LEAGUE OF NATIONS

REPORT

OF

THE COMMITTEE FOR THE STUDY OF INTERNATIONAL LOAN CONTRACTS

GENEVA
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REPORT
OF THE COMMITTEE FOR THE STUDY OF INTERNATIONAL LOAN CONTRACTS

I. Introduction.

1. The Committee for the Study of International Loan Contracts was created as a result of the following resolution, adopted in September 1935, on the initiative of the Netherlands Government, by the Assembly of the League of Nations :

> " The Assembly invites the Council to arrange for the designation of a committee of legal and financial experts to examine the means for improving contracts relating to international loans issued by Governments or other public authorities in the future, and, in particular, to prepare model provisions — if necessary, with a system of arbitration — which could, if the parties so desired, be inserted in such contracts.
>
> " The Committee should be authorised to obtain the co-operation of the International Institute for the Unification of Private Law, at Rome, as well as of representatives of bondholders' associations, and to consult such experts as it may deem desirable."

2. In accordance with this resolution of the Assembly, the Council of the League of Nations appointed, on January 23rd, 1936, the following Committee :

M. L. Baranski (Polish), Director-General of the Bank of Poland ;

M. J. Basdevant (French), Legal Adviser to the Ministry for Foreign Affairs ;

Mr. Reuben Clark[1] (American), Chairman of the Foreign Bondholders' Protective Council, Inc. ;

[1] Mr. Reuben Clark was only able to be present at the fourth session of the Committee, held in June 1938. At the second session, Mr. Merle Cochran, Counsellor at the American Embassy in Paris, acted as substitute, and, at the third session, Mr. Francis White, President of the Foreign Bondholders' Protective Council, Inc., U.S.A. At its final session, the Committee had before it Mr. Clark's written observations on its draft report. As Mr. Clark points out, there are wide differences between the American and other markets. The suggestions made in the present report may not in all respects be applicable to the American market.

Mr. A. Fachiri (United Kingdom), Barrister-at-Law ;

M. M. Golay (Swiss), General Manager of the Swiss Banking Corporation ;

M. A. Janssen (Belgian), President of the Société belge de Banque, former Minister of Finance ;

M. C. E. ter Meulen (Netherlands), of Messrs. Hope & Co., replaced after his death by

M. H. A. van Nierop (Netherlands), Managing Director of the Amsterdamsche Bank ;

M. O. Moreau-Néret (French), Managing Director of the Crédit Lyonnais, Honorary Director at the Ministry of Finance ;

Sir Otto Niemeyer (United Kingdom), of the Bank of England ; Chairman of the Board of Directors of the Bank for International Settlements ;

Dr. V. Pospíšil (Czecho-Slovak), former Governor of the National Bank of Czecho-Slovakia ;

M. C. Tumedei (Italian), Barrister-at-Law, former Under Secretary of State at the Ministry of Justice.

3. The Committee has held five sessions — in April 1936, in May and December 1937, in June 1938 and in May 1939.

4. The Committee elected as its Chairman M. C. E. ter Meulen, and, after his death, M. O. Moreau-Néret.

The Committee takes this opportunity to pay a tribute to the memory of M. ter Meulen, whose death is a severe loss to it. M. ter Meulen had an exceptionally wide experience of international finance, and was always ready to devote his time ungrudgingly to every effort undertaken under the auspices of the League or elsewhere in the cause of financial reconstruction.

The Committee has also been deprived of a valuable member by the death of Mr. A. Fachiri, who took an active part in its labours, both at its meetings and on its Legal Sub-Committee.

M. C. Tumedei resigned from the Committee in December 1937.

II. Scope of the Problem.

5. In accordance with its terms of reference, the Committee examined only international obligations susceptible of being placed in the market on behalf of Governments or other public authorities, in which class may also be included, where their situation is analogous, loans guaranteed by such authorities.

For the purposes of this report, the Committee has, in accordance with normal financial usage, taken as the essential criterion of what is an international loan the fact of issue in a

country or countries other than that of the borrower. The fact that bonds issued in the country of the debtor have been acquired by residents in another country does not of course confer on such loans the character of an international loan. The Committee's recommendations refer only to loans raised in the market of a foreign country ; they are not intended to apply to loans made directly by one Government to another, which, in origin, governing documents and nature, are entirely different from market loans.

This report is exclusively concerned with loan contracts which may be entered into in the future and is not intended to have any influence on existing loan contracts or lawsuits at present pending.

III. General Recommendations.

6. The Committee is asked to deal with the question of the extent to which the difficulties of international lending can be reduced by improvements in the legal form of international loan contracts. It thinks it desirable, in the first place, to give some indication of the scope of this problem.

7. In recent years, there has been a large number of serious defaults, in many cases on loans of the highest standing, and the losses of individual bondholders have been severe. Moreover, in many cases, defaults have resulted from unilateral action by debtor countries without consultation with their creditors, contrary to the practice of normal times, when debtors in difficulties more usually approached their creditors and, in proper cases, obtained by negotiation an alleviation of their contract. But it would be a mistake to suppose that these defaults, serious and extensive though they have been, have covered the whole field of international foreign lending. It is estimated that, of the total amount outstanding of external issues made on the London market, the amount in default does not exceed 30%, and that a corresponding figure for dollar issues on the New York market does not exceed 40%.

There have been times in the past when the percentage of default on loans issued was at least as high, though no doubt the amount of capital to which the percentage applied was not so large.

In the second place, out of this total, the number of defaults which can be attributed to faulty legal provisions is exceedingly small. In the vast majority of cases, the reason for the default is to be found in economic conditions. Defaults have increased since 1931 largely as a result of the attempts which have been made — and are unfortunately still being made — to restrict the movement of men and the flow of goods — the very basis of the exchange of capital. It cannot be expected that capital

movements will be resumed so long as those of men and goods are hampered by restrictions of all sorts.

8. While, therefore, the Committee does not in any way underrate the importance of the improvement in the legal documents connected with international loans and are well aware of the particular legal difficulties which have arisen, it thinks it is necessary to emphasise that legal questions have not been, and, in its judgment, are not likely to be in the future, a frequent cause of default.

9. The Committee is led by this observation to a further comment of a general character. Even if it is admitted that so severe an economic crisis as the past few years have witnessed could hardly have been foreseen at the time when individual loans were issued, some part at least of the defaults which have occurred can be traced to excessive and unco-ordinated lending to countries whose possibilities of repayment were not commensurate with the burdens, and particularly the burdens of foreign exchange, which they thus assumed ; and, in not a few cases, countries whose existing loans were entirely bearable have become insolvent, both as regards those loans and as regards later loans, by undue additions to their total indebtedness.

It seems to the Committee that, in order to prevent the recurrence of these unfortunate results, some steps should be taken in the future to secure a more co-ordinated examination of the economic possibilities of borrowing countries before new loans are granted. In most countries, there is now some co-ordination regarding issues of foreign loans on the national market, but there is no machinery for the much more difficult task of co-ordinating different markets. This is a matter which it is difficult for individual issuing houses, however careful they are in considering proposed issues, to undertake ; and it becomes more difficult when several lending markets may be concerned independently with the same would-be borrower.

10. The Committee feels that it would be difficult and, on the whole, undesirable to endeavour to deal with this matter by compulsory regulation, but it thinks much might be achieved if some recognised international financial authority were prepared, not, indeed, to express an opinion on new loans, but to appoint a small standing body of recognised financial experts who would be available at the request of issuers to express an opinion on the economic limits within which it would be wise to raise loans for a given borrowing country. The Committee feels that the existence of such a body, whose advice could be sought in cases of doubt, would enable a more objective and complete survey to be made of the risks of a proposed loan than has hitherto been the case, and that the advantages both to lenders and borrowers of such an independent examination would

progressively be reflected in the better conditions which proposals which passed such examination would receive in the lending markets.

IV. Points of Detail.

11. Returning now to its terms of reference, and to the possible improvements in future loan contracts, the Committee devoted itself mainly to the following questions :

(1) The means of avoiding ambiguous phrases in international contracts ;

(2) Monetary clauses ;

(3) Functions for the service of loans ;

(4) The settlement of legal disputes.

A. *Drafting of Loan Documents.*

12. The Committee examined certain improvements which might be made in the drafting of the various documents in future loan contracts. It must, however, emphasise that, in what follows, it can only indicate the general lines on which it feels an advance can be made. The structural differences between the financial markets in the various countries, their differences in legislation and still more in habits and tradition, in outlook and experience are such that it is impracticable to attempt to set up a single uniform system to be rigidly and universally applied.

13. It is obviously essential that the drafters of the documents should have the same understanding of the objects in view and that their agreement should not be based on any misapprehension.

14. To secure clear expression to the intentions of the parties, it is desirable to reduce the number of documents containing the terms of the loan to a minimum. Whatever documents may be considered essential, they should be simple, unambiguous and not unnecessarily prolix. But these eminently desirable results cannot be obtained by endeavouring to simplify unduly the subject matter of what are necessarily very complex transactions. There are valid market reasons why large external loans should be spread over a number of leading countries, and these advantages must not be sacrificed merely in order to produce on paper a simple document. The form of the document which is to be instrumental to the achievement of an end must be subordinated to that end.

15. Three documents are normally necessary in the case of every international loan — whether it be simple or complex

in its character — (*a*) a contract between the borrower and the issuing banker; (*b*) a prospectus; and (*c*) the actual bonds (with coupons attached).

In simple cases, no further documents would seem to be needed. But where the terms of the loan envisage complicated international or administrative provisions (for instance, the assignment of revenues or different tranches negotiable on different markets on conditions which are not in all respects identical, it is usual also to have a general bond which contains all the provisions applicable to all parts of the loan.

16. The avoidance of ambiguity is not merely a matter of legal drafting but depends to some extent on a clear realisation by the parties (and, among others, by the bondholder) of the precise object of what is provided in the document.

Considerable misunderstanding would be avoided if it were realised that, in an international document, words correctly enough used in themselves cannot from the nature of things carry in every respect precisely the same implications which they bear in domestic documents. In particular, the words " pledge ", " security ", " mortgage " and " guarantee " may create a wrong impression of security in the mind of the holder. A moment's reflection makes it clear that the implementing of such pledges cannot be achieved in the same conditions in an international loan as in a domestic loan, unless the pledged assets or revenues are situated outside the national territory of the borrower.

In all other cases, the implementing of the security may produce the necessary sums for the service of the loan in the currency of the debtor country, but it will not at all ensure that these sums can be transferred and therefore placed at the disposal of the bondholders in the currencies stipulated in the contract.

Similarly, the functions of " trustee " in the case of international loans, though they so far resemble those of a private trustee in Anglo-Saxon law that they are laid down in the trust document, do not either in law or practice go beyond that document, whereas a private trustee is frequently also guided by general trustee acts and by a practice of semi-paternal discretion.

17. Finally, it is of the utmost importance that the strictest concordance should be observed as between the various loan documents.

It sometimes occurs that certain clauses of the loan contract are not reproduced in the documents placed at the disposal of the public — these being the only ones on which the public can form an opinion — or are even reproduced in different

terms in two documents which reach the public at different times — the prospectus and the bond itself.

18. It has been brought to the notice of the Committee that certain questions frequently arise on the rather technical matter of the prescription of bonds and coupons. They think that misunderstanding may be avoided if, in future loan contracts, clauses were included which gave definite instructions on this question. It appears to the Committee that the following main principles should apply :

(*a*) Prescription is not intended to provide a means by which the debtor may evade or reduce his contractual obligations ;

(*b*) Prescription should be provided for expressly by the contract ;

(*c*) The period of prescription for any bond or coupon cannot begin to run until the debtor has offered full payment, either at the original contractual rate or at a reduced rate fixed in agreement with the holder, this applying only to bonds of which the holders have accepted such settlement in full discharge ;

(*d*) Unless otherwise specifically provided in a contract, interest on any bond drawn for redemption, but on which the amount due for repayment has not been made available to the holder, should continue to accrue until the date on which repayment is effected.

B. *Monetary Clauses.*

19. Among the clauses which may give rise to ambiguity, particular attention must be drawn to those which have been adopted to obviate the drawbacks of a possible fluctuation in the value of monetary units : currency clauses and the gold clause.

20. The principal currency clause employed is that which provides for an option of payment in more than one currency, the bond being expressed in various currencies and the holder having the right, when each payment falls due, to select the currency which seems to him most favourable.

21. Under the gold clause, the bond is expressed in a currency to which is attached a gold stipulation.

22. The Committee feels bound to make certain recommendations with a view to preventing repetition of the disappointment caused in the past by the non-observance of these clauses.

(1) *Currency Options.*

23. It should be made quite clear whether the option given is merely an option of place of payment (at the rate of the day) or an option of form of payment — *i.e.*, a true currency option. If the currency option is adopted, then, in order to avoid the possibility of any dispute arising later, the better procedure would be, not only to specify the different currencies, but also to fix at the outset and to mention on the bond itself, and on every coupon, the number of the monetary units of each country that the bearer will have the free option of collecting on each market for the purpose both of the periodic interest due and of the reimbursement of capital.

24. If the stipulations contained in the contract are not sufficiently precise, the borrower may claim that he only owes the lender an amount in the various currencies of the contract equivalent *at the time of payment* to the amount expressed in the principal currency of the contract; or, in other words, that this principal currency alone should serve as a basis for the calculation of the borrower's obligations, the other currencies specified simply representing an option as to the place of payment given to the lender.

25. It should also be made quite clear that payment can be claimed in any of the countries whose monetary unit is specified in the contract and that the choice will be left exclusively to the holder of the bond.

It is accordingly advisable for the place of payment to be specified at the time of issue.

26. Lastly, the larger the number of currencies from which the holder may choose, the greater his security, though, of course, diversity is only of value in so far as the various currencies do not belong to the same monetary system.

(2) *Gold Clause.*

27. If a gold clause is adopted, the essential requirement should be to give clear expression to the intention of the parties to use gold throughout the period of the loan as the measure of value for ascertaining the amount of a given national currency that is required to release the debtor from his liability. In other words, this liability should be fixed as the equivalent of a given weight of gold in money current at the time of payment, independently of the nominal amount expressed in monetary units in circulation at the time of issue.

In the past, the " gold clause " often took the form of the mere addition of the word " gold " to the description of the currency in which the contract was concluded, or else of a reference to the monetary law which, at the time of issue, laid down the gold content of that currency.

28. It is, of course, difficult to conceive payment being made in bullion. Since, for the purpose of effecting each payment, it will be necessary to convert the weight of gold laid down into a certain number of monetary units constituting legal tender at the appropriate time, the clause requires to be completed by a sentence indicating that the debtor shall always be entitled to discharge his liability by paying in the required currency an amount sufficient to purchase the stipulated weight of gold.

29. At the same time, in order to facilitate the carrying-out of this stipulation and to obviate unnecessary discussion at the time of payment, it might be laid down that holders should only be entitled to demand payment of the equivalent of the given weight of gold if the result of such payment represents for them, in comparison with payment in currency of the nominal amounts stipulated in the contract, a premium exceeding a given percentage — *e.g.*, 5 %.

30. Similarly, it would be useful to define the procedure to be employed in calculating the number of monetary units. For this purpose, the first requirement would be to fix the date at which this calculation should be made.

Gold should, no doubt, be converted into currency at the moment of payment — *i.e.*, when the bearer presents the mature coupon or bond. This method has the disadvantage, however, of leaving the borrower State in doubt as to the actual amounts it will have to pay until every coupon has been paid or bond redeemed. It involves, in addition, certain obvious practical difficulties. For this reason, it would be preferable for the conversion of the stipulated weight of gold to be calculated at the rate prevailing on a fixed date somewhat previous to the actual date on which payment becomes due to the bondholder.

As long as this proviso is notified to the subscribers when the loan is issued and is reproduced in the security itself, it would appear that no criticism can be made of it by them.

31. Once the date for conversion has been fixed, there remains the process of conversion itself, which may in certain cases present difficulties.

If, at the time of conversion, there is a currency based on gold and used for exchange transactions with the country whose currency is to be used for payment, the calculation of the number of monetary units to be paid to the bearers can be easily made by reference to the quotation of this currency, it being stipulated whether the opening rate, the average rate or the closing rate of the day is to apply.

The choice would fall on a basic currency selected from among those resting upon free transactions in gold and free

conversion of fiduciary paper into gold. The weight of gold stipulated in the contract would first be converted into units of that basic currency with due reference to the legal definition of the latter ; and the sums thus expressed in terms of that basic currency would then be converted into the currency of payment, at the sight rate of the basic currency on the market of the payment currency on the day on which the calculation was made.

It is, however, not inconceivable that there might be a monetary upheaval of such magnitude as would make it impossible, on a given date, to find a currency both convertible into gold, in accordance with its legal definition, and dealt in freely on the market of the payment currency.

In such a case, the conversion from gold into such currency might still be effected, by using the price of gold on a given free market and the rate of the currency of payment on that same market.

Although what has been said above may appear exceedingly complex, the only result would be to render the material process of conversion somewhat arduous, without raising serious difficulties in the execution of the operation.

32. Should any dispute arise between the parties concerning quotations, it might be agreed to refer the dispute either to the financial or monetary authorities of the country in which the market in question is situated (issue bank, or, failing such, a bankers' syndicate ; or, again, the leading bank, according to volume of deposits, in the country) or to an international organisation such as the Bank for International Settlements.

33. To eliminate superfluous proceedings, it might finally be laid down that no action at law may be brought for the purpose of contesting the method of conversion of the stipulated weight of gold into the currency of payment, unless the plaintiff is able to allege a loss exceeding a given proportion of the payment which he considers legitimate — *e.g.*, 1%.

34. Where the coverage has to be put down a long time in advance, and especially in the case of monthly instalments, it might be laid down that such coverage shall provisionally be paid, in agreement with the supervisor, in a currency based on gold, the amount being completed, if necessary, on the day before payment becomes due, in order to permit payment in full according to the terms of the contract.

35. The above methods of application, though put forward on the assumption that the loan is offered on one market only, can equally well be used when the loan which includes the gold clause is offered on several markets and expressed in a number of currencies.

* * *

36. In examining the question of the clauses designed to obviate the drawbacks of a possible fluctuation in the value of monetary units, the Committee has observed that currency options were, in practice, more often respected than gold clauses, in connection with which debtors have frequently sought a legal pretext for default. The Committee regrets that gold clauses, the fundamental intention of which was clear, should have been disputed by debtors. It feels, however, that such clauses may aim at too much, and thus, in fact, produce disappointment, though legally inexpugnable. It is therefore led, for the reasons set out in Annex I, to prefer the lesser but more certain guarantee and to favour the adoption, where one or other is thought desirable, of currency clauses rather than gold clauses.

C. *Functions for the Service of the Loan.*

37. The Committee further thinks that it is desirable to indicate more precisely the functions which in its opinion should normally be attributed to the various agencies concerned with the execution of the contract.

(1) *Paying Agent.*

38. On the issue of a loan, a direct legal relationship is set up between the debtor Government and the bondholders which subsists until the last bond has been repaid, and that primary relationship remains, whatever intermediaries may be concerned in its practical application.

39. As a debtor Government is, however, unable to open bank-counters of its own on foreign markets, it is compelled to employ the services of one or more banks operating within the country in whose territory the issue was made, and to entrust them with the functions of intermediaries between its creditors and itself in the performance of the financial obligations resulting from the loan contract; such intermediaries, who represent the borrowing Government, are generally known as " paying agents ".

40. In most cases, the debtor Government quite naturally and properly selects as its intermediary the banking house or houses that have assisted it in issuing the loan.

41. The paying agent is sometimes given the title of " fiscal agent " — an ill-defined general expression, which is open to misunderstanding and should, the Committee thinks, be avoided, since it in no way implies representation of the debtor Government before the fiscal authorities of the country in which the loan has been issued.

42. Moreover, in certain cases, the paying agent has been given the functions of trustee or representative of bondholders, often, indeed, explicitly, as in the case of the Gold Loan of the Republic of Peru, 6%, 1927, the Polish Stabilisation Loan, 1927, and the Swedish Issue of the Belgian Conversion Loan 4%, 1936.

43. It appears to the Committee that, while the paying agent, particularly if he has also been the issuing house, has, in fact, a moral responsibility for the due fulfilment of bondholders' contract, it is not desirable, as he also is the banking agent of the borrowing Government, that he should assume legal responsibility for representing bondholders. Such a cumulation of separate functions may easily lead to confusion and misapprehension, as well as to difficulties in practice.

44. Since the paying agent is the agent of the debtor, it is clear that, if, between the moment at which the Government hands over to him the amounts required for the service of the loan and the moment at which the bondholder is actually paid, he finds himself in difficulties over payment, the debtor Government will only have discharged its liability in so far as the coupon has been wholly paid and the bond wholly refunded, and must shoulder any loss resulting from failure on the part of its paying agent.

45. The debtor Government's responsibility may also be affected by currency fluctuations ; for, if the loan is expressed in a number of currencies, and if one of those currencies becomes devalued after the transfer of resources to meet payments due, it will be for the debtor Government to furnish additional provision to the extent required to meet the demands for payment of coupons that will occur at the place or places of payment where the currency has not been depreciated.

46. Similarly, where there is a gold clause, it will be for the debtor Government, should the need arise, to supplement its payments either before or after the due date, according as, under the terms of the contract, conversion of the stipulated gold amount into the currency of payment has to be effected at the due date, or merely on the day on which coupons are presented for payment.

47. Where transfer has to be carried out on the due date, the Government will naturally have fulfilled all its obligations by providing the number of monetary units resulting from the stipulations of the contract on that date, and the bondholder will have only himself to blame if, by delaying to present his coupons or bonds, he loses on the value of the currency in which he receives payment.

(2) *Trustees.*

48. In the case of loans where there are special pledges to be watched over or guarantees to be brought into effect in the event of failure by the principal debtor to implement the contract, or other special decisions to be taken after the issue, the appointment of a person or body (trustee) to carry out these functions is common.

49. A large number of private loans issued in the United States of America and in the United Kingdom provide for the appointment of trustees, whose principal task is to see to the proper execution of the contract; the same formula was adopted in the case of certain international loans of a complex character such as those issued under the auspices of the League of Nations, in relation to which decisions were required subsequent to the issue.

50. In some contracts, the exact relationship between the trustees and the bondholders is not defined at all; in others, on the contrary, the trustees are " to represent the interests of bondholders " (Hungarian Loan, 1924 — Bulgarian Loans, 1926 and 1928, etc.). In the case of the German Loans of 1924 (Dawes Loan) and 1930 (Young Loan), and of the Danzig Loan of 1927, the contract merely speaks of " trustees for the bondholders ".

51. The use of the term " trustee " has, in fact, given rise to some misunderstanding and confusion; for the Anglo-Saxon trustee has no exact equivalent in continental laws, and his functions and relationship to the various parties to the contract cannot, accordingly, be easily understood or determined by the non-Anglo-Saxon courts applying such laws.

52. It has sometimes been thought that the existence of " trustees " has given rise to a false sense of security in bondholders who have subscribed to a loan; or that a bondholder might believe that the trustee's functions are wholly analogous to those of family trustees, and that he not only has a general responsibility to protect bondholders from loss but also effective legal means to do so.

53. The trustee of an international loan is strictly limited to the precise functions attributed to him in the general bond and, properly speaking, he is a trustee for the carrying-out of that document and not the guardian of the bondholder in a general sense. Moreover, he is not as a general rule in a position to obtain protection from a municipal court in his own country, whose judgment is effective against infringement of a loan contract.

54. In view of these misapprehensions, the Committee thinks it might be worth while to consider whether, where such an office is necessary, it could not be described with advantage by some other name not cumbered with past legal associations such as " Contrôleur de l'emprunt " in French or " Supervisor " in English.

55. But whether styled trustee, " contrôleur de l'emprunt " or supervisor, the holder of this office should be a neutral person not representing either the debtor or the bondholders, but personifying the common intention of the parties as indicated in the contract.

56. It is important to make it clear that he should not appear in the guise of a kind of general creditor, duplicating the functions of the body of individual creditors. For this reason, the general bond, if any, should not create any financial obligation towards the holder of this office, as has sometimes been the case when trustees were appointed.

57. To safeguard his independence, it would appear necessary to appoint him irrevocably, as from the date of the issue, subject to the conditions stated below.

58. Loan contracts by which trustees are appointed generally stipulate that the latter will be " freed of any responsibility whatsoever, except in the case of breach of trust knowingly and wilfully committed ". This provision should be maintained, for it is unlikely that anybody would accept such a task if liability were involved outside of cases of manifest breach of trust.

59. The Committee does not think that the trustee or supervisor should normally appoint the paying agents, which is the responsibility of the debtor Government (though, in the case of the Austrian Loan of 1923, the trustee was given this task ; and there may, in a given case, be special reasons for such an exception).

60. The principal cases in which the holder of this office may be called upon to take action are the following, this list being given as a mere indication, and not as an exhaustive list :

(*i*) To satisfy himself that the portions of the total issue allotted to the several places of payment do not in the aggregate exceed the specified maximum, when the instruments of the loan specify only the total amount ;

(*ii*) To give his approval to the amortisation tables and the text of the bonds ;

(*iii*) To supervise the due provision and transfer of loan service in accordance with the terms of the contract and its maintenance intact in the hands of the several paying agents, and to hold the reserve fund if there is one ;

(*iv*) To approve of the amounts set aside for the payment of coupons and redeemed bonds, especially in cases where there is a gold clause ;

(*v*) To watch over the regular conduct of drawings by lot or repurchase of bonds for redemption, in the case both of normal redemption and of anticipatory drawings of bonds ;

(*vi*) To authorise release of balances lapsing through prescription, both as regards coupons and as regards bonds for redemption ;

(*vii*) To take the necessary steps to secure the implementing of guarantees of third parties, if such exist. These steps vary according to each loan, so that it is impossible to provide for all possible cases, but the following are the chief :

Recourse to guarantor Governments in cases of default by the principal debtor ;

Examination of pledged receipts ;

Registration of mortgages on property.

61. The trustee or supervisor must clearly be free to reach an independent decision. Both the debtor Government and the bondholders may, however, claim the right to contest an interpretation of the contract given by him or to protect themselves from the consequences of an abuse of confidence on his part.

62. The Committee thinks that, again with the object of avoiding doubts as to procedure, the contract should specifically provide that any proceedings against the trustee or supervisor can only be brought in a court agreed at the time of issue.

63. If the contract does not nominate the trustee or supervisor, it should indicate the organ which should nominate him, or, if occasion arises, his successor. Some such financial authority as the Bank for International Settlements or the Chairman of the Financial Committee of the League of Nations would clearly be suitable to make such nominations.

64. The choice of the holder of such an office will always be delicate. If natural persons are appointed, the bondholders, when subscribing, will know that those persons are qualified to perform the duties in question and are trustworthy ; they will thus inspire greater confidence than an impersonal organisation, the heads of which may change.

Nevertheless, since there are many details to attend to, and the work will entail a number of operations that will have frequently to be repeated throughout the term of the loan, a natural person may not have enough time for it. Moreover, in

the event of absence or death, difficulties may arise, which would only be slightly mitigated if two or three persons were appointed jointly. The Committee thinks the choice between the two alternatives can only be made in the light of the particular circumstances of a concrete case.

(3) *Representation of Bondholders.*

65. In the normal case, when the service of a loan is being integrally performed, there is no reason for any special organisation of bondholders ; and as loans are naturally issued in the expectation that this normal procedure will obtain, it is not easy to lay down any generally acceptable rule for exceptional cases, the circumstances and possibilities of which are obviously capable of extreme variations.

66. For the general protection of bondholders, there are two systems between which a choice can be made when a loan is under consideration :

(*i*) Protection and negotiation for agreed modification can be left to the councils of foreign bondholders or corresponding bodies which now exist in all the chief capital markets and can be counted upon to defend the interests of the bondholders to the best of their ability, either on their own initiative or at the special request of some of the bondholders.

(*ii*) The contract may expressly provide for a *legal* representative of all the bondholders whose decision should be binding on all bondholders, either absolutely or if supported by a fixed proportion of the bondholders.

67. In the first case, the negotiator is given no mandate proper ; he acts as *negotiorum gestor* and, after negotiating with the debtor, he frames an agreement which he recommends to the bondholders. The latter accede either explicitly or — as most frequently happens — by the mere fact of encashing the coupons on the new bases.

This formula is more elastic and leaves the negotiator free to open conversations at the most opportune moment.

The great experience acquired by an association gives it a competence and a grasp of principle rarely to be found in a representative appointed for a single negotiation.

68. In the second case, a representative is designated in the contract itself and would be subject to the fact that his powers are limited by some legal formula beyond which he cannot go. This position is similar to that of trustees who are bound by their legal trust.

69. There are also many practical difficulties in conducting general meetings during the course of negotiations and in

obtaining the requisite majorities, particularly when the holdings are mainly in bearer form and the actual holders are unknown. These difficulties are even greater in the case of international loans widely held in different markets.

Again, bondholders often hesitate to appoint representatives. They often refuse to deposit their securities, which are thus immobilised. Consequently, it will be found very difficult either to fix a quorum or to obtain one.

70. In view of the drawbacks attaching to either system, the Committee cannot recommend one single line of conduct for every country. Where associations exist which have proved their worth and enjoy considerable moral authority, there seems no reason to modify the present state of affairs ; in countries, however, which do not possess any body that appears satisfactory from this point of view, it may be necessary to institute a system whereby the contract would specify the name of the representative and provide also for the convening of general meetings to approve his actions.

71. The Committee includes in Annex II a note on certain technical points which would arise if a legal representative were appointed.

D. *Settlement of Legal Disputes.*

72. What is needed in this respect is the greater certainty of the proper law and jurisdiction to be applied.

(1) *Law to be applied to International Loans.*

73. A frequent source of the legal difficulties which have arisen in recent years regarding international loan contracts has been the question of the law to be applied to such contracts.

Every contract which is not an international agreement — *i.e.*, a treaty between States — is subject (as matters now stand) to municipal law, and any court called upon to adjudicate upon an international loan, be it an ordinary court of law or a special arbitral tribunal such as is contemplated later by the Committee, is bound to ascertain what law is applicable and give effect to it. Where, as in the case of international loans, the parties concerned are of different nationalities and domicile and the obligations provided for are to be performed in a country or countries other than that of the debtor, several different laws are involved and questions arise which are among the most difficult in the whole field of legal science. Certain rules are generally recognised, such as that the formal validity of the contract depends upon the law of the place where it is made, and that the authority of the debtor Government to contract the loan is governed by its own constitutional law. These particular rules are not in practice likely to lead to difficulties, as care is

naturally taken in advance of the issue to see that they are complied with. But there are other problems still remaining.

74. The substance of the contract — its essential validity, effect and interpretation and the extent of the obligations involved — is governed by what is sometimes called " the proper law of the contract ". This is usually said to depend upon the intention of the parties, although there may well be certain limitations to their liberty to choose their own law. Subject to certain exceptions, international loan documents have not in the past specified " the proper law " ; and, when disputes have arisen, the intention of the parties in this respect has had to be ascertained by inference. The result has been a series of conflicting decisions and general uncertainty as to what law was applicable in any given case.

75. The choice has generally lain between two laws — that of the debtor State and that of the country of issue. Some courts have held that, where a sovereign State is a party, it must be presumed that the contract was intended to be governed by the national law of that State ; others have held that this presumption can be rebutted by evidence of a contrary intention in the special circumstances of the case.

76. The practical effect of adopting the one view or the other has, as it happens, been vital for bondholders in the American gold clause cases. Thus, for example, in the recent case of the United Kingdom gold bonds, if English law was " the proper law ", the bondholders were entitled to the gold value of their bonds : if American law was the proper law, they were only entitled to the nominal amount in paper dollars. The Court of Appeal decided that English law was applicable ; but the House of Lords reversed the decision. This is only one of many examples. A case of a different character was that relating to the Young Loan before the Swiss courts, where the Swiss Federal Court held that, in the absence of any express provision on the point in the loan documents, the functions of the trustee were governed by Swiss law, although the institution of trustees is, as a matter of fact, peculiar to Anglo-Saxon law.

77. Enough has been said to show that the question of what, in the absence of express stipulation, is " the proper law " is one which it is often impossible for a lawyer to answer in advance with any certainty. Therefore, the Committee thinks it desirable that this point should, in future, be dealt with expressly in loan documents.

78. It is, however, important to appreciate that providing for " the proper law " does not necessarily resolve all conflicts of law. In the first place, the effect of the law of the place of performance has to be borne in mind. If an obligation under

the contract is contrary to public policy in the country of performance, the courts of that country will not enforce the obligation, even though it may be recognised as valid by " the proper law " of the contract.

79. The question of what law should be specified as the proper law has been the subject of much discussion by the Committee. Where the loan is issued in one country only, the position is simple. Either the law of the debtor State or that of the country of issue can be selected. There is much to be said for the latter. It is the law which the bondholders will know and presumably have confidence in ; and it is not too much to ask the borrowing State to accept the law of the country to which it applies for the loan. The same considerations apply in the case of loans issued in more than one country, provided the form of the loan is such that each *tranche* is really a separate and distinct issue.

80. The question assumes an entirely different aspect where a loan is issued in several different countries with identical bonds negotiable in the various markets. In such a case, the choice of the law to be applied is not free from difficulty. Where the greater part of the loan is to be issued in one particular country, the law of that country may be designated in the contract as " the proper law ".

In cases of more or less equal *tranches*, it is eminently desirable that the issuing houses should agree among themselves and with the borrower on the single law to be applied.

81. It may be added that the selection of the law of a third country (*i.e.*, a country having no connection with any of the parties or transactions of the loan) as " the proper law of the contract " was also considered ; but — apart, perhaps, from certain special cases — such a choice does not seem to be acceptable from a practical point of view.

The Committee does not think it can usefully express any definite *a priori* preference as between the various alternatives. The choice must depend upon the circumstances of each case. But it feels very strongly that every international loan contract should specifically state under what law it is to be construed.

82. The foregoing recommendations do not meet the difficulties arising from changes in the law subsequent to the issue of the loan. The danger to the bondholder's rights under this head can come either from changes in " the proper law " of the contract, or in the law of the place of performance, or in the law defining the currency of payment. Recent experience has shown that none of these possibilities is imaginary ; and the Committee has devoted much attention to the question of possible safeguards. Against deliberate default by the debtor, no legal protection exists ; but is there any way of avoiding the

effect of legislation designed for a different purpose but prejudicial to the bondholder's rights under the contract ? The particular problem of legal changes in currency can be dealt with by gold clauses and currency options. For the rest, the Committee has discussed the suggestion that " the proper law " of the contract should be expressly stated to be the law of country X " as existing at the time when the loan was issued ". It was felt, however, that, apart from practical objections, the legal validity of such a clause was highly questionable and that a court of law or an arbitral tribunal would probably reject the attempt to evade the operation of regularly enacted legislation.

83. The Committee is not able to find a theoretically complete answer to the questions raised in the last few paragraphs. It may be that, in practice, the indications which it has given above will suffice, but, if the difficulties are felt to be so serious as to require a final solution, it appears to the Committee that the only way of dealing with them would be to embody into an international convention a code of rules applicable to international loans, thus removing the subject from the field of municipal law into that of international law. The Committee therefore sought the co-operation of the International Institute for the Unification of Private Law, at Rome, whose assistance it was authorised by the Council of the League to seek at the time of its appointment. The Committee is glad that the Rome Institute has agreed to undertake this important task. Such a code might render services in the matter of international loans comparable to those rendered for many years past by the "Hague Rules"[1] in respect of maritime transport. The preparation and adoption of such a code would necessarily take a considerable time. Even before its formal adoption, the draft code might be used as a model by those responsible for drafting loan contracts.

(2) *Choice of Jurisdiction.*

84. A second legal difficulty is to find the proper court whose decisions will have legal and moral force in cases of dispute.

The courts of countries other than the debtor State and, in particular, those of the country or countries in which the service of the loan is effected generally declare themselves incompetent ; on the other hand, an action before the national courts of the debtor State is not always calculated to yield the results which the bondholder is entitled to expect.

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[1] See resolution of the International Law Association adopted September 3rd, 1921, at The Hague, and the International Convention for the Unification of Certain Rules relating to Bills of Lading, signed at Brussels, August 25th, 1924.

85. It is not generally possible to apply to an international tribunal. The Permanent Court of International Justice, to which it would seem natural to have recourse, is by its Statute only empowered to take cognisance of disputes between States, It cannot therefore be seized by bondholders or their representatives. The fact that, in the case of the Serbian and Brazilian loans, the Court did have power to try the dispute is explained by the circumstance that the French Government took up the claim of its own nationals who were bondholders, and obtained the consent of the Serbian and Brazilian Governments to the signature of an arbitration agreement.

86. Most of the legal disputes actually encountered could, no doubt, have been easily settled, if it had been possible to lay them before a tribunal previously accepted by the parties.

Certain loan contracts do, in point of fact, contain clauses stipulating that disputes on interpretation shall be submitted to arbitration (see Annex III). An example of the usefulness of such clauses is to be found in the case of the 1928 7½% Stabilisation Loan of the Kingdom of Bulgaria, the interpretation of which gave rise to a dispute in the autumn of 1936 between the Bulgarian Government and the trustees of the loan. In conformity with the terms of the loan contract, this dispute was submitted to an arbitrator nominated by the Council of the League of Nations and was settled in a few months. The arbitral award, although it went against the Bulgarian Government, was, in its entirety, accepted and executed by that Government. The rapidity of this settlement compares favourably with the interminable complications in the matter of procedure to which other disputes have given rise.

The Committee strongly recommends that loan contracts should in all cases include at least a clause providing for arbitration on matters of interpretation of the contract.

87. The insertion of a clause of the nature of those reproduced in Annex III would represent a very considerable advance. But, even if it exists, difficulties in practice may not be entirely excluded. If action has to be taken by the debtor State, either to appoint the arbitrator (Argentine 1925 6% Redeemable External Gold Loan), or to bring the case before the judge designated in advance (1932-1937 5% Bonds of the Czecho-Slovak Republic, guaranteed by the French Government), no matter how explicit the undertaking entered into may be, a debtor may make it difficult, if not impossible, to carry out the procedure laid down.

A manifest improvement in international loan contracts would therefore be, while laying down in every contract the manner in which legal disputes are to be settled, also to provide for the appointment of arbitrators by some international body.

88. In conformity with the task entrusted to it — namely, " to prepare model provisions (if necessary, with a system of arbitration) which could, if the parties concerned so desired, be inserted in such contracts " — the Committee has accordingly framed a more elaborate draft arbitration clause, the text of which is given hereunder. It will, of course, be understood that this is a model text which the parties can modify to suit their requirements. But the Committee strongly recommends that, once the Permanent Court has agreed to appoint these arbitrators, all contracts should include a clause of this kind.

(3) *Draft Arbitration Clause.*

89. (*a*) Any dispute concerning the rights and obligations arising out of the loan contract shall be submitted to the Arbitral Tribunal constituted as provided hereunder. The Tribunal's decision shall be final and binding.

(*b*) The following parties may seize the Tribunal — namely, the debtor Government; any bondholder or bondholders in possession of securities not less than 10 % of the amount outstanding; any official representative of the bondholders; any officially recognised authority concerned with the protection of bondholders; the supervisor.

(*c*) Failing agreement between the parties for the submission of the case, any party may seize the Tribunal directly by means of a unilateral application. The Tribunal may give judgment, by default if necessary, in any dispute so brought before it.

(*d*) The Tribunal shall decide all questions relating to its competence.

(*e*) The Tribunal shall consist of three persons nominated at the request of one or more of the parties mentioned above, by the President of the Permanent Court of International Justice, from a standing panel of nine persons chosen by the Court.

The persons chosen for this panel shall remain in office for five years and shall be re-eligible.

(*f*) The Court shall fix the remuneration for each day's sitting of the persons appointed by it and settle the method of payment. The cost of such remuneration shall be borne by the borrower, but the Tribunal may, if it thinks an action frivolous, order those bringing the action to pay the whole or part of such remuneration.

(*g*) The Tribunal shall fix where it shall sit in any particular case.

(*h*) The Tribunal shall decide its own procedure, having regard to any agreement on the subject between the parties : similarly, it shall lay down rules as to the right of intervention.

90. In proposing the appointment of the arbitrators by the Permanent Court of International Justice, the Committee hopes that the latter, in its selection of the members of the Tribunals for the various loans, will have recourse, as far as possible, to the same persons, so as to facilitate the establishment of a uniform jurisprudence.

91. The Committee is unanimously of opinion that the Arbitral Tribunal should try disputes exclusively from a legal point of view, and should in consequence confine itself to declaring what are the rights and obligations of the parties. It is necessary to emphasise this point, because the task of arbitral tribunals has sometimes been, not only to declare the law, but to make arrangements which, in point of fact, constitute modifications of the contract. Arbitration in this sense may take on the character of negotiations under the auspices of a third party, with the object of reaching a compromise acceptable to both sides. In the Committee's view, a clear distinction must be drawn between these two functions — viz., on the one hand, the arbitral award — that is to say, the definition of the rights and obligations of the parties — and, on the other, the modification of a contract either by negotiation or by decision of a third party. The rôle of the Tribunal in the foregoing draft arbitral clause is clearly limited to the first of these two functions—that of judge.

* * *

92. The Committee considers that the above suggestions would constitute a considerable step in advance. It is, however, sensible of the fact that a complete solution of the legal difficulties could only be achieved if these questions were taken out of the field of national law by international convention. Under such a convention, States would undertake to set up an International Loans Tribunal, which would be a single Tribunal with competence extending to all international loans.

The Committee had before it a draft for this purpose, but in present circumstances it would seem difficult to obtain adhesion to such a Convention. The Committee therefore has not examined this proposal in detail and confines itself to including it in Annex IV for record.

ANNEX I

RELATIVE ADVANTAGES OF CURRENCY OPTIONS AND THE GOLD CLAUSE

1. On examining the principal cases in which gold clauses have been adopted, it is found that most of the loans accompanied by a gold clause have given rise to difficulties, whether that clause applies to one currency alone or to several currencies.

On the other hand, the stipulations of loan contracts carrying a currency option have in most cases been carried out in full.

2. It is difficult to contend that this difference in treatment has arisen entirely from difficulty in interpreting gold clauses. As a matter of fact, the majority of gold clauses were drawn up in the most explicit terms. But frequently, when a currency has been devalued, States which issued a loan in the country in question have been tempted to take the view that the nationals of that country could hardly insist on the application of the gold clause, since, without so doing, they would receive in the currency of their own country the same amount as before ; and have ignored the fact that the conditions of the loan, and particularly its actual issue price, were substantially determined by the circumstance that the risk of subsequent devaluation appeared to be eliminated.

In justification, borrower States put forward consideration of public policy and refused to apply a stipulation which the law of the country in whose territory it was to be carried out had declared to be null and void, maintaining that the law to be applied should be that of the place of execution and hence of the country in which the devaluation had taken place.

If, however, the contract contains a currency option instead of a gold clause, the holders domiciled in a country whose currency has been devalued will demand payment in the country whose currency has not been devalued or has depreciated less than their own. In such a case, they are treated on exactly the same footing as the nationals of the country in question. The borrower State can adduce no valid argument for paying the latter less than the nominal amount expressed in their own currency, and the other holders benefit by this state of affairs.

3. Moreover, it is probable, in the event of major fluctuations, that the alternative currencies included in the contract will also depreciate, which will make it easier for the borrower

State to fulfil its undertakings ; this has frequently happened during the past few years.

With a gold clause, however, no future reduction in the obligations of the contract can be foreseen, even if the currency of the country in which the loan was contracted is devalued and even if all the principal currencies suffer the same fate ; borrowers are apt to consider that this rigidity of gold clauses makes them intolerable, especially when their own currency has been devalued. They forget that their budgetary receipts will to a greater or lesser extent reflect the upward trend which normally ensues from a reduction in the value of their currency, whereas the lender will have nothing to compensate him for the loss caused by receipt of the same number of monetary units of reduced value.

In a general monetary upheaval, therefore, respect for a currency option does appear to be less onerous than strict adherence to the gold clause, and the paradoxical result emerges that the very holders who appeared to have the best possible guarantee have often been treated worse than holders who were simply entitled to a currency option.

4. The " currency option " offers a further advantage. It widens the market for a loan during the whole of its lifetime and tends to keep up the price. It is often easier to negotiate internationally securities which are expressed in the currency of each market concerned. In order, therefore, to restore solidarity between the principal financial markets, in the interest of the debtor no less than that of the creditor States, it is highly desirable to preserve an instrument which, on account of its special character, circulates most easily between those markets.

5. In a certain number of cases, however, a currency option cannot be made effective. If it is to be of real value, a place of payment must be specified in each of the countries whose monetary unit is included in the contract ; but if the currency which it is desired to include is not that of one of the places of issue, it is by no means certain that a country which is not participating in the loan will allow its currency to be mentioned in the contract, and a place of payment to be specified in its territory, because this might lead to movements of capital which would upset its international financial relations.

This problem arises in every case when a loan is issued on a single market. The only two currencies in which the contract can be expressed without any difficulty — that is to say, which can be offered to the holder accompanied by an option as to the place of payment without its being necessary to obtain the authorisation of a third State — the granting of which is by no means certain — are the currencies of the borrower State and of the country of issue. In many cases,

however, these currencies are not sufficient to ensure the success of the loan, especially as, in the eyes of the holders, the currency of the borrower State always offers the serious drawback of being subject to changes in its gold content by unilateral decision of that State.

6. It may, of course, be stipulated that the number of monetary units of the country of issue will vary according to their relation to other currencies of reference ; this represents a currency guarantee of the type conferred by the French Government on the 4½% 1937 Rente.

The lenders will receive in the currency of their country an amount equivalent at the time of payment to the number of different monetary units specified in the bond or coupon and fixed at the time of issue as equivalent in value to a specified number of monetary units of the country of issue, according to the parity of those currencies at the time of the contract.

As payments are made on a single market and in one currency only, the currency guarantee is not subject to the consent of States in which the currencies of reference are legal tender. But, from the point of view of the lenders, it is much less satisfactory than the full currency option, on the one hand, because they are paid in one currency only, and, on the other, because the equivalent value of the various currencies may become difficult to define if they cease to be freely dealt in on foreign markets.

The fact that an exchange guarantee may be accompanied by an option as to the place of payment, the currencies of the exchange guarantee not being legal tender in the country giving the option (case of the French 4½% 1937 Rente), mitigates these drawbacks, but does not altogether remove them.

7. If, in certain cases, currency guarantees accompanied by an option as to the place of payment present difficulties and in consequence a gold clause has to be adopted, then the Committee thinks that such clause should be so drafted as to avoid any doubt as to its meaning and, in particular, that it should not be connected with any particular currency ; in other words, it should be a gold value clause and not a gold currency clause.

It should be made quite clear that the intention of the parties is to employ gold as the measure of value for determining for the whole period of the loan the amount which will represent the debtor's valid discharge. The very substance of the contract should be clearly shown to be based on a given weight in gold, so that the changes in the definition of any monetary unit will not affect the determination of this gold weight. Suggestions for the application of this principle have been made in paragraphs 27-36 of this report.

8. Even in such a case, it may be that internal legislation might subsequently be applied to the loan contract just as, during the past few years, a certain number of States have prohibited the use of gold as a standard of value and repudiated prior contracts, the obligations of which were so expressed. It would not be possible entirely to prevent this risk, unless an international code of law were accepted which would take this matter outside the sphere of national law.

The Committee feels it desirable that, if there is a gold clause, it should be expressed as above in the most unambiguous terms. At the same time, it must repeat that it feels that a gold clause may well be so rigid in the only circumstances in which it would be called into application as to be likely in fact to be ineffective, and it believes that a currency option clause will in practice be a more effective protection.

ANNEX II

NOTE ON THE MACHINERY REQUIRED IN CASE OF THE APPOINTMENT OF A LEGAL BONDHOLDERS' REPRESENTATIVE IN AN INTERNATIONAL LOAN CONTRACT

1. If the acts performed by the representative of the holders of an international loan cannot be approved by all the persons interested in the same way as in the case of a domestic loan, is it right that full legal powers should be given to such representative, even if he has been chosen with the utmost care and enjoys undisputed authority ?

(*a*) If a lawsuit is brought against the debtor Government, it may be admitted that the authorised representative's signature should be binding on his principals, and that no bondholder should have the right to take individual action.

In such a case, the representative's task is clearly defined, and the propriety of his taking action is undisputed. Consequently, there does not appear to be any fundamental reason why direct action on the part of a bondholder or a group of bondholders should not be ruled out.

Provision must, however, be made for cases in which the representative, although a divergency in interpretation or a breach of the contract has been established and brought to his notice by the supervisor, fails, whether through negligence or wilfully, to institute or to follow up legal proceedings or proceedings for the enforcement of a judgment.

To meet this point, it might be provided that a certain number of bondholders, representing, say, one-twentieth of the number of bonds then in circulation issued in the country or countries concerned, after sending registered letters to the representative calling upon him to take action, might apply to the President of the competent court for an order authorising them to act in the stead of the defaulting representatives.

The calculation of the proportion of bonds referred to above (one-twentieth) is of purely secondary importance; there is no serious objection to this proportion's being calculated, for instance, by taking into account bonds held by the debtor Government itself or by holders whose interests or rights differ from those of the bondholders as a whole, since it is only a question of instituting proceedings, and not of taking a decision on the substance of a dispute.

The above-mentioned proportion has been suggested simply for the purpose of preventing too small a number of bondholders from attempting to institute legal proceedings when the common interest of the bondholders are not really involved. Too many lawsuits would be a bad thing; not only would they be unpleasant for the debtors, but their Stock Exchange effects would be disastrous in the case of international loans (double quotations, speculation, arousing of false hopes or misgivings among the bondholders). It might therefore be specified that the twentieth should be calculated on the number of bonds issued in the country or countries concerned and still outstanding.

Registered letters might also be sent in duplicate, one to the representative and the other to the supervisor, whose duty it would be to ascertain whether the required twentieth had or had not been reached.

(*b*) A more delicate situation arises in the case of a negotiated settlement without the intervention of a court, where the representative's consent has immediate consequences for the bondholders, whose rights are usually reduced; they will resent it if they have no means of expressing their views, and their resentment will make them feel even more strongly that their interests have not been properly protected.

The bondholders' representative may, of course, stipulate that the agreement signed by him shall not become binding unless it has the approval of a number of holders representing a certain percentage of the total number of bonds in circulation, such approval being expressed simply by the encashment of the coupons under the new conditions of the agreement.

But it may be thought difficult to avoid giving the bondholders an opportunity to express their views, and, for that purpose, the following system might be considered :

A meeting of the bondholders would be convened to ratify the arrangements made between the debtor Government and their representative.

This meeting would be convened on the joint responsibility of the debtor and the representative, and would be widely advertised, for instance, on three different occasions at fifteen days' interval in a sufficient number of newspapers containing legal announcements (which would be specified in the contract of issue), in such a manner as to ensure that the notice will actually reach the various parts of the country concerned. The interval between the last notice and the meeting should be long enough (say one month) to give all the bondholders time to hear of it and to be present at the meeting.

It might then legitimately be concluded that bondholders who failed to attend the meeting, either in person or by proxy,

took no interest in the question or had no views. This would dispense with the necessity for a quorum.

The arrangement would be ratified if the meeting approved it by the majority specified in the contract of issue.

As the holding of meetings is costly and inconvenient and bound to delay the entry into force of the agreement reached, the bondholders, instead of being expressly asked to ratify such an agreement, might be informed that, in the absence of any reply, they will be presumed to accept the agreement.

The representative and the debtor Government would then be required to publish the arrangement in the same form as described above for the convocation of meetings.

Unless the holders request a meeting, as stipulated above, the agreement would come into force one month after its last publication.

If bondholders representing, say, one-twentieth of the bonds requested a meeting, the representative would be bound to convoke one as described above.

The number of bonds required for a meeting to be convoked might be calculated in the same way as for the carrying-out of a legal formality in the event of the representative's failure to do so, the number of bonds in circulation being taken as basis, irrespective of the movements of those bonds since their issue : for the object would be merely to ascertain whether the meeting of bondholders should or should not be convoked, and this calculation would not directly affect the approval or rejection of the agreement.

In the case of a loan issued in several countries, when no distinction is made between the issues, and the failure of the debtor affects more than one country, a meeting of bondholders might be necessary in each of these countries.

2. The functions of the bondholders' representative would entail no liability for him, except in the case of gross negligence.

As has already been indicated, the bondholders would have sufficient control over the actions of their representatives in the case of legal proceedings ; they could act in his stead in certain circumstances ; in the case of an agreement, it would be possible for them to express their disapproval.

It would also be possible for the representative to be dismissed by the bondholders at a meeting called by the supervisor at their request. This meeting would be convoked by the same procedure as has been suggested for the ratification of an arrangement concluded between the debtor and the representative outside the original contract.

Naturally, if he had knowingly acted in a manner contrary to the interests which it was his duty to protect, the

representative could be sued by any bondholder in the courts of his country by the ordinary process of law.

3. As regards the choice of the representative, there are again certain drawbacks to the appointment of a natural person : since bond issues frequently have a long currency, if one or more natural persons are appointed at the time of issue, they will in many cases have to be replaced sooner or later.

Moreover, a natural person may be temporarily prevented from discharging his duties ; substitutes can, of course, be appointed at the outset, but it will then be extremely difficult to decide in which cases the principal representative must act and in which cases he may be replaced by one of his substitutes.

On the other hand, the expectation of life of legal entity is very different. Practically, there are no circumstances in which it would be unable to act unless it ceased to exist, which cannot happen suddenly.

From this point of view, there is every advantage to be gained by appointing legal entity as the bondholders' representative.

An advantage of another kind, but equally important, is that legal entities can be found who possess experience, archives and a staff, not always available to a natural person.

4. It is to be hoped that the work which the bondholders' representative would be called upon to perform during the whole term of the loan would not be heavy, but when he were required to take action this would probably entail a good deal of work for a limited period of time. Only a few legal entities will be in a position to place at the bondholders' service, when occasion arises, a sufficiently large and competent staff.

Moreover, discussions with a sovereign State cannot be carried on in the same manner as those that take place between a borrowing company and its bondholders of the same nationality.

The negotiations are often supported by the diplomatic agents of the State to which the lenders belong ; the bondholders' representative must personally enjoy considerable moral authority, and his relations with his own Government must be such as to induce the latter to place confidence in him.

Lastly, this type of negotiation calls for a highly specialised knowledge of questions of public finance ; the representative's skill as a negotiator will be all the greater if he has already had experience of similar cases which will enable him to make comparisons.

It appears to be preferable, therefore, instead of appointing different representatives for each loan, always to select the same person, so that this experience may steadily increase and his archives may become more and more complete.

The Committee may conclude, therefore, that the bondholders would be represented most satisfactorily in each country by a single specialised organisation, such as the existing Councils of Foreign Bondholders. It is clear that, if such a council were appointed as legal representative of the bondholders in the loan contract, its task would have a different legal character than at present.

5. When loans are issued in several countries, a representative should be appointed for each country of issue. In the first place, this is the only way for bondholders to get into effective contact with their representative when necessary ; secondly, the interest of bondholders belonging to different countries of issue may, subsequently to the placing of the loan, be found to diverge.

The loan contract might stipulate that, should the bondholders' representatives be called upon to take action in circumstances which affect all the countries of issue alike, the representatives appointed for the different countries of issue should select one of their number to take the necessary action.

Alternatively, the loan contract might specify which of the representatives belonging to the different countries of issue should be called upon to act on their common behalf — taking, for instance, either the representative of the country in which the largest amount had been placed, or of the country in which the loan contract had been signed.

6. In principle, this mandate should be valid for the whole term of the loan.

Nevertheless, provision must be made for the replacement of the representative originally appointed, because the organisation acting in this capacity may cease to exist, or may resign or be removed from office.

In such cases, the bondholders would be obliged to appoint a new representative. They can do this on the initiative of the supervisor, by the method adopted for the ratification of agreements between the debtor Government and the representative.

7. The existence and activities of the bondholders' representative will necessarily entail expense. Even if this actually amounts to a large figure, it will usually be small in proportion to the very considerable amounts for which international loans are issued.

The contract of issue should, however, specify to whom this expenditure is to be charged.

The following solutions would appear to be reasonable :

(*a*) The cost of the performance of the normal functions of the bondholders' representative (representative's

remuneration, cost of meetings with a view to his replacement, etc.) would be charged to the debtor Government;

(*b*) The cost of legal proceedings would be charged, as the court might decide, either to the debtor Government, or to all the bondholders, or to a certain category, according to the nature of the case, as in civil actions; the court would be authorised in advance to decide that the next coupon or coupons should be kept back, to such amount as might be necessary for the recovery of the costs;

(*c*) The cost of the conclusion of an agreement between the debtor Government and the bondholders (representative's travelling expenses, legal consultations, meeting for the purpose of ratifying the agreement, etc.) would be borne by the debtor Government.

It should be noted that it is only possible for the bondholders to participate in certain expenditure by deducting the amount from a coupon or redemption payment, and that no actual payment can be required of them; consequently, if, as is usually the case, commitments have to be entered into before the expenditure can be deducted from a coupon or redemption payment, the debtor Government will have to advance the amount, which it will recover, by agreement with the supervisor, when the loan service next falls due.

ANNEX III

SOME PROVISIONS OF INTERNATIONAL LOAN CONTRACTS FOR THE SETTLEMENT OF DISPUTES

ARGENTINE 6% REDEEMABLE EXTERNAL GOLD LOAN, 1925

Agreement with the American Bankers.

Article V, Paragraph 5.

Should the bankers and/or the paying agents have any doubts in some particular case as to their rights or obligations under the present Agreement, any question or difficulty of this kind shall be settled by reference to an arbitrator appointed jointly by the Ambassador of the Argentine Republic in the United States of America and the bankers ; the decisions of this arbitrator shall be final and without appeal.

FREE CITY OF DANZIG 6½% LOAN, 1927 (TOBACCO MONOPOLY)

General Bond, Clause 34.

Should any dispute arise between the State and the bankers and/or the trustee, which the trustee considers should be submitted to the Council of the League of Nations, the State undertakes to abide by the decision taken by the League Council or by any person appointed by the Council to settle the said question. Should the State consider that the trustee has abused the powers conferred upon him by the present text, it may appeal on behalf of the State to the League Council, and the State agrees to abide by any decision thus taken by the Council.

* * *

A similar clause (No. 36) has been inserted in the General Bond relating to the 7% 1925 Mortgage Loan of the Municipality of Danzig.

7½% STABILISATION LOAN, 1928, OF THE KINGDOM OF BULGARIA

General Bond, Clause 19.

Whenever any question arises as to the interpretation of the present text, such question shall be submitted to the Council of the League of Nations, and the decision taken by it, or by such person or persons as the Council may appoint to settle the question, shall be binding on all the parties concerned.

When it is necessary to apply the present clause, the decision shall be taken by a majority vote.

5% 1932 and 1937 Bonds of the Czecho-Slovak Republic guaranteed by the French Government

Contract concluded with French Bankers.

Article 22.

Any disputes which may arise as to the interpretation or execution of the present provisions shall be subject to the jurisdiction of the Permanent Court of International Justice at The Hague, acting in execution of Article 14 of the Covenant of the League of Nations. The Czecho-Slovak State undertakes to lay such disputes before the Permanent Court of International Justice, whose jurisdiction it accepts.

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* *

An identical clause (Article 22) is embodied in the contract concluded with the French bankers in respect of the 5% 1937-1942 Bonds of the Czecho-Slovak Republic guaranteed by the French Government. These two loans were guaranteed by the French Government, which could accordingly seize the Hague Court of any dispute arising out of them.

ANNEX IV

INTERNATIONAL LOANS TRIBUNAL : DRAFT INTERNATIONAL CONVENTION PRESENTED TO THE COMMITTEE

The States and Members of the League of Nations acceding to the present Act recognise the following provisions as international obligations binding upon them in their relations with any State or Member of the League of Nations that invokes them in the interest of its nationals, and agree to the application of the said provisions in the following terms :

(*i*) Any disputes which may arise in respect of any loan to which the present Act has been declared to be applicable in the documents by which it is governed shall be finally settled by the International Loans Tribunal. Where the national courts of a State acceding to the present Act are competent to hear disputes in respect of a previously issued loan, the legislation of such State may substitute for such courts the International Loans Tribunal.

(*ii*) The International Loans Tribunal shall consist of three judges appointed by the Permanent Court of International Justice. The Court may also appoint three deputy judges who would be called upon to sit, in the order laid down in the Rules of Procedure of the Tribunal, should one or more judges be prevented from sitting. The judges and deputy judges shall be chosen from among judges or former judges of the highest national courts, or jurists of recognised competence in the matter of international loans. The judges and deputy judges shall be appointed for ten years and shall be re-eligible. Every two years, the Court shall proceed to elect one judge and one deputy judge and shall fill any vacancies ; such vacancies may, however, be filled before that date, should the Court think fit.

(*iii*) The Registrar of the Permanent Court of International Justice shall be requested to provide for the functioning of the Registry of the Tribunal.

(*iv*) The Permanent Court of International Justice shall be requested to draw up the Rules of Procedure and the Financial Regulations of the Tribunal, which, together with any revision thereof by the Court, shall have the same force as if they had been inserted in the present Act.

(*v*) The Permanent Court of International Justice shall be requested in each case to fix the remuneration of the judges, which shall be borne by the debtor State.

Other administrative expenses (if any) of the Tribunal, not being costs of litigation, shall be borne in equal shares by the States and Members of the League of Nations acceding to the present Act.

(*vi*) A dispute may be brought before the Tribunal by any bondholder or bondholders in possession of securities of a nominal value of not less than 10% of the amount outstanding, any official representative of the bondholders, any officially recognised authority concerned with the protection of bondholders, the supervisor, any issuing house of the loan, under the conditions laid down either in the Rules of Procedure of the Tribunal or in the documents by which the loan is governed. A dispute may also be brought before the Tribunal by the debtor State or other debtor body. The loan contract and the law by which it is governed may determine what other persons shall have the right to bring a dispute before the Tribunal.

The conditions relating to intervention or citation of third parties shall be laid down in the Rules of Procedure of the Tribunal, which shall also specify the circumstances in which the decision of the Tribunal shall be binding on all the persons concerned.

(*vii*) The Tribunal shall adjudicate on the basis of the contracts concluded and of the laws which are applicable, provided these are not contrary to international law, as well as on the basis of the general principles of law. It shall also pronounce upon its own competence, should this be disputed.

(*viii*) The decision of the Tribunal shall be final. In each of the States and Members of the League of Nations that have acceded to the present Act, the decision shall have the same force as if it had been rendered by a national court of last instance.

The Rules of Procedure of the Tribunal shall specify the conditions under which a revision of its decision may be requested on the basis of the discovery of a fact unknown to the Tribunal and to the party bringing forward that fact before the decision was pronounced.

(*ix*) The present Act may be revised with the consent of the States and Members of the League of Nations that have acceded thereto. In the absence of their unanimous agreement, the new provisions may come into force six months after they have been ratified by two-thirds of such States and Members of the League. The present Act shall thereupon cease to be binding on those States and Members that have failed to ratify the new provisions.

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