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How international investment agreements have made debt restructuring even more difficult and costly

By Yuefen LI*

Special Advisor on Economics and Development Finance, The South Centre

I. Introduction

International investment and trade agreements are legally binding international treaties which give investors an additional layer of legal protection on top of the host country law and contract law. However, little efforts have been made in ironing out the interface between these different laws and treaties. Inconsistencies and even contradictions have emerged in the process to enforce legal protection of the interest of investors through international arbitration and litigation, sometimes at the expense of public good, sovereignty and financial and economic stability. An asymmetry seems to exist in the allocation of risks and benefits between investors and recipients of investments. Even though arbitration cases for creditor and sovereign disputes arising from sovereign bonds are few and much less numerous than those related to foreign direct investment (FDI), with the few cases becoming more publicized and with more and more developing countries including low income countries floating bonds even with poor or no sovereign risk ratings, the potential of more such kind of disputes in the future does exist and should not be overlooked. The ongoing reform in the design of new international investment agreements (IIAs) including provisions covering debt instruments and the review of existing ones are reassuring and pointing to the fact that many countries, though not all, are aware of the challenges posed by the IIAs and some countries have been trying to redress the problems.

Sovereign default and debt crisis have long become a reality in the world. Actually, since the 1980s, the occurrence of sovereign debt defaults has become more frequent.[1] Debt default and restructuring have reached their height since the global financial crisis with about eleven countries having defaulted and restructured their sovereign debt with private creditors. Among them the Greek debt restructuring in 2012 was the largest in history.[2] Outright formal defaults have sometimes been averted through debt restructuring. Yet, complaints about debt restructurings being "too late and too little" and often lacking fairness, transparency and orderliness have become stronger and more prevalent. However, up to now, the world still does not have a debt restructuring legal framework for the sovereigns. After a few major countries put to sleep the 2003 IMF-led initiative on the Sovereign Debt Restructuring Mechanism (SDRM), there have been various attempts to revive the international efforts to formulate a treaty-based legal framework on sovereign debt restructuring, including the United Nations General Assembly resolution of September 2015 on "Basic Principles on Sovereign Debt Restructuring Processes". Unfortunately these attempts have not yet won political support from major developed creditor countries. History repeats itself. Like what happened after the SDRM debate, main attention has been turned to improvements of bond contracts like tightening up and strengthening the Collective Action Clause (CAC) and the *pari passu* clause. CAC is a common clause in the bond contracts which makes the decision of a supermajority of bondholders (normally 75% and above) to agree to a debt restructuring legally binding on all holders of the bond while ***Pari passu*** used to be an obscure common clause in a bond contract which means "equal footing". The stretched interpretation of it at the US court for the case of *NML vs Argentina* has made it well known and also led to the tightening of the language to avoid the repetition of the Argentina case[3]. While contractual improvements may not really solve the problems facing debt restructuring, it is certainly a welcoming development which would make holdout of debt restructuring more difficult.

Nevertheless, parallel with the international endeavour to

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While the reform process of international investment protection treaties is evolving, it is still at a nascent stage. Systemic reforms that would safeguard the sovereign right to regulate and balance the rights and responsibilities of investors would require more concerted efforts on behalf of home and host states of investment in terms of reforming treaties and rethinking the system of dispute settlement.

Experiences of developing countries reveal that without such systemic reforms, developing countries' ability to use foreign direct investment for industrialization and development will be impaired.

The policy brief series is intended as a tool to assist in further dialogue on needed reforms.

make debt restructuring smoother and fairer, there have been an international tidal wave of signing IIAs. The rush to sign IIAs has been mainly driven by the belief, though not empirically proven, that IIAs could attract more foreign direct investment to promote economic development.[4] Naturally, there were also cases when IIAs have been treated as political or foreign policy gestures or statements. If the IIAs could be attentive to the sovereign right of developing countries to regulate, allowing sufficient policy space for the introduction of industrial policies for economic development and the attainment of SDGs, IIAs do have *ex ante* and *ex post* benefits which this paper will not discuss. By the end of 2016, the IIAs in the world have reached a total of 3,324.[5] The fact that they are legally binding and noncompliance with the IIA clauses can lead to legal punitive actions do not seem to have been given due attention by some developing country policy makers before the signing of the IIAs. Only when IIAs have started to give rise to millions and billions of dollars of compensation for investors as a result of arbitration awards did countries start to realize that IIAs can bite. The IIAs have strengthened markedly the creditor/investor rights and made sovereign debt restructuring more difficult and more costly. If the definition of investment includes bonds in an IIA, bond contracts cannot govern IIAs which are legally binding international treaties. As a result, efforts to improve bond contracts have become futile unless otherwise stipulated in IIAs to allow bonds be excluded or given special treatments in times of debt restructuring or financial crisis. If a country has not signed any IIAs at all, debt restructuring may face litigations in the national courts stipulated in the bond contracts. However, in the scenario which a country has signed IIAs which could be interpreted as including bonds under the broad scope of investment, holdout creditors would have another avenue to get compensation, namely the arbitration tribunal. A very pertinent question for the international community to consider is whether it is fair for the sovereign borrowers to face both litigation and arbitration and the scrutiny of both private law governing bond contracts as well as public law governing IIAs. Yet, in real life countries have been dragged to both. The economic cost of the two layers of legal protection of creditors could be very high for sovereign borrowers. On the one hand there is the compensation for the holdout bond owners if a favourable ruling is won at designated national courts. On the other, the cost for the arbitration process itself can be a big burden for countries suffering from financial distress. On top of this, some provisions in the IIAs make some generally accepted debt crisis containment and prevention measures as non-compliant with IIA provisions. For instance, IIA clauses like national treatment (NT), most favoured nation clause (MFN), fair and equitable treatment (FET) could provide investors grounds to argue that such policies like capital control, bank deposit guarantee, and nationalization of banks present a breach of IIAs. The fear of being dragged to an arbitration tribunal could negatively impact on effective crisis containment thus making debt restructuring bigger in scale and also "too late". It is high time for the international community to address the interface between the private and public law. For countries having signed the first generation of IIAs, this interface could well be neglected.

This paper has four sections. Following the introduction, Section II examines the problems for the interface between IIAs and current debt restructuring practices which have made restructuring more difficult; section III explains why IIAs have made debt restructuring more costly; and section IV has a brief review of the ongoing reforms on IIAs contributing to smoother and less costly debt restructuring .

II. Interface between IIAs and current debt restructuring practices have made restructuring more difficult

A. IIAs can oblige sovereigns to both litigation and arbitration after a debt restructuring

Bond contracts always have a clause stipulating the jurisdiction of the bonds should disputes arise. Normally it is the national court of a country which boasts to be an important international financial centre. New York and London are top on the list. Therefore, it is litigation at designated national courts and not arbitration tribunals should bond holders want to challenge the outcome of a debt restructuring. According to a survey of existing bond contracts, out of the ten sovereign bond issuers surveyed, only Brazil indicates arbitration as a possible avenue for solving disputes.[6] However, with the signing of IIAs, a debt restructuring may very likely have to go through another layer of legal scrutiny as most IIAs have a clause on arbitration for settling disputes.[7] A debt restructuring can, therefore, give rise to both state-to-state and/or investor-to-state dispute settlement requests. It means that if debt instruments are stipulated as a type of investment in the IIAs, bond holders of countries having IIAs with a country going through debt restructuring can resort to arbitration if they do not want to participate in a debt restructuring owing to various reasons. An economist might be puzzled by such a phenomenon and wonder that if a sovereign borrower entering into a bond contract is considered as giving up its sovereignty and be treated at the same level of a private investor thus its assets abroad can be attached (grabbed in normal language) in case of a default, should it also be fairer to think that once a private investor has become a party of a bond contract, the investor should only be treated as a private investor and not rising to the same level of a sovereign in case of a dispute? With the International Centre for Settlement of Investment Disputes (ICSID)[8] handing out awards on claims of holdout bond investors in the context of violation of IIA provisions, some scholars have been examining the blurring of the public law (treaties) and private law (contracts),[9] which is a very pertinent question waiting for an answer.

B. IIAs make bond contract improvements impotent

The international community has made important efforts to improve bond contracts in particular the Collective Action Clause and *pari passu* clause in the past few years. As a response to events like the Greek debt restructuring and the rulings of the United States Supreme Court on Argentina's restructured bond in 2001, there have been an intensification of contract improvements instead of a holistic attempt to resolve challenges facing sovereign debt restructurings which is naturally more difficult. The International Capital Market Association (ICMA) proposed the super collective action clause[10] and tightened language for the *pari passu* clause.

The IMF's proposals are along the same lines.[11] The revised and strengthened CACs would allow bond issuers to aggregate different series of bonds to be restructured, thus making holding out a restructuring proposal more difficult since possessing a blocking vote would require much greater financial power than for a single bond. In the same vein, the tightened *pari passu* clause has made future stretched interpretation of this clause less possible. With these improvements, there is a sense of complacency that major weaknesses existing in the current bond contracts have been more or less addressed and the road for smoother debt restructuring has been paved.

However, even if 75 or 90 percent of holders of several bonds have agreed to the terms of a debt restructuring and voted against litigation which is completely in line with the enhanced CAC, they cannot prevent holdout investors from filing an arbitral claim if the restructured bonds are deemed as protected investment according to an IIA and there is no special stipulation on negotiated restructuring in the IIA. Cases have shown that private law cannot override public law as ICSID has already handled arbitrations over disputes arising from debt restructuring and the awards are supposed to be immediately enforceable. Michael Waibel was among the first to warn that such kind of IIAs would open "a Pandora's box" as bondholders might obtain compensation through arbitration "even though the contractually prescribed majority accepted the restructuring."[12] With more bondholders aware of arbitration as a relatively easy avenue to get compensation for their bonds, more treaty claims could be lodged thus increasing holdout risks. The treaty claims, depending on the specific wording of an IIA, could be based on IIA clauses like expropriation, fair and equitable treatment, and a few other clauses. The sovereign bond issuers are advised to study carefully their bond contract clauses as well as their IIA clauses before they plan for a debt restructuring.

C. IIAs have broadened scope for forum shopping

Debt instruments typically have active secondary markets which allow speedy selling and buying with little transparency. Bond investors can choose at the secondary market the desired jurisdiction for litigation as well as preferred IIA partner countries with IIAs having clauses carrying possibilities of a favourable treaty claim. For instance when a country has already shown signs of difficulty to service bond payments, and has IIAs whose definition of investment could be interpreted as covering bonds and clauses that could be claimed to be breached by a debt restructuring, an opportunist investor with the aim of making profits out of a sovereign debt crisis would purchase the bonds at the secondary market, normally at a much lower price than the face value of the bonds. Then such investors would wait patiently for debt restructuring to happen. For instance, Poštová Bank from Slovakia which took Greece to ICSID under the Slovakia-Greece bilateral investment treaty (BIT) after Greek debt restructuring bought Greek bonds after credit rating agencies had downgraded the Greek bonds. Even for domestic bonds governed by domestic laws, non-resident holders could sue the state under some provisions in the IIA. It would not be surprising for such kind of investors to hold out and file a treaty claim against the debt restructuring. Arbitration could be more appealing to these investors as arbitration process could take less time than litigations and some core provisions of IIAs could be easily claimed to be violated by a debt restructuring. In addition, the arbitration awards could be less complicated to enforce. Depending on the appetite of the holdout bond investors, some could opt for rushing to the local courts designated in the bond contracts and some others would go directly to the arbitration tribunals. Argentina was taken to the New York court as well as ICSID paying huge compensation to two sets of holdout bondholders. IIAs actually present investors with opportunities to bring one complaint before more than one forum, even have parallel proceedings which in legal terms means one case submitted to more than one forum.[13]

D. IIAs are ambiguous about whether debt instruments are protected investment

Whether or not holdout bond investors can drag a sovereign to the arbitration tribunal after a debt restructuring depends mostly on whether the definition of "investment" in the IIAs includes bonds as a "protected investment". This means the definition or the scope of investment of an IIA would be crucial for deciding whether a claim arising from a debt restructuring is qualified as an investment claim. As a matter of fact, for debt restructuring related cases, tribunals normally start deliberation with determining whether a particular IIA applies to government bonds.

Strangely enough, ICSID which claims jurisdiction over any legal disputes "arising directly out of an investment, between a Contracting State ...... and a national of another Contracting State"[14] does not have a clear definition for investment in the ICSID Convention. This gave arbitration tribunals no clear legal basis for deliberation of claims. There had also been the uncertainty whether ICSID has jurisdiction over disputes over sovereign bonds. Then in 1996 ICSID accepted the arbitration case of *Fedax v. Venezuela*[15] which was a claim pursuant to the Venezuela-Netherlands BIT for failure to pay the amounts due under the promissory notes. This was the first time for debt instrument to be classified as "protected investment" and also for the ICSID to claim jurisdiction officially over such kind of disputes. The compensation involved in this case was not significant and the dispute was not very complex either. The award specified that promissory notes, a debt instrument, were the same like a loan. This case marked the start of taking ICSID by default as a forum for dispute settlement over debt restructuring in addition to national courts mentioned in the bond contracts.

In view of the lack of a clear concept of "investment" and resultant difficulty in arbitration deliberations, in 2001, the tribunal over the *Salini v. Morocco case* (ICSID Case No. ARB/00/4) identified four criteria for investment: 1. commitment or contribution of money or assets; 2. for a certain duration; 3. assumption of risks; 4. contribution to economic development of the host country. These are broad principles. It is not surprising that there is the observation that "subsequent tribunals have applied these criteria flexibly"[16].

To make things even more complex, IIAs all have their own definitions of "investment" and the variation in wording and scope of these definitions range from small to large. In this kaleidoscopic range of definitions, debt instruments have been given different treatments.

The first generation of IIAs tend to be more expansive and sweeping in defining investment. Many IIAs have a broad asset-based definition like investment "covers every kind of asset" without going to details. Government bonds could be interpreted as investment with much ease when such kind of sweeping and all-encompassing definition is given. Some IIAs gave a list of assets. One example is the US model which defines investment as including business enterprises, shares, bonds, debentures, derivatives, intellectual property rights, business concessions, contractual rights, and moveable and immovable property. In the case that there is no differentiation between corporate and government-issued securities, it would be quite clear-cut that bonds are under protected investment. Since the late 1990s and especially the new millennium, IIAs tend to be more restrictive.

E. Case by case interpretative approach in ICSID and difficulty in maintaining consistency

In view of the absence of a uniform definition of investment, there have been difficulties with deciding whether a debt restructuring related dispute regarding a sovereign bond is qualified as a protected investment issue. The question arises as to whether the decision should be solely based on the provisions of the individual IIAs, or based on the Salini criteria, or Article 25 of the ICSID Convention which refers generally to "any legal dispute arising directly out of an investment".

So far ICSID has handled three cases relating to debt instrument disputes under IIAs. The aforementioned *Fedax v. Venezuela* case of 1996 was the beginning for ICSID to claim jurisdiction over debt instruments as a protected investment under IIAs. The argument for the tribunal to pass the ruling that a promissory note was a type of foreign investment was that "promissory notes are evidence of a loan and a rather typical financial and credit instrument" and "although the identity of the investor will change with every endorsement, the investment itself will remain constant, while the issuer will enjoy a continuous credit benefit until the time the notes become due"[17].

In the *Abaclat and Others v. Argentina* case,[18] under which a large group of holdout creditors brought their claim against the Argentine debt restructuring of 2001 under the Italy-Argentina bilateral investment treaty, the creditors claimed that the debt restructuring was in violation of the expropriation clause and fair and equitable treatment standards under the treaty. As in the past, the examination of the case started with whether it was under the jurisdiction of ICSID. The Arbitral Tribunal confirmed that sovereign bonds may constitute an investment in the sense of Article 25 of the ICSID Convention. However, should the Salini criteria be used, there would be the possibility of sovereign bonds not qualifying as a typical business transaction like cross border foreign direct investment. As bonds could change hands at the secondary market very quickly after holding them for a very short duration, the duration criteria is thus not met. As for the Salini criteria of contributing to the economic development of host states, some bond investors may only have commercial interests, in particular those who only purchase bonds when there are signs of the need for debt restructuring and hold out when it really happens.

In the *Poštová bank v. Greece* case[19], claimants brought the case to ICSID under the Slovakia-Greece BIT and the Cyprus-Greece BIT as *Poštová banka,* a Slovak bank, filed the case together with its former Cypriot shareholder, *ISTROKAPITAL SE.* The claims were that the Greek 2012 debt restructuring was a breach of international treaties, depriving the value and wealth of investors in Greek bonds, thus illegal expropriation, as well as failure to accord fair and equitable treatment, and violation of umbrella clauses. Based on these claims, the investors assumed they are entitled to compensation for their losses that the debt restructuring may have caused. Unlike the *Fedax v. Venezuela* case, the tribunal differentiated between loans and bonds and highlighted that bonds are held generally by anonymous groups of creditors and are subject to several alterations of their value. Therefore the arguments were based mainly on the Salini test and the specific language of the Slovakia-Greece BIT instead of Article 25 of the ICSID Convention. The legal basis of the case was different from the Argentina case. Not surprisingly the ruling was that the ownership of the Greek bonds could not be considered as a protected investment because they did not contribute to an economic venture and neither was it associated with investment risks.

From the three cases, we could see that the tribunal of different cases have relatively liberally applied different legal bases for the interpretation of "investment" and the jurisdiction of ICSID. For the Abaclat case on restructured Argentine bonds, there was actually the discussion among the tribunals whether they should arbitrate on the basis of the relevant BIT or on the wording of the ICSID Convention. Apparently the latter prevailed.

This case-by-case interpretative approach adopted by ICSID in affirming the status of sovereign debt as an investment has been challenged by some scholars regarding consistency in deciding on the awards of the cases. Some think that such kind of interpretive approach would result in greater ambiguity as to how these provisions will be interpreted in the next dispute and greater ICSID involvement in sovereign debt restructuring disputes does not necessarily imply a greater predictability for how claims will be resolved.[20]

F. Some core IIA provisions are prone to be used as basis for claiming a violation resulting from debt restructuring

Debt restructurings typically include a haircut which reduces the face value of the bonds and/or prolongation of the maturity of the bonds sometimes. Though they could in some cases avert a debt default and may breathe new life to an economy thus resuming the servicing of the bonds, they may easily be claimed as violating several core provisions of IIAs including fair and equitable treatment/minimum standard of treatment, umbrella clause, national treatment, most-favoured-nation treatment and guarantee of compensation for expropriation.

One important target is **direct expropriation or indirect expropriation**. As IIAs typically do not specify limitations for assets associated with the treaties, and older IIAs rarely have exemptions for specific policy measures that governments have to take for public goods or maintaining economic and social stability, expropriation or indirect expropriation have been frequently claimed for debt restructuring. The definition of indirect expropriation is far from clear cut. Some claims of indirect expropriation referred just to the scenario when the ownership of the bonds are not changed but the value of the bonds has been negatively affected/diminished by debt restructuring and extension of maturity which would result in getting paid later than expected, thus seen as tantamount to expropriation.[21] That was the claim by bondholders under the Italy-Argentina BIT case, Abaclat. For expropriation, its main definition is "wealth deprivation". A haircut in debt restructuring would be considered as a reduction of the value of bonds. This is because investors would claim the face value of the bond as the basis irrespective of the transaction value at the secondary market being a fraction of the face value at the primary issuance; and irrespective of the purpose of intent against public good. The Poštová Bank claimed Greek 2012 debt restructuring reduced the value of the investment in Greek bonds even though the bond was purchased when credit rating agencies downgraded Greek sovereign risks. It seems that, with the protection of IIAs, the purchase of bonds seems to be considered a kind of risk free investment while one of the economic rational of floating bonds is to share risks among investors.

Another easy target is the **umbrella clause** which is an expansive clause obliging host countries of IIAs to respect obligations for protecting investments covered by the treaty under the "umbrella" of international law in addition to domestic law. The sweeping and general language in pledging obligations to protect the property of investors and honour contracts means the host countries would carry responsibilities for contractual obligations beyond the scope of the said treaty. This can be used to justify investor-state arbitration. The United Nations Conference on Trade and Development (UNCTAD) warned that "*the language of the provision is so broad that it could be interpreted to cover all kinds of obligations, explicit or implied, contractual or non-contractual, undertaken with respect to investment generally*".[22] A debt restructuring can be easily interpreted as a breach of contracts as a sovereign bond is perceived as a contract between the issuing government and its bondholders, thus, a violation of the IIA. To pay the face value and also the interests of the bond no matter what is considered as implementing and honouring the contract.

Another is **Fair and Equitable Treatment standards** (FET). Debt restructuring could be viewed by holdout bondholders as coercive, discriminative, in bad faith and in violation of investors' legitimate expectations. FET is also subject to interpretation and the specific IIA would also be taken into consideration especially the IIA's objective which is normally spelt out in the preamble of the IIA. It is not uncommon to see FET being lumped together with expropriation and umbrella clauses.

There is also **National Treatment** (NT). During times of debt crisis especially when it is difficult to determine whether it is a liquidity crisis or really an insolvency situation, governments sometimes give favourable treatment to domestic bondholders to shore up the domestic financial system and maintain confidence and stability. This happened in the Argentinian case. Many scholars consider this kind of government policy measures as necessary and these do not constitute a violation of NT[23].

G. Lack of appealing system for ICSID awards

For litigation at national court, the borrowing country can go to the court of appeals after the lower court issues an injunction. This provides the debtor with an opportunity to further

IIA clauses claimed to be breached in past ICSID cases relating to debt instruments

Case	IIA	Clauses claimed to be breached
Abaclat and others v. Argentine Republic (ICSID Case No. ARB/07/5)	Italy-Argentina BIT	Indirect expropriation, Fair and equitable treatment/Minimum standard of treatment, including denial of justice claims, Umbrella clause, National treatment, Most-favoured-nation treatment, Arbitrary, unreasonable and/or discriminatory measures
Fedax N.V. v. Republic of Venezuela (ICSID Case No. ARB/96/3)	Netherlands-Venezuela BIT	Definition of protected investment in the BIT and whether ICSID has jurisdiction over debt under IIAs. Outstanding capital due on the six promissory notes and the outstanding interest. (*Author's note: This 1997 case was the first time the Tribunal found, in its Decision, that the dispute regarding debt instruments was within the jurisdiction of the ICSID and within the competence of the Tribunal.)*
Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic (ICSID Case No. ARB/13/8)	Cyprus-Greece BIT; Slovakia-Greece BIT	Breach "a claim to money, and the right to performance under a contract having financial value under Article 1.1(c) of the Slovakia-Greece BIT" and breach of contractual claims with economic value under Article 1.1(c) of the Cyprus-Greece BIT. Violation of MFN clause, illegal expropriation, failure to accord fair and equitable treatment, and violation of umbrella clauses.

argue the case. For arbitration, once a tribunal hands out an award, the tribunal does not have the power to reconsider the award even though a party of the case has the right to request for interpretation of the award and/or to apply for annulment of an award on procedural grounds. Therefore, it is assumed that awards should be directly enforced. Article 54 (1) of ICSID's Convention states that *"Each Contracting State shall recognize an award rendered pursuant to this Convention 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"*.

III. IIAs have made debt restructuring more costly

A. IIAs increase the likelihood of debt restructuring being "too late"

Debt restructuring is necessary when a country has unsustainable debt burden ranging from debt overhang to severe liquidity problems. The purpose for undergoing a debt restructuring is meant to allow the debtor country to address the debt sustainability problems and restore economic growth by extending the maturity through debt exchange, a debt reprofiling, or through both haircuts and prolongation of maturity.

Timely and effective debt crisis containment and management could allow a crisis stricken country to prevent a collapse of the economy, contain contagion and protect the public interests. For debt and financial crises in the past two decades and more, especially the current global financial crisis, it has become almost a normal practice for governments to intervene to prevent the economy from sinking into a deeper systemic meltdown and also to alleviate the social suffering of the population. Many governments functioned like fire brigades and adopted various policy measures such as capital control, currency devaluation, freezing prices for the public sector, and even debt restructuring. Scholars including Anna Gelpern and Brad Setser argued that these measures may be necessary for governments in a financial crisis,[24] even though inter-creditor equity is an important principle to follow. However, IIA clauses like FET, expropriation, free transfer of funds and NT provide grounds for challenging such kind of policies through investor-state dispute settlement unless would not allow the special reservations are spelt out clearly in the IIAs. Should governments not adopt crisis management measures for fear of a breach of IIA treaty obligations even though there are economic justifications, the cost of a debt crisis and the eventual debt restructuring would certainly increase. This has turned the investor-state dispute settlement (ISDS) mechanism under IIAs into a hindrance to timely debt restructuring and allowed individual bondholders to holdout debt restructuring arrangements agreed by the majority of bondholders and get compensation from the crisis stricken states whose people are going through economic and social sufferings because of the shortage of financial resources.

There is an urgent need to balance between adherence to the treaty obligations for protecting creditor interests and the policy space for macroeconomic measures in times of financial and economic emergencies in order for a country facing unsustainable debt to return to normal economic functioning as soon as possible.

B. High cost of the arbitration process for sovereigns

The cost of the arbitration process is normally quite significant for the sovereigns. For ICSID, all costs relating to a case are borne by the claimants and the respondents of the claim including expenses of the Tribunal comprising travel, salary, lodging and other costs, ICSID charges, administrative fees and expenses. For cash strapped governments going through debt crises, the costs could be a significant burden.

Take the Greek case as an example[25]:

a) Respondent's (the Greek government) legal fees and expenses amount to €4,650,232.73 as of September 30, 2014. Respondent has advanced US$300,000 to ICSID to cover costs of the arbitration. (As the ICSID tribunal took the decision on April 9, 2015, the cost would certainly be higher.)

b) b) The fees and expenses of the Tribunal and ICSID's administrative fees and expenses (the costs of arbitration), including expenses relating to the Hearing, amount to approximately US$600,600.00. These costs are paid out of the advances made by the Parties.

Article 61 of the ICSID Convention gives the Tribunal discretion to allocate costs of the arbitration, including attorney's fees and other costs, between the Parties as it deems appropriate. In light of these circumstances, the Tribunal decided that both sides shall bear the costs of arbitration equally, **and that each side shall bear its own legal and other costs**.

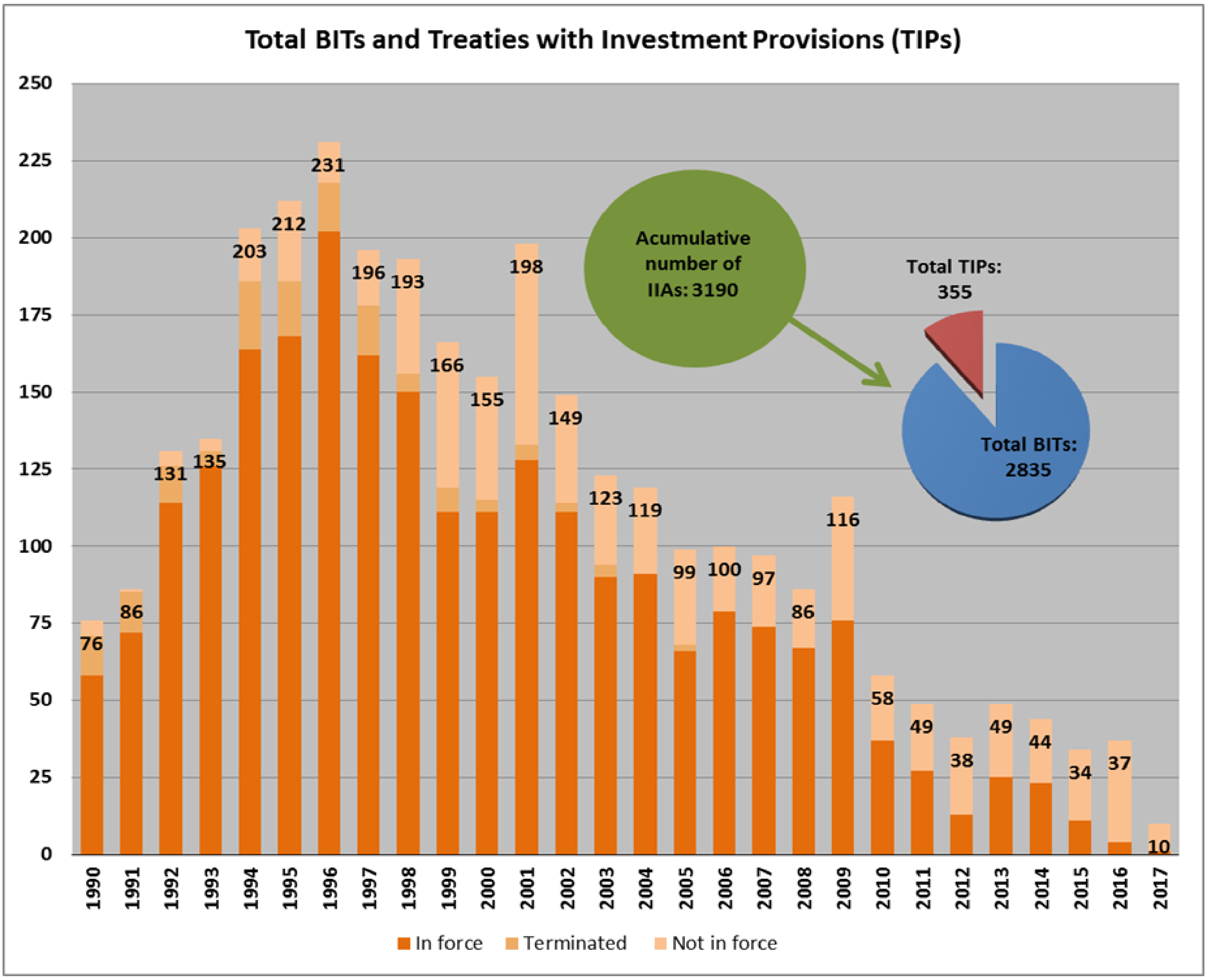
Excluding time spent by officials and staff within relevant governmental institutions, the total cost would go well above 5 million Euros.

Argentina has spent at least US$12.4 million in legal fees for its defence of itself during the Abaclat case.[26] The compensation paid by the Argentinian government to the claimants as stipulated in the April 2016 award was US$1.35 billion.[27]

IV. Ongoing reforms on IIAs contributing to smoother and less costly debt restructuring

Recent years have seen a more cautious and pragmatic attitude towards IIAs from the part of various governments, leading to a slower increase of newly signed IIAs. Countries have also been re-evaluating/reviewing the signed IIAs and reforming the new IIAs in the pipeline. Some IIAs have been terminated (see chart in the next page). The new generation of IIAs are getting longer as provisions are becoming more detailed, restrictive and complex. To reduce cases of arbitration and preserve policy and regulatory space for governments are the main objectives for the ongoing reform of IIAs. Such kind of reform and scrutiny have also their impact on provisions related to debt instruments and the treatment of debt restructuring.

Clearly countries have realised that debt instruments have different features from those for FDI. Governments have used the issuance of sovereign bonds as a monetary and economic policy tool to maintain economic and financial stability as well as for promoting economic development. The extent of social and economic impact of sovereign bonds can be different from that of FDI or corporate debt. Another aspect is that bonds have a secondary market which is out of the reach



Source: Based on UNCTAD database and South Centre calculation

of the issuing sovereigns.

Like bond contracts, IIAs also have boilerplate provisions which countries just cut and paste with little examination onto their IIAs. Many of the new generation of IIAs have modernized some standard yet expansive core provisions to make them more precise to avoid very broad interpretations for arbitration claims. Some new IIAs have also dropped certain problematic standard provisions and/or added information in the form of footnotes and annexes to allow special qualifications and limitations for some standards. This, like bond contract improvements would reduce chances of unjustifiable arbitration claims and contribute to a smoother and less costly debt restructuring.

A. Definition of investment

The definition of investment has proven to be of utmost importance if countries want to minimize exposure to post-debt restructuring related arbitration. According to UNCTAD's database, while only 3% of the old generation IIAs had excluded debt instruments from the definition of investment and had broad asset based definition, 39% of IIAs concluded between 2011 and 2016 had reformed the definition to exclude debt. This way, countries can continue to borrow from the international markets and the linkage of bonds with IIAs has been severed.

There are different ways of excluding debt from the definition of investment:

a) India's model BIT uses an enterprise-based definition and "only recognises those investors who directly own and control an enterprise".[28] Enterprise is defined as entities with 'real and substantial business operations' in the host country with 'substantial and long-term commitment of capital' and a 'substantial number of employees in the territory of the host state'. These standards would meet most of the Salini test criteria and confine almost entirely IIAs to long term FDI.

b) To use a positive or negative list of assets to exclude debt.

B. Special annex or footnotes on debt and debt restructuring

Some IIAs have given public debt (differentiated from corporate debt) special treatment by having a special annex or footnote to prevent investor claims on "negotiated debt restructuring".[29] So long as the sovereign borrowers observe NT and MFN standards in carrying out debt restructuring and have got the consent of the majority of the bondholders which is normally defined as 75% of bondholders, claims against such kind of debt restructuring would be forbidden. On top of it, a 270-day of cooling-off period was introduced to prohibit filing of claims against negotiated debt restructuring. This constitutes a safeguard against claims arising from restructuring following majority consent. With IIA provisions like this, the current international efforts on bond contract improvements may have the benefits the designers hope for. However, countries can be inconsistent in giving such kind of guidelines for debt restructuring. For instance, for the United States quite a number of its IIAs including recently concluded ones included bonds and public debt as protected investment and without a special annex on debt restructuring. Whether this is country oriented or because of special circumstances of the negotiation process is hard to tell. Whatever the case, developing countries, especially those having sovereign bonds, are advised to be attentive to the ongoing reform on IIAs, both the trend and the design of provisions of the IIAs.

C. Preserve policy space for taking measures concerning government security

Some IIAs also have provisions to provide exceptions to allow governments to take special measures to contain financial and debt crisis to avoid default without observing NT and MFN standards. Justifiable security and economic reasons have to be provided. This would give government some space in times of financial crisis. With globalization and financialization, contagion is a major threat for countries which have tapped into the international capital market and using bonds as a way to mobilize financial resources.

Umbrella clause: Some IIAs drop this clause completely as the standard language would make obligations all-embracing and limitless, hoping this would reduce ISDS.

Transfer of funds: Provide detailed exceptions in the clause which could include special circumstances like balance-of-payment problems and enforcement of national laws as well as prudential measures.

Fair and equitable treatment: Specifying obligations of the State would allow measures taken which give some favourable treatments to domestic holders of a debt instrument for the purpose of financial and economic stability. Clarify obligations by including more detailed clauses on FET.

Expropriation: Provide details and criteria to specify what would be considered as expropriation or indirect expropriation to prevent expansive interpretations. This may also have the possibility of excluding restructuring as an arbitration claim if worded well. This would give governments policy space to take actions for the public purpose, with good faith, in a fair and equitable way and with due process of law. For investors' expectations, there are also the efforts to put them in perspective using words like "reasonable". Therefore, under certain circumstances, debt restructuring would be justifiable.

Endnotes:

[1] Paolo Manasse and Nouriel Roubini, ""Rules of thumb" for sovereign debt crises," *Journal of International Economics*, vol. 78, no. 2 (July 2009), pages 192–205.

[2] Lorenzo Forni et al., "Sovereign Debt Restructuring and Growth," IMF Working Paper WP/16/147 (2016), p. 3.

[3] Yuefen Li, "The Long March towards an International Legal Framework for Sovereign Debt Restructuring," *The Journal of Globalization and Development* (Jan. 2016); Lee Buchheit and Sofia Martos, "What to do about Pari Passu," *Butterworths Journal of International Banking and Financial Law* (Sept. 2014).

[4] Yılmaz Akyüz, "Foreign Direct Investment, Investment Agreements and Economic Development: Myths and Realities," South Centre Research Paper, No. 63 (2015).

[5] UNCTAD, *World Investment Report* (2017), Chapter III.

[6] Stephen J. Choi & G. Mitu Gulati, "An Empirical Study of Securities Disclosure Practice," *Tulane Law Review*, vol. 80, no. 4 (March 2006), pp. 1074-78.

[7] The majority of existing investment agreements provide for international arbitration as the mechanism to address disputes between the investor and the State. The 2012 Organisation for Economic Co-operation and Development (OECD) survey of investment treaties showed that 96% contained investor-state dispute settlement provisions allowing foreign investors to raise claims through international arbitration. Source: David Gaukrodger and Kathryn Gordon, "Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community", OECD Working Papers on International Investment, 2012/03, p. 64. Available from http://dx.doi.org/10.1787/5k46b1r85j6f-en. Referenced in UNCITRAL Doc. A/CN.9/WG.III/WP.142, p. 3.

[8] So far all the debt related cases have been handled by ICSID.

[9] Michael D. Nolan and Edward G. Baldwin, "The Treatment Of Contract-Related Claims In Treaty-Based Arbitration," Mealey's International Arbitration Report, vol. 21, no. 6 (June 2006).

[10] Standard Aggregated Collective Action Clauses ("CACS") for the Terms and Conditions of Sovereign Notes (International Capital Market Association, Zurich, Switzerland, August 2014).

[11] "Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring," Policy Paper of the International Monetary Fund (Washington D.C., 2 September 2014).

[12] Michael Waibel, "Opening Pandora's Box: Sovereign Bonds in International Arbitration," *The American Journal of International Law*, vol. 101, no. 4 (Oct. 2007), pp. 711-759.

[13] Jamie Shookman, "Too Many Forums for Investment Disputes? ICSID Illustrations of Parallel Proceedings and Analysis," *Journal of International Arbitration*, vol. 27, no. 4 (2010).

[14] Convention on the Settlement of Investment Disputes between States and Nationals of other States, Article 25 (1)

[15] Fedax N.V. v. Republic of Venezuela (ICSID Case No. ARB/96/3)

[16] Alejandro I Garcia, Herbert Smith Freehills LLP, "ICSID tribunal considers Salini criteria," Thomson Reuters Practical Law, 27 March 2013. Available from https://uk.practicallaw.thomsonreuters.com/9-525-4681? transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1.

[17] Fedax N.V. v. Republic of Venezuela, ICSID Case No. ARB/96/3, Decision on Objections to Jurisdiction, 11 July 1997.

[18] Abaclat and others v. Argentine Republic (ICSID Case No. ARB/07/5)

[19] Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic (ICSID Case No. ARB/13/8)

[20] Alison Wirtz, "Bilateral Investment Treaties, Holdout Investors, and Their Impact on Grenada's Sovereign Debt Crisis," *Chicago Journal of International Law*, vol. 16, no. 1 (2015).

[21] Suzy H. Nikièma, "Best Practices: Indirect Expropriation"(International Institute for Sustainable Development, 2012).

[22] UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (United Nations, 1998), p. 56.

[23] Ugo Panizza, "Is Domestic Debt the Answer to Debt Crises?", in *Overcoming Developing Country Debt Crises*, Barry Herman, Jose Antonio Ocampo, and Shari Spiegel, eds. (New York, Oxford University Press, 2010); Anna Gelpern & Brad Setser, "Domestic and External Debt: The Doomed Quest for Equal Treatment," *Georgetown Journal of International Law*, vol. 35, no. 4 (2004).

[24] Anna Gelpern & Brad Setser, "Domestic and External Debt: The Doomed Quest for Equal Treatment," *Georgetown Journal of International Law*, vol. 35, no. 4 (2004).

[25] See footnote 19.

[26] Cecilia Olivet and Pia Eberhardt, *Profiting from Crisis* (Transnational Institute and Corporate Europe Observatory, 2014).

[27] Abaclat and others v. Argentina (formerly Giovanna A. Beccara and others) v. Argentine Republic (ICSID Case No. ARB/07/5). Available from http://investmentpolicyhub.unctad.org/ISDS/Details/284.

[28] Kavaljit Singh, Madhyam, "The India–US Bilateral Investment Treaty will not be an easy ride," EastAsiaForum, 10 February 2015. Available from http://www.eastasiaforum.org/2015/02/10/the-india-us-bilateral-investment-treaty-will-not-be-an-easy-ride/.

[29] For instance Peru-Singapore FTA, Article 10.18 "Public Debt"; United States-Uruguay BIT, Annex G "Sovereign Debt Restructuring"; China-Peru FTA, Chapter 10, Annex 8 "Public Debt"; the pending Trans Pacific Partnership (TPP).

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The South Centre
Chemin du Champ-d'Anier 17
PO Box 228, 1211 Geneva 19
Switzerland
Telephone: (4122) 791 8050
Fax: (4122) 798 8531
E-mail: south@southcentre.int
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