIS) as part of the Young Plan, which established the final terms of German reparations after the First World War. In addition to prescribing how Germany's remaining indebtedness would be discharged, the Plan also required an entity that would not only serve as a trustee and payment agent for German indemnities, but also possess certain optional functions pursuant to a stated primary objective of promoting central bank co-operation and providing additional facilities for international financial operations.[3] Since 1930, the Bank has weathered the political storms of the Second World War, the rival attentions of sister international financial institutions (including the World Bank and the International Monetary Fund (IMF)), and the debt crises of the 1980s.[4] Although the BIS began as a purely functional institution designed to service the complex requirements of German reparations, it has transformed itself into a robust public international organization with the goal of being the central bank to central banks around the world. The only difficulty with this narrative is that when the Bank was established in 1930 it possessed attributes and features that were not readily associable with a true public international organization, governed by no law other than the *lex specialis* of its constituent instruments and the background rules of public international law. And despite the attempts of the Bank to place itself on that footing, it was bound to happen that a legal dispute would arise that would fundamentally challenge the nature of the institution.

For when the Bank was created in 1930, it really was established as a *bank*. To some degree, the character and tone of the institution was set in the opening articles of its Statutes, as 'a Company limited by shares'.[5] One of the historic curiosities of the Bank was that when it was created, not all of the signatory states and their designated central bank entities elected to own directly the shares allocated to them. Private individuals and concerns have always owned shares in the Bank, and as of 2000, of the 529,165 BIS outstanding shares in circulation, 72,648 (or nearly 14 per cent) were registered as being in private hands.[6] And although such shares did not convey voting privileges in the decision-making bodies of the Bank (such being reserved to central banks and their designates), such privately held shares were treated on terms of equality for most other purposes, including the distribution of profits and dividends. Nonetheless, to have such a significant percentage of privately held shares held in what should ostensibly be a purely public international institution was intensely

3. See BIS Statutes, *supra* note 2, at Art. 3.
4. For more on the history and evolution of the Bank, see R. Auboin, *The Bank for International Settlements, 1930–1955* (1955); J. C. Baker, *The Bank for International Settlements: Evolution and Evaluation* (2002); D. J. Bederman, 'The Bank for International Settlements and the Debt Crisis: A New Role for the Central Bankers Bank?', (1988) 6 *International Tax and Business Law* 92; E. L. Dulles, *The Bank for International Settlements at Work* (1932); P. Einzig, *The Bank for International Settlements* (1930); M. Giovanoli, 'The Role of the Bank for International Settlements in International Monetary Cooperation and its Tasks Relating to the European Currency Unit', (1989) 23 *International Law* 841; 'International Legal Notes, Fiftieth Anniversary of the Bank for International Settlements', (1980) 54 *Australian Law Journal* 560; G. U. Papi, *The First Twenty Years of the Bank for International Settlements* (1951); H. H. Schloss, *The Bank for International Settlements* (1958); G. K. Simons and L. G. Radicati, 'A Trustee in Continental Europe: The Experience of the Bank for International Settlements', (1983) 30 *Netherlands International Law Review* 330; G. B. Tarin, 'The Bank for International Settlements: Keeping a Low Profile', 5 *Transnational Law* 839 (1992).
5. BIS Statutes, *supra* note 2, Art. 1.
6. See Award, *supra* note 1, paras. 4 and 5.

embarrassing to the Bank's management and its official central bank constituents. So in January 2001, the Bank summoned an extraordinary general meeting of its (voting) shareholders and amended the Bank Statutes in order forcibly to recall and repossess the shares in private hands against payment of a compensation of 16,000 Swiss francs per share.[7]

A number of groups of private shareholders thereafter initiated arbitration proceedings against the Bank, pursuant to the dispute settlement clause of the 1930 Reparations Agreement. These groups (hereinafter referred to collectively as the claimants), primarily sought a determination as to whether the level of compensation offered by the Bank in exchange for the recalled shares was adequate. One claimant did, however, seek a ruling as to whether the forced redemption of the shares itself was in compliance with the Bank's constituent instruments and background principles of international law. A distinguished tribunal was formed[8] with the good offices of the Permanent Court of Arbitration and, after some anterior procedural disputes,[9] the panel issued a Preliminary Award on the lawfulness of the share recall and the applicable standards for valuation of the shares on 22 November 2002.

Dealing first with the issue of whether the Bank could lawfully rescind the privately held shares, the Tribunal had the opportunity to consider and make a definitive ruling as to the BIS's international legal status, a question that has vexed commentators for decades.[10] At the outset, the Tribunal observed that 'the rather complicated manner in which the Bank was established must be seen in light of the stage of development of international law in 1930. Apparently, at that time some of the parties to the [Reparation Agreement and Bank Articles] had doubts as to whether a treaty could under public international law create a company limited by shares and whether such a company could be generally recognized.'[11] This accounts, at least in the Tribunal's view, for the original signatory states requiring that one of the parties, Switzerland, grant a charter to the Bank, even as many of the provisions of the constituent instruments disclaim any force or effect of Swiss law on the

7. See *ibid.*, para. 5.
8. The arbitral panel consisted of Professors W. Michael Reisman (president), Jochen A. Frowein, Mathias Krafft, Paul Lagarde, and Albert Jan van den Berg.
9. Two preliminary orders of the Arbitral Tribunal merit some mention. The first, Procedural Order No. 6 (Order with Respect to Discovery of Certain Documents for Which Attorney–Client Privilege Has Been Claimed), issued 11 June 2002, available at <www.pca-cpa.org>, dealt with the increasingly contentious issue in international arbitrations (including those with a public element) of discovery abuses and contentions of evidentiary privileges, and applicable waivers of attorney–client privilege. The Tribunal ordered the protection of a wide set of legal opinions offered to the managers of the Bank. *Ibid.* at 10–12; see also Award, *supra* note 2, at para. 45. The second order, In re the Matter of Reginald H. Howe, issued 31 Aug. 2001, available at <www.pca-cpa.org>, concerns the rights of non-parties to arbitration regarding public disclosures of certain sorts of information about the parties and their claims, especially where the results of the arbitration could affect (and benefit) a wide class of non-parties. Although the Tribunal disclaimed any interest in promoting an international 'class action' approach to litigation, it did allow for certain information to be disclosed, and held open the possibility of allocating costs.
10. In addition to the sources cited in note 4, see also M. O. Hudson, 'The Immunities of the Bank for International Settlements', (1938) 32 AJIL 128; Sir J. F. Williams, 'The Legal Character of the Bank for International Settlements', (1930) 24 AJIL 665.
11. Award, *supra* note 1, para. 105.

BIS's operations.[12] Putting aside the question of whether the law of international institutions of the 1930s was really so protozoan as not to contemplate the creation of a treaty-based international corporate entity, detached from the laws of any particular signatory,[13] there really is no question that the drafters of the Bank's constituent instruments did imagine an institution with substantial and 'particularly urgent international task[s]', functions 'quintessentially public international in character'.[14] That the Bank has been recognized by its hosts, and other entities, as endowed with a public international legal character, was seen as decisive by the Tribunal,[15] a conclusion unaffected by the fact that the BIS performs some commercial activities common to private sector banks. 'Any international organization may have to engage in some private sector activities in pursuit of its public functions', the Tribunal observed, 'and does not automatically and *pro tanto* lose its public international legal character because of them . . . Nor is the Bank the only international organization that shows a profit. But even if the Bank were singular in this regard, or its profits far exceeded those of other international organizations . . . there is a difference between a profit-making and profit-maximizing entity . . . The issue was not that the Bank might make profits, the possibility of which was taken for granted. It was the purpose for which the Bank was created, to which such profits had to be applied.'[16]

But in defending its recall of the privately held shares, the Bank may have gone too far in asserting its absolute right to do so. While noting that the BIS was not subject to Swiss corporation law formalities in undertaking this decision, the Tribunal did hold that the Bank could not act with impunity, according to some notion of 'sovereign powers' or *acta jure imperii*, presumably not subject to any review or correction.[17] Instead, the Tribunal held that the decision to recall the shares was governed by the Bank's constituent instruments, and, in this regard, there being no textual prohibition on the BIS rescinding the private shares, the only question left was whether the formalities for such a decision complied with the BIS Statutes. The nub of this inquiry was whether the January 2001 amendment to the Statute complied with the requirement that it be adopted by two-thirds of the BIS board of directors, followed by a majority vote of the general meeting. This was certainly accomplished in a regular fashion, so that the only issue for the disputing claimants was whether the Statute amendment allowing the share recall was as against a reserved clause of the Statute and thus also had to be 'sanctioned by a law supplementing the Charter of the Bank', as issued by the Swiss government.[18] The Tribunal quite properly brushed aside one claimant's assertion that an added Statute article was impermissible, even while changes to existing articles or outright

12. *Ibid.*, at para. 108 (discussing BIS Charter, *supra* note 2, para. 5).
13. This assumption has been questioned by some. See D. J. Bederman, 'The Souls of International Organizations: Legal Personality and the Lighthouse at Cape Spartel', (1996) 36 *Va. Journal of International Law* 275.
14. Award, *supra* note 1, paras. 113 and 114 (quoting Auboin, *supra* note 4, at 1–2 and BIS Statutes, *supra* note 2, Art. 3).
15. See *ibid.*, para. 115.
16. *Ibid.*, para. 117.
17. See *ibid.*, para. 123.
18. BIS Statutes, *supra* note 2, Art. 58.

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deletions were.[19] The Tribunal thus held that as no reserved provision of the Statutes was implicated in the share recall, there was no need for Swiss law recognizing the amendment, and that all procedural formalities were satisfied.

One might have thought that that would have resolved the matter. But in a passage that is sure to resonate in future disputes about the limits of authority for public international institutions, the Tribunal went on to consider whether the share recall conformed with what it characterized as 'substantive standards of international law', namely the requirements (derived from the law of state responsibility and investment protection) that an expropriation be in the public interest and be non-discriminatory.[20] Regrettably, the Tribunal did not explain the premises by which the international law of expropriations was to be applied wholesale (without apparent qualifications) to international institutions. Indeed, the Tribunal appears to be uncertain whether it does,[21] and although this may well be a proper approach to pursue, it is by no means an intuitive or necessary one, as the International Law Commission (which has had this topic on its agenda for some years) has realized. In any event, one cannot dispute the Tribunal's conclusion that the Bank's discriminatory treatment of its private shareholders was, to some degree, sanctioned by its own constituent instruments,[22] nor its decision that the rescission fulfilled a public purpose, even though the Tribunal may have been a bit too quick to accept the Bank's explanation that the existence of private shareholders was hampering its operations.[23]

Having found that the share recall was lawful, the Tribunal turned to the question of the valuation of the rescinded shares. Again, the application of an international law standard of compensation is assumed here, although (in the Tribunal's defence), it was the Bank which, in its pleadings, relied on that jurisprudence.[24] In a somewhat discursive section of the award,[25] the Tribunal attempts generally to characterize the international law of this subject, relying chiefly on opinions issued by the Iran–United States Claims Tribunal. To its credit, the panel rejected outright the Bank's suggestion that only 'appropriate' compensation was due to the private shareholders in this case, relying on some analogy to human rights instruments.[26] Moreover, the panel rejected the Bank's attempt to offer only the market value of the shares, pungently noting that the BIS's own internal consultants had rejected a market price as inappropriate, and that the original offer of 16,000 Swiss francs was almost twice the market value.[27] Instead, the Tribunal ruled that full compensation was to be afforded, and, in any event, held that this was required by the Bank's own Statutes.

19. See Award, *supra* note 1, paras. 144–46 (relying on an interpretation of the Vienna Convention on the Law of Treaties, 23 May 1969, Art. 31(3)(b), 1155 UNTS 331).
20. See *ibid.*, para. 149.
21. See *ibid.*, para. 155 ('Thus, even were, *arguendo*, the standards of the international law of expropriations to be applied to determine the validity of the Bank's recall of private shares, that transaction would have been lawful').
22. See *ibid.*, paras. 152–155.
23. See *ibid.*, para. 151.
24. See *ibid.*, para. 160.
25. See *ibid.*, paras. 161–171.
26. See *ibid.*, para. 168.
27. See *ibid.*, paras. 5, 171.

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The remainder of the award concerns the claimants' arguments that the valuation method chosen by the Bank, the dividend perpetuity model (DPM), led to an undervaluing of the shares. Ultimately, on this point, the Tribunal agreed with the claimants. First, though, the panel had to reject the use of an earning power method (EPM) of valuation that would have required the Bank fully to maximize shareholder interests by increasing dividends to the limit of profits. Instead, the Bank had withheld dividends, preferring to raise capital reserves, and the panel had validated this strategy by noting that this was consistent with the BIS's 'public international mandate'.[28] In short, an EPM approach, 'despite its cogency for private sector corporations, is an inapt method of valuation of the shares of the [BIS]'.[29]

The Tribunal went on to accept the claimants' use of the net asset value (NAV) method for the Bank's shares. This approach produces a higher per-share value, since it takes into account the accumulated reserves and wealth of the Bank, which would be split on liquidation. Of course, it was precisely for this reason that the BIS forcefully resisted it, arguing that the share recall should be likened more to a freeze-out of a hostile minority interest than to a corporate dissolution. But the Bank's own Statutes foiled this submission. They provided for the equality of shareholders for purposes of participating in the distribution of both the profits and the assets of the Bank.[30] Just because the private shareholders did not have voting rights, that did not diminish their rights to the Bank's assets. Indeed, as became apparent after the disclosure of the Bank's own internal documents, this had been the understanding of the Bank's management since the 1930s.[31] So the Tribunal adopted a net asset valuation of the Bank, qualified only by a 30 per cent discount, a figure which had been used by the Bank to price shares of its stock issued to new central banks upon joining the organization.[32] As of 8 January 2001, the net asset value of the Bank was US$10,072,000,000, producing a per share value of US$19,034 (33,820 Swiss francs),[33] or over double what the Bank had originally offered in compensation. This figure could in fact increase, since not included in the amount were the BIS's real estate holdings, the valuation of which was deferred to a subsequent phase of the proceeding.[34]

In analyzing the decision it is, thankfully, quite difficult to take issue with virtually anything in the Tribunal's well-organized and well-considered award. While, as I have already noted, the panel could have been a bit more forthcoming in its analysis of why certain rules of state responsibility were even notionally applicable to international organizations, this is hardly a signal defect in the decision. Likewise, the Tribunal's consideration of the appropriate standard of compensation for

28. *Ibid.*, para. 178.
29. *Ibid.*, para. 182.
30. See BIS Statutes, *supra* note 2, Art. 13.
31. See Award, *supra* note 1, paras. 192–202.
32. See *ibid.*, para. 201.
33. See *ibid.*, para. 203.
34. See *ibid.*, paras. 203, 205. Also put off was consideration of the Bank's counter-claim against one of the parties for having initiated proceedings in a US court, prior to the constitution of the Tribunal, in breach of Art. 54(1) of the Statutes. See *ibid.*, paras. 99, 206–207. These were resolved in the Tribunal's Final Award of 19 Sept. 2003, available at <www.pca-cpa.org>.

expropriated shareholder interests did tend to truncate a very rich body of case law and academic commentary, but the ultimate acceptance of full compensation for the recalled BIS shares in private hands was a welcome affirmation of that principle. The decision should also prove influential on the technical, but exceedingly important, question of what accounting methodology should be applied to value certain kinds of shareholder interests. Again, the Tribunal's employment of net asset value, and its refusal to allow the Bank simply to pocket the institution's accumulated capital reserves, and not to share them with the private shareholders as with a corporate dissolution, is commendable.

Finally, and most tellingly, the panel was clearly correct in its ruling on the Bank's international legal personality and the applicable law governing its shareholder relations. In this sense, the Tribunal resolved a long-standing puzzle about the BIS's legal character, one that originated in the extraordinary transformation that occurred in the definition of the subjects and objects of public international law in the interwar period. Indeed, no less an authority than the eminent British publicist, Sir John Fischer Williams, linked the hybrid character of the Bank for International Settlements with the larger question of the process by which states would cease to be the sole entities in international relations having legal personality.[35] The creation of the Bank in 1930 heralded the long-awaited emergence of international organizations, as collectivities of states, as a form of international legal actor, and foreshadowed the International Court of Justice's significant pronouncement in the *Reparations for Injuries* Opinion that

> The subjects of law in any legal system are not necessarily identical in their nature or in the extent of their rights, and their nature depends upon the needs of the community. Throughout its history, the development of international law has been influenced by the requirements of international life, and the progressive increase in the collective activities of states has already given rise to actions upon the international plane by certain entities which are not States.[36]

But even more significant in the case of the Bank was the mix of public international law character with private law commercial functions. It was this combination of elements that intrigued scholars, and which ultimately required resolution by the arbitral Tribunal. In his closing remarks to his seminal article on the status of the BIS, John Fischer Williams observed that

> The bank is thus, it may safely be said, an institution which has no exact parallel and which it will not be rash to describe as *sui generis*. . . . But whatever be its classification . . . it has both municipal rights and duties and proceeds from at any rate a tacit recognition of the fact that there is no great gulf fixed between the realms of municipal and international law.[37]

This was a prescient statement, and it anticipated two ideas that probably would have been regarded as heretical in 1930. The first was that public and private

35. See Williams, *supra* note 10, at 665–6.
36. Reparations for Injuries Suffered in the Service of the United Nations (Advisory Opinion), [1949] ICJ Rep. 174, at 178.
37. Williams, *supra* note 10, at 672.

international law – as reflected in the creation of a truly international financial entity, not fixed within one national domain and protected from traditional choice of law concerns – were bound to reunite and reconcile from the divorce that rendered them asunder in the period of high positivism in the late nineteenth century. And so today we scarcely seem unsettled by the prospect of merging public and private international law. The second idea was that the traditional divide between domestic and international legal regimes was also bound to erode. For Williams to have contemplated that two of the traditional limitations on public international law – its need to 'keep out' of domestic law and to distance itself from the transactions and disputes of individuals and business entities – would by necessity have to be overcome in order for international law to be an effective system, was a remarkable intellectual achievement.

It was no accident that reflecting on the status of the Bank for International Settlements was what prodded a number of commentators into seeing a set of deeper trends in the evolution of international law doctrine. The Bank's creation in 1930 reflected an attitude of extraordinary legal imagination and creativity. At stake was nothing less than the resolution of the last great remaining dispute from the First World War, the one that obviously carried the seeds of the next conflagration. And while the Young Plan, and the settlement of German reparations, hardly registers today as a signal event of twentieth-century international relations, it really was. That the BIS has gone on to serve as the quiet partner of the triumvirate of global financial and trade institutions (the World Bank, the IMF and the World Trade Organization (WTO)), and to emerge centre-stage with the periodic global debt crises, shows that the original scheme for the Bank's organic life was well conceived.

The Tribunal's award thus lays to rest any lingering qualms about the BIS's role and function. Nonetheless one can feel a little regret at the Bank's decision to recall the shares of its private shareholders, and to regularize its footing as a pure public international organization. The historic curiosity of having private shareholders owning an interest in an international institution was certainly revealing of many deep-seated assumptions about the nature of the international legal order, and the Tribunal's decision should be remembered and studied in that light.