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Mission Creep
The Emerging Role of International Investment Agreements in Sovereign Debt Restructuring

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Abstract: The global community still lacks a regime for sovereign debt restructuring (SDR). However, the recent financial crisis has spawned numerous efforts to fill this glaring gap in global economic governance. At the same time however, there is increasing concern that international investment agreements (IIAs) have already begun to expand their reach into the realm of SDR. Indeed, private investors have attempted to use IIAs to recoup the full value of their bonds in order to circumvent debt restructurings in Argentina and Greece. In this paper we examine the extent to which IIAs are becoming tools for creditors to circumvent debt restructurings and whether new IIAs such as the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership will further advance the ability of creditors to do so. We find that contemporary IIAs are increasingly interpreting sovereign bonds as being under their jurisdiction. Thus, debt restructurings may be increasingly subject to claims filed by holdout creditors wishing to recoup the full value of their bonds through private tribunals under IIAs. That said, we also find that some treaties have begun to provide exceptions for certain types of debt restructurings. While such safeguards are a step in the right direction, they will need to become broader in scope and more widespread in application in order to not interfere with the orderly workout of debt problems in the world economy.

Keywords: international investment agreements; international investment arbitration; sovereign debt restructuring.

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1 Introduction

Financial markets and finance ministries alike held their breaths in 2010 as the Greek government restructured its debt in the wake of the Eurozone crisis. While some creditors were not happy with the final outcome, the restructuring went into effect because a supermajority of the creditors tendered. Shortly thereafter however, a Slovakian bank attempted to sue the Greek government for the full value of their bonds under an obscure Slovakia-Greece Bilateral Investment Treaty. Luckily for Greece and the international financial system, the private tribunal presiding over the case ruled that the treaty did not have adequate jurisdiction over sovereign bonds and the case did not move forward. If it had, the legitimacy of the initial Greek restructuring may have come in question and worse, bondholders would be less apt to tender in future restructurings and thus undermine the already fragile system of restructuring now practiced in the world economy. The Greek case is not an isolated incident, as multi-billion dollar cases against Argentina are currently in mid-stream.

Moreover, the international investment treaty regime is proliferating. The US is in the process of negotiating investment agreements with nations across the globe. The Trans Pacific Partnership (TPP) among Pacific Rim countries has now been completed. The Transatlantic Trade and Investment Partnership (TTIP) with the European Union is currently under negotiation. What is more, Bilateral Investment Treaties (BITs) between the US and China and the US in India are also underway. Looking at these US based agreements alone, they essentially amount to a re-writing of global economic rules for almost 80 percent of the world economy.

Inevitably, with each financial crisis one or more nations find themselves restructuring or defaulting on their sovereign debt commitments. Debt crises can be a function of government profligacy, unpredictable swings in global markets, or both. Although sovereign debt restructuring (SDR) and default have been a constant feature of the global economy for centuries, the fact that there is no comprehensive and uniform regime for governing debt workouts has been seen as one of the most glaring gaps in the international financial architecture.

This paper begins with the question: to what extent is modern international investment governance seeping into the SDR regime? This question has received relatively little attention in both economic and international investment policy communities. The on-going drama surrounding Argentina's restructuring since 2001 and the current European crises have triggered a new interest in the interactions between financial crises and international investment agreements (IIAs). In our research, we found that some IIAs have jurisdiction over SDR because they define "investment" broadly enough to include it within their purview. In fact,

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there have already been cases where countries have been challenged in their restructuring by private bondholders. The regime, however, is disparate. Some treaties do not cover sovereign debt at all, while others do, and still others cover it while providing certain protections for countries undergoing restructuring. From these findings, we argue that the lack of a formal SDR mechanism has left a gap for IIAs to begin to exercise de facto control over the SDR process.

Many experts are taking on this challenge of how to fix the glaring gaps in the SDR regime. The literature varies widely. Some suggest improving the existing contractual approach with better collective action clauses (CACs) and new provisions placed into sovereign bonds. Others urge a reliance on a "soft law" approach – non-mandatory standards for SDR set forth by the International Law Commission or a model law drafted for countries engaged in restructuring (Guzman and Stiglitz 2015; Howse 2016). Still others, recommend continuing to push for a multilateral treaty to govern SDR, even if it is not feasible in the near term future, relying on the contractual approach in the meantime (Ocampo 2016). Experts are each attempting to balance concerns for human rights, equal treatment among creditors, and state sovereign immunity, as well as political realities and moral hazard problems (Guzman and Stiglitz 2015; Howse 2016; Raffer 2016).

All these are important. International law must leave room for the evolution, however slow, of a new SDR regime. What we notice is the potential mission creep of IIAs as they become fora for international arbitrations over SDR. Our overarching policy goal would be to make sure that these agreements leave space for these discussions and negotiations so that a new regime can emerge. Our policy proposals are three-fold:

- First, that IIAs would get out of the business of governing sovereign debt altogether and leave SDR to its own exclusive regime.
- Second, if IIAs continue to include sovereign debt as a covered investment within the agreement, then we must safeguard it by restricting all but the most egregious claims from going forward.
- Third, if IIAs continue to include sovereign debt as a covered investment, then state-state dispute settlement (or at least mandatory consultations) should take precedence over the problematic and controversial investor-state dispute settlement (ISDS).

Following this brief introduction we discuss the role of debt in economic development, sovereign debt crises, and the process of SDR. We then undertake an initial analysis of the extent to which IIAs reach into the area of SDR. This is followed by a look at two countries' experiences with ISDS and SDR – Argentina and Greece. The final part summarizes the lessons learned and explores our policy suggestions for states negotiating IIAs as they intersect with world of SDR.

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2 Debt and Development: The Trajectory Toward Sovereign Debt Restructuring

Many developing countries, especially in Asia, have mobilized their domestic savings for structural change and growth. If managed appropriately, however, government borrowing can also be an essential ingredient for economic development. Many developing countries, like Argentina and Greece, have a savings gap – they lack the savings to finance planned investment, and thus seek to fill such a gap with foreign resources. If the gap is not reversed over time, for example, if the ratio of exports to imports does not increase, the rate of the return on development projects fails to exceed the interest rate on the debt, or the nation's general stage of development does not equip it with the absorptive capacity to turn loans into successful income, then nations begin to see problems in servicing their debt.

Even when nations manage to circumvent such pitfalls, they could still spiral into a debt crisis – simply defined as the situation when a nation cannot (or is no longer willing to) service its debt. Contagion from other crises or herd-like bouts expressing a lack of investor confidence could prevent creditors from rolling over or increasing loans. Developing country debt is most often denominated in a foreign currency, so when interest rates rise or the value of the national currency falls, the cost of debt servicing can skyrocket. When left unchecked, debt markets are too often pro-cyclical – there is a lot of liquidity during boom times and thus nations tend to borrow, but liquidity dries up during recessions and can make it difficult for nations to rollover or increase debt (Minsky 1986). Even nations with low budget deficits can quickly be affected as governments borrow to stimulate an economy during a recession but then experience slow growth and low tax revenue thereafter. These tensions are exacerbated for developing nations that are overly exposed to international financial markets. Any number of the factors discussed above could cause massive inflows of debt and large swings in outflows that can cause financial instability (Herman et al. 2010).

Many countries, if not sooner, then later, may need to reschedule, restructure, or even default on their debt. At present there exists no adequate forum for nations to work out their debt problems.

2.1 The Decline of Bailouts

Coordinated global bailouts have been part of the traditional response to prevent and mitigate debt crises. In an attempt to prevent default, or to manage a recovery after such an event, nations are often granted "bailouts" in the form of new loans

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and grants from international financial institutions. Chief among those institutions is the International Monetary Fund (IMF), but national governments and other institutions (such as the Paris Club) often pitch in as well.

Increasingly however, bailouts are seen as costly, unfair, providing the wrong incentives, and lacking in effectiveness. The most costly bailout until recently was the $50 billion rescue package for Mexico's crisis in 1994. Once seen as an unthinkable bailout, it has become eclipsed by the staggering $1 trillion rescue for Europe's current crisis. These bailouts are often quickly sent out of the country to pay creditors and seldom help the nation regain its economic footing. Moreover, there is a real question of fairness given that global taxpayers (through contributions to the IMF or their governments) are the ones footing the bill to foreign creditors. Critics also refer to the "moral hazard" problem that can come with international bailouts. If global investors (and debtors) know that they will be bailed out, they may have the incentive to make evermore risky loans. Some research has shown that the moral hazard problem may be overblown (Stiglitz and Guzman 2015). Still, the record on the effectiveness of bailouts is limited at best, with many nations taking years to recover, if at all (Eichengreen 2003).

2.2 The Rise of Bailins?

SDR is increasingly seen as an alternative to bailouts. However, the international community agrees that the SDR regime lacks coherence and effectiveness. Many go so far as to argue that the lack of such an adequate regime to restructure sovereign debt in a comprehensive, fair, and rapid manner is among the most glaring gaps in the international financial architecture (Krueger 2002; Herman et al. 2010).

When a sovereign government is no longer willing or able to pay its debts, SDRs occur during what amounts to a formal change to debt contracts that is negotiated between creditors and debtors. SDRs (or "workouts") often take the form of reducing the face value of the debt, "swaps" where new bonds with lower interest rates and longer maturities are exchanged for the defaulted bonds, and so forth. Such workouts are usually highly discounted and result in a loss for bondholders. Losses or discounts are commonly referred to as "haircuts". The process is often referred to as a "bailin" because the participants are not "out" side of the investment itself as the IMF, governments and taxpayers are during a bailout. In the wake of the recent crisis, both the IMF and the EU Commission have encouraged these "bailins" as a part of their bailout package deal, even publicly endorsing negotiations between governments and the private sector. Table 1 lists some of the major SDRs over the last 17 years according to the duration of

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Table 1: Sovereign Debt Restructurings, 1998–2015.

	Duration (m)	Value (USb)	Haircut (%)	Participation (%)
Russia (1998–2000)	23	31.9	50.8	98
Ukraine (1999–2000)	4	1.6	18	95
Pakistan (1999)	4	0.6	15	95
Ecuador (2000)	25	6.7	38.3	97
Uruguay (2004)	2	3.1	9.8	93
Argentina				
2005	42	43.7	76.8	76
2010	60	18	75	66
Argentina Total	100	99.8		93
Greece (2012)	4	206	53.3	94

Source: Das et al. (2012) Hornbeck (2010), Poštová banka v. Greece (2015).

the SDR negotiations, the total face value of the bonds under restructuring, the "haircut," and the participation rate.

It is held that a restructuring is deemed successful when 90 percent or more of bondholders participate in an offering that is no less than 50 percent of the net present value of the debt (Hornbeck 2010). There are always some "holdouts" during a restructuring, disgruntled investors who refuse to negotiate and demand the full value of their investment. These holdouts often file suits under the municipal laws that govern bond contracts in New York, London, and beyond. More recently (and of utmost interest in the present paper), they have even filed investor-state disputes at the International Centre for Settlement of Investment Disputes (ICSID). Some of these holdouts are "vulture funds," 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 (Thompson and Runciman 2006).

SDR is seen as a strong alternative to bailouts, at least in theory. Among the key rationale for efficient SDRs are the avoided costs of taxpayer-funded bailouts and of the moral hazard associated with bailouts. However, changes in the nature of private debt have complicated the process. At the end of the 20th century, public debt became dominated by bonds, which can be held by many individual investors rather than a few large commercial banks. These bondholders can be dispersed across the globe and hard to track down, thus making the restructuring process more complex (Eichengreen 2003; Gelpern 2013).

Another complication that flows from the large numbers of investors is collective action problems at the restructuring negotiation stage. Although a swift and efficient settlement could make creditors, debtors, and international institutions better

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off, there are complex incentives – such as the inability to convene all of the creditors and the asymmetric bargaining power of creditors over debtor nations – that make negotiations drag on for long durations and can favor one party over another. Table 1 shows that even the shortest recent SDR took one month. And of course Argentina's debt was not restructured until 2010 – 9 years of restructuring that still may not be over. Long workouts like that can accentuate debt overhang whereby a nation spends so much time and effort servicing its debt that a country cannot grow to its full potential (Rogoff and Zettelmeyer 2002; Gelpern 2013).

These costs could be significantly reduced with a swift and orderly SDR process – a goal that would benefit all parties. It is in the interest of private creditors to support a regime that would prevent all creditors from rushing to exit given that such a run would jeopardize the collective value of the asset and keep a debtor solvent enough to pay debts. However, individual creditors have an incentive to quickly exit before other creditors do and still other investors may holdout from negotiating until they are sure that the behavior of free riders that rush to exit is under control (Hagan 2005; Helleiner 2008). Of course it is in the debtors' interest to restructure debt in a manner that allows the nation to service its debt burden and begin to recover. Yet debtors have been reluctant to support a regime because they fear that the nation might be seen as more willing to default, resulting in a lack of general investor confidence in the country and a subsequent drain of investment (Helleiner 2009).

The proliferation of SDR at the end of the 20th century led to a near consensus that the SDR regime was in need of repair. The international community grew fed up with IMF bailouts and frustrated with the SDR process. In 2001, Anne Krueger, a well-known US economist who had just taken the helm as the Deputy Managing Director of the IMF proposed a "Sovereign Debt Restructuring Mechanism" (SDRM). The SDRM was to be a new global mechanism analogous to bankruptcy courts for private creditors (known as Chapter 11 in the US). The argument for the SDRM was that it would minimize the need for major taxpayer and IMF bailouts to private creditors and reduce the moral hazard problem. The main features of the SDRM were:

- a payments standstill on bonds, and capital controls, all to be monitored by the IMF;
- a stay on litigation altogether or at least the requirement of a supermajority (75 percent) approval of stays on litigation;
- a process to prioritize some loans over others and for new loans to be made by the IMF and others; and
- a supermajority across all bondholders regardless of a particular bond issue, would be all that was needed to accept the terms of the restructuring (Hagan 2005).

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The SDRM was vehemently opposed by private creditors, the US government, and even some debtor nations. As Helleiner (2009) and Setser (2010) explain, the US government did not want to grant the IMF so much power and did not want to engage in dollar diplomacy across the world. Private creditors argued that the status quo was not a bad one. Although there was a theoretical discussion of the collective action problem just described, creditors noted that no restructuring had been held up due to litigation. Some debtors were concerned that they would not receive any more IMF support, and were concerned that they would be scorned by private investors in the market place.

US Deputy Treasury Secretary John Taylor proposed an alternative, which has become the widely accepted view. Taylor proposed a more market-based "contractual" approach, whereby bonds themselves would have CACs within their contracts. Most bonds issued from London at the time included such clauses, but most US bonds did not. The key features of CACs are that they have:

- a collective representation component, whereby a bondholders meeting can take place such that creditors exchange views and discuss the default/restructuring;
- a minimum enforcement component, whereby 25 percent of the bondholders must agree that litigation can be taken; and
- a majority restructuring component, which enables a 75 percent supermajority of bondholders to bind all holders within the same bond issue to the terms of restructuring;

In June of 2014, 80 percent of the approximately $ 900 billion in foreign law bonds issued worldwide contained CACs (IMF 2014).

Although CACs are a significant improvement, some challenges remain for future restructurings. First, bondholders are often globally dispersed and many bonds are also sold on secondary markets, making it more difficult to "call a vote." Second, for some bond issues it may be easy for holdouts to purchase a 75 percent majority for a vote and neutralize the collective action component of the issue. Third, and even more concerning is what is called the "aggregation problem." CACs only cover individual bond issues but have no effect on the holders of other issues. Restructurings increasingly involve multiple bond issuances and CAC provisions do not hold for collective action across multiple issuances (the SDRM would have allowed for such a mechanism) (Hagan 2005).

As for today, there still remain many bond issuances that were sold prior to Taylor's proposal, which may continue to pose a threat to countries currently defaulting on their external debt. The experiences of Argentina and Greece, which we discuss below, highlight the practical implications of this concern. Before we

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turn to these examples, however, we explore how IIAs could begin (and have begun) to exercise de facto control over SDR.

3 Regime Overlap: IIAs Reaching into SDR

There are a number of components within many IIAs that have the potential to conflict with SDR. The following paragraphs examine the extent to which various trade and investment agreements interfere with developing nations' policy space to restructure sovereign debt in a comprehensive, just, and efficient manner.

3.1 Jurisdiction

In order for an IIA tribunal to decide an investor-state dispute, there must be both an "investment" at the center of the conflict and consent by the state party. The definition of "investment" as well as the consent of the state is governed primarily by the IIA. That is to say, if an agreement explicitly includes sovereign bonds and other debt instruments as covered investments, then by definition, the country has given its consent to jurisdiction. Correspondingly, if the agreement lists any limitation to those claims, then that is also a limitation to consent (Glinavos 2014).

Definitions of "investment" in IIAs vary widely. While some expressly exclude sovereign bonds and even portfolio investment more generally, others (especially modern agreements) explicitly include sovereign bonds in a long non-comprehensive list of types of covered investments. Analysis of BITs and free trade agreements (FTAs) for this paper reveals that almost all of the agreements by major capital exporters from industrialized nations include "any kind of asset" as investments and therefore could cover sovereign bonds. Some treaties, such as the North American Free Trade Agreement (NAFTA), the majority of Peru's IIAs and some others (such as the Australia-Chile FTA) exclude or safeguard sovereign debt.

There is a further potential barrier to jurisdiction found in the Convention governing the International Centre for the Settlement of Investment Disputes (ICSID). The convention does not define investment but subsequent case law supports the view that a conflict must not only meet the jurisdictional requirements of the IIA, but also of the Convention. Under Salini v. Morocco, the most widely cited case on the subject, to count as an investment, the transaction must involve "a significant commitment of resources, an economic risk..., sufficient duration of the operation, a regularity of profit and return and a contribution to the economic and social development of the host state" (Waibel 2011: p. 229).

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The alternative view holds that the Salini criteria are helpful guidelines, but not requirements. Waibel argues that, in general, sovereign debt is more like an ordinary commercial transaction (which are explicitly excluded from the Convention) and therefore should not be adjudicated there (Waibel 2011). The case studies below show some divergence in their treatment of Salini, and there remains much uncertainty about the role of those criteria in future cases.

Even if a CAC were present and deployed under a certain bond issuance, it may still not protect sovereign debtors from an investor-state arbitration claim. CACs cover contractual rights of enforcement under municipal laws and are not designed to deal with treaty claims. Waibel (2007) points out that "ICSID arbitration could blow a hole in the international community's collective action policy" (Waibel 2007: p. 715). Furthermore, bondholders could "treaty shop" and file claims under treaties where it may be more certain that a bondholder will win jurisdiction (Wells 2010). Waibel (2011) has pointed out that a large number of sovereign bonds are traded on secondary markets and nationality can literally change in a matter of minutes, accentuating the ability of a bondholder to "shop" for favorable treaties.

3.2 Umbrella Clauses

Umbrella clauses, further expand jurisdiction by imposing "an international treaty obligation on host countries that requires them to respect obligations they have entered into with respect to investments protected by the treaty. This places such obligations under the "umbrella" of international law, not just the domestic law that would otherwise apply exclusively." (Salacuse 2010: p. 275). This exposes the host state to the dual jurisdiction of investor-state arbitration and domestic courts governing the contract.

Although not determinative in the jurisdictional outcome, the Italian claimants in the Argentine case (discussed below) attempted to bring in an umbrella clause from the Chile-Argentina BIT by way of the Most Favored Nation provision. The tribunal side-stepped this issue, holding that the claims were not purely contract claims and the umbrella clause was not necessary to reach them. However, the claimant's argument is a novel one, and one likely to show up in future cases.

3.3 National Treatment

National treatment provisions demand that foreign investors are treated no less favorably than their domestic counterparts. Domestic investors have been treated

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differently under some restructurings, with considerable economic justification, and could thus trigger claims under IIAs. Put simply, a national treatment claim could occur when a foreign bondholder receives different terms during a restructuring than do domestic holders.

Economists who specialize in mitigating financial crises agree that there are numerous circumstances when domestic investors should be given a priority over foreign creditors. As countries liberalize their capital accounts, the line between external and domestic debt becomes blurred. In years past it was relatively easy to delineate between external and domestic debt. In a nutshell, external debt was issued in foreign currency and was held by foreigners and domestic debt was denominated in local currency and held by residents. Under a liberalized capital account, foreign investors may invest in domestic debt and domestic residents may purchase foreign debt. Indeed, domestic financial institutions and residents held close to half of Argentina's debt that was restructured between 2001 and 2010. Economists and prominent legal scholars alike conclude that "the ability to treat domestic and foreign creditors differently is a necessary policy option for governments in a financial crisis" (Gelpern and Setser 2004: p. 796).

The economic (and political) rationale for treating domestic and foreign investors differently during a debt crisis is multi-pronged. First, it is recognized that domestic investors are often hit by a "double-adjustment" during a crisis and restructuring. Not only do they suffer the reduction in the value of their bonds through the restructuring, but they are also affected by the impact of post-crisis ramifications that could include slow growth, high unemployment, high interest rates, and devaluation. Foreign investors' commitments, by contrast, are not as vulnerable to these secondary domestic effects (Caliari 2009). Furthermore, prioritizing domestic debt may be in order so as to revive a domestic financial system, provide liquidity and manage risk during a recovery. In both the Russian and Argentine cases, domestic investors received more favorable treatment with this in mind (IMF 2002; Gelpern and Setser 2004; Blustein 2005; Gorbunov 2010; Panizza 2010). Finally, the support of important constituents and political groups is often essential for a recovery and reform effort to be successful. There is also a clear rationale to prioritize the citizenry through maintaining the ability of economic actors to pay wages, salaries, and pensions in order to maintain livelihoods, enable domestic demand, and avoid mass protest (IMF 2002; Gelpern and Setser 2004).

3.4 Expropriation

Historically, international rules on expropriation were laid out to protect foreign investors from governments. Investors were vulnerable to land and property

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seizures, as well as expulsion from the host state. Today expropriation has a much more expansive definition. NAFTA arbitration on the subject has expanded it to include not only direct property takings, but "covert or incidental interference with the use of property, which [deprives] the owner … of the use or reasonably-to-be-expected economic benefit of property" (Glinavos 2014). This has been labeled "indirect" expropriation. IIAs require expropriation be carried out (1) for a public purpose, (2) in a non-discriminatory way, and (3) on payment of prompt, adequate and effective compensation.

Both defaults and restructuring obviously diminish the value of an asset, and under a "take-it-or-leave-it" swap arrangement a bondholder has the choice to either accept a new bond with a haircut or risk losing the whole value of their original investment. Tribunals often perform a "substantial deprivation" test to examine the level of diminished value in a restructuring, and would thus in this case be examining the size of the haircut in a bond exchange (Newcombe and Paradell 2009). A large haircut both "interferes with investor expectations and can lead (as in the case with Greece) to a significant reduction in value" (Glinavos 2014). Furthermore, we can easily see how different treatment among bondholders (as with the national treatment example) may violate the non-discrimination requirement, while slow, diminished payment in the event of a restructuring could fail the compensation standards.

3.5 Fair and Equitable Treatment

The "fair and equitable treatment" (FET) standard has been controversial in its application. Some IIAs specify that FET means only the recognition of basic due process requirements and explicitly does not grant "additional substantive rights" to the investor. Others however, specify what constitutes FET by listing examples. The EU-Canada Comprehensive Economic and Trade Agreement (draft text), for example, includes, among other things, that "legitimate expectations" of the investor should be taken into account in determining a violation of this article.

Waibel (2007) outlines a number of justifications for claiming that bond exchanges violate FET under IIAs. Waibel sees it as possible that exchanges could trigger allegations that the process lacks transparency and is coercive. In addition, the "take-it-or-leave-it" nature of exchanges could be seen as violating due process and not in good faith, especially when the government does not take part in serious restructuring negotiations. Finally, Waibel also sees restructuring as possibly actionable because a restructuring may transform the business environment or undermine the legal framework of the bonds themselves.

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3.6 Transfers

The transfers clauses in IIAs increasingly require that all covered investments of participating parties be transferred "freely and without delay." Restructuring could potentially clash with transfers provisions on three levels. First, an outright default ceases the transfer of the bond in question and thus could be seen as a clear violation. Second, during the restructuring negotiations presumably transfers related to bonds can slow down and could possibly be grounds for disgruntled investors to file a claim (or threaten to file to speed negotiation). Third, under some of the proposals for the SDRM, the IMF or another body would hold a "standstill" during the negotiations whereby the nation deploys temporary capital or currency controls during the negotiations. In one of the numerous cases against Argentina in the aftermath of its 2000–2001 crisis, an ICSID tribunal ruled that a tax on outflows (a common form of capital control used during crisis by Malaysia as well) was a violation of the transfers and expropriation clauses (*El Paso Energy* 2006; Salacuse 2010).

3.7 Investor State Dispute Settlement

What makes these measures particularly concerning with respect to SDR is that the emerging norm for settling disputes on these issues puts creditors at an advantage over borrowers. Probably the most controversial provision in most modern BITs and FTAs, this dispute resolution mechanism is referred to as ISDS. ISDS provides a way for private investors to file claims against sovereign nations in a private arbitral forum for claimed violation of IIAs. It is this mechanism which amplifies the importance of the rest of the agreement. If sovereign debt falls under the jurisdiction of the IIA, and SDR is found to violate other provisions in the agreement, then nations that are already experiencing financial difficulty are vulnerable to private arbitration pursued by private investors. Whereas in the World Trade Organization (WTO), nation-states themselves discuss and settle disputes, under ISDS, disputes are instigated by private investors. By its very nature, SDR seeks to negotiate a restructuring in order to generate net welfare benefits for the nation as a whole, recognizing that some actors of course will have to bear costs. By placing the power to file claims in the private sector however, ISDS allows minorities that will absorb some costs to tilt the scales in order to recoup the full value of their bonds at the potential cost of the net national welfare.

3.8 Safeguards

Some IIAs do have some safeguards regarding emergency measures to prevent and mitigate a financial crisis, but few are applicable to SDR. There is a

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heterogeneity of safeguards for countries facing financial difficulties. Under the Italy- Model BIT, states will find a balance of payments safeguard in the provision on transfers (Ortino 2013). It protects transfers generally speaking, and specifically mentions "funds to repay loans connected to an investment and the payment of relevant interests" (Art. VI(1)(d)). In this way it almost seems to apply directly to payments on sovereign debt. Paragraph four then makes allowances for temporary restrictions on transfers in the case of "very serious balance of payments problems."

EU IIAs do not explicitly include sovereign bonds within their purview, however, they do include some safeguards for financial services regulation and capital controls liberalization. A prudential carve out permits signatory states to "adopt or maintain measures for prudential reasons such as … ensuring the integrity and stability of their financial system" (EU-CARIFORUM Art. 104). Temporary capital controls are also permitted "in exceptional circumstances, [where] payments and capital movements cause or threaten to cause serious difficulties for the operation of monetary [or exchange rate] policy" (Art. 124).

It is commonly understood that such balance of payments and prudential carve-out safeguards do not apply to SDR. Especially in the case with the EU agreements, it is intended very clearly for the context of financial regulation and capital controls (Waibel 2011; Viterbo 2012).

While US agreements generally keep sovereign bonds within their jurisdiction, some – including the recently concluded TPP – acknowledge the uniqueness of sovereign bonds as an investment instrument (see, e.g., TPP Annex 9-G, Public debt, below). The annexes prohibit investor claims against countries engaged in "negotiated" restructurings, unless the claim is a violation of the national treatment or most favored nation provisions. Such treaties sometimes define "negotiated restructuring" as a restructuring in which 75 percent of bondholders consent to a change in the payment terms. Investors may bring other claims in a non-negotiated SDR, but only after waiting 9 months from when the restructuring state received a request for consultations ("cooling-off period").

These annexes still fall short of providing adequate safeguards for SDR for three key reasons. First, due to the broad definition of investment and the potential role of umbrella clauses, investors may bring suit in international arbitration even if there would be an existing remedy in domestic courts. That is, the annexes do not address the problem present under the CACs, which is dual jurisdiction under contract clauses and under the IIA governing investment. Second, as we discussed above ("National Treatment"), it is common and even expected for policy makers to treat domestic creditors preferentially during a crisis, running afoul of the national treatment demands in these annexes for even negotiated restructurings (Gelpern and Setser 2004). Third, many bond exchanges take a

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"take-it-or-leave-it" form that would not likely be considered "negotiated" under these annexes. Argentina's unilateral default and restructuring, for example, would have failed this obstacle, and been vulnerable to any and all arbitration as a result (Gallagher 2012). As we will see below, even Greece's efforts at negotiation took some coercive turns that may have been considered non-negotiated, depending on the perspective taken by the tribunal.

4 Case Studies: IIAs and SDR in Argentina and Greece

Argentina first, then Greece, found themselves defending their restructuring in a private arbitration under the ICSID. In the following pages, we compare these two countries, to show how investment treaties can act as a de facto sovereign debt regime in dealing with real instances of national default (for better or for worse).

4.1 Argentina: Poster Child Turned Prodigal

In June of 2010, Argentina accomplished the most costly sovereign default in history (until Greece, as we will see). Argentina restructured $100 billion of debt twice between 2001 and 2010; the final exchange involving a staggering 75 percent haircut for participating investors. As a result, Argentina found itself mired in years of litigation – both in the US courts and in the ICSID, as creditors brought their claims hoping to see the full value of their investments restored.

During the 1990s Argentina was seen as the poster child of the Washington Consensus. Argentina undertook major privatization programs, trade and investment liberalization, and a general reduction of the state's role in economic affairs, as well as a "convertibility plan", which guaranteed a one-to-one convertibility of the peso to the US dollar and capped the ability of the nation to print domestic currency at the level of US dollars held in reserve (Blustein 2005). The plan got off to a positive start but convertibility and an open capital account left the nation vulnerable to external shocks.

When the crises of the late 1990s in Asia and Russia spread to Brazil and led to a depreciation of the Brazilian real, Argentina was faced with competitors with weaker currencies – in an environment of a rising dollar, falling commodity prices, and a retreat from emerging market investment. Rather than warning Argentina of its eroding position, the IMF continued to support Argentina's

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policies (Damill et al. 2010). The debate rages on regarding the relative importance of each of these factors, but it is clear that by 2001 the Argentine economy ran out of steam and the country defaulted in January of 2002. GDP fell by 10 percent that year and poverty doubled.

After failing to negotiate a restructuring under the supervision of the IMF, Argentina announced that it would open a one-time bond exchange and passed domestic legislation that it would never hold a future swap with a better offer. In January of 2005, the country opened an exchange on over $100 billion in principal and interest on a diverse number of bond issuances whereby the bondholders were to receive a 67 percent haircut. In the end it restructured just over $62 billion with a 76 percent participation rate. Holdouts were furious, some of which, took the litigation route in the US, where 158 suits have been filed (Hornbeck 2010).

For the first time ever, a number of those holdouts filed claims under IIAs to the ICSID. In September 2006, approximately 180,000 Argentine bondholders filed a claim under the Italy-Argentina Bilateral Investment Treaty (BIT) for approximately $4.3 billion. The creditors claim that the Argentine restructuring was tantamount to expropriation and violated fair and equitable treatment standards under the treaty (Waibel 2007).

In April of 2010, Argentina launched another take-it-or-leave-it exchange for $18 billion of its debt – offering a 75 percent haircut under the same rationale as in 2005, despite experiencing a recent boom (Porzecanski 2010). Though some of the Italian bondholders tendered, $1.2 billion or more remain with their ICSID claim (IMF 2009; Hornbeck 2010). Taken together, the two swaps amounted to 93 percent participation.

Still, Argentina has not been able to move on. The ICSID tribunal found jurisdiction over Abaclat and others v. Argentina in August of 2011, based largely on a finding that the Italy-Argentina BIT included sovereign bonds as a covered investment. Currently, both parties are awaiting a final award. In a letter dated May 31, 2015, the claimants expressed their impatience with the process, both for procedural delays and the fact that they have born the entire cost of the proceedings due to Argentina's unwillingness to pay (Lamm 2015).

We should note that, despite the fact that the US and Argentina have not signed a BIT, US creditors are causing plenty of trouble for Argentina in US courts. In 2012, Judge Griesa of the Southern District Court of New York ordered the banks holding the money to be paid to the exchange bond holders NOT to pay out until Argentina had paid the holdout creditors. Griesa relied on what is called the *pari passu* clause in these original bonds (issued in 1994), which states that the bonds "shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness." To the extent that the exchanged bonds from the 2005 and 2010 exchanges are "external indebtedness",

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holdout creditors must be paid “a ratable payment” along with those creditors who took a haircut (NML v. Argentina 2012).

Since then, the court has permitted a discrete number of payments made on the bonds governed by Argentine law, but payments continue to come due (NML v. Argentina 2015). Although, legally, none of this has any direct bearing on the ICSID tribunal’s decision, the claimants in Abaclat have submitted these decisions as supporting evidence of their position and referred to them in their post-hearing briefs (Abaclat v. Argentina 2014). Still, even if the US cases sway the ICSID tribunal in favor of the holdout bondholders, Argentina has yet to pay in the cases it has already lost. Will the outcome be different here? Absent a global SDR mechanism, not only does Argentina suffer, but so do the creditors in this case who have born the cost of the entire arbitration and still have no guarantee of getting any return on their investment.

4.2 Greece: A Different BIT, a Different Outcome

After Argentina, Greece undertook an even more costly SDR in 2012, in the wake of the financial crisis. Greece restructured $262.3 billion of sovereign debt in an attempt to maintain the stability needed to stay in the Eurozone (Zettelmeyer et al. 2013). Unlike Argentina, Greece took extensive steps to negotiate with its private creditors and even did it with the blessing of the EU and the IMF. Still, holdout creditors decided to pursue their interests at the ICSID, forcing Greece to face an investor-state dispute as well.

Like the rest of the world, Greece faced financial difficulties in the wake of the 2008 Financial Crisis. By 2010, much of its debt had been downgraded, including certain series of government bonds. Starting in January of 2010, Greece began working with the EU Commission to reduce their fiscal deficit, including economic austerity measures. May of 2010 brought some much needed financial support from Euro area members and the IMF, accompanied by fiscal, financial and structural measures (Poštová banka v. Greece 2015).

Quickly, however, the bailout package proved not to be sufficient in the face of Greece’s exploding debt to GDP ratio. In October of that year, a Franco-German-Russian summit called for a more effective and permanent crisis resolution mechanism. The resultant “Deauville statement” represented the first time that EU countries would accept the possibility of SDR in the Eurozone. An IMF review in mid-July of 2011 reiterated this point and noted that absent 70–104 billion euros in additional official sector financing, “some form of [private sector involvement (PSI)] was unavoidable” (Zettelmeyer et al. 2013: p. 519). PSI is essentially a euphemism for “requiring private holders of government debt to accept some

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reduction in the principal or interest or both due on that debt" (Poštová banka v. Greece 2015). The initial proposal for restructuring was relatively small in scale and private sector losses. Among four options available to investors in a voluntary debt exchange, only two of them involved any amount of haircut on the debt and only at 20 percent. That proposal was never adopted due to doubts about its ability to actually contribute to Greek's debt sustainability.

By October, IMF analysis showed the Greek debt-to-GDP ratio at 170 percent, rather than the 133 percent initially predicted during the first bailout in 2010. The second proposal involved a "much stronger PSI" and reached a much wider audience of bondholders. Greece extended the exchange offer to all privately-held sovereign bonds issued before 2012. The exchange package included short-term European Financial Stability Facility notes worth 15 percent of the old debt, new sovereign bonds worth 31.5 percent of the old debt face value with longer maturities, new GDP-linked security allowing for extra payments if the GDP grew faster than expected, and compensation for accrued interest still owed in the old bonds given in 6 months EFSF notes (Zettelmeyer et al. 2013). By the time the deal was done, in April 2012, Greece had achieved a 96.9 percent participation in restructuring $262.3 (€199.2) billion in sovereign debt. The result was to reduce Greek's debt burden by more than half – 52.5 percent.

Getting a majority of bondholders to relinquish half of the value of their debt required some strategizing on Greece's part. Greece relied primarily on its Greek Bondholder Act, which retrofit CACs into sovereign bond contracts governed by domestic law. Athens also designed the new securities to be as attractive as possible, first with highly rated, short term EFSF notes and other new bonds issued under English (rather than Greek) law. Finally, the new bonds involved co-financing with the EFSF. That meant that, if Greece suffered a default in the future, the new bonds would be much more secure than any remaining bonds held by holdouts from the 2012 restructuring.

Despite these incentives and the high percentage of participation, certain holdouts remained. Some of these determined that the bond exchange violated their rights as investors and sued. Poštová banka, and its shareholder Istrokapital, brought investor-state claims under the Slovakia-Greece BIT (1991) and the Cyprus-Greece BIT (1966), respectively. A tribunal was formed and the issue of jurisdiction first addressed. Despite Poštová banka's earnest effort to show that there was a protected investment under the BIT, the award (in favor of Greece) turned primarily on the specific language of the BIT which expressly includes corporate bonds, but makes no reference to sovereign bonds. The court highlighted and distinguished this outcome from that of Abaclat, in which the tribunal did find jurisdiction at least in part because of the wording of the "investment" definition (Poštová banka v. Greece 2015). Istrokapital, as a shareholder of Poštová

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banka was excluded because of the general principal of commercial law that shareholders are distinct legal entity from the company that they hold and therefore do not have the same claim to assets as the company itself (Stylopoulos 2015). And thus the case was dismissed. Greece could then breathe a sigh of relief that it had one less thing to worry about. However, as Glinavos (2015) noted in the aftermath, there are 43 other states holding BITs with Greece, whose treaty language might lead to a different result.

4.3 Lessons Learned?

The two outcomes were based solidly and simply on the text of the two "investment" definitions. Both the Italy-Argentina BIT and the Slovakia-Greece BIT defined covered investments broadly ("any kind of asset"). However, while Italy-Argentina listed "obligations, public and private titles, and other debt instruments", the Slovakia-Greece BIT, listed only corporate bonds, thereby implicitly excluding sovereign ones. Thus, the Poštová banka tribunal was able to explicitly distinguish their decision textually.

On the other hand, the Greek tribunal indicated, in dicta, that even if the BIT had been ambiguous about including sovereign debt (it was not), then the claim would have failed based on criteria similar to the Salini test. The Salini tribunal was the first to articulate the requirement that a transaction must qualify as an "investment" both under the ICSID convention and the relevant BIT (Waibel 2011). Under Salini, an investment must demonstrate the following characteristics: that it be a "contribution[], [with] a certain duration of performance of the contract … a participation in the risks of the transaction [and] ... contribution to the economic development of the host State of the investment" (Salini 2003, para. 52). The bondholders' interests did not qualify for failure to share in the risks and contribute to the development of the Greek economy (Poštová banka v. Greece 2015). On this point, the two tribunals, as others before them, seemed to disagree. An alternative to the Salini view suggests that the criteria provide "useful guidance [but] do not create any jurisdictional requirements (Waibel 2011). If Poštová banka is followed, however, the Salini test certainly could contract the definition of investment in the case of ambiguity in the IIA text.

Context is important as well. Both Argentina and Greece suffered from their creditor countries' initial belief that debt sustainability could come from structural adjustments rather than needing direct debt relief. As a result, both relief and recovery were delayed. Greece, however, faced the additional difficulty as a member of an important monetary union. In order to devalue their currency, they would have had to leave the Euro zone and many Euro zone countries were

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reluctant to see that happen. Argentina's default was followed by failed restructuring negotiations with the IMF and a unilateral, take-it-or-leave it exchange offer. Argentina has also refused to make payments on bonds held by holdouts from the exchange. Greece, by contrast, worked closely with the EU and the IMF to negotiate the terms of their bailouts and those institutions proposed the inclusion of PSI as a necessary part of the process. Athens also initiated ex ante negotiations with larger bondholders in order to come up with a PSI offer likely to be palatable by the required majority of investors. Furthermore, since the exchange, Greece has paid in full all holdout bonds that matured during that time. The outcomes that we can compare here are limited to the question of jurisdiction, limited to the interpretation of a word or phrase. If these situations arise under a different IIA, however, the outcomes may reveal a collision course between the treaties and a SDR regime.

5 New Trade and Investment Treaties and SDR: Avoiding a Collision course

Global trade and investment are being remapped as we speak. As alluded to in the introduction, the US alone is negotiating new agreements that would cover close to 80 percent of world output. With all these new treaties on the horizon, it is paramount that they give space for SDR. At this writing it is not clear that the forthcoming IIAs will give the regime enough space to change. If the Greek case had taken place under the TTIP rather than the Slovakia-Greece BIT, the outcome may have been different. US treaties clearly state that sovereign bonds are covered by the treaty and thus the Greece case would have cleared the jurisdictional hurdle. However, some recent US treaties, such as the TPP, include an annex that would have likely given Greece cover. Nonetheless, even the US annexes are limited and may not be enough protection for future SDRs or an emerging reformed SDR regime. It is paramount to include provisions that give deference to the SDR regime.

Both the EU and the US have very clearly defined models for trade agreements. EU trade agreements, which cover investments only under the auspices of certain cross-border services and capital flows, have no definition of investment at all and no provision for investor-state disputes. US treaties are the other extreme, specifically noting that bonds are covered investments under both trade agreements and BITs.

The EU, as a customs union, has not entered into any BITs, but has relied instead on the individual BITs of its member nations to govern treatment of

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foreign investment. As of the 2009 Lisbon Treaty, the EU has gained competence over the treatment of foreign direct investment and has been attempting to formulate region-wide policy in this area (Bernasconi-Esterwalder 2012). As it develops its regional investment policy, one of the first areas to be incorporated is an investor-state dispute mechanism (Bernasconi-Esterwalder 2012). And this is not surprising. Almost all modern IIAs contain them including recent BITs between Germany and China (2005), Germany and Jordan (2009), and France and Colombia (2014).

If the Greek case had taken place under the forthcoming Transatlantic Trade and Investment Partnership (TTIP), the text would either resemble a European or a US approach to IIAs – and more likely some combination of the two. We first look at the prospect of a European-style TTIP and then examine the dispute under the US model. Western European BITs tend to exhibit some similar characteristics. Germany and France, for example, have included all of the usual BIT provisions, requiring fair and equitable, national and most favored nation treatment for foreign investors. There are provisions governing expropriation and capital transfers, as well as state-state and investor-state disputes.

The definition of "investment", however, leaves some uncertainty as to the coverage of sovereign debt under the agreement. Investment is defined as "every kind of asset ... in particular, though not exclusively, ... (c) claims to money or to any other performance having economic value associated with an investment" (Germany-China BIT Art. 1, see also Germany-Guatemala, Germany-Jordan, and France-Colombia). According to the Greek tribunal, this ambiguous definition may have been enough to invoke the Salini criteria to determine whether the sovereign bonds in this case qualified as an investment. As noted above, relying on Salini could contract the reach of the TTIP's provisions in the face of a vague "investment" definition.

Unlike the EU, however, US treaties are rarely vague. Ever since NAFTA, which was anomalous in excluding sovereign debt, US treaties have consistently included sovereign debt as a "covered investment". In determining the US approach, we examine both the recently-completed TPP and the US Model BIT. The TPP represents a model of particular importance, according to statements by the US Trade Representative that this most recent treaty is an up-to-date reflection of US economic priorities and values (USTR 2015). In both of these texts, the definition of investment is a broad one.

> *"Investment" means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.* (US Model BIT Art. 1, TPP Art. 9.1)

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What follows is a comprehensive list of forms that investment might take. Both texts, differ from the Italy-Argentina BIT, as well as the Greece-Slovakia BIT. Both the TPP and Model BIT state clearly that investment includes, "bonds, debentures, other debt instruments and loans." Based solely on that language, the tribunal in the Greek case would likely have had to accept jurisdiction if this case had been brought under a future TTIP. In addition, given the presence of a Public Debt Annex in the TPP, public debt would not only be covered by the agreement, but SDR is governed, in part, by the terms of the annex. The following short analysis shows that with jurisdiction found, the tribunal would then have to determine the merits of the case.

TPP Annex 9-G
Public Debt

1. The Parties recognize that the purchase of debt issued by a Party entails commercial risk. For greater certainty, no award shall be made in favor of a claimant for a claim under Article 9.18.1(a)(i)(A) (Submission of a Claim to Arbitration) or Article 9.18.1(b)(i)(A) with respect to default or non-payment of debt issued by a Party unless the claimant meets its burden of proving that such default or non-payment constitutes a breach of an obligation under Section A, including an uncompensated expropriation pursuant to Article 9.7(Expropriation and Compensation).

2. No claim that a restructuring of debt issued by a Party breaches an obligation under Section A shall be submitted to, or if already submitted continue in, arbitration under Section B if the restructuring is a negotiated restructuring at the time of submission, or becomes a negotiated restructuring after that submission, except for a claim that the restructuring violates Article 9.4(National Treatment) or Article 9.5(Most-Favored-Nation Treatment).

3. Notwithstanding Article 9.18.4 (Submission of a Claim to Arbitration), and subject to paragraph 2, an investor of another Party shall not submit a claim under Section B that a restructuring of debt issued by a Party breaches an obligation under Section A, other than Article 9.4(National Treatment) or Article 9.5(Most-Favored-Nation Treatment), unless 270 days have elapsed from the date of receipt by the respondent of the written request for consultations pursuant to Article 9.17.2(Consultation and Negotiation).

The Public Debt Annex (TPP, Annex 9-G) first asks whether the restructuring was a negotiated one. Since Greece achieved a 96.9 percent participation rate, the tribunal would like consider the restructuring prima facie "negotiated". Prior to restructuring, Greece was involved in on-going discussions with both the EU and the IMF and both institutions actively encouraged and recommended relying on PSI for much-needed debt relief. Greece also engaged in ex ante negotiations with large Greek and European banks and insurance companies, which together held a majority of the eligible bonds. These negotiations resembled restructurings under the widely accepted London Club approach from the 1980s (Zettelmeyer et al. 2013). Furthermore, Greece relied heavily on the attractiveness of the exchanged

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bonds to garner the needed support. Between the short-term EFSF bonds, the fact that new bonds were issued under English (rather than Greek) law, and a co-financing agreement with the EFSF, which lent more credibility to Greece's commitment to pay, holders of exchanged bonds were given a clear advantage over any holdouts with older Greek law bonds.

There is another perspective, of course. The primary tool that Athens employed for restructuring was the Greek Bondholder Act (GBA). By retroactively placing a collective action clause across all issues of debt governed by Greek law, only 75 percent of those eligible bondholders had to vote in favor of the change in bond terms. Although Greece could have used domestic legislation to push through the restructuring more directly, it was afraid of conjuring expropriation claims. Still, the GBA considerably altered the playing field for holders of domestic law bonds in ways they did not anticipate. Once the PSI package was offered, the negotiating stopped altogether. Bondholders could take it or leave it, but nothing in between. Finally, very late in the game, an ominous Greek press release, perhaps out of desperation, changed its conciliatory tone stating that Greece did not "contemplate the availability of funds to make payments to private sector creditors that decline to participate in PSI" (Zettlemeyer et al. 2013).

Assuming the tribunal found Greece's restructuring to be "negotiated", Poštová Bank may only bring a claim on the basis of national treatment or most favored nation standards. These claims would require a showing that the bank was treated "less favorably" than their domestic counterparts (i.e. Greek banks) or than other investors from other parties to the TTIP (i.e. US and other European banks). There was a class of investors exempt from the exchange. These were largely official sector financial institutions such as the European Central Bank, the European Investment Bank and Central Banks of other European countries. The nature and quality of the ex ante negotiations with larger private banks could be examined to determine whether those negotiations were adequately inclusive of all similarly situated private European and US banks.

However, the Greek story is not one of discrimination based on nationality. Greece, if it coerced anyone, did so by way of the GBA imposed on all holders of domestic law bonds. Indeed there is no evidence that domestic investors were given preference at all, but rather the opposite if Greek nationals were those more likely to hold Greek law bonds. Furthermore, the final PSI exchange offer was extended to all investors regardless of nationality.

There is a chance that the tribunal would find, on the contrary, that the restructuring was not negotiated. In that case, Poštová Bank could, after waiting 9 months, bring a claim on the basis of uncompensated expropriation, unfair or inequitable treatment, or restricted or failed transfers. With respect to these claims,

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Athens is actually in a rather good position. As of April 2013, five of the holdout bonds had matured and all of the eligible holdouts had been paid in full. If Greece continues to make those payments on time, no claims under the transfers provision could stand. US treaties also tend to be rather specific and narrow in their definition of "fair and equitable treatment". The TPP states that the standard for such treatment does not "create additional substantive rights," but only "includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process" (TPP Art. 9.6).

There is also a possibility that the introduction of the GBA would, on its own be considered an expropriation. If Poštová Bank was not a holdout from the restructuring itself, but a bondholder forced into the restructuring by way of the retrofit CACs introduced into all domestic law bonds, then it may have a claim that the GBA was an indirect expropriation. Glinavos (2014) suggests that, in that case, there is a good chance that the tribunal would demand compensation for the losses caused by domestic legislation.

This short analysis reveals that if the TTIP resembled more recent EU treaties that holdouts would not have made it past a determination on jurisdiction. However, if the TTIP resembled the US-backed TPP and included a safeguard analogous to the Public Debt Annex, the tribunal would have found jurisdiction and gone on to determine the merits of the case. In this case, there is only a small likelihood that the TTIP could be used to circumvent restructuring. That said, for reasons discussed earlier, there are still limitations to the US approach that may or may not provide the proper policy space for future SDRs.

6 Conclusions for SDR and Trade and Investment Treaties

The current regime for effective SDR is very fragile. The ability of holdout bondholders to use IIAs to reclaim the full value of their bonds could further undermine the development of a new effective regime. Sovereign debt restructuring, by definition, changes the investment environment, reduces the value of an investment, allows a host government to "take" back some of a loan, and often results in bonds held by domestic financial institutions and citizens being restructured differently than foreign bondholders. For that reason, when sovereign debt is counted as "investment" by an IIA, numerous conflicts could arise.

Neither the Greek or Argentine cases have made it past a finding on jurisdiction. As we await the award in Abaclat, we can only speculate how certain IIA provisions may determine the outcome. There are numerous nations, however,

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that have a long history of default, and which are experiencing debt-to-GDP ratios far beyond what experts see as the threshold for triggering a debt crisis. If not immediately, at some point in the future debt default will certainly occur. Since investor-state claims through IIAs are now a new avenue for holdout bondholders to bring a claim, ICSID tribunals will almost certainly have more opportunities to apply investment treaties to SDR.

The US is the only nation that includes explicit provisions regarding SDR in some of its IIAs. While a step in the right direction, such provisions need improvement. At the very least, the annexes should recognize the special role of domestic interests and the complex political realities present in a financial crisis. Given that the US is now the largest debtor nation and the value of that debt could drastically be affected in the event of a default or a stiff rise in interest rates, the US may be at a point when it too should reconsider how deep the coverage of sovereign debt in its IIAs should be.

IIAs have begun to creep into the arena of SDR, with high costs and high risks for creditors and debtors alike. Going forward, investment agreements should take one of two paths: (1) to eliminate the inclusion of sovereign debt as a covered investment, thereby removing consent for jurisdiction under these agreements, or (2) to more actively shape the sovereign debt safeguards in a way that effectively addresses SDR. We put forth here a number of policy options with these paths in mind:

- **Definitions matter.** As demonstrated by the differing outcomes between the Greek and Argentine cases, the wording of the definition of "covered investment" matters greatly in the preliminary determination of jurisdiction. If there's no jurisdiction, then there's no case. In new trade and investment agreements and in renegotiating old ones, countries should consider excluding sovereign debt explicitly from coverage under the treaty and leaving SDR to other international fora.
- **Improve sovereign debt safeguards.** On the other hand, given the general trend toward broader and deeper coverage in investment agreements, countries could turn instead to the US Public debt annexes for a model. One simple, albeit controversial, way to improve the annexes would be to not maintain the national treatment requirement for negotiated restructurings. Since national treatment is one of the pillars undergirding these agreements, the allowance for discrimination in the case of SDR would have to be carefully limited. However, if legitimate domestic financial interests are taken into account, these annexes would go a long way (together with other measures) to protect SDR.
- **State-to-State dispute resolution for SDR.** Investor-State disputes are a well-established practice for modern IIAs. However, given the sensitive

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nature and complicated political realities of SDR, this context calls for a more collaborative process. One approach to address these political complexities would be to specify a state-state dispute settlement process specifically for cases involving SDR. Many current European BITs contain both a state-state process and an investor-state process. The annex could simply preserve SDR for state-state dispute resolution. An alternative approach would be modeled on a financial services safeguard present in both the US Model BIT and the TPP. Art. 11.22 of the TPP states that in the case of an investor-state conflict over financial services, the authorities of the respondent state and the Party of the claimant investor must meet together to make a determination of whether an exception applies in that context. The determination of the authorities "shall be binding on the tribunal" making the decision between the investor and the state. That same provision could be read into a Public Debt annex, such that the authorities of each Party would have the chance to collaborate and determine whether a prudential reason exists for the restructuring.

As the world turns to bigger, broader and deeper trade and investment agreements, this is the perfect time to assure that these treaties reflect the realities of sovereign debt in an environment with liberalized capital markets. This list of reforms is by no means a final one, nor is this paper the end of discussion on this subject. The global financial crisis that began in 2008 has triggered a discussion on the proper forums for preventing and mitigating financial crises. We hope, rather, that this paper contributes to that on-going discussion.

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