

TESTING THE *STUFENBAU*
IN INTERNATIONAL FINANCIAL LAW*

Probando la Stufenbau en Derecho financiero internacional

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Abstract

This article focuses on a specific area of the writings of Kelsen, reassessed by Paolo Carozza: the *Stufenbau*, the pyramidal structure for the ordering of the sources of law. Section One examines the formal, hierarchical theory of the sources of law. Section Two focuses on the practical relevance of this theory with regard to hybrid, or private, sources in the field of sovereign debt restructuring law. Section Three examines the emergence of soft law stemming from public authorities, in the area of financial regulation.

Keywords

Kelsen; Constitutional Law; sovereign debt; financial regulation.

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Resumen

Este artículo se centra en un área específica de los escritos de Kelsen, reevaluada por Paolo Carrozza: la *Stufenbau*, la estructura piramidal para el ordenamiento de las fuentes del derecho. La Sección Uno examina la teoría jerárquica formal de las fuentes del derecho. La Sección Dos aborda la relevancia práctica de esta teoría con respecto a las fuentes híbridas o privadas en el campo del derecho de la reestructuración de la deuda soberana. Y la Sección Tres alude al surgimiento de una ley blanda derivada de las autoridades públicas, en el área de la regulación financiera.

Palabras clave

Kelsen; Derecho constitucional; deuda soberana; regulación financiera.

SUMARIO: I. INTRODUCTION. II. THE *STUFENBAU*, A PYRAMID OF THE SOURCES OF LAW. III. HYBRID SOURCES IN SOVEREIGN DEBT RESTRUCTURING LAW. IV. PUBLIC SOFT LAW IN EUROPEAN FINANCIAL REGULATION. V. CONCLUDING REMARKS.

I. INTRODUCTION

If we are to agree with George Steiner that “a culture advances, spirally, via translations of its own canonic past”², working on legal concepts elaborated by Hans Kelsen is a testimony to the significance of such a scholar for legal theory, in Europe and beyond. This article focuses on a specific area of the writings of Kelsen, reassessed by Paolo Carrozza in his analysis of the continuous presence of Kelsenian themes in contemporary constitutionalism³: the *Stufenbau*, the pyramidal structure for the ordering of the sources of law. It attempts to answer the following questions: How relevant is this theory to today’s international financial law? What insights does it offer? What conceptual challenges does it have to overcome?

The formal, hierarchical theory of the sources of law is presented in Section One. Section Two examines the practical relevance of this theory with regard to hybrid, or private, sources in the field of sovereign debt restructuring law. Section Three casts the Kelsenian concept against the emergence of soft law stemming from public authorities, in the area of financial regulation. Finally, some concluding remarks are proposed.

II. THE *STUFENBAU*, A PYRAMID OF THE SOURCES OF LAW

In continental Europe more than in the Anglo-American world, the legal scholar has a tendency to detach her discipline both from the facts and from other, kindred social sciences such as economics, history, sociology, politics, and the like. At least in part, this attitude is connected with the intellectual aspiration to conceive of a pure theory of law, part of Hans Kelsen’s endeavour.⁴ It is in this sense that Kelsen has become part of the “canons” of

² George Steiner, *After Babel. Aspects of Language and Translation* (Oxford: Oxford University Press, 1975), 459.

³ Paolo Carrozza, “Kelsen and Contemporary Constitutionalism: The Continued Presence of Kelsenian Themes”, in *Kelsenian Legal Science and the Nature of Law*, ed. Peter Langford, Ian Bryan, and John McGarry, vol. 118, Law and Philosophy Library (Cham: Springer International Publishing : Imprint: Springer, 2017).

⁴ Hans Kelsen, *Pure Theory of Law. Translation from the 2d Rev. and Enl. German Ed. by Max Knight* (Berkeley: University of California Press, 1970).

European legal culture, as it were. This is without neglecting the significant criticism, “often justified”, that this piece of Kelsenian work has stirred.⁵

By constructing his pure theory of law, Kelsen sought to sever the link with natural law that had imbued legal norms, notably in the Roman and Christian traditions. His writings were meant to clear legal knowledge from spurious elements which scholars had imported from other fields and which inhibited the understanding, and functioning, of law.⁶ Instead, a positivist-normativist conception of law would be propounded.⁷

Within the legal system so conceived, the sources of law (as sources of law-creation rather than law-cognition⁸) acquire paramount importance. They serve to give order to the norms to be applied to preserve the monopolisation of force (the essential function of law, on which Kelsen dwelled in the first part of his reflection). As the classical derivation of norms from one or another instantiation of natural law was no longer available, as we have seen, a different proposition was needed.

Kelsen resorted to the concept of *Stufenbau*, the hierarchical structure of the legal system elaborated by Adolf Julius Merkl, of the same Vienna School as Kelsen himself.⁹ Although the notion itself had been authored by Merkl, it was Kelsen who aptly integrated it into his pure theory of law so that the two became effectively enmeshed and drew significance from each other.¹⁰ Indeed, as Carrozza points out, the *Stufenbau* presupposes “the essential logical coherence and unity of a system of positive law” as the one erected by Kelsen.¹¹

⁵ Carrozza, “Kelsen and Contemporary Constitutionalism: The Continued Presence of Kelsenian Themes”, 76.

⁶ Hans Kelsen, *Introduction to the Problems of Legal Theory: A Translation of the 1. Ed. of the Reine Rechtslehre or Pure Theory of Law* (Oxford: Clarendon Pr., 1992), para. 1.

⁷ Stanley L. Paulson, “The Neo-Kantian Dimension of Kelsen’s Pure Theory of Law”, *Oxford Journal of Legal Studies* 12, no. 3 (1992): 312.

⁸ This distinction is known in many legal orders (*fonti di produzione* vs. *fonti di cognizione*, *Rechtserzeugungquelle* vs. *Rechtserkenntnisquelle*, *fuentes de producción* vs. *fuentes de conocimiento*).

⁹ The classical version of the theory is in Adolf Julius Merkl, “Prolegomena einer Theorie des rechtlichen Stufenbaues”, *Gesellschaft, Staat und Recht / Hrg. von Alfred Verdross.*, 1931, 252–94; reprinted in Alfred Verdross and Josef Dobretsberger, *Gesellschaft, Staat und Recht. Untersuchungen zur reinem Rechtslehre* (Wien: J. Springer, 1931), 252–94.

¹⁰ Thomas Olechowski, “Legal Hierarchies in the Works of Hans Kelsen and Adolf Julius Merkl”, in *Reconsidering Constitutional Formation II Decisive Constitutional Normativity. From Old Liberties to New Precedence*, ed. Ulrike Müßig, vol. 12, Studies in the History of Law and Justice (Cham: Springer, 2018), 354.

¹¹ Carrozza, “Kelsen and Contemporary Constitutionalism: The Continued Presence of Kelsenian Themes”, 87.

The *Stufenbau*, or hierarchical pyramid, is a theory that attempts to study the relationships among norms. It focuses on the relationship of validity, whereby one level of norms provides validity (or justification) to the subsequent layer of norms. This theory sheds light on a dynamic – or *ex ante* – point of view on the nature of law, as it focuses on law as a process, and is complementary to the static– or *ex post* – point of view on law as the issued legal norm and coercion.¹² The dynamic element is clearer when the mechanism is understood in terms of empowerment: the higher level of norms empowers a subject to issue a norm of a lower level. Such empowerment is thus “a necessary (but not sufficient) condition” of the existence of the lower norm as a norm.¹³

This approach is linked to the inherent characteristic of law: to determine the norms for the production of other legal norms. In other words, law regulates its own creation.¹⁴ Some norms directly contain prescriptions for the conduct of human affairs, whereas others define the procedures for lower-level norms to be enacted.

This theory is concerned with the procedural validity of the norms: each level represents the outer boundaries of the field within which the lower norm can arise. Yet, each level also determines, at least in part, the content of the next level of norms:

In governing the creation of the lower-level norm, the higher-level norm determines not only the process whereby the lower-level norm is created, but possibly the content of the norm to be created as well.¹⁵

The definition of the procedure and part of the content of the lower level of norms does not entirely preclude the exercise of a *quantum* of discretion on the part of the norm-issuer. This is due to the more specific character that the norm takes as it is produced at a lower layer: the broader content of the upper-level norm needs to be made more concrete.

The *Stufenbau* clearly involves a certain sense of spatiality: the pyramid is made up of a top level of norms, from which all the others derive validity.

¹² Stanley L. Paulson, “How Merkl’s *Stufenbaulehre* Informs Kelsen’s Concept of Law”, *Revus: Journal for Constitutional Theory and Philosophy of Law* 21 (2013): 30.

¹³ Jörg Kammerhofer, “Sources in Legal-Positivist Theories. The Pure Theory’s Structural Analysis of the Law”, in *The Oxford Handbook of the Sources of International Law*, ed. Samantha Besson and Jean d’Aspremont (Oxford: Oxford University Press, 2017), 347.

¹⁴ Hans Kelsen, “Wesen und Entwicklung der Staatsgerichtsbarkeit”, in *Wer soll der Hüter der Verfassung sein? Abhandlungen zur Theorie der Verfassungsgerichtsbarkeit in Der pluralistischen, parlamentarischen Demokratie*, by Robert Chr Van Ooyen (Tübingen: Mohr Siebeck, 1929), 2.

¹⁵ Kelsen, *Introduction to the Problems of Legal Theory: A Translation of the 1. Ed. of the Reine Rechtslehre or Pure Theory of Law*, 77–78.

In domestic legal settings, the uppermost layer is represented by the constitution, which acts as the *Grundnorm* of the entire system. The intermediate layers can be exemplified by statutes, ordinances, court decisions and administrative acts. The lowest level of the pyramid is not itself a norm, but a legally relevant fact.¹⁶ The latter is typically the execution (or enforcement) of the legal norm, for instance the bailiff taking property.

Crucial in this design are the empowerment norms, i.e. those that determine the conditions for the legitimate enactment of lower-level norms. They authorize the creation of norms and constitute a specific part of the legal system.¹⁷

The exercise of regression from the lowest to the highest level of norms ends with the *Grundnorm*. The validity of the *Grundnorm* itself is to be presumed.¹⁸ The origin of the constitution in modern States can often be found in the midst of revolutions, from which emerges a *pouvoir constituant*. The basis of the validity of domestic legal systems has been the subject of controversy. One of the theories, expounded by Kelsen's disciple Alfred Verdross, maintains that some norms of international law lie at the foundation of national law.¹⁹ This would create an interesting interrelation between domestic legal orders and the international legal order, which would provide, so to speak, the *Grundnorm* for each of them.

Carrozza highlights that the *Stufenbau* enjoys continuous relevance in today's constitutionalism.²⁰ It is regarded as providing the condition of validity of all lower-level norms in multilevel legal systems in Europe. Differently from 18th-century flexible constitutions, contemporary rigid constitutions determine the procedures for issuing norms both at the level of the central State and at the level of decentralised entities by using the criteria of competence and of hierarchy.

Another aspect emphasised by Carrozza's analysis is the general, indirect character of the legacy of the Kelsenian notion of *Stufenbau*.²¹ Thus, the latter can be understood more in terms of a rationalising device to deconstruct apparent contradictions between different norms than as a mechanical tool of immediate application.

¹⁶ Merkl, "Prolegomena einer Theorie des rechtlichen Stufenbaues", 260.

¹⁷ Hans Kelsen, *Allgemeine Theorie der Normen* (Wien: Manz, 1979), 82–84.

¹⁸ Hans Kelsen, *Reine Rechtslehre* (Wien: Deuticke, 1960), 228.

¹⁹ Alfred Verdross, *Die Einheit des rechtlichen Weltbildes auf Grundlage der Völkerrechtsverfassung* (Tübingen: J.C.B. Mohr, 1923), 134.

²⁰ Carrozza, "Kelsen and Contemporary Constitutionalism: The Continued Presence of Kelsenian Themes", 88. Carrozza also emphasises the undeniable significance of Kelsen's legacy for the judicial review of legislation, which is somehow a "necessary" corollary of the place of the constitution in the legal hierarchy of norms. This aspect, however, lies beyond the scope of the present analysis.

²¹ Carrozza, 89.

This latter point recoups an important characteristic of the *Stufenbau* as elaborated by Merkl and Kelsen: its value lies in its analytical efficacy. The notion is the result of the theoretical study of the structure of a legal system, and the “metaphor follows the theoretical insight, not vice versa”.²² Consequently, if the pyramid is no longer adequate to describe a system, it should be revised.

III. HYBRID SOURCES IN SOVEREIGN DEBT RESTRUCTURING LAW

After providing an illustration of the notion of *Stufenbau* in Kelsen’s (and Merkl’s) scholarship, this Section and the next one seek to appraise its relevance in contemporary international financial law. They will do so with regard to two sets of norms: hybrid, or private, sources of law in sovereign debt restructuring law, and public soft law in European financial regulation.

Sovereign debt restructuring is an area of the law concerned with the solutions for countries that encounter difficulties in repaying their liabilities to other States, international organisations, or private creditors.²³ Despite several proposals to establish a centralised mechanism to restructure sovereign debts,²⁴ no such tool has thus far seen the light of day.

Consequently, the restructuring of sovereign debt is tailored to the particular circumstances of the debtor State and the characteristics of the debt at stake. In the absence of a pre-determined forum for negotiations between debtors and creditors, several informal gatherings have arisen over the years to host such discussions. Their respective success stories have been a mixed record.²⁵

A structural analysis of the legal norms that apply to sovereign debt restructuring stems from the same, basic question from which Kelsen’s

²² Kammerhofer, “Sources in Legal-Positivist Theories. The Pure Theory’s Structural Analysis of the Law”, 346.

²³ For an overview of sovereign debt restructuring from a legal perspective, see: Malcom N. Shaw and Dominique Carreau, eds., *La Dette Extérieure / The External Debt*, The Hague Academy of International Law (Dordrecht: M. Nijhoff, 1995); Rodrigo Olivares-Caminal, *Legal Aspects of Sovereign Debt Restructuring* (Sweet and Maxwell, 2009); Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (Cambridge: Cambridge University Press, 2011).

²⁴ Anne Krueger, “A New Approach to Sovereign Debt Restructuring. Address by Anne Krueger, First Deputy Managing Director, IMF” (November 26, 2001), <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp112601>.

²⁵ Michael Waibel, “Bank Insolvency and Sovereign Insolvency”, in *Cross-Border Bank Insolvency*, ed. Rosa Lastra (Oxford: Oxford University Press, 2011), para. 13.73.

enquiry arguably originated: “What is the law (on this point)?”.²⁶ As anticipated, the answer depends on the type of debt subject to the restructuring. Where this is in the form of a bond issued by the debtor State and purchased by a foreign individual, for example, the contractual clauses of the bond will identify the law applicable to the contractual relationship and the competent forum to hear claims related to that bond, as well as other important aspects.

If one were to construe a pyramid structure of the legal norms applying to sovereign debt restructuring, the hierarchy would be dependent on the form of the portion of the debt taken into account. This would result in several, different pyramids corresponding to the various forms of the debt issued by the particular government and the several national laws applicable to them. Therefore, the fragmentation of the real situation would be mirrored in the structural representation of the legal norms presiding over it.

Furthermore, the *Stufenbau* would face the challenge of framing the interrelations with hybrid (or private) forms of law present in sovereign debt restructuring. By hybrid sources of law, we refer to those stemming from non-public bodies, which are of a private nature, but can include public members. We will consider two such instances.

First, the contractual clauses of sovereign bonds are the result of a process of international standardisation. Albeit each government issues bonds and could theoretically draft their clauses in a tailor-made manner, in practice the provisions are greatly aligned across countries.²⁷ As sovereign bonds are financial instruments that circulate on secondary markets, identical or similar clauses reduce transaction costs and thus facilitate circulation.

The evolution of contractual clauses is the result of complex interactions between different marketplaces (notably, New York and London), developments in case law, official pressure, and industry groups.²⁸ Such evolution is not linear: as the parties involved attempt to solve the incomplete contracting problem, the result is that over time, on the one hand, the terms that enable creditors to enforce their debts judicially have been strengthened and, on the other, terms that enable sovereigns to restructure their debts have been inserted.²⁹ A further factor that complicates the analysis is that, in the discussions

²⁶ Jörg Kammerhofer, “Sources in Legal-Positivist Theories. The Pure Theory’s Structural Analysis of the Law”, 344.

²⁷ Stephen J. Choi, Mitu G. Gulati, and Eric A. Posner, “The Evolution of Contractual Terms in Sovereign Bonds”, *Journal of Legal Analysis* 4, no. 1 (2012): 131–79.

²⁸ Anna Gelpert and Mitu G. Gulati, “Innovation after the Revolution: Foreign Sovereign Bond Contracts since 2003”, *Capital Markets Law Journal* 4, no. 1 (2009): 85–103.

²⁹ Stephen J. Choi, Mitu Gulati, and Eric A. Posner, “Political Risk and Sovereign Debt Contracts”, *University of Chicago Institute for Law & Economics Olin Research Paper No. 583*, 2011.

between government debt managers and prospective investors, more attention is paid to purely “financial” terms than to “legal” ones in sovereign bonds.³⁰

In the midst of such complex admixture and stratification of clauses drafted in greatly or slightly differing manners, the search for their meaning and explanation is not straightforward. Sociological enquiries amongst elite law firm partners have brought to the foreground “origin myths” for the birth of some bond clauses, which have proved untenable when subjected to more objective scrutiny.³¹

The significance of hybrid sources in sovereign debt restructuring law can be appreciated in particular with respect to the *pari passu* clause.³² This clause had typically been understood as preventing a sovereign issuer from granting the holders of a different issue of bonds a higher legal ranking than holders of that particular issue.

However, a different interpretation gained prominence in the context of the Argentine crisis. After the government declared a moratorium on its debt in 2001, two bond exchanges took place in 2005 and 2010. In the litigation initiated by several minority creditors against Argentina, the *pari passu* clause was interpreted as requiring a rateable payment by the issuer to all the bondholders, i.e. to both those having participated in a restructuring and those that had held out. This was most apparent with the decisions taken by judge Thomas Griesa of the United States District Court for the Southern District of New York in 2011³³, which *de facto* prevented the government of Argentina from paying the bondholders that had accepted the 2005 or the 2010 debt offers if it did not also pay the hedge funds that had initiated that litigation.

This unexpected development could threaten the functioning of sovereign bond markets on a global scale.³⁴ Consequently, the International Capital

³⁰ Anna Gelpern and Mitu G. Gulati, “How Much Is This Clause? Debt Managers on Pricing Bond Contract Terms”, 2016, 51.

³¹ Mark Weidemaier, Robert Scott, and Mitu Gulati, “Origin Myths, Contracts, and the Hunt for *Pari Passu*”, *Law & Social Inquiry* 38, no. 1 (2013): 72–105.

³² A typical drafting of the *pari passu* clause would be as follows: “The debt securities will be direct, unconditional, unsecured and unsubordinated obligations of [the government] and will rank *pari passu* and without preference among themselves. [The government]’s payment obligations under the debt securities will rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness”. Example taken from Republic of Argentina. 2010. “Prospectus. Debt Securities, Warrants, Units”, in *PROSPECTUS SUPPLEMENT (to Prospectus Dated April 13, 2010)*: 16, http://www.mecon.gov.ar/finanzas/sfinan/documentos/us_prospectus_%28version_ingles%29_30042010.pdf.

³³ See esp. *NML Capital Ltd. v. Republic of Argentina*, No. 08-cv-6978 (U.S. District Court for the Southern District of New York, December 7, 2011).

³⁴ France, “Brief for the Republic of France as Amicus Curiae in Support of the Republic of Argentina’s Petition for a Writ of Certiorari, in the Supreme Court of the United

Market Association developed a new standard clause. This process took place in the framework of the “Roundtable on Sovereign Debt” promoted by the Treasury of the United States in 2013-2014.³⁵

The International Capital Market Association (“ICMA”) is a private organisation that groups together actors involved in the international debt capital market.³⁶ In particular, investment and commercial banks, securities dealers and brokers, and asset managers are full members, whereas government institutions, central banks, credit rating agencies and law firms are associate members.³⁷

The outcome of the Roundtable process was to steer the interpretation of the *pari passu* clause towards that of non-subordination of bondholders of the series concerned to bondholders of other series. The alternative interpretation (propounded by judge Griesa’s decisions) of the rateable payment obligation was expressly refuted. An important specification was inserted to this end:

no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa.³⁸

Thus, the ICMA clause unequivocally provides that the debtor is not obliged to pay all bondholders simultaneously. In particular, the issuer can decide not to pay creditors that have not taken part in a restructuring offer, whilst paying those that have agreed on it.

The Executive Board of the International Monetary Fund expressed its favour for this new clauses.³⁹ Real “catalysis”, in the sense of adoption by

States, Republic of Argentina, v NML Capital” (No. 13-990, March 24, 2014), <http://www.shearman.com/~/media/Files/Services/Argentine-Sovereign-Debt/2014/Arg48-Brief-for-Republic-of-France-as-Amicus-Curiae-in-Support-032514pdf.pdf>.

³⁵ For an insider’s overview on the process, see Mark Sobel, “Strengthening Collective Action Clauses: Catalysing Change – the Back Story”, *Capital Markets Law Journal* 11, no. 1 (2016).

³⁶ Jonathan Law, “International Capital Market Association”, in *A Dictionary of Finance and Banking* (Oxford: Oxford University Press, 2015).

³⁷ International Capital Market Association, “Membership”, accessed November 3, 2017, <http://www.icmagroup.org/membership/>.

³⁸ International Capital Market Association, “Standard Pari Passu Provision for the Terms and Conditions of Sovereign Notes”, August 2014, <http://www.icmagroup.org/assets/documents/Resources/ICMA-Standard-Pari-Passu-Provision-August-2014.pdf>.

³⁹ International Monetary Fund, “IMF Executive Board Discusses ‘Strengthening the Contractual Framework in Sovereign Debt Restructuring’, Press Release 14/459”, October 6, 2014, <https://www.imf.org/en/news/articles/2015/09/14/01/49/pr14459>.

sovereign debtors, took place around October 2014.⁴⁰ In particular, Mexico issued sovereign bonds with the enhanced clauses, governed by New York law, in November 2014. These bonds were sold at favourable pricing and interest rate conditions. This was perceived as an extremely positive reaction, which solved the first mover problem, and could lead the way for other issuers to follow suit.⁴¹

A structural analysis of the sources of law applicable to sovereign bonds containing such clauses would have to decide on the status of the ICMA model clauses. A strictly formalist view would highlight the fact that such standard clauses only become relevant as and when they are incorporated into the terms of a specific bond issued by a given government. Before that point in time, the ICMA model clauses would not be applicable and would thus be irrelevant. After that point, the actual contract terms would be applicable, and their derivation from a model drafting would equally be irrelevant.

The Kelsen-Merklian *Stufenbau* would arguably side with this perspective: the sources of law applicable to the case at stake are concerned with the law effectively governing the contractual relationship. The Constitution (as the *Grundnorm*) allows for freedom of contract, which in turn empowers the government and the bondholder to agree on the bond contract terms. Only these contract clauses need to be reflected in the pyramid structure.

However, the disregard of the *Stufenbau* for the process of standardization of *pari passu* clauses would seem inapposite. The hybrid source of law represented by the ICMA model clause does have a bearing on the drafting of bond terms. The convergence of legal drafting at the international level in a certain direction provides an orientation for the acceptability of such terms to the community of investors, law firms, and debt managers. Such reaction to an unexpected development in the case law signals that relevant actors are ready to overcome the habitual inertia and adopt a change in their contractual relationships.

This important shift in the context in which sovereign debt markets operate undoubtedly has an impact on the individual government's drafting of bond contractual clauses. The choice to adopt the ICMA model *pari passu* clause, to adopt an amended version of the model clause, or to stick to the previous drafting are significant for legal analysis. They can indicate a preference for a certain interpretation of the respective rights and obligations of the debtor and of the creditors. Consequently, they can guide the interpreter (e.g. a judge) and have an impact on the outcome of a case.

⁴⁰ Stephen J. Choi, Mitu Gulati, and Robert E. Scott, "The Black Hole Problem in Commercial Boilerplate", *NYU School of Law, Public Law Research Paper No. 16-40*, 2016, <https://ssrn.com/abstract=2835681>.

⁴¹ Sobel, "Strengthening Collective Action Clauses: Catalysing Change – the Back Story", 10.

Therefore, a structural analysis of the sources of law would need to consider the origins of the contract terms in the international model. The ICMA clause, a hybrid source of law, should be recognised as a meaningful part of the *Stufenbau*. To represent it spatially, a horizontal layer could be added to the side of the contractual level of norms to accommodate the international standard.

This remodelling of the *Stufenbau* could provide a more complete and reliable account of the sources of law relevant to depict, and understand, the case. The inclusion of hybrid sources of law, widely present in international standardization, enriches the perspective embodied in the pyramid.

This adjustment to the pyramid begs the further question of the empowerment norm. As we have seen in Section One, the Kelsen-Merklian model is based on the theory that a higher-level norm empowers the norm-issuer to enact the lower-level norm. With respect to the hybrid source of law, one might wonder about such an empowerment norm. To the extent that the hybrid source of law is relegated to a parallel, horizontal layer, no empowerment norm is arguably needed. The pyramid is still made up of a series of levels vertically ordered, with the contractual layer enabled by the higher-level norm (a statute, or the Constitution itself). The hybrid source (the ICMA standard in our example) would come into play only collaterally, and be understood as one of the forces acting on the discretion of the norm-issuer. The question can thus be put to rest provisionally.

The second instance of hybrid sources in sovereign debt restructuring law concerns the negotiations between a sovereign debtor and its creditors. In the absence of binding rules, the “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets” have been adopted through a drafting process which included several representatives of financial institutions as well as officials from emerging countries. In 2004, the Principles were announced and welcomed by the Group of Twenty (“G20”) in its Berlin Communiqué, in which the Group also expressed its “general support” for them.⁴²

The content of the Principles focuses on transparency, debtor-creditor dialogue, good faith actions and fair treatment. Each of these four objectives is further broken down into more specific rules of conduct which build on best practices. The Principles sometimes include some open-ended wording, such as “as appropriate” or “to the extent consistent with their business objectives and legal obligations”, which makes them flexible and warrants their case-by-case application.

⁴² Meeting of Finance Ministers and Central Bank Governors in Berlin, “Communiqué, November 21, 2004”, 2004, para. 8, <http://www.g20.utoronto.ca/2004/2004communiqu.html>.

The Principles were soon complemented by a light governance structure by one of its drafters, the Institute of International Finance (“IIF”). The IIF is a private association of a hybrid character, as it includes private as well as public financial institutions amongst its members.

Since December 2005, the IIF “Principles Consultative Group” has the mandate to assess countries’ compliance with the Principles. It is composed of senior financial executives and officials from emerging countries.⁴³ The second governance leg is provided by the Group of Trustees of the Principles, established in March 2006 to encourage the implementation of the Principles and promote its development.

The Principles slowly morphed into a legislative enterprise structured around the IIF. Both the Principles Consultative Group and the Group of Trustees benefit from the technical support of the IIF Secretariat.⁴⁴ Thus, the IIF selects the countries to review and prepares the background documents to be discussed by the two groups. In October 2010, the applicability of the Principles was extended to include all sovereign issuers (as well as non-sovereign entities where the restructuring is heavily influenced by the State).⁴⁵ This amendment was reflected in the title, which is currently “Principles for Stable Capital Flows and Fair Debt Restructuring”, and makes no reference to emerging countries any more.

The relevance of the *Stufenbau* conception of the sources of law with regard to a phenomenon such as the IIF Principles is problematic. On the one hand, it could be argued that non-binding forms of law do not need (or are not worthy of) being analysed in terms of a structural pyramid. The breach of IIF Principles does not entail an official sanction on the debtor government, and therefore a structural analysis could exclude them altogether. On the other hand, the informal “governance apparatus” illustrated above can exert influence on the debtor and raise expectations on the creditors’ side. To the extent that compliance with the IIF Principles is assessed over time and non-compliance is criticised publicly, governments could be pushed to act in accordance with such a hybrid source of law.

Consequently, the hierarchical pyramid could include this hybrid source of law. Its respective level, however, would need to be determined according to the view of the legal system at stake. As sovereign debt can include forms of

⁴³ Eric Helleiner, “Filling a Hole in Global Financial Governance? The Politics of Regulating Sovereign Debt Restructuring”, in *The Politics of Global Regulation*, vol. Walter Mattli & Ngaire Woods (Princeton University Press, 2009), 114.

⁴⁴ Institute of International Finance, Inc., “Report on Implementation Prepared by the Principles Consultative Group”, October 2015, 6, <https://www.iif.com/file/13103/download?token=ExIBNRKm>.

⁴⁵ Institute of International Finance, Inc., 3.

debt issued under several different domestic laws, a transnational legal sphere is involved, which cuts across private and public dimensions (pertaining to creditors and the debtor, respectively). The resulting *Stufenbau* appears rather indeterminate. A pyramid that sought to remain closer to Kelsen's legal positivism would arguably include only formal, binding sources, but fail to include significant driving forces framing the relationship. A hierarchy that would be more open to other insights (economic, sociological, and political) – and which would thus be more distant from the Kelsenian model – would encompass hybrid sources that influence the actual conduct of the parties.

In the latter scenario, a *Stufenbau* that includes hybrid sources of law would encounter the issue of their empowering norm. Neither public international law nor domestic legal systems would contain a norm that officially empowers a private association as the IIF to enact norms governing sovereign debtors' and creditors' actions. Therefore, an empowering norm in the classic sense cannot be identified.

Rather, a pragmatic approach would point to the endorsement by a prominent actor in international financial regulatory landscape, the G20. Its support for the IIF Principles could be understood as a “weak” form of empowerment norm that would render the IIF a norm-issuer, when taking into account the exercise of (*lato sensu*) normative power in the absence of binding rules. This conclusion would however soften the requirements of the *Stufenbau* structure to a significant extent.

IV. PUBLIC SOFT LAW IN EUROPEAN FINANCIAL REGULATION

This Section seeks to appraise the relevance of *Stufenbau* with regard to public soft law in European financial regulation. The scholarship on the theory of the sources of European law is rich, especially after the adoption of the Lisbon Treaty, and has devoted much attention to delegated legislation.⁴⁶ The latter, from a hierarchical perspective, does not seem to raise insurmountable problems, to the extent that its rank is clearly provided under European law.

A less studied area concerns soft law which several European public bodies are empowered to enact. The focus here is on a disparate body of

⁴⁶ Koen Lenaerts and Marlies Desomer, “Towards a Hierarchy of Legal Acts in the European Union? : Simplification of Legal Instruments and Procedures”, *European Law Journal* 11, no. 6 (2005); Herwig Hofmann, “Legislation, Delegation and Implementation under the Treaty of Lisbon: Typology Meets Reality”, *European Law Journal* 15, no. 4 (2009): 482–505; Bart Driessen, “Delegated Legislation after the Treaty of Lisbon: An Analysis of Article 290 TFEU”, *European Law Review* 35, no. 6 (2010): 837–48; Paul Craig, “Delegated Acts, Implementing Acts and the New Comitology Regulation”, *European Law Review* 36, no. 5 (2011): 671–87.

documents which authorities and agencies of the European Union can issue within the ambit of their mandates.

In the area of financial regulation, the demand for convergence among national regulatory and supervisory practices has been steadily increasing. Even in the aftermath of the reforms adopted pursuant to the Lamfalussy Report,⁴⁷ financial actors felt there was fragmentation in the European market which prevented the development of cross-border activities.⁴⁸

The considerable reforms adopted in the wake of the global financial crisis and the De Larosière Report⁴⁹ have created the European Supervisory Authorities.⁵⁰ The authorities have been entrusted, amongst other tasks, with the drafting of implementing and regulatory technical standards to be adopted by the European Commission (which thus become binding). They can also adopt guidelines and recommendations addressed to competent authorities or financial institutions with a view to establishing consistent, efficient and effective supervisory practices within the European System of Financial Supervision, and to ensuring the common, uniform and consistent application of Union law.⁵¹

Although guidelines and recommendations issued by the European Supervisory Authorities are not binding instruments, all parties to the European System of Financial Supervision are required to cooperate with trust and full mutual respect.⁵² Furthermore, competent authorities and financial institutions have to make every effort to comply with those guidelines and recommendations.⁵³ Competent authorities not wishing to comply with them have to explain their reasons to the Authority, which will publish the fact of non-compliance.⁵⁴

⁴⁷ Committee of Wise Men on the Regulation of European Securities Market, “Final Report” (Brussels, February 15, 2001).

⁴⁸ Francesco Guarracino, *Supervisione bancaria europea: sistema delle fonti e modelli teorici* (Milano: CEDAM, 2012), 23.

⁴⁹ The High-Level Expert Group on Financial Supervision in the European Union, “Report” (Brussels, February 25, 2009).

⁵⁰ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority).

⁵¹ Article 16 of the Regulations establishing the European Supervisory Authorities.

⁵² Article 2(4) of the Regulations establishing the European Supervisory Authorities.

⁵³ Article 16(3) of the Regulations establishing the European Supervisory Authorities.

⁵⁴ Matteo De Poli, *European Banking Law* (Milano: Wolters Kluwer, 2017), 63.

It has also been suggested that guidelines and recommendations should be taken into consideration by national courts when interpreting EU binding acts and national legislation, as well as by the European Court of Justice of the European Union.⁵⁵ The argument is that, first, the EU and its Member States should abide by the duty of sincere cooperation and refrain from acts that could endanger the attainment of the Union's objectives,⁵⁶ and, second, that authorities' statements on technical matters could be particularly helpful to interpret EU law.⁵⁷

A further layer of soft law issued by the European Supervisory Authorities is made of "Questions and Answers" ("Q&As"). The European Banking Authority describes this tool as pursuing the objective of ensuring "consistent and effective application of the new regulatory framework across the Single Market, and hence contribut[ing] to the building of the Single Rulebook in banking".⁵⁸ Whilst Q&As are not binding and are not subject to the "comply or explain" procedure mentioned above, the EBA notices their "undoubted practical significance to achieve a level-playing field. Peer pressure and market discipline are also expected to play a driving force in ensuring adherence to and compliance with the answers provided in the Q&A process".⁵⁹

Analysing these forms of soft law through the prism of the *Stufenbau* would place guidelines and recommendations on a lower level than European legislative acts. The empowerment norm is explicitly found in the regulations establishing the European Supervisory Authorities. The latter thus have the power to enact this species of soft law, devoid of binding force, but capable of having the significant effects highlighted above.

With regard to Questions and Answers, the picture becomes more blurred. Formally, they do not represent a form of law enacted by the European Supervisory Authorities. As such, the pyramid could exclude them altogether. Yet, their practical usefulness and their issuance by authorities

⁵⁵ Francesco Guarracino, *Supervisione bancaria europea: sistema delle fonti e modelli teorici*, 113.

⁵⁶ Article 4(3) TEU.

⁵⁷ This latter argument has been made also by the Board of Appeal of the European Supervisory Authorities in *SV Capital OÜ v. EBA*, Decision of 24 June 2013, paras. 55-57. See Anna Gardella, "L'EBA e i rapporti con la BCE e con le altre autorità di supervisione e di regolamentazione", in *Unione bancaria europea*, ed. Mario P. Chiti and Vittorio Santoro (Ospedaletto (Pisa): Pacini giuridica, 2016), 131.

⁵⁸ European Banking Authority, "Single Rulebook Q&A", <https://eba.europa.eu/single-rule-book-qa>; Similar wording is used by ESMA European Securities and Markets Authority, "Questions and Answers", <https://www.esma.europa.eu/questions-and-answers>; and by EIOPA European Insurance and Occupational Pensions Authority, "Q&A on Regulation", <https://eiopa.europa.eu/regulation-supervision/q-a-on-regulation>.

⁵⁹ European Banking Authority, "Single Rulebook Q&A".

entrusted with the application of European financial regulation suggest that they are relevant sources to interpret such regulation. Therefore, the *Stufenbau* notion faces a new challenge.

The criteria of hierarchy and of competence, which Carrozza singled out as a legacy of Kelsen's scholarship, are confronted today with the phenomenon of soft law from European Supervisory Authorities. More in general, the interrelations between national legal systems and the EU have brought about serious problems for a hierarchical ordering of sources, so much so that scholars have started talking of a "crisis" of the hierarchy principle.⁶⁰ It has been aptly pointed out that the sources of EU law seem to be characterized by significant forms of overlapping.⁶¹ The latter are the result of the complexity of the composite European legal system.⁶²

A reliable analysis of the functioning of this area, as well as, of European law needs to be based more on a substantive than on a formal perspective. Rather than hierarchy and competence, a horizontal, collaborative framework appears more appropriate to represent the current system of sources of law.⁶³ Integration thus requires ever more loyalty, sincere co-operation and fair play amongst the institutional actors involved in the process.

V. CONCLUDING REMARKS

This article has sought to reappraise the relevance of the *Stufenbau* in contemporary international financial law. It has first revisited the notion of a hierarchical pyramid of the sources of law, as elaborated by Merkl and Kelsen at the beginning of the 20th century. It has then tested it in two different areas.

In sovereign debt restructuring law, sources stemming from hybrid (i.e. semi-private) bodies have been assessed. With regard to hybrid sources of law that represent an international standard, the *Stufenbau* seems flexible enough to accommodate their collateral inclusion. However, where such hybrid sources represent the only applicable norms of conduct, the adherence to the original Kelsenian model seems more problematic.

⁶⁰ Maurizio Pedrazza Gorlero, "L'ordine delle fonti fra crisi del 'sistema' e rischio casistico", in *Alle frontiere del diritto costituzionale: scritti in onore di Valerio Onida*, ed. Valerio Onida (Milano: Giuffrè, 2011), 1353.

⁶¹ Giulio Stolfi, "Tempi (post-)moderni: Nuovi impulsi normativi europei alla prova delle sovrapposizioni", *SOG Working Papers* 32 (2016): 21.

⁶² Giuseppe Martinico, *The Tangled Complexity of the EU Constitutional Process. The Frustrating Knot of Europe* (London: Routledge, 2014).

⁶³ Renato Ibrido, *L'Unione bancaria europea: profili costituzionali* (Torino: G. Giappichelli Editore, 2017), 205.

With regard to European financial regulation, the resort to several forms of soft law issued by public bodies has been examined. The criteria of competence and hierarchy, that permit a straightforward application of the pyramid, appear to have given way to more flexible, overlapping sources of law in light of the peculiar character of the European process of integration. The erosion of a formal, positivistic framework as envisaged by Kelsen calls for a thorough reconsideration of the pyramidal ordering of the sources of law.

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IN INTERNATIONAL FINANCIAL LAW*

Probando la Stufenbau en Derecho financiero internacional

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