



Research article

# An elusive safeguard with loopholes: sovereign debt and its “negotiated restructuring” in international investment agreements in the age of global financial crisis

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## Abstract

Financial crises often compel indebted countries to restructure their external public debt in order to ease their economic burden. Since this is usually quite disadvantageous to the creditors, they consequently sometimes begin “holdout” litigation so as to obtain the face value of their original bonds with interest. In this context, investor-state arbitration has been seen as an attractive alternative to litigation for creditors because the recognition and enforcement of arbitral awards is far more effective than those of foreign judgments. Yet such a holdout strategy would undermine an orderly process of debt workout because a successful holdout by some creditors will necessarily bring other creditors to take the same step to obtain remedies. The question therefore is, how is it possible to strike a proper balance between the protection of creditors and the macroeconomics policy leeway needed by defaulting states. One solution to prevent such holdout arbitration is to arrange for the coverage of sovereign debts in international investment agreements. This article analyses the development of such arrangements in investment treaties with special reference to

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provisions dealing with a “negotiated restructuring” of public debt, and it concludes that a proper balance between public and private interests as expected by contracting parties is struck by such agreements.

*Keywords:* sovereign debt, debt restructuring, financial crisis, investor-state arbitration

## Introduction

Financial crises often compel indebted countries to restructure their external public debt in order to ease their economic burden.<sup>1</sup> This process—usually called sovereign debt restructuring—consists not only of negotiations between a defaulting state and its foreign private creditors, but also of the sovereign’s unilateral offer of exchange (in the “take-it-or-leave-it” form) of the original bond with a new one<sup>2</sup> that is usually quite disadvantageous to the creditors. Such measures may at times entail a breach of contract and/or a violation of international obligations.<sup>3</sup> As a result, creditors who are not satisfied with the terms of the offer sometimes adopt “holdout” strategies so as to obtain the face value of the original bonds with interest. In order to attain this objective, creditors bring their claims not only in litigation before domestic courts, such as the Federal District Court of New York, in accordance with the terms of their contracts, but also through investor-state arbitrations under the auspices of the International Centre for Settlement of Investment Disputes (ICSID) or other arbitration centres. Investor-state arbitration is regarded as an attractive option for creditors because, as will be discussed later, the recognition and enforcement of arbitral awards is far more effective than those of foreign judgments.

However, it has been pointed out that holdout strategies will undermine an orderly process of debt workout because a successful holdout by some creditors will necessarily bring other creditors to take the same step to obtain remedies. Because creditors are likely to recover much more money by commencing litigation or arbitration than by accepting an offer of debt rescheduling, there is little incentive for creditors to choose the latter option. The result is that defaulting states are prevented from adopting necessary economic policies to recover from crises.<sup>4</sup>

The question therefore is, how is it possible to strike a proper balance between the protection of creditors and the macroeconomics policy leeway needed by defaulting states. One solution to prevent holdout arbitration is simply to exclude or at least to limit sovereign debt from the scope of relevant international investment agreements (IIAs), thereby putting it outside the jurisdiction of arbitral tribunals.

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<sup>1</sup>INTERNATIONAL LAW ASSOCIATION SOVEREIGN INSOLVENCY STUDY GROUP, STATE INSOLVENCY: OPTIONS FOR THE WAY FORWARD, 3 (Report for the Hague Conference, 2010), available at [http://www.ila-hq.org/en/committees/study\\_groups.cfm/cid/1026](http://www.ila-hq.org/en/committees/study_groups.cfm/cid/1026). Giorgio Sacerdoti classifies financial measures to be taken to address crises as follows: (i) limitations of current payments; (ii) limitations of capital transfers; (iii) rescue/reorganization of (only) selected national financial institutions (“too big to fail”); (iv) sovereign default and debt restructuring; (v) currency redenomination; and (vi) prudential measures for the stability of the financial sector and/or specific intermediaries. Giorgio Sacerdoti, *BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defence of Necessity*, 28 ICSID REV. 351, 355 (2013). The present article deals with the fourth category.

<sup>2</sup>Ugo Panizza et al., *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LITERATURE 651, 671 (2009).

<sup>3</sup>Regarding possible scenarios for the violation of international standards for investment protection, see, e.g., Anne van Aaken & Jürgen Kurtz, *Prudence or Discrimination? Emergency Measures, the Global Financial Crisis and International Economic Law*, 12 J. INT’L ECON. L. 859, 884–891 (2009); MICHAEL WAIBEL, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS 273–297 (2011).

<sup>4</sup>In *Abaclat v. Argentina*, the arbitral tribunal assumed that the aim of sovereign debt restructuring is to preserve “the functioning of the defaulting State as well as the international financial system while equitably protecting the interests of the creditors.” *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, 4 August 2011, § 29, available at <http://www.italaw.com/cases/35>.

In this regard, at least two approaches, which are not mutually exclusive, can be identified: a restrictive interpretation of IIAs by arbitral tribunals and law-making arrangements in newly-concluded IIAs by states. Because the former is not the focus of this article, the latter is analysed in relation to the development of investment treaty law.

The approach to IIAs, including bilateral investment treaties (BITs), has changed in recent years. While traditional BITs were relatively short and concise, consisting of fifteen articles, more or less, and five to ten pages in length, modern investment treaties are far longer, more complex, and accompanied by detailed annexes. For example, the Germany-Pakistan BIT (signed in 1959), considered to be the first BIT, covered just ten pages of the *Bundesgesetzblatt* of the Federal Republic of Germany.<sup>5</sup> In contrast, the investment chapter of the Trans-Pacific Partnership (TPP) Agreement, which was released on 5 November 2015, comprises a fifty-two page PDF file with many detailed annexes.<sup>6</sup> One of the remarkable developments found in these more complex and detailed modern IIAs is that they now sometimes contain provisions that explicitly deal with sovereign debts and debt restructuring, as if these were special circumstances. Yet, as will be discussed below, the relevant provisions are not uniform or consistent, so a comprehensive analysis is necessary in order to arrive at an understanding of the current state of affairs with regard to how sovereign debt is dealt with on the international investment plain.

At first glance, at least two interpretations of the current state of affairs are possible. One interpretation is that the investment treaties are moving in the right direction, but that the situation is still far from satisfactory. As pointed out by the United Nations Conference on Trade and Development (UNCTAD), the provisions in question do not necessarily provide an effective solution to the holdout because they leave only limited options for investment claims by creditors.<sup>7</sup> From this point of view, the provisions contain loopholes that undermine the safeguards provided for special circumstances. The other possible interpretation is that such an incomplete safeguard embodies a balance between investment protection and public policy. Assuming that the detailed and complex provisions in modern IIAs are the fruit of the struggle of investment treaty law having encountered the “legitimacy crisis”<sup>8</sup> of the 2000s, it could reasonably be assumed—at least *prima facie*—that a proper balance between public and private interests as expected by contracting parties is embedded in such provisions, and that the loopholes within the safeguard are a heuristic readjustment of the balance between the two, at least for the moment.

This article traces the development of IIA provisions dealing with sovereign debt—which are so far relatively underexplored—and then analyzes their significance from the perspectives described above.

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<sup>5</sup>Almost all the IIAs analysed in this article are available at the UNCTAD website on the Investment Policy Hub: <http://investmentpolicyhub.unctad.org/IIA>.

<sup>6</sup>The TPP text is available on the website of the New Zealand Ministry of Foreign Affairs & Trade: <http://www.mfat.govt.nz/Treaties-and-International-Law/01-Treaties-for-which-NZ-is-Depositary/o-Trans-Pacific-Partnership.php>.

<sup>7</sup>UNCTAD, *Sovereign Debt Restructuring and International Investment Agreements*, 2 IIA ISSUE NOTE 8 (2011), available at <http://unctad.org/en/pages/publications/Intl-Investment-Agreements--Issues-Note.aspx>.

<sup>8</sup>See generally Charles H. Brower, *Structure, Legitimacy, and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. 37 (2003); Ari Afilalo, *Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve their Legitimacy Crisis*, 17 GEO. INT'L ENVTL. L. REV. 51 (2004); Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005); Charles N. Brower & Stephan W. Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?* 9 CHI. J. INT'L L. 471 (2009); Stephan W. Schill, *Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach*, 52 VA. J. INT'L L. 57 (2011); Daniel Behn, *Legitimacy, Evolution, and Growth in Investment Treaty Arbitration: Empirically Evaluating the State-of-the-Art*, 46 GEO. J. INT'L L. 363 (2015).

It first revisits legal discourses on the definition of “investment” in relation to sovereign bonds (Part I) and then analyses the recent developments of treaty provisions dealing with sovereign debt instruments (Part II).

## I. Definition of “Investment” Revisited

The longstanding debate about whether investor-state arbitration is an appropriate forum for settling sovereign debt disputes (Part A) is reflected in the debate about whether sovereign bonds can qualify as an “investment” to be protected by BITs (Part B). While arbitral tribunals have tended to interpret “investment” liberally so as to include financial instruments, and more specifically, sovereign bonds, two recent backlashes—one of which is the subject of this article—against this trend can be identified (Part C).

### A. Investor-state arbitration as a means to settle sovereign debt disputes

#### 1. Arguments in favour of arbitration

While arbitration clauses were frequently included in contracts for public debt during the first half of the twentieth century,<sup>9</sup> modern sovereign debt instruments usually submit disputes to the jurisdiction of the domestic courts in the countries where important financial markets are located.<sup>10</sup> Karen Halverson Cross conducted a survey of publicly-available documents and concluded that sovereign debt instruments issued and traded in US markets almost always provide for litigation rather than arbitration.<sup>11</sup> An empirical study conducted by Stephen J. Choi and G. Mitu Gulati suggests that among the ten sovereign bond issuers they surveyed, only Brazil provides for submission to arbitration.<sup>12</sup> This divergence is explained by the existence of a particular arrangement of Brazilian national legislation, according to which the Brazilian government is “constitutionally incapable of submitting to the jurisdiction of foreign courts.”<sup>13</sup> The case of Brazil is thus unique and exceptional,<sup>14</sup> and therefore does not alter the present landscape in which arbitration clauses are rarely found in bonds issued by sovereigns.

Desite current practices, conventional wisdom does not view international arbitration as an impracticable or improper option for settling sovereign debt disputes. Quite the contrary, commentators argue that arbitration is potentially more advantageous than domestic litigation. Cross posits that the persistent failure to include an arbitration clause in sovereign debt instruments can be explained, using the terms of law and economics, by “lock-in” effects and “network effects,” according to which revising standardized corporate contract terms entails “switching costs” and thus constitutes an obstacle to

<sup>9</sup>For the historical account, see generally W. Mark C. Weidemaier, *Contracting for State Intervention: The Origins of Sovereign Debt Arbitration*, 73 L. & CONTEMP. PROBS. 335 (2010).

<sup>10</sup>Otto Sandrock, *The Case for More Arbitration when Sovereign Debt is to be Restructured: Greece as an Example*, 23 AM. REV. INT'L ARB. 507, 508 (2012).

<sup>11</sup>Karen Halverson Cross, *Arbitration as a Means of Resolving Sovereign Debt Disputes*, 17 AM. REV. INT'L ARB. 335, 339 (2006).

<sup>12</sup>Stephen J. Choi & G. Mitu Gulati, *An Empirical Study of Securities Disclosure Practice*, 80 TUL. L. REV. 1023, 1074-78 (2006). The subjects of the survey are Mexico, Brazil, Colombia, Italy, China, the Philippines, Lebanon, Israel, Jamaica, and South Africa. These samples were chosen partly because some are major issuers of bonds (Mexico, Brazil, and Colombia), and partly in order to guarantee geographical diversity (the other countries). *Id.* at 1025.

<sup>13</sup>J. Anthony Clare, *Enforcement of the Arbitration Clause in Brazilian Loan Agreements*, 7 INT'L FIN. L. REV. 18 (1982).

<sup>14</sup>The other exception so far reported is Ukraine. Ukrainian bonds, which are governed by English law, provide the option of either litigation in an English court or arbitration in London. According to Cross, this is due to the fact that Ukraine is not an EU member country, so the EU mechanism for recognition and enforcement of foreign judgments that will be mentioned below has no role to play. Cross, *supra* note 11, at 340 n. 22.

change.<sup>15</sup> In Cross's view, law firms that serve as agents for the issuance of sovereign bonds can be a catalyst for changes in this practice in light of the visible increase of ICSID arbitration since the mid-2000s.<sup>16</sup>

Generally speaking, arbitration is advantageous for the settlement of disputes relating to transnational business transactions because of its flexibility, confidentiality, and neutrality, as well as the enforceability of arbitral awards.<sup>17</sup> This last characteristic is particularly highlighted when it comes to arguing for the appropriateness of arbitration for settling sovereign bonds disputes in which a sovereign state is the defendant.<sup>18</sup> Unlike the international mechanism for recognition and enforcement of foreign judgments—so far established in only a limited geographical area, mainly within the European Union<sup>19</sup>—the recognition and enforcement of arbitral awards are governed by international treaties that have a quasi-universal nature.

The 156 parties<sup>20</sup> to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 “shall recognize arbitral awards as binding and enforce them,” and they may refuse to do so only on the basis of limited procedural and public policy grounds.<sup>21</sup> The New York Convention applies to investor-state arbitration under the auspices of the ICSID Additional Facility Rules<sup>22</sup> or the UNCITRAL (United Nations Commission on International Trade Law) Arbitration Rules.<sup>23</sup> Also, the ICSID Convention provides an autonomous system of enforcement, according to which the 159 signatory states<sup>24</sup> shall recognize an ICSID award “as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.”<sup>25</sup> Furthermore, it is estimated that the affiliation of the ICSID with the World Bank would induce the compliance of state parties with ICSID awards because non-compliance entails reputation costs that might be counted negatively when the state attempts to borrow from the Bank in the future.<sup>26</sup>

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<sup>15</sup>*Id.* at 374-77.

<sup>16</sup>*Id.* at 376-77.

<sup>17</sup>*Id.* at 354.

<sup>18</sup>Sandrock, *supra* note 10, at 510; Felipe Suescun de Roa, *Investor-State Arbitration in Sovereign Debt Restructuring: The Role of Holdouts*, 30 J. INT'L ARB. 131, 138–143 (2013).

<sup>19</sup>Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2001 Official Journal L 012, available at <http://curia.europa.eu/common/reldoc/convention/en/c-textes/2001R0044.htm>.

<sup>20</sup>The number as of May 25, 2016. To see if the number of parties has changed, see [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html).

<sup>21</sup>Articles III & V of the New York Convention, 330 U.N.T.S. 3, available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html).

<sup>22</sup>Available at <https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Pages/ICSID-Additional-Facility-Rules.aspx>.

<sup>23</sup>Available at <https://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf>.

<sup>24</sup>The number as of June 30, 2015. See Background Information on the ICSID, available at <https://icsid.worldbank.org/apps/ICSIDWEB/about/Documents/ICSID%20Fact%20Sheet%20-%20ENGLISH.pdf>.

<sup>25</sup>Article 54(1) of the ICSID Convention, 575 U.N.T.S. 159, available at [https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR\\_English-final.pdf](https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf).

<sup>26</sup>Cross, *supra* note 11, at 363 n.146 (referencing the remarks by IMF General Counsel Sean Hagan at the Conference on Odious Debt held at University of North Carolina School of Law on 10 February 2007). However, the commentary on the ICSID Convention prepared by Christoph Schreuer does not share this view. CHRISTOPH H. SCHREUER ET AL., *THE ICSID CONVENTION: A COMMENTARY* 1108 (2d ed. 2009) (“it is by no means clear whether it was expected that the World Bank’s strong position with many host States would serve as an incentive to comply with awards.”).

As a result, investor-state arbitration is considered to be an attractive alternative to domestic litigation.<sup>27</sup> With regard to domestic litigation, it is significant that even vulture funds that obtained favourable judgments have been barred from successful enforcement in cases such as *Elliott Associates, L.P., v. Banco de la Nación*<sup>28</sup> and *EM Ltd v. Republic of Argentina*,<sup>29</sup> both before the US Court of Appeals for the Second Circuit.

## 2. Arguments against arbitration

Qualifying investor-state arbitration as a mechanism of dispute settlement is yet a sort of euphemism for recovering sovereign bonds in that it is the settlement—or in the word of Cross, “resolving”—of disputes only as seen from the creditors’ point of view: obtaining pecuniary relief from debtors. For defaulting sovereigns, investment arbitration is nothing more than another option for creditors to implement a holdout strategy that adversely affects the process of debt workouts by entailing so-called collective action problems, which bears two serious consequences: first, a successful holdout eliminates the effect of debt relief by other creditors, especially by official sectors,<sup>30</sup> and second, a holdout strategy reduces the incentive for a majority of creditors to join reschedules of debts.<sup>31</sup>

With these concerns in mind, Michael Waibel warns that such a use of ICSID arbitration would open “a Pandora’s box” in that “[b]ondholders might be able to obtain compensation, even though the contractually prescribed majority accepted the restructuring.”<sup>32</sup> Also, the consolidation of bondholder claims before investment arbitration is likely to “shift bargaining power to nonparticipating creditors as a group, and away from participating bondholders and the country in default.”<sup>33</sup> As a result, Waibel concludes that arbitration “could fundamentally alter the dynamics of future sovereign debt restructurings.”<sup>34</sup> His view has been endorsed by Georges Abi-Saab, who dissented in *Abaclat v. Argentina* by saying that such an option “can also potentially unravel patiently negotiated settlements.”<sup>35</sup>

## B. Sovereign debt and the definition of investment

Waibel and other authors who share his view have argued that sovereign bonds are not “investments” and, therefore, that arbitral tribunals have no jurisdiction *ratione materiae* to entertain sovereign debt disputes (Part 1). However, this interpretation has been criticized by commentators who recognize the utility of international arbitration in cases of sovereign defaults, as well as being countered by arbitral awards affirming that sovereign bonds can qualify as an “investment” for the purpose of the ICSID Convention (Part 2).

<sup>27</sup>Cross, *supra* note 11, at 377; Sandrock, *supra* note 10, at 543; Suescun de Roa, *supra* note 18, at 153–154.

<sup>28</sup>*Elliott Assocs., L.P., v. Banco de la Nación*, 194 F.3d 363 (2d Cir. 1999).

<sup>29</sup>*EM Ltd. v. Republic of Argentina*, 473 F.3d 463 (2d Cir. 2007).

<sup>30</sup>See Matthias Goldmann, *Sovereign Debt Crises as Threats to the Peace: Restructuring under Chapter VII of the UN Charter*, 4 GOETTINGEN J. INT’L L. 153, 161-62 (2012).

<sup>31</sup>See *Brief for the United States of America as Amicus Curiae in Support of the Republic of Argentina’s Petition for Panel Rehearing and Rehearing en Banc*, Case No. 12-105-cv(L) (2d Cir., 28 December 2012).

<sup>32</sup>Michael Waibel, *Opening Pandora’s Box: Sovereign Bonds in International Arbitration*, 101 AM. J. INT’L L. 711, 715 (2007).

<sup>33</sup>*Id.*

<sup>34</sup>*Id.*

<sup>35</sup>*Abaclat v. Argentine Republic*, *supra* note 4, § 271 (dissenting opinion of Georges Abi-Saab).

1. *Interpretative approach denying the status of sovereign debt as an investment*

Although it has not been firmly established,<sup>36</sup> it is broadly assumed that a two-step test applies when determining what comes within the jurisdiction of the ICSID tribunal: whether interests or properties claimed by investors qualify as an investment under the applicable BIT and, if so, whether the investment falls within the ambit of Article 25 of the ICSID Convention stipulating that “[t]he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment.” In addition, the definition of “investment” in Article 25 has certain core elements that constitute “the outer limits”<sup>37</sup> to the jurisdiction *ratione materiae* of ICSID tribunals. Authors who highlight the negative aspects of investor-state arbitration in solving disputes relating to a sovereign default argue that sovereign bonds do not even fit within these outer limits. By referring to the famous *Salini* test,<sup>38</sup> they argue that sovereign bonds lack core elements of investment such as contributions to the economic development of host states, a certain duration of performance, and participation in the risks of transactions. It is also often argued that an investment must have a territorial link with the host state and that it must be associated with a commercial undertaking.

The fundamental premise of Waibel’s interpretation is arguably the twofold objective of the ICSID Convention: not only “to increase investor protection” but also “to ensure that investments perform an essential economic and social service in developing countries.”<sup>39</sup> Although he does not specify the relationship between the two, it seems that the first objective is understood to be encapsulated by the second one: investment is protected to the extent that it contributes to host states’ development. Waibel therefore argues that “potential development and abstract financial flows are not enough”<sup>40</sup> to satisfy the element of contribution to the host state’s economic development. He thus insists that “[t]o avoid asymmetrical treatment of host state and investor, the actual, present impact in the host country” is needed.<sup>41</sup> He arguably assumes that “a significant contribution,” in the words of the tribunal in *Malaysian Historical Salvors v. Malaysia*,<sup>42</sup> is necessary.<sup>43</sup> As a result, he inclines to the conclusion that claims by individual bondholders fall short of this criterion.<sup>44</sup>

Regarding duration, Waibel seems to assume that the idea behind this element is to distinguish investments from ordinary commercial transactions, and he thereupon insists that “ICSID lacks jurisdiction over short-term financial flows.”<sup>45</sup> This idea of distinguishing “genuine investments” from normal commercial transactions strikes a chord with the understanding of the ICSID’s dual objective described above, and it could at least logically be assumed that as the duration of holdings is shorter the contribution would be smaller. Based upon this premise, Waibel concludes that since vulture funds speculatively purchase debt instruments in secondary markets—where they can resell them at any time—to

<sup>36</sup>Suescun de Roa, *supra* note 18, at 145.

<sup>37</sup>Aron Broches, *The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 132 RECUEIL DES COURS 330, 351, 361 (1972-II).

<sup>38</sup>*Salini Costruttori S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001, § 52; *Joy Mining Machinery Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, 6 August 2004, § 53.

<sup>39</sup>Waibel, *Opening Pandora’s Box*, *supra* note 32, at 724.

<sup>40</sup>*Id.* (emphasis in original).

<sup>41</sup>*Id.* at 724 n.86.

<sup>42</sup>*Malaysian Historical Salvors SDN, BHD v. Malaysia*, ICSID Case No. ARB/05/10, Award on Jurisdiction, 17 May 2007, § 123.

<sup>43</sup>Waibel, *SOVEREIGN DEFAULTS*, *supra* note 3, at 231.

<sup>44</sup>*Id.* at 234.

<sup>45</sup>*Id.*

hold for a short term so as to demand payment at face value, such holdings “fail to meet the jurisdictional requirement of a long-term transfer of financial resources.”<sup>46</sup>

The third element is participation in the risks of transactions. For Waibel, the “[h]ost country and [the] investor [must] share the risk of success and failure” before their project qualifies as an investment.<sup>47</sup> Bondholders bear the risk of default—non-payment by debtors at the time of maturity date—which is theoretically inherent in all financial instruments. Yet as Emmanuel Gaillard highlights, this risk is different from the risk of an investment in that the repayment of bonds is not dependent on the ultimate success or failure of a venture project; in contrast, the profit from an investment depends on the success or failure of the economic venture in question.<sup>48</sup> As the respondent in *Poštová banka v. Greece* argued, “investment risk entails uncertainty as to returns and expenditures, even if all parties fulfill their contractual obligations,” but the extraordinary nature of sovereign default “does not make this an investment risk.”<sup>49</sup> While default risk only indicates that the bond may not be repaid, investment risk predicts that the economic venture may bring a profit both to the investor and to the host state and thereby constitutes an indicator delimiting the scope of protected investments.

Waibel further argues that the ICSID Convention inherently implies a territorial link requirement for the term “investment” in Article 25, and thereby demands a physical presence of investment in the host state.<sup>50</sup> Referring again to the twofold objective of the ICSID Convention, he understands that the ICSID arbitration was “designed to counterbalance the host state’s regulatory authority over investments *in its territory*.”<sup>51</sup> Based upon this premise, he insists that the territorial link of debt instruments traded in foreign secondary markets is especially tenuous.<sup>52</sup> Even assuming that a purchase of sovereign bonds in a primary market had contributed to the development of the host state, Waibel doubts whether the subsequent purchaser could meet a territorial qualification.<sup>53</sup> One may argue at least that secondary market purchases do not involve “inflow of funds” to a host state and thus lack a territorial connection in that sense.<sup>54</sup>

Finally, Waibel contends that an investment in Article 25 of the ICSID Convention must be associated with a commercial undertaking. The goal of equity holdings must be commercial and distinct from the general budgetary purposes of borrowing states.<sup>55</sup> This element seems to be intertwined with the third element (participation in risks) in that such holdings must share the fate of the economic venture.<sup>56</sup> The distinction is perhaps that the existence of risks can be identified objectively, whereas this final element relates to the subjective goal of financial contribution. From this point of view, he argues that holdings of sovereign bonds might be seen as a commercial undertaking only to the extent that they are tied to

<sup>46</sup>Waibel, *Opening Pandora’s Box*, *supra* note 32, at 726.

<sup>47</sup>Waibel, *SOVEREIGN DEFAULTS*, *supra* note 3, at 237.

<sup>48</sup>EMMANUEL GAILLARD, *LA JURISPRUDENCE DU CIRDI [ICSID CASE LAW] 479* (2004) (“un simple prêt dont la rémunération ne dépend en rien du succès de l’entreprise ne peut être qualifié d’investissement”).

<sup>49</sup>*Poštová Banka, a.s. v. Hellenic Republic*, ICSID Case No. ARB/13/8, Award of 9 April 2015 § 106.

<sup>50</sup>Waibel, *SOVEREIGN DEFAULTS*, *supra* note 3, at 238.

<sup>51</sup>*Id.* (emphasis added).

<sup>52</sup>*Id.* at 241.

<sup>53</sup>*Id.* at 241–242.

<sup>54</sup>*Cf. Poštová Banka v. Greece*, *supra* note 49, § 112.

<sup>55</sup>Waibel, *Opening Pandora’s Box*, *supra* note 32, at 728.

<sup>56</sup>*Id.*

specific projects, such as railway or power plant construction.<sup>57</sup> However, since sovereign bonds usually serve general budgetary purposes, he concludes that such holdings have no association with a commercial undertaking.<sup>58</sup>

## 2. Interpretative approach affirming the status of sovereign debt as an investment

Waibel's argument has been countered and criticized by subsequent authors who recognize the utility of arbitration for the settlement of claims arising out of sovereign defaults. Among others, Youngjin Jung and Sangwook Daniel Han do not even share the fundamental premise of Waibel's interpretation and instead argue that "the drafting history of the Convention suggests there is more onus to interpret the term broadly instead of narrowly."<sup>59</sup> They agree with the analysis done by Julian Davis Mortenson of the *travaux préparatoires* of the ICSID Convention, which concludes, "[a] group led by developed countries [that] advocated wide-open jurisdiction over any foreign enterprise . . . eventually won out."<sup>60</sup> For them, Waibel's interpretative approach, based upon the *Salini* test and additional requirements, is itself flawed and questionable. For instance, the territorial link requirement is "an outdated idea without due regard to the global nature and operation of modern financial markets."<sup>61</sup>

Regarding contributions, Felipe Suescun de Roa argues that a purchase of bonds in a secondary market does constitute a contribution because "[f]or the primary market to succeed, there should be a secondary market that gives liquidity to debt instruments. Otherwise, investors would not buy such instruments from underwriters, and governments would hardly raise capital for their operations."<sup>62</sup> He does not necessarily see holdout litigation as an evil to be removed. Rather, he believes that holdout litigation might increase the liquidity of the sovereign debt market because the mere existence of the holdout option would limit potential "opportunistic defaults."<sup>63</sup> From this point of view, the other requirements (duration, participation in the risks, and a commercial undertaking) would have little or no significance because they are just signs indicating a prospect of contribution. By increasing the liquidity of the market, the mere purchase of sovereign bonds contributes to the development of borrower countries.

In fact, arbitral jurisprudence has developed in line with this line of argument. In *Fedax v. Venezuela*, the arbitral tribunal decided that the promissory notes issued by Venezuela and acquired by the claimant by way of endorsement constituted an investment, stating that because "promissory notes are evidence of a loan and a rather typical financial and credit instrument, there is nothing to prevent their purchase from qualifying as an investment under the Convention."<sup>64</sup> According to the tribunal, "although the identity of the investor will change with every endorsement, the investment itself will remain constant, while the

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<sup>57</sup>*Id.*

<sup>58</sup>*Id.*

<sup>59</sup>Youngjin Jung & Sangwook Daniel Han, *Sovereign Debt Restructuring under the Investor-State Dispute Regime*, 31 J. INT'L ARB. 75, 81–82 (2014).

<sup>60</sup>Julian Davis Mortenson, *The Meaning of Investment: ICSID's Travaux and the Domain of International Investment Law*, 51 HARV. INT'L L.J. 257, 259 (2010).

<sup>61</sup>Jung and Han, *supra* note 59, at 82.

<sup>62</sup>Suescun de Roa, *supra* note 18, at 147.

<sup>63</sup>*Id.* at 149. An "opportunistic default" is a type of sovereign default "when the sovereign debtor is unwilling, but not unable, to pay." See Jill Fisch & Caroline Gentile, *Vultures or Vanguard? The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L. J. 1043, 1044 (2004).

<sup>64</sup>*Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision on Objections to Jurisdiction, 11 July 1997, §§ 29, 45.

issuer will enjoy a continuous credit benefit until the time the notes become due"; therefore, the notes constituted a foreign investment.<sup>65</sup> In *Československa Obchodní Banka v. Slovak Republic*, the tribunal affirmed that a loan made by the claimant to the Slovak Collecting Company qualified as an investment even if it did not, standing alone, constitute an investment "provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment."<sup>66</sup> The tribunal's premise was that "investment as a concept should be interpreted broadly because the drafters of the Convention did not impose any restrictions on its meaning," and therefore "an international transaction which contributes to cooperation designed to promote the economic development of a Contracting State may be deemed to be an investment."<sup>67</sup>

In this way, the two classical ICSID cases on debt instruments interpreted the term investment liberally. In particular, the determination by the tribunal in *Fedax* that changes in the holders of notes do not deprive the notes of their nature as an investment to be relevant for the qualification of sovereign bonds purchased in a secondary market. In fact, the tribunal in *Abaclat v. Argentina* held that the security entitlements to Argentine sovereign bonds qualified as an investment because "the bonds and the security entitlements are part of one and the same economic operation and they make only sense together."<sup>68</sup> Unlike Waibel's argument—which was broadly shared by the dissenting arbitrator<sup>69</sup>—the majority argument in *Abaclat* did not apply the *Salini* test by highlighting the objective of ICSID "to encourage private investment while giving the Parties the tools to further define what kind of investment they want to promote."<sup>70</sup> Instead, according to the tribunal, the only requirement is that the contribution "be apt to create the value that is protected under the BIT."<sup>71</sup> Based upon this criterion, the tribunal held that the purchase of security entitlements in the Argentine bonds generated a value, namely, "the right attached to the security entitlements to claim reimbursement from Argentina of the principal amount and the interests accrued."<sup>72</sup>

### C. Two backlashes against the second approach

The interpretative discourse about the definition of investment is thus predicated on perceptions of the propriety and usefulness of investment arbitration in the context of sovereign defaults. The argument that is wary of arbitration is inclined to assume the validity of the *Salini* test so as to limit the scope of jurisdiction *ratione materiae* of tribunals, while the argument in favour of arbitration tends to reject the validity of the *Salini* test so as to qualify sovereign debt instruments as an investment for the purpose of Article 25 of the ICSID Convention. Although the latter approach seems to have been taken by arbitral tribunals, two recent developments which might constitute backlashes against this trend are identified.

One is the case of *Poštová Banka v. Greece*, in which the arbitral tribunal denied its jurisdiction to entertain claims based upon the claimant's ownership of Greek government bonds. The *ratio decidendi* of

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<sup>65</sup>*Id.* § 40.

<sup>66</sup>*Československa Obchodní Banka, A.S v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, 24 May 1999, §§ 69–72.

<sup>67</sup>*Id.* § 64.

<sup>68</sup>*Abaclat v. Argentina*, *supra* note 4, §§ 376, 387.

<sup>69</sup>*Id.* §§ 2, 34–117 (dissenting opinion of Georges Abi-Saab).

<sup>70</sup>*Id.* § 364.

<sup>71</sup>*Id.* § 365.

<sup>72</sup>*Id.* § 366.

the award was apparently the interpretation of the applicable Slovakia-Greece BIT—whose language is, in the analysis of the tribunal, significantly different from the language that led the *Abaclat* tribunal to conclude that government bonds qualified as investments under the Argentina-Italy BIT—and not Article 25 of the ICSID Convention. But the tribunal touched upon the outer limits *in arguendo* and concluded that ownership of the Greek bonds did not constitute an investment because there was neither a contribution to an economic venture nor an associated investment risk.<sup>73</sup> The question thus arises whether this award is consistent with prior arbitral jurisprudence or constitutes a departure from it.<sup>74</sup> The present author will address this issue in a future article.

The other development, addressed below in the second part of this article, concerns IIA provisions regarding sovereign debt and debt restructuring. Although some literature has pointed out the existence of such peculiar clauses in a limited number of BITs, few attempts have been made to analyse the overall trend. Nevertheless, it is worth examining, not only because the arrangement is complex and therefore necessitates some explanatory notes, but also because these arrangements are gradually becoming common, notably via recent preferential trade agreements (PTAs) establishing multilateral mechanisms for investment protection.

## II. The Elusive Development of Sovereign Debts and Debt Restructuring in International Investment Agreements

The interpretation of the term “investment” found in each BIT is normally considered a separate jurisdictional question, though the benchmarks and elements to be analysed will inevitably overlap with those of Article 25 of the ICSID Convention discussed above. Irrespective of the interpretative approach to Article 25, ICSID tribunals cannot exercise jurisdiction over claims on interests or properties not qualifying as an investment for the purpose of the applicable BIT. Also, for non-ICSID tribunals having no “outer limits” of jurisdiction *ratione materiae*, the definition of an investment in each BIT is critically decisive.

Most BITs define the term “investment” broadly, using phrases such as “all assets” or “every kind of asset” followed by several illustrative categories,<sup>75</sup> and these definitions have been invoked by authors to argue that the term includes sovereign debt instruments as well.<sup>76</sup> While investment treaties using the words “sovereign debt” or “sovereign bonds” are relatively rare, special arrangements for “government securities” and “public debt” can be found in a limited number of treaties concluded since the 1990s (Part A). An even more elusive recent development that requires some explanation is that BITs and investment chapters within Free Trade Agreements (FTAs) limit—but curiously, do not exclude—treaty claims to a “negotiated restructuring” of debts by defaulting sovereigns (Part B).

<sup>73</sup>*Poštová Banka v. Greece*, *supra* note 49, §§ 351–371 (citing Waibel, *Opening Pandora's Box*, *supra* note 32, in § 364 of the tribunal opinion).

<sup>74</sup>See Francesco Montanaro, Case Comment, *Poštová Banka S.A. and Istrokapital SE v Hellenic Republic: Sovereign Bonds and the Puzzling Definition of 'Investment' in International Investment Law*, 30 ICSID REV. 549 (2015).

<sup>75</sup>RUDOLF DOLZER & CHRISTOPH SCHREUER, *THE PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 62–63 (2d ed. 2012). See, e.g., Article 1 of Indian Model BIT (2003); Article 1 of Colombian Model BIT (2007); Article 1 of German Model BIT (2008); Article 1 of French Model BIT (2006); Article 1 of US Model BIT (2012), all available at <http://www.italaw.com/investment-treaties>.

<sup>76</sup>E.g. Cross, *supra* note 11, at 346; Suescun de Roa, *supra* note 18, at 144–145.

## A. Inclusion and exclusion of sovereign bonds from the definition of investment

As of the end of 2015, the phrases “government securities” and “public debt” can be found in at least 59 and 22 investment treaties, respectively. Interestingly, the uses of these phrases fall into two groups that go in completely opposite directions: references to “government securities” or “public debt” so as to include them in the definition of investment (Part 1), and the same references so as to exclude them from protected investment (Part 2).

### 1. Explicit inclusion: Italian BITs

Italian BITs concluded with Eastern European countries in the middle of the 1990s tended to explicitly include “government securities” in the definition of an investment. For example, Article 1(1) of the Italy-Georgia BIT (signed in 1997) defines investment as “any kind of asset property invested,” which includes in its subparagraph (b) “shares, debentures, equity holdings or any other form of participation in a company and any other instruments of credit, *as well as Government securities.*”<sup>77</sup> A similar arrangement can be found in Article 1(2) of the India-Uzbekistan BIT (signed in 1999), in which an investment is broadly defined as “any kind of asset established or acquired,” which includes “government securities” as well.<sup>78</sup>

Although these treaties do not define “government securities,” the rules of treaty interpretation reasonably lead to the conclusion that they include sovereign debt instruments. First of all, the term “government securities” is ordinarily defined as “[a] bond (or debt obligation) issued by a government authority, with a promise of repayment upon maturity that is backed by said government.”<sup>79</sup> Also, these clauses deal primarily with private financial instruments such as shares in a company, and the term “government securities” is added after the connecting words “as well as.” The context within which the terms are used thus indicates that “government securities” refer to financial instruments issued by a government or a public entity, which in practice are called sovereign bonds.

If this interpretation is correct, it appears that the common intention of the parties is to qualify sovereign debt instruments as a protected investment, and thereby to open the door for creditors to have recourse to holdout investment arbitration. The parties might have assumed that investments should be protected even at the cost of sacrificing some leeway in the financial policies of each government. Yet the same or a similar provision does not appear in the subsequent BITs concluded by Italy or other countries.

### 2. Explicit exclusion: Colombian IIAs

In contrast, Colombian IIAs concluded with developed countries in the 2000s to explicitly exclude “public debt operations” from the definition of an investment. For instance, the investment chapter of the Colombia-Canada FTA (signed in 2008) stipulates in its footnote to Article 838 that “public debt operations of a Party or

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<sup>77</sup>Italy-Georgia BIT (1997)(emphasis added); *see also* Article 1(1)(b) of the Italy-Uzbekistan BIT (signed in 1997); Article 1(1)(b) of the Italy-Moldova BIT (signed in 1997); Article 1(1)(b) of the Italy-Azerbaijan BIT (signed 1997); Article 1(1)(b) of the Italy-Armenia BIT (signed in 1998), *all available at* <http://investmentpolicyhub.unctad.org/IIA>.

<sup>78</sup>India-Uzbekistan BIT, *available at* <http://investmentpolicyhub.unctad.org/IIA>.

<sup>79</sup>This definition is given by the dictionary of *Investopedia*, available at <http://www.investopedia.com> (accessed 25 May 2016). In a similar vein, Donald Rutherford defines the term as “[a] bill or bond issued by a local, regional or central government. . . . The ultimate guarantor of the payment . . . is usually the central government.” DONALD RUTHERFORD, *DICTIONARY OF ECONOMICS* 196 (Routledge Reference, 1992). An American dictionary defines it as “securities issued by the U.S. government, such as Treasury bills, bonds, notes, and savings bonds.” JOHN DOWNES AND JORDAN ELLIOT GOODMAN, *EDS.*, *DICTIONARY OF FINANCE AND INVESTMENT TERMS* 226 (1995).

a state enterprise” are not investments.<sup>80</sup> Because this clarification is found in the provision excluding “claims to money arising solely from commercial contracts” from the definition of “investment,”<sup>81</sup> the contracting parties seem to have assumed that public debt qualifies as a commercial transaction that is not an investment. The same arrangement can be found in subsequent Colombian IIAs.<sup>82</sup>

This arrangement is consistent with the provision of the Colombian Model BIT stating that an investment does not include “public debt operations,”<sup>83</sup> so, arguably, the IIAs incarnate a Colombian investment treaty policy. Although no Colombian sovereign default has been reported since the Second World War, it is understandable that a Latin American country would establish such an arrangement in the latter half of the 2000s, when an enormous number of arbitration proceedings against Argentina—the country that declared the largest sovereign default in history in 2001—were witnessed. But there is some indication that the same arrangement is spreading to IIAs concluded by countries other than Colombia, and beyond Latin America, as well.<sup>84</sup>

## **B. Non-discrimination and “negotiated restructuring”**

Special circumstances, such as financial crises, at times require defaulting countries to take measures differentiating the treatment of foreign and domestic sovereign bondholders. Anna Gelpern and Brad Setser argue that “despite important concerns about inter-creditor equity, the ability to treat domestic and foreign creditors differently is a necessary policy option for governments in financial crisis.”<sup>85</sup> With these economists’ justification, legal arrangements justifying different treatment that would otherwise constitute a breach of non-discrimination obligations are straightforward (Part 1). In contrast, a recent trend limiting treaty claims based only upon non-discrimination standards is probably rather elusive (Part 2) and requires extensive analysis (Part 3).

<sup>80</sup>Colombia Free Trade Agreement, available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/colombia-colombie/can-colombia-toc-tdm-can-colombie.aspx?lang=eng>.

<sup>81</sup>*Id.*

<sup>82</sup>See Article 1.2.1, Colombia-BLEU (Belgium-Luxembourg Economic Union) BIT (signed in 2009 but not in force) and Article 1(2)(b)(i), Colombia-United Kingdom BIT (signed in 2010 but not in force), both available at <http://investmentpolicyhub.unctad.org/IIA/CountryBits/45#iialnnerMenu>. Article 8.28 of the Colombia-Korea FTA investment chapter (signed in 2013 but not in force), available at [http://www.sice.oas.org/TPD/Col\\_kor/Draft\\_Text\\_06.2012\\_e/June\\_2012\\_Index\\_PDF\\_e.asp](http://www.sice.oas.org/TPD/Col_kor/Draft_Text_06.2012_e/June_2012_Index_PDF_e.asp), might be ambivalent in this respect. It stipulates that an investment does not mean “public debt operations,” but the latter are still subject to Articles 8.3 (NT) and 8.4 (MFN) of the chapter. As a result, despite not being an “investment,” limited claims on public debt operations can be brought before investor-state arbitration in accordance with the chapter (Article 8.18), in relation to NT and MFN obligations. If this reading makes sense, the exclusion of “public debt operations” from the definition of investment would have little significance, bringing the Colombia-Korea FTA much closer to US and Canadian BITs, as will be discussed below.

<sup>83</sup>Article 1.2.1(i) of Colombian Model BIT (2007), available at [http://www.italaw.com/documents/inv\\_model\\_bit\\_colombia.pdf](http://www.italaw.com/documents/inv_model_bit_colombia.pdf).

<sup>84</sup>See Article 10.1 of the investment chapter of the Canada-Honduras FTA (signed in 2013), available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/honduras/index.aspx?lang=eng>, and Article 1(i)(a)(6) of the Israel-Myanmar BIT (signed in 2014 but not in force), available at <http://investmentpolicyhub.unctad.org/IIA/treaty/3529>. In a similar vein, Article 1(a)(iii) of the Japan-Uruguay BIT (signed in 2015 but not in force), available at <http://investmentpolicyhub.unctad.org/IIA/country/105/treaty/3549>, provides that investment for the purpose of the treaty “does not include a sovereign debt of, regardless of original maturity, a Contracting Party or a debt of a state enterprise” (emphasis added). See also Article 1(i)(c)(iii) of the Japan-Ukraine BIT (signed in 2015 but not in force), available at <http://investmentpolicyhub.unctad.org/IIA/country/105/treaty/3550>.

<sup>85</sup>Anna Gelpern & Brad Setser, *Domestic and External Debt: the Doomed Quest for Equal Treatment*, 35 GEO. J. INT’L L. 795, 796 (2004).

### 1. *Maintaining discriminatory measures on securities: US and Canadian BITs*

BITs concluded by the United States during the 1990s tend to include an annex stipulating that the United States—and in some cases the other contracting party as well—reserve the right to deal with the issue of government securities in ways that would otherwise be inconsistent with national treatment (NT) and/or most-favoured nation (MFN) treatment obligations. For instance, the Annex of the US-Congo BIT (signed in 1990) stipulates that “[c]onsistent with Article II paragraph 1 [*i.e.*, NT and MFN],” the United States “reserves the right to maintain limited exceptions in the sectors or matters” including “primary dealerships in government securities.” The subsequent BITs tend to add the verb “make,” resulting in the United States reserving the right to “make or maintain” government securities exceptions to NT and/or MFN obligations.<sup>86</sup> In a similar vein, the Protocol of the US-Tunisia BIT (signed in 1990) provides that the United States “reserves the right to limit the extent to which nationals or companies of Tunisia or their investments may within U.S. territory establish, acquire interests in, or carry on investments engaged in ... primary dealership in U.S. Government securities.”

A similar trend can be found in Canadian BITs from the mid-1990s to the present. For instance, paragraph 1 of the Annex of the Canada-Ukraine BIT (signed in 1994) stipulates that “[i]n accordance with Article IV, subparagraph 2(d) [*i.e.*, exceptions to NT obligations after the establishment of an investment], Canada reserves the right to make and maintain exceptions in the sectors or matters” including “government securities.”<sup>87</sup> In this regard, the Canada-Costa Rica BIT (signed in 1998) defines “government securities” as “acquisition, sale or other disposition by nationals of the other Contracting Party of bonds, treasury bills or other kinds of debt securities issued by the Government of Canada, a province or local government.”<sup>88</sup> Some Canadian BITs concluded in the late 2000s even seem to extend the scope of exceptions. For example, paragraph 1 of Annex A of the Canada-Latvia BIT (signed in 2009) provides an exception for “government securities” that applies not only to NT and MFN obligations but also to senior management and performance requirements (article V).<sup>89</sup> Subsequent BITs, however, explicitly confine the

<sup>86</sup>The Annex of the US-Sri Lanka BIT (signed in 1991); Paragraph 2 of the Annex of the US-Czech BIT (signed in 1991); Paragraph 4 of the Protocol of the US-Argentina BIT (signed in 1991); Paragraphs 1 & 2 of the US-Kazakhstan BIT (signed in 1992); Paragraphs 1-3 of the US-Romania BIT (signed in 1992); Paragraphs 1 & 2 of the US-Armenia BIT (signed in 1992); the Annex of the US-Bulgaria BIT (signed in 1992); Paragraphs 1 & 2 of the US-Kyrgyzstan BIT (signed in 1993); the Annex of the US-Moldova BIT (signed in 1993); Paragraphs 2 & 3 of the US-Ecuador BIT (signed in 1993); the Annex of the US-Belarus BIT (signed in 1993 but not in force); Paragraphs 1 & 2 of the US-Jamaica BIT (signed in 1994); Paragraphs 1 & 2 of the US-Ukraine BIT (signed in 1994); Paragraph 2 of the US-Estonia BIT (signed in 1994); the Annex of the US-Mongolia BIT (signed in 1994); Paragraphs 1 & 2 of the US-Latvia BIT (signed in 1994); Paragraphs 1 & 2 of the US-Lithuania BIT (signed in 1998). *Texts of BITs available at* <http://investmentpolicyhub.unctad.org/IIA>.

<sup>87</sup>See also Paragraph 1 of the Annex of the Canada-Trinidad Tobago BIT (signed in 1995); Section 1(a) of the Canada-Philippines BIT (signed in 1995); Paragraph 1 of the Canada-Ecuador BIT (signed in 1996); Paragraph 1 of the Canada-Barbados BIT (signed in 1996); Paragraph 11(d)(i) of the Canada-Venezuela BIT (signed in 1996); Paragraph 1 of the Annex of the Canada-Panama BIT (signed in 1996); Paragraph 1 of the Canada-Egypt BIT (signed in 1996); Paragraph 1 of Annex I of the Canada-Thailand BIT (signed in 1997); Section II(1)(c) of Annex I of the Canada-Croatia BIT (signed in 1997); Section II(1)(d) of Annex I of the Canada-Lebanon BIT (signed in 1997); Paragraph 1 of Annex of the Canada-Armenia BIT (signed in 1997); Section II(1)(c) of Annex I of the Canada-Uruguay BIT (signed in 1997). *Texts of BITs available at* <http://investmentpolicyhub.unctad.org/IIA>.

<sup>88</sup>Section II(1)(c) of Annex I of the Canada-Costa Rica BIT (signed in 1998), *available at* <http://investmentpolicyhub.unctad.org/IIA/CountryBits/35#iialnnerMenu>.

<sup>89</sup>See also Paragraph 1(c) of the Canada-Romania BIT (signed in 2009); Annex II of the Canada-Jordan BIT (signed in 2009); Annex 1 of the Canada-Kuwait BIT (signed in 2011). *Texts of BITs available at* <http://investmentpolicyhub.unctad.org/IIA>.

exception to the NT obligations.<sup>90</sup> A similar arrangement can also be found sporadically in BITs concluded by other countries.<sup>91</sup>

As has been mentioned earlier, there is an economic justification for differentiating between national and foreign bondholders in a time of crisis. Although it is not clear whether such differentiation arrangements were included specifically to address such cases, the language of these treaties does reasonably permit discriminatory measures concerning sovereign debt instruments to be taken in those special circumstances.

## 2. *Exceptions narrowed: “negotiated restructuring” of sovereign debt*

However, another group of IIAs exclude treaty claims based upon substantive provisions *other than* NT and MFN obligations before investment arbitration. One of the oldest examples is found in Annex G of the US-Uruguay BIT (signed in 2005), which provides as follows:

No claim that a restructuring of a debt instrument issued by Uruguay breaches an obligation under Articles 5 through 10 may be submitted to, or if already submitted continue in, arbitration . . . if the restructuring is a *negotiated restructuring* at the time of submission, or becomes a *negotiated restructuring* after such submission.<sup>92</sup>

Put differently, if public debt is the object of a “negotiated restructuring,” investors cannot bring treaty claims based upon provisions such as fair and equitable treatment standards and expropriation, but they can still claim a breach of NT (Article 3) and MFN (Article 4) obligations. Unlike the US and Canadian BITs justifying measures that would otherwise be discriminatory, this group of IIAs consciously keeps the door open for claims of a breach of non-discrimination obligations.<sup>93</sup> In order to analyse the implications of this arrangement, the evolution of subsequent IIAs must be traced.

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<sup>90</sup>Annex II (Schedule (e) of Canada) of the Canada-Benin BIT (signed in 2013); Annex II (Schedules of Canada and Tanzania) of the Canada-Tanzania BIT (signed in 2013); Annex II (Schedules of Canada and Cameroon) of the Canada-Cameroon BIT (signed in 2014 but not in force); Annex I (Schedules of Canada and Nigeria) of the Canada-Nigeria BIT (signed in 2014 but not in force); Annex II (Schedules of Canada and Serbia) of Canada-Serbia BIT (signed in 2014); Annex I (Schedule of Canada) of the Canada-Senegal BIT (signed in 2014 but not in force); Annex II (Schedules of Canada and Mali) of the Canada-Mali BIT (signed in 2014 but not in force); Annex II (Schedule of Canada) of the Canada-Côte d’Ivoire BIT (signed in 2014 but not in force); Annex II (Schedule of Canada) of the Canada-Burkina Faso BIT (signed in 2015 but not in force). *Texts of Canadian BITs available at* <http://investmentpolicyhub.unctad.org/IIA/CountryBits/35#iialnnerMenu>.

<sup>91</sup>The Annex of Bulgaria-Czech BIT (signed in 1999), *available at* <http://investmentpolicyhub.unctad.org/IIA/country/30/treaty/667>.

<sup>92</sup>US-Uruguay BIT, Annex G. *See also* Article 5 (Minimum Standard of Treatment); Article 6 (Expropriation); Article 7 (Transfers); Article 8 (Performance Requirements); Article 9 (Senior Management and Boards of Directors); Article 10 (Publication of Laws and Decisions). *Texts of all articles available at* <http://investmentpolicyhub.unctad.org/IIA/country/223/treaty/3069> (emphasis added).

<sup>93</sup>In a similar vein, Annex 10-A of the FTA between Central America, the Dominican Republic, and the United States (CAFTA) provides as follows:

The rescheduling of the debts of a Central American Party or the Dominican Republic, or of such Party’s institutions owned or controlled through ownership interests by such Party, owed to the United States and the rescheduling of any of such Party’s debts owed to creditors in general are not subject to any provision of Section A other than Articles 10.3 and 10.4 [*i.e.* NT and MFN].

*Text available at* <https://ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text>. Although no definition is given to the term “rescheduling,” the context of the term reasonably indicates that it is equivalent to “restructuring” in other IIAs.

Kevin P. Gallagher understands that the 2005 Annex above was proposed by Uruguay to ensure that the treaty would recognize the lawfulness of the debt restructuring that Uruguay had undertaken in 2004 and allow “for that kind of flexibility should a similar circumstance arise in the future.”<sup>94</sup> According to paragraph 2(a), a “negotiated restructuring” is defined as the restructuring or rescheduling of a debt instrument that has been effected through (i) “a modification of the key payment terms of such debt instrument, as provided for under the terms of such debt instrument,” or (ii) “a debt exchange or other process in which the holders of no less than the percentage of debt specified in subparagraph (b) have consented to such debt exchange or other process.”<sup>95</sup> Although subparagraph (b) refers in an abstract manner to “the percentage required to modify the key payment terms of a single series of bonds in the most recent widely-distributed issue of external sovereign bonds,”<sup>96</sup> it requires that the Uruguayan bonds in question be governed by New York law.<sup>97</sup> One of the standardized clauses in the sovereign bond contract issued under New York law is the so-called collective action clause (CAC), which provides procedural rules for sovereign default and debt restructuring.<sup>98</sup> According to this clause, if a super majority of bondholders, typically holding 75% of the principal, agrees to a restructuring plan offered by the debtor government, then this agreement binds the minority creditors as well.<sup>99</sup>

Such a CAC-like mechanism was subsequently incorporated into IIAs concluded by Latin American countries. For example, Article 10.28 of the investment chapter of the US-Peru FTA (signed in 2006) states:

[N]egotiated restructuring means the restructuring or rescheduling of a debt instrument that has been effected through . . . a comprehensive debt exchange or other similar process in which the holders of no less than 75 percent of the aggregate principal amount of the outstanding debt under such debt instrument have consented to such debt exchange or other process.<sup>100</sup>

In sum, it can be concluded that the objective of the treaty arrangement on “negotiated restructuring” is to provide a safeguard for a sovereign debt restructuring against investment claims before investor-state arbitration. In order to identify debt workouts that deserve to be protected, the subsequent agreements incorporated the market practice found in sovereign debt instruments.

Originally, it was always Latin American countries that enjoyed the benefits of these arrangements. Put differently, no similar benefits were provided for the other contracting party—the United States. In fact, Annex G of the US-Uruguay BIT examined above applies only to “a restructuring of a debt instrument issued by Uruguay,”<sup>101</sup> and the public debt exception in the US-Peru FTA is limited to “a restructuring of

<sup>94</sup>Kevin P. Gallagher, *The New Vulture Culture: Sovereign debt restructuring and trade and investment treaties*, 2 INT'L DEV. ECON. ASSOCIATES WORKING PAPER 23 (July 2011), available at: [http://www.networkideas.org/working/jul2011/02\\_2011.pdf](http://www.networkideas.org/working/jul2011/02_2011.pdf).

<sup>95</sup>US-Uruguay BIT, *supra* note 92.

<sup>96</sup>*Id.* (emphasis added).

<sup>97</sup>*Id.*

<sup>98</sup>Christian Hofmann, *Sovereign-Debt Restructuring in Europe Under the New Model Collective Action Clauses*, 49 TEX. INT'L L. J. 385, 390-91 (2014).

<sup>99</sup>See generally, Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. 719 (2004); Mark Gugiatti & Anthony Richards, *The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers*, 35 GEO. J. INT'L L. 815 (2004); Sönke Häsele, *Collective Action Clauses in Sovereign Bonds*, in SOVEREIGN DEBT: FROM SAFETY TO DEFAULT 236 (Robert W. Kolb ed. 2011).

<sup>100</sup>US-Peru FTA, available at <https://ustr.gov/trade-agreements/free-trade-agreements/peru-tpa> (emphasis added).

<sup>101</sup>See note 92, *supra*, and accompanying text.

debt issued by a Party other than the United States.”<sup>102</sup> Both Uruguay<sup>103</sup> and Peru<sup>104</sup> experienced sovereign debt managements respectively in 2003 and in the middle of the 1990s, so the “negotiated restructuring” provision can be regarded as an *ex post* arrangement to set up a safeguard for debt workouts by these countries.

However, Peru changed this one-sided arrangement into a bilateral one in its subsequent treaty-making. Article 10.18 of the investment chapter of the Peru-Singapore FTA (signed in 2008) and Annex 9-D of the South Korea-Peru FTA (signed in 2010) provide the same mechanism for “negotiated restructuring,” but it is applicable for debts issued by both contracting parties.<sup>105</sup> Considering the size and profile of the counterparts, it is unlikely that the government of Peru specifically bore its own debt re-profiling in the 1990s in mind, so the arrangements in these Peruvian FTAs can be seen rather as an *ex ante* safeguard for future sovereign debt workouts. Also, mega-regional free trade agreements subsequently began to incorporate the same mechanism, as exemplified by Annex X of the EU-Canada Comprehensive Economic and Trade Agreement (CETA), which was consolidated and published on 26 September 2014,<sup>106</sup> and by Annex 9-G of the TPP Agreement. The language employed by both CETA and the TPP is almost identical to that of the Latin American IIAs examined above, so no new element can be found in these agreements. Their significance is thus the multilateralization of the “negotiated restructuring” arrangement.

In light of the global financial crisis of 2007–2008 and the subsequent Greek debt crisis, this trend is quite straightforward. As a matter of course, it is difficult to provide an empirical study showing what the negotiators of these investment treaties actually had in mind when they brought this sort of annex to the negotiation table, because the *travaux préparatoires* of trade and investment agreements are usually not made public. Nevertheless, the evolution of IIA provisions mentioned above does almost coincide with the development of the global economy since the beginning of twenty-first century. Therefore, the following account most likely is valid. First, Argentine and other Latin American sovereign defaults highlighted the serious threat brought by the collective action problem and holdout litigation—and possible holdout arbitration—so the annex on “negotiated restructuring” was invented to address this issue in *post factum*. Then the global financial crisis raised the spectre of sovereign defaults not only by developing countries but also by developed countries,<sup>107</sup> and therefore the arrangement on “negotiated restructuring” was transformed into an *ex ante* safeguard that would apply generally to countries regardless of their previous experience of default or their creditworthiness.

<sup>102</sup>Annex 10-F, ¶ 2 of the US-Peru FTA (signed in 2006), *supra* note 100; see also Annex 10-F, ¶ 2 of the investment chapter of the US-Colombia FTA (signed in 2006), available at <https://ustr.gov/trade-agreements/free-trade-agreements/colombia-tpa>.

<sup>103</sup>For Uruguay’s experience, see Carlos Steneri, *Uruguay Debt Reprofitting: Lessons from Experience*, 35 GEO. J. INT’L L. 731 (2004).

<sup>104</sup>For Peru’s experience, see Manuel Monteagudo, *Peru’s Experience in Sovereign Debt Management and Litigation: Some Lessons for the Legal Approach to Sovereign Indebtedness*, 73 L. & CONTEMP. PROBS. 201 (2010).

<sup>105</sup>Both provide that “[n]o claim that a restructuring of debt issued by a Party breaches an obligation under this Chapter may be submitted to ... arbitration.” Both available at [http://www.sice.oas.org/ctyindex/PER/PERAgreements\\_e.asp](http://www.sice.oas.org/ctyindex/PER/PERAgreements_e.asp) (emphasis added).

<sup>106</sup>Available at <http://ec.europa.eu/trade/policy/in-focus/ceta/>. Assuming that the contents of a leaked draft of the CETA investment text were correct, it was the government of Canada that proposed the inclusion of this arrangement to CETA. See Canadian proposal in Draft CETA Investment Text (21 December 2013), previously available at the website of Trade Justice Network, <http://www.tradejustice.ca/leakeddocs/>. In fact, the same arrangement can be found in one of the recent Canadian BITs. See Article 21(3) of the Canada-Burkina Faso BIT (signed in 2015), *supra* note 90.

<sup>107</sup>ILA Study Group, *supra* note 1, at 3.

If this analysis is valid, the gradual spread of the “negotiated restructuring” annex among IIAs and in mega-regional FTAs can be seen as an attempt to reconcile investors—including creditors—to the protection and financial public policy of states in an age of global financial crisis, during which almost all countries are forced to be concerned with the severe aftereffects of sovereign defaults.

### 3. *NT and MFN claims remain: a loophole or balance?*

The remaining question is how one can understand how NT and MFN claims fit into this picture. As has been pointed out earlier, the object and purpose of a “negotiated restructuring” arrangement is to set up a safeguard for a debt workout against investment claims through arbitration. However, all the IIAs examined in this article consistently maintain that NT and MFN claims are possible, even if a debt workout constitutes a “negotiated restructuring,” provided that a cooling period (usually 270 days)<sup>108</sup> has elapsed. As a result, UNCTAD is probably not satisfied with these loopholes because, as justified by economics, “there can be good reasons to discriminate between domestic and foreign bondholders.”<sup>109</sup> In line with Waibel’s argument, UNCTAD’s assumption is that investor-state arbitration can threaten efficient debt restructuring and that “[a]s a matter of policy, it is desirable that countries retain the tools to resolve their debt problems in an effective manner in order to return to normal economic functioning as soon as possible.”<sup>110</sup>

In fact, at least two economic justifications to segregate domestic and foreign bondholders can be sustained. First, payments to national creditors by a government merely result in a redistribution of financial resources within the country and do not produce inflows or outflows, while payments to foreign creditors directly cause capital outflows.<sup>111</sup> Since governments usually want to maintain their foreign exchange in a time of crisis so as to achieve a balanced budget, prioritizing the repayment that would cause much smaller damage is a straightforward economic policy. Second, governments have a good reason to protect their domestic finance system, typically banks, by guaranteeing the repayment of the debts owed to them.<sup>112</sup> Otherwise, they might begin to squeeze credit and thereby worsen a domestic economy that has already suffered a severe depression. As a result, economics may justify differing treatment of sovereign bondholders as a matter of crisis management.

Nevertheless, the explicit terms of public debt annexes do not provide evidence definitively showing that such economic rationales were incorporated into the treaties. In this regard, contracting parties could have chosen other options such as the explicit exclusion of public debt operations or the reservation of measures for government securities that would otherwise be inconsistent with NT and MFN obligations. But they did not do so. Negotiators should have known about these publicly available options when agreeing on their arrangements. Accordingly, the presumption should be that this arrangement has been consciously adopted and maintained, especially by negotiating and contracting parties in mega-regional FTAs that attract more public attention than normal BITs.

<sup>108</sup>See, e.g., Paragraph 2 of Annex X of CETA, *supra* note 106; Paragraph 3 of the Annex 9-G of the TPP, *supra* note 6. An exception is CAFTA, *supra* note 93. According to its Annex 10-E, an investor needs to await the elapse of one year from the date of the events giving rise to the claim.

<sup>109</sup>UNCTAD, *supra* note 7, at 8.

<sup>110</sup>*Id.*

<sup>111</sup>Gelpern & Setser, *supra* note 85, at 809, 813.

<sup>112</sup>*Id.* at 809.

As a matter of course, this understanding does not automatically lead to a conclusion that a tribunal will decide that a “negotiated restructuring” differentiating between domestic and foreign bondholders breaches NT and MFN obligations. Justifications that are embedded within the substantive obligations or found elsewhere—such as essential security interest provisions and the customary international law of necessity—are still available. And for greater certainty, further justification can be provided in each IIA. For instance, the Canada-Burkina Faso BIT, which has the same “negotiated restructuring” arrangement as examined here, provides a GATT Article XX-like general exception with new elements according to which the treaty “does not prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as . . . ensuring the integrity and stability of a Party’s financial system.”<sup>113</sup>

A plausible counter to this analysis could be that the very institution of holdout arbitration constitutes an obstacle to orderly debt restructuring. However, what has been pursued by investment treaty law, having experienced the legitimacy crisis, is to strike a proper balance between investment protection and public interests. It is clear that the search for balance was originally the search for defences to liability that could be invoked by host states,<sup>114</sup> so the introduction and generalization of a public debt annex would be welcomed from this point of view. Yet foreign investment deserves to be protected by international treaties not only because it is property of foreigners that is vulnerable to the interference by host states, but also because it may contribute to the economic development of host states. The true contemporaneous challenge is thus how to achieve a proper balance between investment protection and the legitimate regulatory goals of host states.<sup>115</sup> From this point of view, the existence of loopholes can be seen as a re-adjustment in favour of investment protection within the safeguard guaranteeing public policy leeway in debt workouts. Consequently, public debt annexes in recent IIAs may be seen as embodying a balance between public and private interests as expected by contracting parties, although in a somewhat complicated manner.

Assuming a pluralistic account on international law<sup>116</sup> in which no one specific project will dominate its wisdom—at least in the short term—various balances between the two poles could theoretically be possible. A particular balance seems to have been consciously chosen and elaborated as a public debt annex. Provided that it embodies the will of the contracting parties, the search for the positive law ends here. Yet striking a balance is one thing, and looking for *the better* balance is another. As pointed out above, there seem to be economic rationales for segregating domestic and foreign sovereign bondholders during a time of crisis. If one translates economic rationale into legal justification, investment claims based upon the breach of non-discrimination obligations—especially NT obligations—should be excluded from the jurisdiction of investor-state arbitration tribunals. To compensate for this approach, claims based on other provisions, such as fair and equitable treatment as the minimum standard of protection, could be allowed. As a result, it remains to be seen whether the balance chosen and maintained in the recent public debt annexes can be replaced by a different and/or better balance between the two competing interests.

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<sup>113</sup>Canada-Burkina Faso BIT, *supra* note 90, art. 18(2). The text of GATT (General Agreement on Tariffs and Trade), is available at [https://www.wto.org/english/docs\\_e/legal\\_e/gatt47.pdf](https://www.wto.org/english/docs_e/legal_e/gatt47.pdf).

<sup>114</sup>See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 473 (3d ed., 2010).

<sup>115</sup>SANTIAGO MONTT, *STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION* 5 (2009).

<sup>116</sup>See NICO KRISCH, *BEYOND CONSTITUTIONALISM: THE PLURALIST STRUCTURE OF POSTNATIONAL LAW* (2011).

## Conclusion

This article has analysed provisions in IIAs dealing with sovereign debt and debt restructuring as well as legal discourses about them. The main practical findings can be summarized as follows:

- The debate about whether investor-state arbitration is an appropriate forum to settle sovereign debt disputes is reflected in the debate about whether sovereign bonds can qualify as a “protected investment.” Arbitral tribunals have tended to interpret this term liberally so as to include sovereign debt instruments as well.
- Various arrangements concerning public debt instruments can be found in IIAs. A few BITs explicitly include “government securities” in the definition of investment, while some IIAs exclude “public debt operations” from the definition. Thus, two opposite directions can be identified for IIA coverage of sovereign debt instruments.
- BITs reserving the right of states to take measures concerning government securities that would otherwise be inconsistent with NT and MFN obligations are consistent with economic justifications for differentiating between national and foreign bondholders in a time of crisis.
- IIAs that have an annex on public debt generally bar an investor from bringing investment claims against a “negotiated restructuring” through arbitration proceedings. Yet they explicitly open the door for claims based upon a breach of NT and MFN obligations.
- This public debt annex can be seen as embodying a proper balance between investment protection and legitimate regulatory goals of host states in the age of global financial crisis.
- Economic rationales suggest that there might be a better balance between the two. Yet it remains to be seen whether such a balance will be chosen in future investment treaty-making.

The next topic, to be addressed elsewhere, is the recent arbitral award that denied the jurisdiction of the tribunal over Greek sovereign debt instruments. Also, the question still remains whether contemporaneous debt restructuring practice in the “take-it-or-leave-it” form genuinely constitutes a *negotiated* restructuring; this question will have to be analysed when an arbitral award touching upon this issue appears in the future. The work of this author is to provide a feasible legal framework for sovereign debt restructuring in the decentralized international order, of which this article could constitute a milestone.

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