THE RELATIONSHIP BETWEEN THE INTERNATIONAL INVESTMENT ARBITRATION AND SOVEREIGN DEBT RESTRUCTURING

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ABSTRACT

The two cases of Abaclat and others v. Argentina Republic *and* Ambiente Ufficio S.p.A. and others v. Argentine Republic *have attracted much attention in the application of international investment arbitrationin sovereign debt restructuring. However, the relationship between the international investment law and the sovereign debt restructuring is complex and controversial, since the widespread investment arbitration may hinder the process of sovereign debt restructuring. It may even eradicate its role in the sovereign debt issues under the international investment law framework.To avoid such problems, international investment arbitration under BITs should be applied to sovereign debt restructuring in a more restrictive manner.*

KEYWORDS: *sovereign debt restructuring (SDR), international investment arbitration, bilateral investment treaty (BIT), massive claim, sovereign debt crisis.*

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I. INTRODUCTION

Issuing sovereign debt is an important way for many states to enhance their economic growth. However, when a state has insufficient assets to pay for the debt, a sovereign debt default will occur. According to Standard & Poor's definition, a sovereign debt default is a failure of a sovereign borrower to meet principal or interest payment of its debt obligations on the due date.[1] When it comes to the situation of a state's failure to pay interest and principal, its financial situation should become very devastating. To resolve such a serious problem, the most widely adopted measure is to engage in sovereign debt restructuring, which is seen by many people as an effective cure for a states' economy when it faces terrible crisis arising from the debt default.[2]

The recent investment arbitration cases between the bondholders and Argentina based on a Bilateral Investment Treaties (hereinafter "BITs") has attracted much attention in the field of international investment law. After these cases, it becomes a serious problem concerning whether BITs will turn out to be a potent instrument for sovereign debt bondholders to seek relief and recover their economic loss from the failure of states to pay their debt. A series of questions need to be asked in this context: What is the role of BITs in sovereign debt restructuring? Are BITs a suitable remedial platform for state debt bondholders? What might be the effect of such a remedy to the host state and to the current regime of international investment? To answer these questions, we need to look into the complicated relationship between a state's financial crisis and BITs.

This Article will seek to address these issues in the following parts. Part II provides a brief overview on sovereign debt restructuring, introducing the relationship between sovereign debt and economic development. It further provides a survey on the advantages and disadvantages of sovereign debt restructuring. In Part III, this Article will provide a review on the decision on jurisdiction in the case of *Abaclat v. The Argentina Republic*. The jurisdictional and massive claim issues discussed in the case will provide guidance in resolving relevant issues. In Part V, this Article willidentify its implications for investment arbitrations on sovereign debt restructuring and analyze some special clauses on BITs. Finally in part VI, this Article will propose a policy solution to the questions presented in this Article.

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[1] *See* Joy Dey, *Collective Action Clauses Sovereign Bond holders Cornered?*, 15 LAW & BUS. REV. AM. 485, 493 (2009); *see generally* J. Chambers & D. Alexeeva, *Rating Performance, 2002, Default, Transition, Recovery and Spreads*, STANDARD & POOR'S (2002), http://www4.stat.ncsu.edu/~bloomfld/RatingsPerformance.pdf.

[2] *See* Kevin P. Gallagher, *Financial Crises and International Investment Agreements: The Case of Sovereign Debt Restructuring*, 3(3) GLOBAL POL'Y 362, 363 (2012).

II. OVERVIEW ON SOVEREIGN DEBT RESTRUCTURING

A. Debts and National Development

Sovereign debt, also called public debt or government debt, refers to a debt incurred by governments.[3] Though sovereign debt is increasingly notorious due to the recent debt crises, it plays an important part in economic growth and development. However, debts can become unsustainable and can force nations to default on their loans if they are not properly managed.[4] Theoretically, it is hard to imagine the existence of a sovereign debt default since there are so many measures that a state may adopt to resolve a situation of possible default of such kind. Some possibilities include raising taxes, floating a new loan, and exporting commodities to earn foreign exchanges, etc.[5] Therefore, a sovereign debt default could also be the result of political decision influenced by macroeconomic components. A state can thus be economically or politically forced to restructure its debt so as to expect the creditors to agree to reduce or postpone the debt payments.[6]

Sovereign debts are usually issued in a foreign law and foreign currencyto float the loans with international organization, such as International Monetary Fund (hereinafter "IMF"), foreign countries, or international financial institutions.[7] Because of the close connection between sovereign debt and the global financial system, a sovereign debt default, along with the lowering of a credit rating of a state could result in a serious regional or global economic catastrophe.

B. Sovereign Debts Restructuring

According to the IMF official document "*Restructuring Sovereign Debt: Lessons from Recent History*", a sovereign debt restructuring can be seen as the mechanism for sovereign debt exchange where sovereign debt bondholders take old bonds for new debt instruments or cash under a formal process.[8] Sovereign debt restructuring can be differentiatedby the

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[3] Rebecca M. Nelson, *Sovereign Debt in Advanced Economies: Overview and Issues for Congress* 3 (Cong. Research service, 2013).

[4] *See* Kevin P. Gallagher, *Mission Creep: International Investment Agreements and Sovereign Debt Restructuring*, INVESTMENT TREATY NEWS (Jan. 12, 2012), http://www.iisd.org/itn/2012/01/12/mission-creep-international-investment-agreements-and-sovereign-debt-restructuring-3/.

[5] *See* Anne Krueger & Sean Hagan, *Sovereign, Workouts: An IMF Perspective*, 6 CHI. J. INT'L L. 203, 206 (2005).

[6] Dey, *supra* note 1, at 493.

[7] Gallagher, *supra* note 2.

[8] Udaibir S. Das et al., *Restructuring Sovereign Debt: Lessons from Recent History*, INT'L MONETARY FUND 4 (2012), http://www.imf.org/external/np/seminars/eng/2012/fincrises/pdf/ch19.pdf.

following elements: 1. debt rescheduling, which is defined as a lengthening of maturities of the old debt, possibly involving lower interest rates; and 2. debt reduction, which is defined as a reduction in the face value of the old instruments. Both types of debt operations involve a "haircut," which means a loss in the present value of creditors' claims.[9]

In addition, the IMF working paper of August 2012 (WP/12/203) illustrate that sovereign debt restructurings have been a pervasive phenomenon, amounting to more than 600 cases in 95 countries between 1950 and 2010.[10] Among these cases, 186 debt exchanges were with private creditors, whereas 447 were agreements involving restructured bilateral debt.[11]

Sovereign debts restructuring have been seen as an effective measure for sovereign debts default compared to "global bailout", which is a solution that the foreign government or international financial organization offers money to a defaulting government in order to prevent the consequences that arise from a government's downfall and it has been regarded as part of traditional response to prevent and mitigate debt crises.[12] Bailouts receive a great deal of criticism because they are costly and unfair. They also provide the wrong incentives and there is a lack of effectiveness.[13] Actually, there are many failed cases of global bailouts, including, for instance, the $50 billion rescue package for Mexico's crisis in 1994, and the almost $1 trillion for Europe's current crisis. These bailouts often repay creditors immediatelyand seldom help nations regain their economic footings.[14] Therefore, in those cases, the bailouts cannot effectively respond to the expectation of investors or taxpayers. Moreover, bailout may lead to other serious problems. Fiscal justice is one of the most serious problems since domestic taxpayers might not be willing to pay the bill for foreign creditors. A good example is that the protest in Germany against the government to bailout Greece. The other problem is a "moral hazard" that critics worry about. It is possible that bailouts will stimulate the global investors to make more risky loans.[15] On the contrary, sovereign debt restructuring does not require the creditors or other bondholders to invest much money. Hence, it can maintain the requirement for liquidity. Therefore, sovereign debt restructuring is more effective and would not

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[9] *Id.*
[10] *See* Udaibir S. Das et al., *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 5 (IMF working paper, WP/12/203, 2012), http://www.un.org/esa/ffd/ecosoc/debt/2013/IMF_wp12_203.pdf.
[11] *Id.*
[12] *See* Gallagher, *supra* note 2.
[13] *See* Kevin P. Gallagher, *The New Vulture Culture: Sovereign Debt Restructuring and Trade and Investment Treaty* 7 (The IDEAs Working Paper Series, Paper No. 02/2011, 2011).
[14] *Id.*
[15] *Id.*

create the moral hazards problems.

III. RELATIONSHIP BETWEEN SOVEREIGN DEBT RESTRUCTURING AND BITS: GUIDANCE FROM RELEVANT CASES

To figure out the relationship between sovereign debt restructuring and BITs, the jurisdiction of the International Centre for the Settlement of Investment Disputes (hereinafter "ICSID") convention and the scope of "investment" under the BITs are two important sources of guidance in which we may look into. In this section, the author will introduce the decision for the definition of investment and the jurisdiction issues of the ICSID under the *Abaclat and Others v. The Argentine Republic case* (hereinafter "*the Abaclat case*") and the *Ambiente Ufficio S.p.A. and others v. Argentine Republic* (hereinafter "*the Ambiente case*").

A. Factual Background

In the early 1990s, Argentina restructured its economy to encourage growth and to reduce debt and inflation. As part of its overall scheme, Argentina engaged in a series of negotiations of BITs, including a treaty with Italy. In May 1990, Italy and Argentina concluded the "Agreement between the Argentine Republic and the Republic of Italy on the Promotion and Protection of Investments" (hereinafter "the Argentina-Italy BIT"), which came into force in October 1993.[16]

In addition, Argentina's government issued sovereign bonds to raise capital for its economic development. Argentina placed over a total of USD 186.7 billion in sovereign bonds across domestic and international markets from 1991 through 2001, including 179 bonds that raised approximately USD 139.4 billion in international capital markets.[17] Of these 179 bonds, Claimants allegedly purchased 83 kinds of foreign currency bonds that were from various international exchanges and were governed by laws of different jurisdictions.[18]

However, Argentina faced a severe economic recession in the 1990s. Since the economic crisis in 2001, the Argentinian government announced that it had defaulted on over USD 100 billion of external debt. The default

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[16] According to SICE Foreign Trade Information System, Argentina entered into fifty-seven bilateral investment treaties between 1990 and 2000. *See* SICE FOREIGN TRADE INFORMATION SYSTEM, http://www.sice.oas.org/ctyindex/ARG/ARGBITs_e.asp (last visited May 5, 2014).

[17] Jessica Beess und Chrostin, *Sovereign Debt Restructuring and Mass Claims Arbitration before the ICSID The Abaclat Case*, 53 HARV. INT'L L.J. 505, 506 (2012); *See also* Abaclat and Others v. The Argentine Republic [hereinafter the Abaclat case], ICSID Case No.ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 50 (Aug. 4, 2011), http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf.

[18] *Id.*

affected more than 600,000 Italian bondholders. Therefore, eight major Italian banks established an association called "Task Force Argentina" (hereinafter "TFA") in September 2002, representing the interests of Italian bondholders to negotiate with Argentina. Nevertheless, in 2005, Argentina chose sovereign debt restructuring as the way to solve its problems, and declared that it would offer all foreign bondholders a one-time bond exchange option on a take-it-or-leave-it basis.[19]

Because of the terrible "hair-cut", many of Argentina's creditors refused to participate in the sovereign debt restructuring project in 2005.[20] For relief, the TFA sought out and received authorizations from roughly 180,000 Italian bondholdersto jointly bring their claims as a mass claimbefore the ICSID. In September 2006, the TFA filed a request for arbitration based on the Argentina-Italy BIT.[21]

The Claimants' alleged that Argentina's sovereign debt restructuring project was an expropriation and breached the fair and equitable treatment obligations under the Argentina-Italy BIT. This article concentrated on the two important procedural issues: Did sovereign debt restructuring involve in the concept of "investment"? Could the dispute be considered to have arisen out of the Argentina-Italy BIT? And did the ICSID framework permit the massive claims?

B. ICSID Jurisdiction over Sovereign Debt

Before *the Abaclat case*, some had already argued[22] that the concept of investment in financial market differs from the one used in the foreign investment context. Many investment arbitration tribunals have seen the financial instruments as a protected investment in the majority of cases under scrutiny. Therefore, promissory notes and loan have been deemed to be covered.[23]

For instance, in *the Fedax v. Venezuela case*, although a Dutch company acquired the promissory notes of the Venezuela government by way of endorsement,[24] the Tribunal rejected Venezuela's position that the term "investment" under the ICSID convention Article 25(1) should be limited to foreign direct investment. The Tribunal cited the drafting history of the Convention, academic commentary and prior ICSID decisions for the

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[19] *See id.*

[20] Karen Halverson Cross, *Investment Arbitration Panel Upholds Jurisdiction to hear mass bondholder claims against Argentina*, 15(30) INSIGHT 1.

[21] Chrostin, *supra* note 17, at 507.

[22] *See* MICHAEL WAIBEL SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS 217 (2011).

[23] *See* Josef Ostřanský, Sovereign Defaults and Investment Arbitration 33 (2011-2012) (unpublished thesis, graduate institute of international and development studies, Geneva).

[24] *Id*. at 34.

proposition that the term "investment" should be given a relatively broad meaning.[25] In particular, the Tribunal found that "the loan and a rather typical financial and credit instrument, there is nothing to prevent their purchase from qualifying as an investment under the ICSID Convention in the circumstances of a particular case such as this."[26]

ČSOB v. Slovak Republic is another ICSID case discussing the jurisdictional issue on debt instruments. This case involved an agreement between the ČSOB bank and the Czech and Slovak Ministries of Finance whichprovided that ČSOB has assigned its non-performing loan receivable to a specifically constituted collection company.[27] To enable to pay for the receivables, ČSOB provided a loan to Slovakia. The dispute concerned the obligation by which Slovakia had undertaken to cover the losses incurred by the collection company so that the loan could be repaid.[28] The Tribunal noted that the loan, by itself, does not qualify as an investment. However, the Tribunal has jurisdiction when the loan is part of an overarching operation between the parties bearing the characteristics of an investment.[29] In addition, the Tribunal noted that the term "directly" in Article 25 (1) of the ICSID Convention should not be interpreted narrowly.[30]

However, in *the Abaclat case*, the first ICSID case that deals with the jurisdictional issues on sovereign debt restructuring, the Tribunal noted that the sole criterion as to whether the bonds at issue constituted an "investment" for the purposes of the ICSID Convention is whether the bonds fell within the definition of investment provided for in the Argentina-Italy BIT.[31] This approach differed from previous ICSID tribunal decisions that articulated additional criteria, including the duration of the investment and the significance of the investment to the host state's development.[32]

Argentina argued that a particular economic transaction must meet certain criteria set forth in the *Salini* case[33] to qualify as an investment. These criteria, known as the *"Salini factors"*, include: "(a) a substantial

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[25] Karen Halverson Cross, *Arbitration as a means of resolving sovereign debt disputes*, 17(3) AM. REV. INT'L ARB. 335, 348 (2006).

[26] *Id*. Fedax N.V. v. The Republic of Venezuela, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, ¶ 29 (July 11, 1997).

[27] Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic, ICSID Case No. ARB/97/4, Objections to Jurisdiction (May 24, 1999), 14 ICSID REV. 251 (1999). *See also* Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 AM. J. INT'L L. 711, 721 (2007).

[28] Ostřanský, *supra* note 23, at 34.

[29] *Id.*

[30] Waibel, *supra* note 27, at 721

[31] Cross, *supra* note 20.

[32] CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 128-134 (2d ed. 2009); Waibel, *supra* note 27, at 227-231.

[33] Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction (July 31, 2001).

contribution of the investor, (b) a certain duration, (c) the existence of an operational risk, (d) a certain regularity of profit, and (e) a contribution to the economic development of the host state."[34] However, the Tribunal declined to follow the *"Salini factors"* since the test may create a concept of an "investment" that neither the ICSID Convention nor the Argentina-Italy BIT intend to create. Therefore, the Tribunal focused on the intent of BITs and the ICSID and developed a *"double-barreled test."*[35] Under this test, an instrument is considered an investment as long as it falls within both of the definitions of investment in relevant BITs and the ICSID Convention, and the Tribunal should have the jurisdiction over the case, even if the definition of investment in each other are different.[36]

In this case, the Tribunal noted that Article 1(1) subsection (c)[37] of the BIT was broad and inclusive. It protected the right attached to the security entitlements to claim reimbursement from Argentina of the principal amount and the interests accrued. In particular, subsection (c) seemed to explicitly include financial instruments like bonds.[38] Considering the aim of the ICSID Convention, which encourages private investments and provide parties to a BIT with the tools and flexibilities to specify the kind of investments the parties intend to promote, the Tribunal noted that "the ICSID Convention does not serve to create a limit, which the Convention itself nor the Contracting Parties to Argentina-Italy BIT intended to

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[34] The Abaclat case, ¶ 341(i).
[35] The Abaclat case, ¶ 344.
[36] The Abaclat case, ¶ 351.
[37] According to the Tribunal's own English translation of Article 1(1) BIT, the term investment includes, without limitation:

> - lit. (a): ―movable and immovable goods, as well as any other right in rem, including ― to the extent usable as investment ― security rights on property of third parties;
> - lit. (b): ―shares, company participations and any other form of participation, even if representing a minority or indirectly held, in companies established in the territory of a Contracting State;
> - lit. (c): ―obligations, private or public titles or any other right to performances or services having economic value, including capitalized revenues;
> - lit. (d):―credits which are directly linked to an investment, which is constituted and documented in accordance with the provisions in force in the State where the investment is made;
> - lit. (e):―copyrights, intellectual or industrial property rights ― such as invention patents, licenses, registered trademarks, secrets, industrial models and designs ― as well as technical processes, transfer of technology, registered trade names and goodwill;
> - lit. (f): ―any right of economic nature conferred under law or contract, as well as any license and concession granted in compliance with the applicable provisions applicable to the concerned economic activities, including the prospection, cultivation, extraction and exploitation of natural resources.

[38] The Abaclat case, ¶ 366.

create".[39] Consequently, the Tribunal finds that Claimants' purchase of security entitlements in Argentinean sovereign bonds falls within the "investment" under Article 25 of the ICSID Convention.[40]

In addition, the parallel case of *the Abaclat case*, the *Ambiente Ufficio S.p.A. and others v. Argentine Republic* (hereinafter "*the Ambiente case*"), also followed *the Abaclat case* decision on the jurisdiction issue, and noted that "all requirements in this regard are satisfied of the pertinent bonds and security entitlements, both under Art. 25 of the ICSID Convention and Art. 1(1) of the Argentina-Italy BIT"[41] The Tribunal notes that the "*Salini test*" is proper when assessing the jurisdiction *ratione materiae*, and agreed that the bonds complied with the above criteria, although the ICSID Convention did not necessitate a test of this kind.[42]

In this case, the Tribunal disagreed with the Argentina's submission that the investment was completed outside of Argentinean territory and was not covered by the Argentina-Italy BIT. The Tribunal took the standard that the host state was the beneficiary of the investment, and found that the investment had contributed to its economic development and such contribution was sufficient to establish that the investment was made "in the territory" of Argentina. Therefore, the *Ambiente* Tribunal concluded that the sovereign bonds are covered by the ICSID and Argentina- Italy BITs.[43]

To concluded, the ICSID Tribunals have taken a broad view toward the jurisdiction over debt instruments, although the Tribunals have not established explicit criteria for the "investment" arising from Article 25 of the ICSID Convention. The cases in which the ICSID Tribunals have declined jurisdiction for not meeting the "investment" requirements are few.

C. The "Massive Claim" and "Multi-Party Proceedings"

The *Abaclat* case and the *Ambiente* case receive much attention for its massive claims and multi-party proceedings. Unprecedented in ICSID's 45-year history, the *Abaclat* Tribunal decision upheld the Tribunal's jurisdiction to hear mass claims alleging breach of the 1990 Argentina-Italy BIT but in the process made some different noteworthy findings of jurisdiction.[44] In the *Ambiente* case, the Tribunal also held that it had

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[39] The Abaclat case, ¶ 364.
[40] The Abaclat case, ¶ 367.
[41] *See* Ambiente Ufficio S.p.A. et al. v. the Argentine Republic [hereinafter the Ambiente case], ICSID case No. ARB/08/9, decision on jurisdiction and admissibility, ¶ 520 (Feb. 8, 2013); *See also* Diana Rosert, *Majority dismisses Argentina's objections to jurisdiction in second sovereign bonds claim*, 4(3) INV. TREATY NEWS 1, 17 (2013).
[42] *See* The Ambiente case, ¶ 482.
[43] Rosert, *supra* note 41.
[44] Cross, *supra* note 20.

general jurisdiction over a multi-party claim initiated by 90 Italian bondholders against Argentina in respect of harm said to have been resulted from Argentina's default and the later partial restructuring of its sovereign debt.[45]

The *Abaclat* tribuanl faced the challenge of whether the mass claims, such as those brought by the approximately 60,000 Claimants in *Abaclat* case, were permissible under the ICSID framework. On this issue, Argentina argued that "allowance of class claims, would fundamentally change the nature of ICSID proceedings by making it impossible to evaluate the individual circumstances of each claimant and requiring the Tribunal to ignore the particulars 'in favor of the lowest common denominator'." [46] However, the Tribunal noted that the relevant questioningis not whether Argentina consented to the mass arbitration, but whether the ICSID Convention can be conducted in such a form.[47] Although the ICSID framework is silent on mass proceedings, the Tribunal found that it would run counter to the purpose of the Argentina-Italy BIT and to the spirit of the ICSID to interpret such silence as a prohibition of the mass proceedings.[48] Also, the Tribunal acknowledged that it would not be able to examine the mass claims in the same way it would have done with individual claimants. The Tribunal weighed this consideration against the consequences of a rejecting the bondholders' claims for lack of admissibility and found that a rejection could result in a "shocking" denial of justice to the Claimants.[49]

However, the Tribunal also took the particularities of massive claims into account, and noted that "the massive claim were acceptable where claims raised by a multitude of claimants are to be considered identical or at least sufficiently homogeneous."[50] Further, the Tribunal found that the rights of the Claimants derived from the same BIT and the same provisions and each Claimant's individual claims arose from the same basic type of financial instrument and the same fault with Argentina's post-default behavior. Thus, the Tribunal found that the claims here were sufficiently homogenous.[51] Eventually, the *Abaclat* decision upheld the tribunal's jurisdiction to hear the mass claims which alleged a breach of the Argentina-Italy BIT.[52]

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[45] Herbert Smith Freehills LLP et al., *Ambiente Ufficio S.p.A. and others v Argentine Republic (ICSID Case No ARB/08/9)*, http://www.lexology.com/library/detail.aspx?g=054de59b-b5db-42f2-b3d4-e25800834549 (last visited May 5, 2014).
[46] Cross, *supra* note 20.
[47] The Abaclat case, ¶ 491.
[48] *See* The Abaclat case, ¶¶ 517-19.
[49] Cross, *supra* note 20.
[50] The Abaclat case, ¶ 540.
[51] The Abaclat case, ¶ 544.
[52] Cross, *supra* note 20.

Since there were only 90 claimants in the *Ambiente* case, the tribunal believed the case was a multi-party arbitration instead of a massive claim. In addition, the tribunal held that the multi-party arbitration is found "in harmony" with the Argentina-Italy BIT and the ICSID Convention. Here, Argentina insisted that the case constituted a class action or mass claim which necessitated its explicit consent, as neither the ICSID Convention nor the Argentina-Italy BIT covered collective claims.[53] The Tribunal distinguished the "dimension" of the "multi-party" claim in the *Ambiente* case from the "class-action or mass claim-type collective proceedings" in the *Abaclat* case, the former "being merely one thousandth of the latter."[54] The Tribunal found that there have been dozens of ICSID cases involving multiple claimants, thereby rendering multi-party arbitration a "common feature" in the ICSID arbitration.[55] According to the Tribunal, the silence of respondents and tribunals regarding the number of claimants in these cases might indicate that a multitude of claimants is notan obstacle for ICSID cases to proceed.[56] To conclude, since the Argentina-Italy BIT had provided collective protection through the collective claim, it should include the spirit which envisaged a large number of potential claimants.[57] Also, in this case, the tribunal found that, while there were certain differences between the Claimants regarding the dates and the series of bonds under which the different security entitlements were acquired, there was sufficient homogeneity between the claims to justify a single proceeding.[58]

D. The Implication of Abaclat *and* Ambiente *Tribunal Decisions*

The unprecedented decisions in *Abaclat* and *Ambiente* Tribunals, which may encourage other holders of defaulted sovereign debt to consider investment treaty arbitration seem to be a means of recourse against the issuers. On the other hand, since the Tribunal in *Ambiente* clearly sought to distance itself from the mass claim debate, it is unlikely that the outcome in the *Ambiente* case will attract the same degree of criticism as the *Abaclat* case. The highly homogeneous nature of the claims, including nearly identical factual and investment backgrounds, is likely to be manageable. Moreover, as the *Ambiente* Tribunal emphasized, bond investments will naturally give rise to large numbers of claimants.[59] The decision may affect

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[53] *See* The Ambiente case, ¶ 147.
[54] Herbert, *supra* note 45.
[55] *See* The Ambiente case, ¶ 137.
[56] Herbert, *supra* note 45.
[57] The Ambiente case, ¶ 144.
[58] The Ambiente case, ¶¶ 159-163; Herbert, *supra* note 45.
[59] *Id.*

other tribunals to respond to Argentina's jurisdictional challenges.[60]

IV. ADVANTAGES AND DEFICIENCIES OF INVESTMENT ARBITRATION OVER SOVEREIGN DEBT RESTRUCTURING

After the *Abaclat* and *Ambiente* Tribunals, many commentators tried to figure out the effects of investment arbitration over sovereign debt restructuring and its implication for economic recovery of nations, especially for developing countries, which face horrible financial crises due to debt default. In the following section, this Article will try to compare the positive and negative opinionson the effects of arbitration over sovereign debt restructuring. The author is of the view that the outcome of the widespread investment arbitration over sovereign debt restructuring will trigger the next economic and debt crises, leading to another global economic catastrophe. This Article urges states to carve out the public debt issuesfrom the coverage of BITs to prevent bondholders from seeking remedy through investment arbitration.

A. The Positive Implications

Some commentators believe that the investment arbitration may have a positive impact on the restructuring process and the sovereign debt markets. These opinions include:

1. Investment Arbitration Makes the Sovereign Debt Restructuring More Efficient. — Some commentators believe that the sovereign bondholders can push the host state to implement its sovereign debt project through filing international investment arbitration to challenge the term of the restructuring plan.The sovereign state may not be allowed to delay the restructuring process under the investment arbitration.[61]

2. Investment Arbitration Can Limit the "Opportunistic Defaults". — The investment arbitration may improve the sovereign debt market by limiting potential "opportunistic defaults." These kinds of defaults occur when debtors deliberately fail to make payment of their debts for which they are able to pay. For example, Ecuador decided to default in 2008 because of its domestic politics, but not due to any financial and economic necessity. Investment arbitration may help improve the sound sovereign debt market.[62]

3. Investment Arbitration May Increase the Liquidity of Sovereign

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[60] Chrostin, *supra* note 17, at 507.
[61] *See* Felipe Suescun De Roa, *Investor-State Arbitration in Sovereign Debt Restructuring: The Role of Holdouts*, 30 (2) J. INT'L ARB. 131, 148 (2013).
[62] *See id.* at 149.

Debts Markets. — Investment arbitration may enhance the operation of the sovereign debts markets. It also increases the liquidity of the market in two ways. One is that the investment arbitration may encourage foreign investors by limiting "opportunistic defaults." The other is that future funds might be interested in purchasing distressed sovereign debts. Such funds create liquidity because they give other creditors a chance to exit the market for a fixed price. Therefore, investment arbitration may bring active participants to the sovereign debts market.

4. Investment Arbitration Is An Effective Way to Protect Investors. — Although there are many kinds of mechanisms to avoid different problems under sovereign debt restructuring, there are no mechanism which can provide relief as effective as international investment arbitration does. It is because an arbitral award arising from an international investment arbitration has the advantage of being recognized and enforced in other countries.[63]

B. The Negative Implications

On the contrary, some scholars are not so optimistic about investment arbitration being applied to issues arising from sovereign debt restructuring. Sovereign debt restructuring contains a complicated, anonymous, and unpredictable feature which makes it different from other issues that may occur in investment arbitration. The negative opinions are explained as following:

1. Investment Arbitration May Disrupt the Process of Sovereign Debt Restructuring. — Some commentators worry that international investment arbitration could hinder the ability of debtor nations and their creditors to negotiate issues of public debts and could raise the cost of process of sovereign debt restructuring.[64] As mentioned above, sovereign debt bondholders are pluralized and diversified. So they face difficulty in comprehensively negotiating with the sovereign debtors and in unifying the opinions and interest between each bondholder. Moreover, a successful investment arbitration could encourage bondholders not to participate in sovereign debt restructuring. This could eliminatethe possibility of sovereign debt restructuring.

2. Investment Arbitration over Sovereign Debt Restructuring could Trigger A Sovereign Debt Crisis. — According to Professor of Boston University, Kevin P. Gallagher's research, on average, nations prone to default have signed 39 BITs. Most BITs cover sovereign debt and leave it open for bondholder to file claims against nations to recoup the full value

[63] *Id.* at 143.
[64] Gallagher, s*upra* note 13, at 1.

of their investments. In addition, a recent study by the IMF found that 28 of the poorest nations are now at high risk of debt crisis, and among them, 25 nations face the highest probability of default.[65] Therefore, critics worry about the chaotic result that may arise from investment arbitrations.

Moreover, the "vulture funds," entities which purchase debt when it is of a very low value before or after a restructuring and then file suits to increase the value of their investment, will attack nations even when they face financial and economic crises.[66] Those funds are significantly influential in deteriorating the process of sovereign debt restructuring for economic recovery by the debtor nation. Therefore, widespread investment arbitration cases may cause nations to become more vulnerable to vulture funds' attacks, which in turn can trigger serious sovereign debt crises when such action deteriorates the effectiveness of sovereign debt restructuring.

3. Arbitration cannot Solve the Problems Arising from Sovereign Debt Restructuring. — The core elements of arbitration over sovereign debt restructuring lie in a country's payment capacity, its financial necessity and its emergency legislation. However, because ICSID has no jurisdiction to determine a country's payment capacity,[67] that the fair market value is difficult to valuate, and that the prices of each bondholder to buy the sovereign debt bond in the secondary market are different, tribunalscan hardly assess the precise compensation for each claimant in an investment arbitration case. If a tribunal grants the same compensation for each bondholder, the result may not be fair, of justice, and acceptable for the Claimants. Therefore, investment arbitrations cannot serve as an effective means in resolving the problems between bondholders.

4. The Conflict between ICSID and Other Institutions. — Based on current state practices, some key questions in sovereign debt restructurings are addressed in the established political forums. The International Monetary Fund and the various multilateral development banks are important players. Good examples of questions that are routinely decided by these organizations are debt sustainability, the appropriate amount of debt relief, and the nature of financial assistance to be provided. It can be anticipated that ICSID arbitrations on bonds would lead to some conflicts with these ongoing institutional tasks.[68]

In conclusion from the above, investment arbitrations not only cannot provide appropriate remedy to bondholders, but may also lead to serious economic effects that may cause harm not only to the nations with debt problems, but also to the global economy in general. Under the current circumstance, some commentators emphasized the unique problems and

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[65] *Id.* at 5.
[66] *Id.* at 8.
[67] Waibel, *supra* note 27, at 758.
[68] *Id.* at 759.

worry that investment arbitration under the BITs may undermine the advantages of the sovereign debt restructuring. They believe that the investment arbitration may restrict the ability of nations to recover from financial crises and thus broaden the impact of such crises. They suggest that the investment arbitration should be taken out from the provisions of BIT.[69]

V. SPECIAL CLAUSES ON SOVEREIGN DEBT RESTRUCTURING UNDER BITS: PREVENTING FRIVOLOUS CLAIMS OR PROVIDING A SENSIBLE SOLUTION?

Many suggestions have been provided by commentators for solving the dilemma between investor interest and sovereign economy recovery. But as mentioned above, these suggestions cannot properly cope with the problem. If we only concentrate on the bondholders' protection, widespread arbitration will lead to serious outcomes, such as the vulture fund problem. On the contrary, the suggestion of excluding all sovereign debt restructuring issues from the provisions of BITs is impossible. This is because every state will take the domestic investors' interest into account when it negotiates a new BIT or a free trade agreement (hereinafter "FTA") which has an investment chapter, with other states. For example, one of deadlocks in the negotiation of the US-Korea FTA is the safeguard of SDR issue. Although Korea wanted to exclude the sovereign debt issue from FTA, based on the historic Korean SDR project in 1990 to deal with its serious economic crisis, the US insists that the provision should include the SDR issue, and should exclude the safeguard provision from applying to the SDR process.[70]

Therefore, the author believes that the key point is to avoid arbitration being used in an abusive way. The suggestion here is that we should raise the standard for filing investor-State arbitration over SDR issues. In addition, there are some BITs already having some limited provisions for the SDR issue. In this section, the author will introduce some special clauses on sovereign debt restructuring and point out issues arising from these clauses.

Actually, many BITs have special clauses dealing with sovereign debt restructuring. Moreover, some recent BITs contain guidelines for the interaction between sovereign debt restructuring and the BIT concerned, usually in the form of a special provision or an annex on public debt.[71]

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[69] For instance, Professor Kevin P. Gallagher and Michael Waibel take the negative attitude toward the investment treaty for dealing with sovereign debt restructuring. *See* Gallagher, *supra* note 13, at 27.

[70] *See id*. at 21-23.

[71] For example Peru-Singapore Free Trade Agreement (2008), Art. 10.18 "Public Debt", United

Some provision of BITs divided the sovereign debt restructuring into two types, namely the "negotiated restructuring" and the "non-negotiated restructuring." For instance, Article 10 of the Peru – Singapore Free Trade Agreement[72] and Chapter 10, Annex 8 of the China – Peru Free Trade Agreement[73] clearly define the "negotiated restructuring" as a restructuring

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States-Uruguay BIT (2005), Annex G "Sovereign Debt Restructuring"; Central America-Dominican Republic-United States Free Trade Agreement (DR-CAFTA) (2004), Annex 10-A "Public Debt"; Chile-United States Free Trade Agreement (2003), Annex 10-B "Public Debt Chile"; China-Peru Free Trade Agreement, Chapter 10, Annex 8 "Public Debt".

[72] Peru-Singapore Free Trade Agreement, May 29, 2008:
Art. 10.1 Definition:

> 8. negotiated restructuring means the restructuring or rescheduling of a debt instrument that has been effected through (i) a modification or amendment of such debt instrument, as provided for under the terms of such debt instrument, or (ii) a comprehensive debt exchange or other similar process in which the holders of no less than seventy-five percent (75%) of the aggregate principal amount of the outstanding debt under such debt instrument have consented to such debt exchange or other process.

Art. 10.18 Public Debt:

> 1. The Parties recognize that the purchase of debt issued by a Party entails commercial risk. For greater certainty, no award may be made in favour of a disputing investor for a claim with respect to default or non-payment of debt issued by a Party unless the disputing investor meets its burden of proving that such default or non-payment constitutes an uncompensated expropriation for purposes of Article 10.10 (Expropriation and Nationalisation) or a breach of any other obligation under this Chapter.
>
> 2. No claim that a restructuring of debt issued by a Party breaches an obligation under this Chapter may be submitted to, or if already submitted continue in, arbitration under this Chapter if the restructuring is a negotiated restructuring at the time of submission, or becomes a negotiated restructuring after such submission, except for a claim that the restructuring violates Article 10.3 (National Treatment) or Article 10.4(Most-Favoured-Nation Treatment).
>
> 3. Subject to paragraph 2, an investor of the other Party may not submit a claim under this Chapter that a restructuring of debt issued by a Party breaches an obligation under this Chapter (other than Article 10.3(National Treatment) or 10.4(Most-Favoured-Nation Treatment)) unless two hundred and seventy (270) days have elapsed from the date of the events giving rise to the claim.

[73] China–Peru free Trade Agreement, Apr. 28, 2009, Chapter 10, Annex 8: "PUBLIC DEBT"

> 1. The Parties recognize that the purchase of debt issued by a Party entails commercial risk. For greater certainty, no award may be made in favor of a disputing investor for a claim with respect to default or nonpayment of debt issued by a Party unless the disputing investor meets its burden of proving that such default or nonpayment constitutes an uncompensated expropriation for purposes of Article 133 (Expropriation) or a breach of any other obligation under Chapter 10 (Investment).
>
> 2. No claim that a restructuring of debt issued by a Party breaches an obligation under Chapter 10 (Investment) may be submitted to, or if already

where 75% of the bondholders have consented to a change in payment terms. In the "negotiated restructuring" type, the host countries can execute sovereign debt restructuring without being liable of losses to foreign investors. On the contrary, a sovereign bondholder can still present a challenge after the 270-days cooling-off period under the "non-negotiated restructuring" situation.[74] Additionally, the National Treatment and the Most-Favoured-Nation claims may be brought regardless whether the restructuring is negotiated.[75]

However, not all FTAs or BITs divide the provisions of sovereign debt restructuring into two different types. The Central America-Dominican Republic-United States Free Trade Agreement (DR-CAFTA),[76] for example, clearly excludes the National Treatment and the Most-Favoured-Nation obligations from sovereign debt restructuring. Moreover, there is no mentioning about "negotiated restructuring," "non-negotiated restructuring," and the coolingoff period.[77]

Although these provisions have shown that debt restructuring is a special case and may limit the scope of debt restructuring procedure under BITs, the provisions, unfortunately, cannot reach their intended goal. Such clauses try to prevent frivolous claims and collect the united opinion of bondholders. However, the bondholders can acquire more than 25% in a bond issuance in order to block a "negotiated restructuring" through the transaction in the secondary markets for sovereign debts. Moreover, bondholders may evade the clause easily by "treaty shopping" and making the special clauses impracticable. Therefore, these clauses neither prevent frivolous claims nor provide sensible solution. Under the situation, more investment arbitrations related to sovereign debt restructuring could be

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submitted continue in, arbitration under Chapter 10 (Investment) if the restructuring is a negotiated restructuring at the time of submission, or becomes a negotiated restructuring after such submission, except for a claim that the restructuring violates Article 129 (National Treatment) or Article 131(Most-Favoured-Nation Treatment).

3. Subject to paragraph 2, an investor of the other Party may not submit a claim under Chapter 10 (Investment) that a restructuring of debt issued by a Party breaches an obligation under Chapter 10 (Investment) (other than Article 129(National Treatment) or Article 131(Most-Favoured-Nation Treatment) unless 270 days have elapsed from the date of the events giving rise to the claim.

[74] *See* United Nations Conference on Trade and Development, *Sovereign Debt Restructuring and International Investment Agreement* 7-8 (2011), http://unctad.org/en/Docs/webdiaepcb2011d3_en.pdf.

[75] *Id.* at 8

[76] Central America–Dominican Republic–United States Free Trade Agreement, Aug. 5, 2004, Annex 10-A: Public Debt. 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 Arts. 10.3 & 10.4.

[77] *See* United Nations Conference on Trade and Development, *supra* note 74, at 8.

filed in the future.

VI. CONCLUSION: POLICY SUGGESTION FOR THE FUTURE

Concerning the purpose of international investment arbitration, it is hard to believe that the investment arbitration can balance the protection bondholders with the stability of sovereign economy. Investment arbitration cannot take up a comprehensive role for to bondholders to seek remedy when they face sovereign debt restructuring. It is more appropriate to conclude that BITs are not the proper mechanism to remedy defaultsin sovereign bonds. The philosophy for bondholders' protection under international law held by the consultant to the League of Nations, Professor Ernst H. Feilchenfeld is apparently true: "Generally speaking, it might be said that international law will guarantee to the creditor the existence of a debt and of a debtor, but not the existence of a good debt and of a rich debtor."[78] International law ought not to affect the risk distribution in sovereign debt market.[79] Investment arbitration could upset the sovereign debt market's delicate equilibrium. In a world without a legal toolbox for sovereign insolvency, investment arbitration focusing on creditor protection alone would threaten the proper resolution of future sovereign debt crises.[80]

Back to the core of international investment arbitration, this article disagrees with widespread use of investment arbitration over sovereign debt restructuring for an additional reason. The author worries that widespread investment arbitration will lead more and more host countries to attempt to close the door to taking BITs as the means to protect bondholder under sovereign debt restructuring. Since the sovereign debt restructuring is the final mechanism for dealing with sovereign debt default under the emergent situation, sovereign states need certain extent of flexibility. The outcome of the widespread investment arbitration is constraining the host country to take more restrictive attitude toward investment arbitration. And even worse, some nations (such as countries in the NAFTA) have already excluded sovereign debt issues from their BITs. Argentina's new model BIT is reported to be moving toward this direction.[81] Ultimately, the widespread investment arbitration will eradicate its role in the sovereign debt issues under international investment law framework. The relationship between the international investment law and the sovereign debt will be concluded by the international investment

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[78] Waibel, *supra* note 27, at 755; *See also* ERNST H. FEILCHENFELD, PUBLIC DEBTS AND STATE SUCCESSION 657.
[79] Waibel, *supra* note 27, at 755.
[80] *Id.* at 759.
[81] *See* Gallagher, *supra* note 13, at 27.

arbitration itself.

To conclude, the most reliable way to avoid the outcome of this problem would be to come up with a more comprehensive regime which balances the competing interests between bondholders and borrowing states. Before establishing such regime, this Article is of the view that the specific provision of the BITs should take more limited attitude toward the sovereign debt restructuring. The provision should take "discretion reason" into account and sovereign states should be givena room for dealing with sovereign debt default issue. It would be more beneficial to the global economy and international investment law if specific clauses under BITs take serious consideration of the possible effects of its procedures on sovereign debt restructuring.

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