CIFILE Journal of International Law (CJIL), Vol. 5, Issue.10, 32-47 (2024)

Homepage: https://www.cifilejournal.com

Print ISSN: 2563-6820

Online ISSN: 2563-3341

# Qualification of Central Banks as Foreign Investors in Light of Recent Developments in International Law: Focus on the ICJ Judgments in the Case Concerning Certain Iranian Assets

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*https://doi.org/10.30489/cifj.2023.424602.1093*

**ARTICLE INFO**

***Article history:***

*Receive Date: 10 November 2023*

*Revise Date: 23 November 2023*

*Accept Date: 24 November 2023*

***Keywords:***

*Central Bank, Foreign Investor, Treaty Protection, ICJ, Certain Iranian Assets, Commercial Activity, Sovereign Function, Nature Test, Bonds and Securities, Portfolio Investment, Expropriation*

**ABSTRACT**

*Central banks, which traditionally perform exclusively sovereign functions associated with their role as guardians of national monetary and fiscal policies, have increasingly diversified their roles in the evolving financial landscape. They now embrace a range of commercial activities aligned with international banking practices and investment ventures. The dual role they play in today's world sparks vital questions about how to characterize their activities, which subsequently influences their protection under international law. Such characterization becomes particularly significant in international investment law, as public entities can only claim investment treaty protections if engaged in commercial activities. Two primary tests—based on an activity's purpose and its nature—serve to distinguish between commercial and sovereign roles. Of course, the "nature test" is increasingly gaining prominence in international jurisprudence. A salient exemplar of this discourse is seen in the case concerning Certain Iranian Assets before the ICJ. In 2019, the Court recognized that the Central Bank of Iran, Bank Markazi, could qualify for treaty protections if its U.S.-based operations were commercial in nature. Whereas an in-depth analysis in the present research suggests that Bank Markazi's U.S. bond transactions largely bear a commercial hallmark, the ICJ, in a divergent decision in 2023, declined to classify the Bank as a company eligible for treaty protections. This shift from the Court's earlier stance highlights a need for consistency in the application of international law and prompts deeper inquiry into the trajectory of international legal discourse.*

## INTRODUCTION

In the complex realm of international law, central banks stand as unique financial entities straddling the border between sovereign regulators and global economic actors. These financial institutions play a crucial role in shaping the economic landscape of nations, controlling monetary policy, ensuring financial stability, and engaging in an expanding variety of commercial activities.[1]

One of the fundamental principles protecting central banks under international law is the doctrine of State immunity.[2] This principle traditionally shields central banks from measures of constraint on their property in foreign territories.[3] However, this robust protection has not been invulnerable to breaches, with several instances of violation raising complex legal questions and disputes in the international arena.[4]

The foundation of sovereign immunity for States and their instrumentalities, including central banks, is rooted in the evolving norms of customary international law.[5] However, despite the firm foundation of these norms, the lack of an international adjudicative body with universal jurisdiction makes their enforcement challenging. Such enforcement typically depends on the presence of international instruments conferring jurisdiction on international courts and tribunals.[6] The absence of such instruments casts doubt about the effectiveness of this safeguard and prompts the search for alternative international legal channels to protect central bank assets from unwarranted expropriation.

A prominent case highlighting such a search is the case concerning *Certain Iranian Assets* before the International Court of Justice (ICJ).[7] In this case, Iran contended that the United States had breached its obligations under the 1955 Treaty of Amity, Economic Relations and Consular Rights[8] between the two nations by failure to recognize the separate legal personality of Iran's Central Bank, unfair and discriminatory treatment of this entity, expropriation of its property, *etc.*[9] The essence of Iran's argument was that its central bank, *Bank Markazi*, should be considered a "company" within the meaning of the Treaty of Amity and thus entitled to the Treaty's protections akin to those granted under contemporary international investment law. This marked an attempt to categorize a central bank as a foreign

[1] See examples of central banks' commercial activities in Mervyn King, 'No Money, No Inflation – The Role of Money In the Economy', in Paul Mizen (ed), *Central Banking, Monetary Theory and Practice* (Edward Elgar 2003) 62, 81.

[2] Xiaodong Yang, *State Immunity in International Law* (Cambridge University Press 2012) 410.

[3] See Ernest Patrikis, 'Chapter 8 Sovereign Immunity and Central Bank Immunity in the United States', in Robert Effros (ed), *Current Legal Issues Affecting Central Banks, Volume I* (International Monetary Fund 1992) 159.

[4] Ingrid Brunk, 'Central Bank Immunity, Sanctions, and Sovereign Wealth Funds' (2023) George Washington Law Review 1, 38.

[5] Pierre-Hugues Verdier and Erik Voeten, 'How Does Customary International Law Change? The Case of State Immunity' (2015) 59 International Studies Quarterly 209.

[6] See, for example, the case of *Jurisdictional Immunities of the State (Germany v. Italy: Greece intervening)*, ICJ Reports 2012, in which the 1957 European Convention for the Peaceful Settlement of Disputes constituted the basis for the jurisdiction of the ICJ.

[7] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on Preliminary Objections (n 11); Judgment on the Merits (n 14).

[8] The Treaty of Amity, Economic Relations and Consular Rights between the United States and Iran, signed in Tehran on August 15, 1955, entered into force on 16 June 1957.

[9] *Certain Iranian Assets (Iran v. United States)*, Application Instituting Proceedings, 14 June 2016, 32-34.

investor whose rights were violated by the host State. On the other hand, the United States contested Iran's claims, asserting that *Bank Markazi* could not be deemed a "company" for the purposes of the said Treaty because, as a central bank, it exclusively engaged in sovereign functions.[10]

The ICJ, in its 2019 Judgment on the preliminary objections, ventured into a legal inquiry of paramount importance. The Court emphasized that *Bank Markazi* possessed a distinct legal personality as recognized under Iranian law, and the fact that the Iranian State maintained ownership of the Bank and control over its activities did not preclude its status as a "company".[11] Thus, the central question that remained open was whether the nature of *Bank Markazi*'s activities warranted its classification as a "company" in accordance with the definition given by the Treaty and in the light of its object and purpose. In the opinion of the Court, since the Treaty was aimed at guaranteeing the rights and protections of entities engaging in activities of a commercial nature, a legal person carrying out entirely sovereign activities could not be characterized as a "company". Nevertheless, a single entity carrying out activities of both types, should be regarded as a "company" to the extent that it was engaged in commercial activities.[12] The Court therefore noted that the question of the nature of *Bank Markazi*'s activities carried out within the U.S. territory would be dealt with at the next stage of the proceedings, when all the facts necessary to determine the issue would be presented by the parties.[13]

This complicated legal puzzle took a turn in 2023 when the ICJ rendered its Judgment on the merits, in which it declined to categorize *Bank Markazi* as a "company", despite the facts provided by Iran about the commercial nature of the Bank's activities.[14] This decision, marked by controversy among the Court's members, gives rise to questions as to its consistency with the previous Judgment and prompts deeper exploration to address the question at hand.[15]

As a contribution to this exploration, the present essay seeks to argue that a central bank engaged in commercial investment activities should be qualified as an independent legal person entitled to the protections provided under international investment treaties.

To dissect this proposition, the essay unfolds in three main Chapters. The first Chapter provides a concise overview of the functions and activities of central banks. The second Chapter deals with different criteria for characterizing central banks' activities. Finally, the third Chapter applies the

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[10] Preliminary Objections Submitted by the United States of America, *Certain Iranian Assets (Iran v. United States)*, 1 May 2017, 95-99.

[11] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on Preliminary Objections, ICJ Reports 2019, 13 February 2019, Para. 88.

[12] Ibid, 31, Paras. 89-92.

[13] Ibid, 31, Para. 93.

[14] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on the Merits, ICJ Reports 2023, 30 March 2023, Paras. 50-54.

[15] See, for example, *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Separate opinion of Judge Bennouna, ICJ Reports 2023, 30 March 2023, 2-3.

proposed test to the relevant activities carried out by *Bank Markazi* in order to evaluate its qualification as a foreign investor.

## 1. Functions and Activities of Central Banks: A General Overview

Central banks are the backbone of a country's financial system, responsible for issuing currency, managing monetary policy, and ensuring financial stability.[16] Traditionally, their role is predominantly regulatory and governmental. However, central banks in many countries, including the U.S., the UK, the Eurozone, and Iran have expanded their functions to include commercial activities, blurring the lines between their regulatory roles and commercial ventures.[17]

The convergence of central banks' roles not only underscores the evolving character of central banks but also raises crucial questions about their status in international law, particularly when they make investments abroad. How do we distinguish between their commercial and sovereign activities? And what are the implications of such categorizations?

Granting a central bank the status of a foreign investor can endow it with specific protections under international treaties. This recognition, given the vast financial assets and global influence of central banks,[18] could reshape the landscape of international finance and diplomacy. However, the very blending of their regulatory and commercial duties complicates the task of unequivocally classifying them as foreign investors. Delving deeper into their multifaceted activities might offer more insights into this intricate issue. Activities, whether regulatory or commercial in nature, conducted by central banks are often clearly defined and distinguished by the domestic laws that regulate them.[19] One prime example of this distinction can be observed in the laws governing the Central Bank of Iran, *Bank Markazi*.

When delving into the nature of *Bank Markazi*'s activities, it is crucial to review the Monetary and Banking Act of 1960,[20] as amended in 1972, which contains the statutes of *Bank Markazi*. The Act contains various provisions defining the types of activities in which *Bank Markazi* can engage. The Bank has been established as an independent institution "governed by the laws and regulations pertaining to joint-stock companies in matters not provided for by this Act".[21] The Act states that *Bank*

[16] See Thammarak Moenjak, *Central Banking: Theory and Practice in Sustaining Monetary and Financial Stability* (Wiley 2017) 37-57.

[17] For an overview of the diverse activities of central banks, see Jaime Caruana, 'The Role of Central Banks in Macroeconomic and Financial Stability', in Madhusudan Mohanty (ed), *The Role of Central Banks in Macroeconomic and Financial Stability* (Bank for International Settlements 2014) 1-5.

[18] See Mahmood Pradhan, Tristan Perrier, and Lorenzo Portelli, 'Central Banks' Endgame: A New Policy Paradigm' (2023) Themes in Depth, Amundi Investment Institute 4.

[19] Lucía Satragno, *Monetary Stability as a Common Concern in International Law: Policy Cooperation and Coordination of Central Banks* (Brill/Nijhoff 2022) 127.

[20] The Monetary and Banking Act of Iran, Approved on 27 May 1960, available at: <www.cbi.ir/page/5298.aspx>, access 8 July 2023.

[21] Article 10, Para. (c), the Monetary and Banking Act, Approved on 9 July 1972, Annex 73 to Iran's Memorial, *Certain Iranian Assets*, 1 February 2017, 8.

*Markazi* has "the task of formulating and implementing monetary and credit policies" aligned with the general economic policy of the State. The policy referred to in this Act is aimed at "maintain[ing] the value of the currency and equilibrium in the balance of payments, [facilitating] trade transactions, and [assisting in] the economic growth of the country". [22]

In comparison, the European Central Bank (ECB) maintains price stability in the euro area and engages in financial operations, like purchasing government and corporate bonds.[23] The Federal Reserve System (U.S.) not only conducts monetary policy but also buys and sells government securities and extends credit to financial institutions.[24] The Bank of England, too, has a dual role in setting interest rates and ensuring financial stability while engaging in commercial functions like buying government and corporate bonds.[25]

Back in Iran, the law clearly delineates the responsibilities of *Bank Markazi* "as the regulatory authority of the monetary and credit system of the State". Among its designated functions, the Bank holds the prerogative to intervene in and supervise financial and banking activities in order to ensure the effective implementation of the country's monetary system.[26] Such roles are illustrative of the functions over which the Bank has exclusive authority, due to their sovereign character. On the other hand, this Bank also performs commercial activities. For instance, *Bank Markazi* has the power to grant loans, guarantee undertakings of the government, purchase and sell treasury bills, bonds, gold, and silver, and open accounts with other banks.[27] The latter activities are performed, without any exclusive authority by *Bank Markazi*, like any other private party doing business in a free and competitive market.[28] In particular, the Bank can purchase or sell bonds issued by foreign governments or accredited international financial institutions, and open current accounts with foreign banks and perform banking operations inside or outside Iran.[29]

Central bank involvement in commercial activities is not exclusive to Iran. Central banks globally have evolved, adapting to the changing financial landscape by incorporating both sovereign functions and commercial operations.[30]

In sum, while central banks are inherently sovereign entities, their interwoven regulatory and commercial roles reflect the complexities of today's financial systems. Recognizing this duality is vital for the international legal framework, shaping the

[22] Ibid, Article 10, Paras. (a) and (b).

[23] See European Central Bank's Official Website, <https://www.ecb.europa.eu/ecb/tasks/html/index.en.html>, access 28 July 2023.

[24] Cheryl Edwards, 'Open Market Operations in the 1990s' (1997) Federal Reserve Bulletin 859.

[25] The Sterling Bond Portfolio, Bank of England, available at: <https://www.bankofengland.co.uk/markets/the-sterling-bond-portfolio>, access 2 August 2023.

[26] See Iran's Monetary and Banking Act of 1972 (n 21), Articles 11 and 14.

[27] Ibid, Article 13.

[28] Reply of Iran, *Certain Iranian Assets (Iran v. United States)*, 17 August 2020, 20.

[29] Iran's Monetary and Banking Act of 1972 (n 21), Articles 13, Paras. 5 and 7.

[30] Rosa Lastra, *International Financial and Monetary Law* (2nd edn, Oxford University Press 2015) 33.

rights and protections central banks can claim on the global stage.

## 2. Criteria for Characterizing a Central Bank as a Foreign Investor

The preceding Chapter examined how central banks stand at the crossroads of sovereign and commercial operations. The distinction between these roles has significant consequences in the context of international investment law. This is because central banks can only enjoy the protections afforded to foreign investors if their relevant activities are characterized as commercial activities.[31] Historically, two primary criteria have emerged to characterize such activities: the nature of the activity and the purpose behind it. Although some adjudicators have weighed the purpose test,[32] the predominant trend leans towards the nature of the activity.[33]

This jurisprudential inclination is evident in the 2019 ICJ Judgment in the case concerning *Certain Iranian Assets*. Here, the respondent, the United States, sought to disqualify *Bank Markazi* from being categorized as a "company" under Article III of the Treaty of Amity, emphasizing the Bank's sovereign functions to argue against its engagement in commercial activities. It posited that even though certain powers listed in Iran's Monetary and Banking Act were not unique to central banks, such powers had to be viewed in the context of the sovereign tasks and objectives assigned to *Bank Markazi*.[34] Contrary to this, the ICJ, in its 2019 Judgment on the preliminary objections, indicated its intention to consider the nature of the activities at issue, irrespective of any objective and purpose for which the Bank might have engaged in those activities. Accordingly, the Court held that "since it is the nature of the activity actually carried out which determines the characterization of the entity engaged in it, the legal person in question should be regarded as a 'company' within the meaning of the Treaty to the extent that it is engaged in activities of a commercial nature, even if they do not constitute its principal activities".[35]

[31] State entities can have access to ICSID if they act in a commercial capacity. See Stephan W Schill, Christoph Schreuer and Anthony Sinclair, 'Article 25 – Jurisdiction' in Stephan W Schill (gen ed), Loretta Malintoppi, August Reinisch, Christoph Schreuer, and Anthony Sinclair (eds), *Schreuer's Commentary on the ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (3rd edn, Cambridge University Press 2022) 293.

[32] See, for example, *Milantic Trans S.A. v. Ministerio de Producción de la Provincia de Buenos Aires (Argentina), Astillero Río Santiago (Argentina)*, Contentious Administrative Court of Appeal of La Plata (2007) 30 August 2007, (2008) 33 ICCA Yearbook of Commercial Arbitration, 329-330. For the disadvantages of characterizing an activity by its purpose, see Roohollah Mansouri, *The Restrictions of Domestic Law on the Arbitrability of Disputes Involving the State and Public Entities in the Context of Foreign Investment Arbitration: Rule of Law Implications* (Doctoral Thesis, University of Cologne 2023) 246-248.

[33] Academic commentators have rightly argued that the purpose or motive of an act is irrelevant, because "anything a State does is by definition in the public interest". See John Paulsson, 'May a state invoke its internal law to repudiate consent to international commercial arbitration?: Reflections on the Benteler v. Belgium Preliminary Award' (1986) 2 Arbitration International 90. See also Schill, Schreuer and Sinclair (n 31), 290-293.

[34] U.S. Counter-Memorial, *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, 14 October 2019, 66.

[35] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on Preliminary Objections (n 11), Para. 92.

This rationale aligns with the prevailing practice of investment arbitral tribunals and, in particular, ICSID tribunals,[36] which have addressed the question of whether State entities can be considered foreign investors.[37] A prime example is the 1999 *CSOB v. Slovakia* case, where CSOB, which acted on behalf of the Czech Republic in facilitating and executing international banking transactions, brought its disputes for mistreatment by the respondent State before an ICSID Tribunal. The respondent challenged the competence of the Tribunal, contending that the dispute was not an investment dispute because CSOB was a government agency "discharging essentially governmental functions throughout its existence".[38] However, the tribunal rejected this argument, holding that the decisive test in determining whether CSOB exercised governmental functions was the nature of these activities and not their purpose. According to the tribunal, "[w]hile it cannot be doubted that in performing the [activities in question], CSOB was promoting the governmental policies or purposes of the State, the activities themselves were essentially commercial rather than governmental in nature".[39]

The "nature test" was similarly employed in *Flughafen Zürich v. Venezuela*[40] and *Stadtwerke München v. Spain*. In the latter case, the ICSID Tribunal dismissed the respondent's argument that the ownership and control of Stadtwerke München (SWM) by the City of Munich implied that the actual party bringing the case was the Federal Republic of Germany.[41] All this fact, in the Tribunal's view, meant that SWM was a State entity. It noted that there is no provision in the Energy Charter Treaty (ECT) requiring State-owned companies to be treated differently from companies owned by private parties. According to the Tribunal,

> "SWM falls squarely within the definition of 'Investor…with respect to Contracting Party' since it was organized in accordance with the law of a Contracting Party, that is, in accordance with the law of Germany. As a G.m.b.H., SWM is clearly a 'company' as that term is understood in Germany".[42]

[36] See Schill, Schreuer and Sinclair (n 31), 290-293.

[37] Apart from ICSID tribunals whose practice is examined below, other arbitral tribunals have also adopted the same approach in characterizing the activities of States and public entities. For instance, in *Benteler v. Belgium*, the Belgium State argued that its activity with respect to a company of its own was not a commercial activity, since it did not have commercial motives; it was rather performed to preserve public interest. However, the arbitral tribunal rejected this argument and held that, in determining whether a certain activity is commercial, the motive of the activity is not at issue. The tribunal rather concentrated on the following elements: (1) the contract concluded between the parties "had the character of a private law agreement", and (2) the State company's "activity was industrial and commercial in nature". See *Benteler et autres v. Etat belge*, Award, 18 November 1983, Revue de l'Arbitrage (1989), p. 339.

[38] *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, Para. 19.

[39] Ibid, Para. 20.

[40] *Flughafen Zürich v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/19, Award, 18 November 2014, Paras. 262-286.

[41] *Stadtwerke München GmbH v. Kingdom of Spain*, ICSID Case No. ARB/15/1, Award, 2 December 2019, Para. 133.

[42] Ibid, Para. 134.

The Tribunal indeed applied the nature test to affirm that SWM's corporate form and activities met the criteria for being considered a "company", thereby classifying it under the ECT's "investor" definition.

The arbitral practice of characterizing an activity in the light of its nature is mirrored in the law and jurisprudence of well-developed legal systems. In the United States, for example, the same practice is recognized, albeit in the distinct context of sovereign immunity. [43] The Foreign Sovereign Immunities Act (FSIA) of 1976 is indicative of this, with its legislative history emphasizing the nature of the activity.[44] The guiding principle is clear: the end use of goods or services procured under a contract, even if for a public pupose, does not alter their character. In other words, "it is the essentially commercial nature of an activity or transaction that is critical. Thus, a contract by a foreign government to buy provisions or equipment for its armed forces or to construct a government building constitutes a commercial activity [notwithstanding its ultimate object to further a public function]".[45]

This approach is firmly supported by U.S. Supreme Court precedent. In the landmark 1992 case of *Republic of Argentina v. Weltover*, the Supreme Court was tasked with ascertaining whether Argentina's bond issuance was a commercial activity for the purpose of commercial exception of the FSIA. [46] The Court dissected the FSIA's definition of commercial activity, drawing a clear line between the underlying purpose of an activity, which refers to "the reason why the foreign state engages in the activity", and its nature, which pertains to "the outward form of the conduct that the foreign state performs or agrees to perform".[47] The Court underscored that an act's commerciality should be determined by reference to its nature rather than its purpose. This led to the formulation of the "private person test", under which "the question is not whether the foreign government is acting with a profit motive or instead with the aim of fulfilling uniquely sovereign objectives. Rather, the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the type of actions by which a private party engages in 'trade and traffic or commerce'". Applying this test to the facts before it, the Supreme Court concluded that the issuance of bonds by Argentina was a commercial activity.[48]

The Supreme Court's analysis in this case not only clarifies the scope of the law of State immunities but also bears significant consequences for other areas of law, particularly within the sphere of foreign investment. This legal precedent, in harmony with the international practice, casts a revealing light on the commercial engagements of States and their instrumentalities, including central banks,

[43] Reply of Iran, *Certain Iranian Assets (Iran v. United States)*, (n 28), 85.
[44] Gary Born and Peter Rutledge, *International Civil Litigation in United States Courts* (7th edn, Aspen Publishing 2023) 302.
[45] House Report, Rep. No. 1487, 94th Cong., 2d Sess. 7 (1976), reprinted in 1976 U.S. Code Cong. & Admin. News, 6615.
[46] *Republic of Argentina v. Weltover*, Supreme Court of the United States, 504 U.S. 607 (1992) 613.
[47] Ibid, 618.
[48] Ibid, 615, 618.

and shapes a proper understanding of their roles within the global legal order.

## 3. U.S. Bond Investments by Iran's Central Bank In Light of the Nature Test

Chapter 2 established the precedence and significance of the nature test in distinguishing between sovereign and commercial activities. Building on this, the ensuing discussion aims to deal with the practical application of this test in the area of global financial operations. The preceding analysis showcased how international courts, investment arbitral tribunals, and even domestic jurisdictions, such as that of the United States, emphasize the essence of an activity—its nature—as the defining feature rather than the purpose behind it. Using this lens, the current Chapter will turn its focus to a real-world scenario involving the Central Bank of Iran, whose treatment by the United States was at issue in the case concerning *Certain Iranian Assets* before the ICJ.[49] An in-depth analysis will be conducted of the Bank's operations and undertakings within the U.S. territory, assessing them against the established framework of the nature test. By doing so, the intent is to contextualize the theoretical and jurisprudential foundations discussed previously, presenting a clear picture of how the nature test is employed in determining the commercial character of a central bank's activities.

Delving further into the complexities of financial governance, it is observed that central banks operate with a mandate that transcends typical financial roles, directing economic policies through strategic asset allocation.[50] By design and necessity, these institutions invest in a diverse portfolio of assets to maintain economic stability, mitigate inflation, and foster growth. However, such public motives do not alter the nature of their investment activities whose "outward form" appears to be commercial.[51] Notably, they allocate a substantial portion of their portfolios to bonds and securities issued by foreign governments or internationally acclaimed financial institutions.[52] It is common for central banks to purchase bonds as a method to diversify their investments across a variety of instruments, instead of limiting themselves primarily to short-term money market instruments. Diversifying into credit risk-free instruments, such as treasury bonds from leading economies, mirrors the strategies adopted by many of their counterparts as part of prudent reserve management.[53] In the process of managing, customizing, and settling these bonds and securities, central banks typically engage the

[49] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on Preliminary Objections (n 11); Judgment on the Merits (n 14).

[50] OECD, *OECD Sovereign Borrowing Outlook 2019* (OECD Publishing 2019) 45.

[51] See the definition of "nature" in *Republic of Argentina v. Weltover* (n 46), 618.

[52] European Central Bank, *Collateral Eligibility Requirements: A Comparative Study Across Specific Frameworks* (ECB Publications 2013) 10.

[53] See Affidavit of Ali Asghar Massoumi, *Peterson v. Iran*, Doc. 815, filed on 31 August 2017 in United States District Court for the Southern District of New York, Case No. 10 Civ. 4518 (BSJ), Para. 18.

services of specialized clearing institutions.[54]

In a similar vein, the Central Bank of Iran, *Bank Markazi*, engaged in the purchase of certain US dollar-denominated bonds between the years 2002 and 2007, utilizing the clearing services of *Clearstream Banking, S.A.*, based in Luxembourg. The bonds, issued by a number of governments and intergovernmental organizations such as the World Bank, were accessible in the U.S. market through the *Federal Reserve Bank* of New York and the *Depository Trust Company* of New York, which served as their depositories.[55]

Within the U.S. financial architecture, the investment of *Bank Markazi* in these bonds took the form of "security entitlements".[56] Such entitlements are a hallmark of the modern securities holding system, a structure that "accommodates more than one tier of securities intermediary between the issuer and ultimate investor".[57] Under this system, the actual securities are often held in a dematerialized, or non-physical, form—represented not by tangible certificates, but as electronic records maintained by the intermediaries.[58] Within this framework, *Bank Markazi*'s security interests were recorded in a book-entry at *Clearstream*, which, in turn, held a corresponding security account with its upper tier, *Citibank* of New York. This multi-tiered model ensured that *Bank Markazi*'s interaction with the bond issuers was through a series of custodial links. In essence, *Bank Markazi* managed its securities holdings in the United States via the services provided by *Clearstream*, which acted on its behalf in this intermediary-driven investment system.[59]

Through *Clearstream*'s infrastructure, *Bank Markazi* orchestrated a comprehensive range of activities. These included executing payments for bond acquisitions, utilizing custody and safekeeping services, collecting distributions related to the securities' principal and interest, and managing the surrender of matured securities.[60] These activities, each inherently commercial in nature, collectively amounted to a type of foreign portfolio investment.[61]

A portfolio investment typically involves the entry of funds into a country by a foreigner, who may deposit its money in a bank or acquire various types of assets[62]—such as stocks, government bonds, corporate bonds, or treasury bills—with the expectation of earning a return over a set

[54] Central Bank & International Account Services, Federal Reserve Bank of New York, available at: <https://www.newyorkfed.org/markets/central-bank-and-international-account-services>, access 6 September 2023.
[55] Reply of Iran, *Certain Iranian Assets (Iran v. United States)*, (n 28), 60.
[56] United States Uniform Commercial Code (UCC) Article 8, Investment Securities, § 8-102. Definitions.
[57] Carl Bjerre and Sandra Rocks, *The ABC's of the UCC, Article 8: Investment Securities* (American Bar Association 2004) 36.
[58] Steven Schwarcz, 'Intermediary Risk in a Global Economy' (2001) 50 Duke Law Journal 1541.
[59] Reply of Iran, *Certain Iranian Assets (Iran v. United States)*, (n 28), 61.
[60] See Clearstream Banking S.A., General Terms and Conditions, July 2008 Edition, Document No. 0067, Article 20.
[61] Jun Wu, Shaomin Li, and David Selover, 'Foreign Direct Investment vs. Foreign Portfolio Investment: The Effect of the Governance Environment' (2012) 52 Management International Review 643.
[62] Dennis Appleyard, Alfred Field, and Steven Cobb, *International Economics* (7th edn, McGraw-Hill/Irwin 2010) 229.

period.[63] Such an investment can be made directly by foreign investors or managed by financial institutions.

*Bank Markazi*'s bond transactions aligned with this definition, encompassing all the defining features of an investment. They included the international transfer of funds through financial intermediaries, the expectation of profit, and adherence to bond maturity dates that delineated the investment duration.[64] The maturity dates, in particular, underscored the strategic nature of these transactions, extending beyond mere buying and selling to signify deliberate, time-bound investments. Such strategic investment behavior unequivocally characterized *Bank Markazi* as a foreign investor on U.S. soil.

The U.S. courts, in judicial proceedings that resulted in the expropriation of *Bank Markazi*'s assets, affirmed this characterization by observing that the Bank, like many large financial institutions, "invest[ed] in foreign sovereign bonds"[65] through "a series of financial transactions over an extended period of time".[66] This viewpoint suggests that, in the eyes of the U.S. judiciary, the bond operations of *Bank Markazi* were "the type of actions by which a private party [would engage in commerce]".[67] Nevertheless, despite this recognition, the pursuit of such commercial activities was intentionally thwarted by U.S. measures,[68] presenting a contradiction to the provisions of the Treaty of Amity.

The International Court of Justice, had it remained consistent with its 2019 approach of prioritizing the nature test, might have been inclined to qualify *Bank Markazi* as a foreign investor, potentially holding the United States accountable for contravening its treaty obligations.[69] However, in its 2023 Judgment on the Merits, the Court departed from its previous stance, declaring that:

> "these operations are not sufficient to establish that *Bank Markazi* was engaged, at the relevant time, in activities of a commercial character. Indeed, the operations in question were carried out within the framework and for the purposes of *Bank Markazi*'s principal activity, from which they are inseparable. They are merely a way of exercising its sovereign function as a central bank, and not commercial activities performed by *Bank Markazi*

[63] Wu, Li, and Selover (n 61), 646.
[64] Reply of Iran, *Certain Iranian Assets (Iran v. United States)*, (n 28), 91.
[65] *Peterson v. Iran, Bank Markazi, Banca UBAE, Clearstream, JP Morgan Chase Bank*, United States Court of Appeals for the Second Circuit, Opinion and Order, 21 November 2017, Case No. 15-0690, 8.
[66] *Peterson v. Iran*, United States District Court, Southern District of New York, Opinion and Order, 28 February 2013, LEXIS 40470, 6.
[67] *Republic of Argentina v. Weltover* (n 46), 615.
[68] The U.S. measures in question involved legislative, executive and judicial measures aimed at taking the Bank's assets. Iran alleged that the United States violated its obligations under the Treaty of Amity, *inter alia*, by expropriating the property of *Bank Markazi* and failing to provide it with fair and equitable treatment (FET). For FET criteria in general, see Agata Zwolankiewicz, 'The Brave New World of Foreign Investment in the Wake of Covid-19 Pandemic: Current Situation and Potential Disputes' (2021) 2 CIFILE Journal of International Law 1, 12.
[69] See *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on Preliminary Objections (n 11), Para. 92, (Stating that "the legal person in question should be regarded as a 'company' within the meaning of the Treaty to the extent that it is engaged in activities of a commercial nature").

'alongside [its] sovereign functions'".[70]

In this articulation, the Court determined it would not characterize *Bank Markazi* as a "company" under the Treaty of Amity definitions based merely on the nature of activities conducted, even when the Bank engaged in security entitlements purchasing on the open market similarly to other operators.[71] Instead, the focus shifted to whether the activities in question could be disentangled from the Bank's sovereign functions.[72]

This revised stance prompted dissent among a number of the Court's judges, who asserted that it "deviate[d] from" the 2019 Judgment and was "in complete contradiction" with it.[73] However, notwithstanding this divergence, the trajectory set by the ICJ's previous decision remains a significant contribution to the corpus of international law. It is expected that it will be further contemplated through future discourses within the international legal community, particularly in the light of the emerging exigencies of the dynamic spheres of the financial market and foreign investment.

## Conclusion

Central banks play a key role in national financial ecosystems. Their primary mandates typically include ensuring monetary and financial stability, devising and implementing monetary policy, and promoting sustainable national economic growth. To effectively carry out these multifaceted responsibilities, central banks are endowed with significant authority. This encompasses their capacity to function as regulators of their respective financial systems and also to undertake commercial activities. Yet, as central banks expand their horizons and involve themselves in various international financial undertakings, the challenge of correctly classifying these ventures within the framework of international law becomes more complex.

In attempting to classify the activities of central banks, legal scholars and practitioners often rely on two distinct criteria: one focuses on the nature of the activities, while the other examines the underlying purpose behind them. Among these, the nature test stands out prominently. This criterion, which assesses the outward form of an activity rather than its motives, finds support across a variety of legal forums—from international courts to investment arbitral tribunals. Even within national jurisdictions, such as the United States, the preeminence of the nature test is noticeable. This test is applied to assess whether the activities performed by a central bank mirror those that a private party would

[70] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on the Merits (n 14), Paras. 50 (Emphasis Added).
[71] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Separate opinion of Judge Bennouna, ICJ Reports 2023, 30 March 2023, 3.
[72] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, Judgment on the Merits (n 14), Paras. 51.
[73] *Certain Iranian Assets (Iran v. United States)*, International Court of Justice, ICJ Reports 2023, 30 March 2023, Declaration of Judge Salam, 4; Separate opinion of Judge Bennouna, 3; Separate Opinion of Judge Yusuf, 2-3; Separate Opinion, Partly Concurring and Partly Dissenting, of Judge Robinson, 3; Separate Opinion of Judge *ad hoc* Momtaz, 4-5.

undertake in the realm of international commerce.

The nature test's applicability was notably brought to the fore in the ICJ case concerning *Certain Iranian Assets*. The core issue in this case revolved around the expropriation directed against bond investments of Iran's Central Bank, *Bank Markazi*, in the U.S. financial market. The U.S. bond operations performed by the Bank consisted of all elements of portfolio investments made by private players within a free market and, thus, were of a commercial nature. Iran sought affirmation of this classification by the ICJ, as the Court had found in its 2019 judgment that the Bank would be considered a company eligible for protection under the 1955 Treaty of Amity between Iran and the United States if its relevant activities were commercial in nature. However, in a stark departure from its earlier stance, the ICJ declined in 2023 to qualify *Bank Markazi* as an investor, ruling that the Bank's operations were carried out for the purposes of its sovereign activity.

This jurisprudential shift by the ICJ, accompanied by dissenting voices within its bench, calls for further reflection on the consistent application of legal principles in a world where central banks are evolving into multifunctional entities. Ensuring the protection of central banks' rights in this dynamic landscape is essential. As these institutions underpin national prosperity and play a critical role in shaping global financial trends, the harmonization of practices and legal principles applicable to them is of paramount importance.

**FUNDING:** This research did not receive any specific grant from funding agencies in the public, commercial, or not-for-profit sectors.

**DECLARATIONS OF INTEREST:** The authors declare none.

**CONFLICT OF INTEREST**

The author (s) declares that there is no conflict of interest regarding the publication of this manuscript. In addition, the ethical issues, including plagiarism, informed consent, misconduct, data fabrication and/or falsification, double publication and/or submission, and redundancy, have been completely observed by the authors.

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**PUBLISHER'S NOTE**

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