State responsibility — Necessity — Whether part of customary international law — Effect of a declaration of necessity on private contracts — Economic necessity based on a State's inability to pay — Temporary suspension of payments on sovereign bonds — Effect in relations between a State and a private individual under private law — International Law Commission Articles on State Responsibility, Article 25 — Whether declaratory of customary international law

Economics, trade and finance — Sovereign debt — Foreign currency bonds — State suspending payments in foreign currency due to economic crisis — Whether justified by defence of necessity — The law of the Federal Republic of Germany

Argentine Necessity Case

(Case No 2 BvM 1-5/03, 1, 2/06)

Federal Republic of Germany, Federal Constitutional Court (BVerfG) (Second Chamber)

(Hassemer, *Vice-President*; Bross, Osterloh, Di Fabio, Mellinghoff, Lübbe-Wolff, Gerhardt and Landau, *Judges*)

8 *May* 2007

Summary: *The facts*:—In 2002 Argentina, which was facing severe economic problems and a loss of confidence in its currency, adopted a Law and consequent measures which suspended payment on Argentina's foreign debt due to what the Law described as a state of "public emergency in social, economic, administrative, financial and monetary policy". Various bondholders brought proceedings in the German courts regarding Argentina's default on the payment of these bonds. Argentina maintained that it had acted lawfully under international law, because international law recognized necessity as a ground excluding the wrongfulness of the acts of a State and that economic conditions were such that Argentina was in a state of necessity when it suspended payment. The Local Court in which these proceedings were filed asked the Federal Constitutional Court for an opinion on the question whether Argentina was entitled under international law to rely upon a state of necessity to suspend payment on the bonds and, if so, whether that was a general rule of international law which, pursuant to Article 25 of the Basic Law, was an element of federal

law which gave rise to rights and obligations for the individual, enforceable in the German courts.

Held (Judge Lübbe-Wolff dissenting):—There was no general rule of international law which entitled a State, by invoking a doctrine of necessity, temporarily to refuse to meet private law claims for payments due to individuals. Under international law the defence of necessity was not available to the State of Argentina in the circumstances of the present case.

(1) The submissions were admissible (pp. 8-9).

(2) There was no general rule of international law whereby a State was entitled temporarily to suspend payments arising from private law claims due to insolvency of the State. General rules of international law, within the meaning of Article 25 of the Basic Law, were rules of universally applicable customary international law, supplemented by the traditional general legal principles of national legal orders. Article 25 of the International Law Commission Articles on State Responsibility[1] on necessity as a ground for precluding wrongfulness was now generally accepted as stating a rule of customary international law. However, this ground was applicable only if certain specified preconditions were satisfied (pp. 9-12).

(3) While necessity might operate to preclude wrongfulness in the context of relations between States, including in the application of a bilateral investment treaty, where an investor was given standing to enforce obligations owed by one State to another State, it was not applicable to private law relations between a State and individuals, and hence had no application to the present case (pp. 13-18).

Per Judge Lübbe-Wolff (dissenting): There existed a public international law principle which entitled a State to give priority to the fulfilment of its fundamental domestic obligations over the timely repayment of foreign creditors in a case of necessity. In this sense necessity was available in respect of private law claims by individuals and should have been recognized as such by the Court (pp. 18-34).

The following is the text of the judgment of the Federal Constitutional Court:

RULING

The proceedings are combined for a joint ruling.

No general rule of international law is ascertainable which entitles a State temporarily to refuse to meet private-law payment claims due towards private individuals by invoking State necessity declared because of inability to pay.

[1] The text of Article 25 is set out at pp. 11-12 below.

GROUNDS

A.

I.

The Republic of Argentina has been confronted since 1999 with considerable economic problems, which at least temporarily expanded to become a State financial crisis. In connection with the financial crisis, Argentina made considerable use of the tool of government bonds abroad in order to cover the need for currency and for capital. Such bonds were also issued on the German capital market and subscribed to by German creditors.

In 2000, the Republic of Argentina received a loan of US $39.7 billion from the International Monetary Fund (IMF). In order to comply with the conditions attached to disbursement, the Republic of Argentina initiated drastic budgetary cuts, which in turn led to a grave loss of confidence in the Argentinian currency. The consequence was that Argentina had to pay higher interest on the capital markets, which, against the background of the existing economic problems, ultimately led to the declaration, by Act no 25,561 on Public Emergency and the Reform of the Exchange Rate System of 6 January 2002, of the "public emergency in social, economic, administrative, financial and monetary policy". On the basis of Decree no 256/2002 of 6 February 2002 on the Restructuring of Obligations and Debt Payment of the Argentinian Government issued thereupon, foreign debt service was suspended by the Argentinian Government in order to restructure the foreign debt service. The Act on Public Emergency has been extended annually, most recently until 31 December 2007.

After a decision to this effect pronounced on 15 December 2005, the Republic of Argentina has now repaid, ahead of schedule, its complete obligations to the IMF amounting to US $9.6 billion.

II.

1. Several actions entered by German investors are pending against the Republic of Argentina before the Frankfurt civil courts. By orders of 10 March 2003 and 21 March 2003, the Local Court initially submitted the question as to whether rules of international law stand in the way of convicting the defendant.

2. By orders of 2 July 2003, 3 July 2003, 4 July 2003, 24 November 2003 and 9 December 2003, the Local Court reformulated the submission orders, and now submitted the question whether the State necessity

declared by the defendant with respect to the inability to pay entitles the defendant by force of a rule of international law temporarily to refuse to meet due payment claims, and, if appropriate, whether this is a general rule of international law which, pursuant to Article 25 of the Basic Law, is an element of federal law which directly gives rise to rights and obligations for the individual, in this instance the parties.

The Local Court specifically explained that the submitted question was material to the ruling for the respective proceedings because the actions were admissible and well founded as to the main claims, and the claims could only be dismissed based on the application of the principle of international law proposed by the defendant which purportedly justifies the defendant's refusal to pay due to State necessity. The court handing down the judgment presumed the existence of State necessity, and was of the view that it was unable to judge on the factual circumstances of such State necessity itself. Serious doubts as to the existence of a general rule of international law on the use of State necessity as a plea were said to emerge from the fact that there was a principle of State necessity under international law, which in principle could also justify the non-fulfilment of an international obligation, but that there were no unambiguous rulings by international courts on the legal consequences of the inability to pay, in particular in the case of due claims by private third parties.

3. By orders of 16 May 2006 and 19 May 2006, the Local Court submitted two more sets of proceedings relating to the same question.

III.

1. The German *Bundestag*, the *Bundesrat* and the Federal Government were afforded the opportunity to make a statement pursuant to § 83.2 of the Federal Constitutional Court Act (*Bundesverfassungsgerichtsgesetz—BVerfGG*).

The Federal Ministry of Justice made a statement for the Federal Government by letter of 30 December 2003 on the impact of State necessity under international law. In its statement, the Ministry of Justice asserted that regulations on the lack of actionability of claims pursuant to Article VIII section 2(b) of the Articles of Agreement of the International Monetary Fund in its version of 30 April 1976 (*Bundesgesetzblatt* (Federal Law Gazette—*BGBl*) 1978 II pp. 13 *et seq*.) did not contradict the materiality of the submitted question to the ruling. In the view of the Federal Government, there was no general rule of international law within the meaning of Article 25 of the Basic Law permitting a State to suspend payment obligations under private-law

contracts unilaterally by invoking State necessity. There were said to be sufficient indications that State necessity had gained a foothold in customary international law. This, however, was said to apply only in the context of the strict preconditions of Article 25 of the Articles on State Responsibility of the United Nations International Law Commission, in other words only for the justification of the violation of international obligations. Additionally, the State may not have caused the occurrence of the peril itself.

There were, however, said to be considerable doubts when it came to transferring these principles to a case in which a State does not meet its payment obligations because of overindebtedness. Moreover, there were said to be only individual precedents which did not allow for the recognition of any unambiguous legal conclusions. The general principles of State necessity were also said not to have been lent concrete form in the sense of their being directly applicable to cases of inability to pay and a resulting justification of a breach of contract. A rule under customary law would have not only to entail a justification, but over and above this would have to order the applicability of the contractual relationship under international law also in the sphere of private law. This was said to be conditional on an obligation of the forum State to protect the debtor State against its creditors. Such an obligation was, however, said not to be ascertainable. Arguments contained in literature on international law according to which a private creditor should not be placed on a better footing than a State creditor were said not to apply in the case at hand. There could be no question of a better position applying across the board since, as a rule, State immunity would be invoked towards private creditors in the enforcement proceedings at the latest. A declared waiver of immunity was however said not to be allowed to be circumvented de facto by invoking the applicability of an exception under international law with regard to private-law contracts.

2. Furthermore, the Federal Court of Justice (*Bundesgerichtshof*) was afforded the opportunity to make a statement. The President of the Federal Court of Justice referred by letter of 5 December 2003 to a statement from the Chairpersons of the IX and IXa Civil Senates. In this statement, the Chairpersons stated that at that time two legal complaints had been pending for which the dates of their ruling could not yet be estimated. Moreover, the named Civil Senates had not yet dealt with the legal issues raised in the submission proceedings.

3. The parties to the initial proceedings were afforded the opportunity to make a statement pursuant to § 82.3 and § 84 of the Federal Constitutional Court Act.

a) The plaintiffs of the initial proceedings essentially alleged that the Republic of Argentina had no longer been in a position of State necessity as early as 2003, and that such State necessity was certainly its own responsibility, so that invocation of such a situation had to be ruled out. By way of documentation, they referred to statistics and considerable data on positive economic development in Argentina, as well as to foreign court judgments in which State necessity had not been recognized as an obstacle for a conviction and the enforcement of due payment claims benefiting private creditors.

b) The Republic of Argentina submitted a statement by virtue of its written pleading of 4 February 2004 on the proceedings submitted in 2003, and submitted a joint expert report by Prof. Dr Michael Bothe and Prof. Dr Gerhard Hafner which it had commissioned. By written statement of 10 October 2006, the Republic of Argentina furthermore made a statement on the submissions from 2006 in which it confirmed its view that it could also invoke State necessity as a justifiable plea in the proceedings before the German courts towards private creditors.

In the view of the Republic of Argentina, the justification of State necessity is a rule of customary international law. State responsibility had allegedly not yet been codified, so that rules on reasoning of responsibility, as well as on the justification of conduct which per se was wrongful, must belong to customary law. Recognition of State necessity as a reason for justification under customary law was said to emerge from the work of the International Law Commission, the rulings of the International Court of Justice and the relevant literature on international law.

Necessity was said to apply if major State interests were at risk. It was not possible to define these interests objectively in a manner that would be universally valid, but it was not necessary for the existence of the State itself to be at stake in order to justify necessity. State insolvency was said to be a vital interest that was worthy of protection. If a State was insolvent, the ability to fulfil all State purposes was said to be impaired. It was said to follow from international jurisprudence and doctrine that a State could also invoke State necessity if it were in dire economic and financial straits. Moreover, the act resulting from necessity must be the only possibility to avert peril, and must stand up to a weighing of interests. Both criteria were said to have been met here. It was in fact not possible to invoke State necessity if a State had caused the occurrence of the peril itself, but the judgment of economic policy assessments was said not to be amenable to court review and to be restricted to a mere review for arbitrariness. In the case of a financial crisis, it was furthermore not possible to prove the causality of specific conduct because of the dependence of the national economy on global economic contexts.

As to the transferability of the rules on necessity under international law to private-law relationships, the Republic of Argentina states that economic necessity could be pleaded towards private individuals before the courts of the Federal Republic of Germany. The Articles on State Responsibility are said certainly not to be contrary to extending [such rules] also to private-law relationships. Were one to interpret Article 25 of the Articles on State Responsibility such that it were restricted to international obligations, Article 56 explicitly referred to the supplementation of the Articles through further customary international law. International jurisprudence was said to comprise a number of cases in which necessity was permitted to justify refusal to pay.

Furthermore, with regard to private individuals, financial obligations were said to become international obligations in so far as they were raised to the level of international law by means of diplomatic protection.

IV.

The Senate handing down the judgment commissioned Prof. Dr August Reinisch to draft an expert report on the question of the validity and impact of State necessity under international law. The expert report was in particular to contain statements on whether State necessity is embedded as a justification in customary international law, what the State practice on the recognition of State necessity in international legal transactions is, and what practical impact the financial necessity of a State has on proceedings before foreign national courts.

On the basis of a discussion of relevant international-law practice, the expert witness reached the conclusion that there is no rule of international law embedded in customary law stating that State necessity as a justification under international law may also be used in private-law relationships towards private individuals before national courts. The ruling practice of international courts and tribunals was said not to provide any clear indications that State necessity as a justification under international law also affected debt contracts under private law. Legal literature was also said to give virtually no indications of a decision on the relevance of necessity in relationships between a State and private individuals on the basis of loans that were subject to national law. Whilst there were various statements in favour of equal treatment of international-law and private-law relationships, the lack of relevant proceedings nonetheless disfavoured imposing an obligation on national courts to recognize State necessity as a justification for non-compliance. However, a consideration [of State necessity] on the basis of domestic law was not out of the question. Yet the practice of national courts was said to have so far

not displayed any uniform trend with regard to the transferability of the rules of necessity under international law. The case law was said in many cases not to deal with the argument of State necessity at all, but to have the admissibility of proceedings fail because of the matter of State immunity.

B.

The submissions are admissible.

1. The questions submitted are to be presented in greater detail in that the question which is material to the ruling relates to the possible application of State necessity as an objection towards private individuals and in relation to payment claims due under private law. It emerges from the reasoning of the orders in conjunction with the circumstances of the proceedings that private-law payment claims of private creditors towards a foreign State are at issue in the matter, and that the Local Court doubts whether there is a general rule of international law which recognizes invoking necessity in this specific constellation.

2. A submission by a non-constitutional court to the Federal Constitutional Court (*Bundesverfassungsgericht*) is admissible pursuant to Article 100.2 of the Basic Law if the existence or scope of a general rule of international law is called into doubt in a legal dispute (see Decisions of the Federal Constitutional Court (*Entscheidungen des Bundesverfassungsgerichts—BVerfGE*) 15, 25 (31); 16, 27 (32); 46, 342 (358); 75, 1 (11-12)). What is more, the submitting court must adequately explain materiality to the ruling (see *BVerfGE* 4, 319 (321); 15, 25 (30); 16, 27 (32-3); 75, 1 (12); Order of the Second Senate of the Federal Constitutional Court of 6 December 2006—2 BvM 9/03, *Deutsches Verwaltungsblatt—DVBl* 2007, pp. 242 *et seq.*). These prerequisites are met.

Serious doubts can already be assumed because the Local Court has explained that there is no relevant highest-court case law on the submitted questions, and that the jurisprudence of international courts has not, for the questions submitted, taken a decisive position on the transferability of State necessity as a justification [for non-payment] to the relationship with private individuals.

The Local Court adequately explained in its submission orders that the Constitutional Court ruling on the existence of a general rule of international law is of prior importance to the non-constitutional proceedings. According to the statement made by the Local Court, the initial proceedings are essentially concerned with the impact of State necessity as a possible general rule of international law. In principle, a

State which undertakes private economic transactions abroad and agrees to the application of the rules of the civil-law system and jurisdiction of the forum State subjects itself fully to this national order and to its rules. The special relevance of international law, and coupled therewith the materiality of the submitted questions to the ruling, however emerges from the fact that in individual cases, on the basis of the sovereignty of States under international law, exceptions exist to private individuals being placed on an equal footing with a State. This also applies if a State undertakes private economic transactions, for instance if the non-constitutional courts must rule on execution against assets of a State used for sovereign purposes (see also *BVerfGE* 46, 342 *et seq.*; Order of the Second Senate of the Federal Constitutional Court of 6 December 2006—2 BvM 9/03, loc. cit.).

The presumption of the submitting court that State necessity continues to the present day is certainly not unjustifiable with regard to the fact that the Republic of Argentina has extended the Act on Public Emergency until 31 December 2007 (Act 26,204 of 13 December 2006 extending Act 25,561).

If there is a general rule of international law permitting the Republic of Argentina to invoke necessity under international law as justification for refusal to pay also in private-law relationships towards its creditors, a judgment could certainly not be declared executable as long as this objection applies. If the proceedings on the constitutionality of a statute, by contrast, reveal that the Republic of Argentina may not invoke State necessity towards the creditors, the submitting court is not prevented from taking its decision without allowing for the objection of inability to pay on the basis of the applicable federal statutes.

C.

A general rule of international law which entitles a State temporarily to refuse to meet private-law payment claims due towards private individuals by invoking State necessity declared because of inability to pay cannot be currently ascertained.

A rule of international law is "general" within the meaning of Article 25 of the Basic Law if it is recognized by the vast majority of States (see *BVerfGE* 15, 25 (34)). The general nature of the rule relates to its application, not to its content, recognition by all States not being necessary. It is equally not necessary for the Federal Republic of Germany in particular to have recognized the rule.

General rules of international law are rules of universally applicable customary international law, supplemented by the traditional general

legal principles of national legal orders (see *BVerfGE* 15, 25 (32 *et seq.*); 16, 27 (33); 23, 288 (317); 94, 315 (328); 96, 68 (86)). Whether a rule is one of customary international law, or whether it is a general legal principle, emerges from international law itself, which provides the criteria for the sources of international law. According to the unanimous view, Article 25 of the Basic Law, by comparison, does not relate to provisions that are contained in international agreements. Treaties under international law are to be applied and interpreted by the non-constitutional courts themselves (see *BVerfGE* 15, 25 (32-3, 34-5); 16, 27 (33); 18, 441 (450); 59, 63 (89); 99, 145 (160); Order of the 4th Chamber of the Second Senate of the Federal Constitutional Court of 12 December 2000—2 BvR 1290/99, *Juristenzeitung—JZ* 2001, p. 975; established case law). Stringent requirements are to be made as to the establishment of a general rule of international law because of the fundamental obligation of all States which it expresses.

1. International law contains neither a uniform nor a codified insolvency law of States (see Ohler, *Der Staatsbankrott*, *Juristenzeitung* 2005, p. 590 (592); Baars/Böckel, *Argentinische Auslandsanleihen vor deutschen und argentinischen Gerichten*, *Zeitschrift für Bankrecht und Bankwirtschaft—ZBB* 2004, p. 445 (458)). Individual international agreements do contain general necessity clauses; whether these relate to economic emergencies, however, requires interpretation in individual cases, as do the detailed preconditions for invoking necessity in legal relationships under international and private law in the event of insolvency. The rules on the legal consequences of a State's insolvency are hence fragmentary and, if the corresponding establishment of these rules can be documented using the criteria of international law, can only belong to customary international law or to general legal principles.

2. Invocation of State necessity is recognized in customary international law in those legal relationships which are exclusively subject to international law; by contrast, there is no evidence for a State practice based on the necessary legal conviction (*opinio juris sive necessitatis*) to extend the legal justification for the invocation of State necessity to relationships under private law involving private creditors.

a) The principle that conduct which does not comply with the respective legal order can be justified under certain circumstances is inherent in both the national legal orders and in international law. In very general terms, national legal orders see both criminal-law and civil-law necessity as a justification for conduct otherwise regarded as wrongful, even though the concrete manifestation of the preconditions for assuming the justification may differ. Von Liszt stated in his international-law manual already in 1898 that the terms "necessary defence" and "necessity", as