MEJOR TESIS DE POSTGRADO

«DISPUTE SETTLEMENT AFTER SOVEREIGN DEBT DEFAULTS: A FORUM MENU FOR HOLDOUT CREDITORS» (2018).

Tomas-Daniel Rodriguez-Correa

CAM
SANTIAGO • CHILE
CENTRO DE ARBITRAJE Y MEDIACIÓN
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Premio del CAM Santiago a las Mejores Tesis en Métodos Adecuados de Resolución Pacífica de Conflictos – Primera Edición.

Mejor Tesis de Postgrado

«Dispute settlement after sovereign debt defaults: A forum menu for holdout creditors»

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Profesora Guía: Andrea Ernst

Universidad de Chile & Universidad de Heidelberg

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El CAM Santiago premia a las mejores tesis en métodos adecuados de resolución pacífica de conflictos

En agosto de 2022, el Centro de Arbitraje y Mediación (CAM) de la Cámara de Comercio de Santiago (CCS) reconoció a los ganadores del «Premio CAM Santiago 2022 a las Mejores Tesis en Métodos Adecuados de Resolución Pacífica de Conflictos», iniciativa organizada por la Dirección Ejecutiva y de la Oficina de Estudios y Relaciones Internacionales del Centro.

La primera edición del galardón convocó a egresados de pregrado y postgrado de Facultades de Derecho nacionales, con el objetivo de incentivar la investigación académica en métodos adecuados de resolución pacífica de conflictos en Chile (tales como el arbitraje, la mediación y los dispute boards) a través de tesis, tesinas, ensayos, investigaciones y memorias de prueba aprobadas entre el 1° de enero de 2015 y el 31 de diciembre de 2021.

Durante la convocatoria se recibieron un total de 18 postulaciones, resultando ganadores Felipe Montero Rafols (Licenciado en Ciencias Jurídicas y Sociales de la Universidad de Concepción) en la categoría de pregrado y Tomás Rodríguez Correa (Máster en Derecho Internacional, Inversiones, Comercio y Arbitraje por la Universidad de Chile y por la Universidad de Heidelberg) en la categoría de postgrado. Adicionalmente se entregó la mención Francisco Orrego Vicuña a la mejor tesis de pregrado en arbitraje de inversiones, escrita por Joaquín Schäfer Rodríguez (Licenciado en Ciencias Jurídicas de la Pontificia Universidad Católica de Valparaíso).

La «mejor tesis de pregrado» (escrita por Felipe Montero y guiada por el profesor Mauricio Inostroza Sáez) lleva por título «El principio de validación como criterio para la determinación del derecho aplicable a la validez del acuerdo de arbitraje» (2020) y propone la aplicación de este principio con el objetivo de hacer efectiva la auténtica intención de las partes en orden a someterse al procedimiento arbitral, aplicando al efecto el Derecho más favorable al acuerdo de arbitraje, solución que su autor estima consistente con la Convención sobre el Reconocimiento y la Ejecución de las Sentencias Arbitrales Extranjeras (Convención de Nueva York de 1958) y demás textos uniformes que configuran el marco regulatorio de la disciplina.

La «mejor tesis de posgrado» (escrita en inglés por Tomás Rodríguez y guiada por la profesora Andrea Ernst) fue «Dispute settlement after sovereign debt defaults: A forum menu for holdout creditors» (2018) y tuvo como objetivo identificar el mejor foro para lograr el pago total de los términos financieros de los bonos soberanos, mediante la comparación de factores como la jurisdicción, los méritos y la ejecución en tres escenarios: desde la aproximación del Derecho contractual, el Derecho convencional y la negociación en el mercado de capitales. Estos enfoques se derivaron del derecho doméstico (principalmente Derecho inglés y Derecho del Estado de Nueva York), el derecho internacional público y el derecho financiero internacional.

Ambas memorias fueron presentadas por sus autores y comentadas, respectivamente, por la Dra. María Agnes Salah Abusleme (entonces, Vicepresidenta del Consejo Directivo del CAM Santiago) y por la abogada Macarena Letelier Velasco (entonces, Directora Ejecutiva del Centro).

Por su parte, la «mención Francisco Orrego Vicuña» fue entregada a la tesis «Notas sobre la configuración normativa del arbitraje internacional de inversiones en Chile: Regulación y crítica» (escrita en 2020 por Joaquín Schäfer y guiada por el profesor Mauricio Ríos Lagos). Esta investigación se propuso demostrar cómo el arbitraje internacional de inversiones ha puesto en jaque el monopolio estatal en la producción normativa, así como se ha instaurado como una figura con una fisionomía propia con relación al esquema de la jurisdicción constitucional chilena. Con este fin, esta memoria se planteó los siguientes objetivos: enmarcar al arbitraje de inversiones como una figura jurídica que obedece y responde al sistema político económico actual; identificar la forma en que su consagración ha implicado un desafío en el monopolio de la producción normativa estatal; revisar cómo responde a la teoría de la jurisdicción chilena, y, en general, ofrecer un panorama general y crítico de su regulación en Chile.

El trabajo fue comentado por el abogado Francisco Orrego Bauzá, quien destacó las características de la memoria y la influencia de don Francisco Orrego Vicuña en el desarrollo del Derecho Internacional y el Arbitraje.

El jurado de la 1° edición estuvo integrado por María Teresa Vial Álamos, la Dra. Elina Mereminskaya, la Dra. María Agnes Salah Abusleme, Marcela Radović Córdova, Cristián Maturana Miquel, Macarena Letelier Velasco,

Ximena Vial Valdivieso, María Soledad Lagos Ochoa, Laura Aguilera Villalobos, Daniela Escobar Pizarro, Jazmina Santibáñez Farías y Benjamín Astete Heimpell.

La ceremonia de premiación, también contó con la participación de Carlos Soublette Larraguibel, Manuel José Vial, Felipe Correa Molina, Josefina Trujillo Silva, Claudio F. Osses Garrido, Tomás Correa Cannobio e invitados especiales.

Luego de esta primera edición, el CAM Santiago recibe postulaciones en su página web de manera permanente.

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El CAM Santiago.

El Centro de Arbitraje y Mediación (el CAM) es un organismo creado al interior de la Cámara de Comercio de Santiago (CCS) que tiene por finalidad administrar mecanismos adecuados de resolución pacífica de conflictos: arbitraje nacional (1992), internacional (2006) y de emergencia (2023), mediación (1998) y dispute boards (2015). Asimismo, el CAM Santiago periódicamente imparte cursos tendientes a la preparación de profesionales en el ámbito de su competencia. Con cerca de 7.000 solicitudes entre arbitrajes y mediaciones que han sido presentadas al CAM Santiago desde 1992, la institución se ha constituido como referente en materia de solución adecuada de conflictos en Chile y en América Latina.

La CCS.

La Cámara de Comercio de Santiago (CCS) es una Asociación Gremial sin fines de lucro, fundada en 1919, que reúne a 2.230 empresas asociadas: grandes, pequeñas y medianas, representativas de los más relevantes sectores económicos de Chile. Su visión es ser la asociación gremial líder para el comercio del futuro y su propósito es impulsar el desarrollo de un Chile emprendedor.

Para Alba, Julio, y Hernando.
Ustedes han hecho este afortunado proyecto posible.

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My special thanks are extended to the staff of the University of Chile, Heidelberg University, Max Planck Institute for Comparative Public Law and International Law and the Institute of International Studies of the University of Chile, especially the staff at Marcial Martinez Library. Comments given by Claudia Fernandez and Juan Felipe Toro have been a great help in this project. I am particularly grateful for the assistance and legal review given by Prof. Andrea Ernst. Thanks to the Colombian institution ICETEX and the HCAL, which provided me with financial support. Finalmente, quiero agradecer a mi mamá, mi papá y a mi hermano por su apoyo incondicional y continua motivación, ¡gracias familia!

Content

Abstract

This thesis aims to identify the best forum for looking full enforcement of sovereign bond terms by comparing issues related to jurisdiction, merits, and enforcement of awards in three scenarios: the contractual law approach, the statutory law approach and the market-based approach. These approaches derive from domestic, public, international, and international financial law. The research uses descriptive, comparative, and case study techniques to identify pros and cons. After describing these aspects, Chapter 4 shows the best approach for enforcing bond terms.

The thesis reveals that the best scenario for bondholders looking for full enforcement should consider the kind of market. If bondholders have acquired the bond in the primary market, it would be better to issue a claim before the ICSID because this forum offers more options for enforcement purposes than other approaches. However, if bondholders have acquired the bonds in the secondary market, they should sue before national courts, as they do not differentiate between primary and secondary bondholders. ICSID might not be a good option for bondholders who acquire bonds in the secondary market as state-of-the-art information about the abuse of rights demonstrates that investment tribunals tend to limit compensation for speculative investments. Finally, the results reveal that the Market-based approach plays a limited role for full enforcement purposes. Firstly, it is designed to facilitate debt restructuring, and secondly, its legal framework is still soft law.

Introduction

"Weapons of mass destruction, if they should exist at all, should certainly not exist in the hands of a small group of private actors—they are a political issue par excellence."[1].Lisa Herzog, 2017.

Up to now, an international framework for sovereign debt management has not been designed; therefore, dealing with sovereign debt defaults (SDD) has been an odyssey. Sovereign debt disputes resulted from the international community's incapacity to deal with this global challenge[2]; additionally, it has been continuously criticized by scholars, experts, state representatives and the United Nations (UN).

Likewise, Buchheit has said that sovereign debt implies not only legal issues but also financial, economic, political, social, and sometimes moral dimensions for which no national judge has the legal standing or competence to make determinations[3]. Accordingly, he believes that the International Monetary Fund (IMF) would be the best institution for dealing with debt restructurings[4]. In general, no judicial body has been accepted by the international community, so it is conceivable to state that even Dworkin's imaginary judge Hercules[5] could not rule a sovereign debt dispute.

As a result, tensions arising from sovereign bonds appear between the public interest of sovereign governments and the private interest of financial market participants[6]. Accordingly, judicial and non-judicial means have been used to settle disputes: litigation and arbitration on the one hand and negotiation on the other. Likewise, litigation before domestic courts has taken place mainly in tribunals in the United States and the United Kingdom; in the International Centre for Settlement of Investment Disputes (ICSID), arbitral procedures have been used; the Paris Club[7] has been dealing with restructuring negotiations debts between states, and the London Club[8] which has been dealing with debt between commercial banks and states[9]. How-

1 Lisa Herzog, "*Introduction: Just Financial Markets? Finance in a just Society*," in *Just Financial Markets?: Finance in a just Society*, ed. Lisa Herzog, Vol. 1 (Published in the United States of America: © Oxford University Press 2017, 2017) 1.

2 Juan Pablo Bohoslavsky and Kunibert Raffer, "Introduction: We Need to Learn from Experience ," in Sovereign Debt Crises what have we Learned? , eds. J. Bohoslavsky and K. Raffer (United States of America: © Cambridge University Press 2017, 2017)1. "The number and recurrence of crises and their disastrous social and economic consequences distinctly reveal the inadequate response of states and the international community to this global challenge. One reason".

3 Buchheit talking at *Max Planck Lecture Series on Sovereign Debt: Proposals for Reform of Sovereign Debt Restructuring: The Statutory Approach - 14 Dec 2016,* directed by Max Planck Institute for Procedural Law Luxembourg (Max Planck Institute Luxembourg 4, rue Alphonse Weicker L-2721 Luxembourg: YouTube, LLC., 2017b). 50'46''; see also: Lee C. Buchheit, "*Part V, Proposals to Reform Sovereign Debt Systems: 28. Sovereign Debt in the Light of Eternity*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014) 28.12. "Judges, powerful as they may be within the four walls of their own courtrooms, are ill-equipped and ill-positioned to decide how the discomfort of a financial crisis should be apportioned among the citizens of the debtor country and the various classes of its creditors."

4 L. Buchheit taking at: *Max Planck Lecture Series on Sovereign Debt: Proposals for Reform of Sovereign Debt Restructuring: The Statutory Approach,* 51'40''.

5 See: in general: Cesar Rodriguez Garavito, *La Desición Judicial: El Debate Hart - Dworkin*Siglo del hombre editores, Universidad de los Andes, 1997).

6 Rosa M. Lastra, *11th UNCTAD Debt Management Conference. Responsible Financing: The Role of 'soft Law' in Promoting Sustainable Lending and Borrowing Practice* (Palais des Nations , Geneva: , 2017). P.4

7 Mauro Megliani, *Sovereign Debt: Genesis - Restructuring - Litigation*, ed. Springer International Publishing Switzerland 2015 (Milan, Italy: Springer International Publishing Switzerland 2015, 2015). doi:10.1007/978-3-319-08464-0. Pag. 282.

8 Ibíd. Pag. 331.

9 Though, other mechanisms remain available. Likewise, the European Union has the Debt Restructuring Mechanism, and also debtors and creditors are free to solve their bonds issues as they prefer.

ever, currently, the UN, the United Nations Conference for Trade and Development (UNCTAD)[10], the Institute of International Finance (IIF), the Institute for Capital Market Associations (ICMA), experts and scholars are working on a multilateral legal framework for sovereign debt restructuring.

Each legal scenario has different features, especially governing laws, which imply diverse outcomes for bondholders (holdouts) looking for full payment. The contractual law approach (CL), developed mainly in New York courts, has been the most used means for breaching bond contract terms. One of the main advantages is its strict enforcement of contractual terms. Financial institutions[11] prefer litigation over arbitration when dealing with financial disputes, and mainly major financial centers such as New York or London because of their experience dealing with financial disputes and their "reputation for enforcing written agreements according to their terms"[12]. Nevertheless, when looking for enforcement in those jurisdictions, lawyers have had to deal with the State Immunity Act 1978 in the UK and the Sovereign Immunities Act, 28 U.S.C. §§ 1602 in the U.S., which has complicated the enforcement of awards.

The international investment law approach (IIL) has been highly controversial as it is perceived as an inadequate forum to deal with debt distress; for instance, Waibel has suggested that "Investment Arbitration has a very limited role to play in resolving sovereign debt disputes"[13]. Even though ICSID tribunals had not been dealing with foreign debt until 2006, after a complex legal discussion between the parties in the Abaclat case[14], an ICSID tribunal decided that under treaty law, ICSID had jurisdiction over the dispute. According to Waibel, the Global Committee of Argentine Bondholders suggested that the fact that countries are expected to pay ICSID awards and that ICSID awards do not pass through national review make this particular jurisdiction a "more efficient litigation path"[15]. ICSID arbitrators frequently have different legal backgrounds; therefore, understanding financial obligations may differ. For instance, it is perceived that arbitral awards tend to be more tolerable with debtors than court awards are[16]". In addition, some publicists have supported the idea that ICSID is a good forum for resolving sovereign debt disputes because it incentivises investors to get into the public bonds market due to their willingness to invest in a country with investment protection agreements[17].

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10 Mauro Megliani, *Sovereign Debt: Genesis - Restructuring – Litigation*, 570. In 2001, the IMF intend to implement a Sovereign Debt Restructuring Mechanism (SDRM), however, due to opposition by US Government and Association of Investors it failed.

11 Ib. 574 The contractual approach has been supported by U.S. investors and the Financial Industry Association.

12 Judith Gill and James Freeman, "*9. Practical Issues Specific to Arbitration Containing Financial Products*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015) 9.04, 9.79 .

13 See Waibel talking at: *Max Planck Lecture Series on Sovereign Debt: Investment Arbitration as a Means of Resolving Sovereign Debt Disputes - 9 Nov 2016,* directed by Max Planck Institute for Procedural Law Luxembourg (Max Planck Institute Luxembourg 4, rue Alphonse Weicker L-2721 Luxembourg: YouTube, LLC., 2017a) 2' 35''.

14 International Center for Settlement of Investment Disputes Washington, D.C., *ICSID Case no. ARB/07/5, Abaclat and Others (Case Formerly Known as Giovanna A Beccara and Others*) (Claimants) and the Argentine Republic (Respondent), Decision on Jurisdiction and Admissibility.*

15 Michael Waibel, "Opening Pandora's Box: Sovereign Bonds in International Arbitration," *The American Journal of International Law* 101, no. 4 (2007), 711-759. Pag. 715.

16 Judith Gill and James Freeman, "*9. Practical Issues Specific to Arbitration Containing Financial Products*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015). *Gill and Freeman have described it like : "concerns about the tendency of arbitrators to follow King Solomon´s approach and "split the baby" linger, perhaps not in the extreme sense of deciding the dispute on the basis of a 50/50 financial outcome but rather on the basis that debtors are treated more leniently than in courts"*

17 Ellie Norton, "International Investment Arbitration and the European Debt Crisis," *Chicago Journal of International Law* 13, no. 1 (2012). Pag. 302.

The multilateral legal framework for a sovereign debt restructuring process (also known as the market-based approach) seems to be the most complex and ambitious project supported by international organizations like the UN, the UNCTAD and the IMF and experts like Buchheit[18] and Bohoslavsky[19]. The mechanism reacted to disorderly workouts of private sector claims and the increased number of distressed sovereigns. It has been intended to organize creditors, facilitate negotiations, reach agreements and, most importantly, avoid debt litigation[20]. Even though the international community has not agreed on the mechanism, the UN has established some essential features. Likewise, on September 10th, 2015, the United Nations General Assembly adopted Resolution 69/319 related to the *Basic Principles on Sovereign Debt Restructuring Processes,* which basis was designing macroeconomic policies, good faith, transparency, impartiality, equitable treatment, sovereign immunity in foreign courts, legitimacy, sustainability and majority restructuring[21].

In addition to jurisdiction and substantive law, sovereign bonds are essential to the problem[22]. Generally, bonds are classified according to their maturity date, which is when the issuer must pay the borrowed amount. Likewise, "The US federal debt classified bonds as follows: "Bills" are bonds maturing in less than one year, "Notes" between one and ten years, and "Bonds" maturing in more than ten years"[23]. In addition, after the Argentine crisis, some changes were made regarding sovereign bonds' clauses to avoid holdout creditors and problems with debt restructuring. Among them are the Gross Domestic Product Link Bond (GDP link bond)[24] introduced in the London Term Sheet by the Bank of England[25], new Collective Actions Clauses (CACs) and New Standard Pari- passu Clauses introduced by the International Capital Market Association[26]. In addition, the IMF Executive Board has supported the inclusion of CACs and reformulated Pari-passu clauses in new sovereign bonds[27].

The measures above have dealt with the contractual problem of sovereign bonds, but the policy prob-

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18 Cleary Gottlieb Steen & Hamilton LLP, "Lee C. Buchheit Partner," © 2017 Cleary Gottlieb Steen & Hamilton LLP;, https://goo.gl/k36stT (accessed 12/12, 2017).

19 United Nations Human Rights Office of the High Commissioner, "*Independent Expert on the Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of all Human Rights, Particularly Economic, Social and Cultural Rights*," © OHCHR 1996-2017;, https://goo.gl/zSkqGh (accessed 12/14, 2017).

20 L. Buchheit taking at: *Max Planck Lecture Series on Sovereign Debt: Proposals for Reform of Sovereign Debt Restructuring: The Statutory Approach*. 41'48''. However, Buchheit has explained that private creditors think that by creating a statutory mechanism (basically, institutionalizing sovereign debt restructuring) sovereign default will be encouraged.

21 *Resolution 69/319. Basic Principles on Sovereign Debt Restructuring
Processes,* 69th sess., (29 September 2015, 2015): .

22 Mauro Megliani, *Sovereign Debt: Genesis - Restructuring - Litigation*, ed. Springer International Publishing Switzerland 2015 (Milan, Italy: Springer International Publishing Switzerland 2015, 2015). doi:10.1007/978-3-319-08464-0. "Besides syndicated loans, the other private channel of lending to sovereign is constituted by the issuance of sovereign bonds on the international markets. This particular form of sovereign indebtedness, widely resorted to until the first third of the twentieth century, currently constitutes the major source of sovereign financing." p. 205.

23 Adam Hayes, "*Bond Basics: Different Types of Bonds*," © 2017, Investopedia, LLC.;, https://goo.gl/7Jv5YC (accessed 12/14, 2017).

24 Mr. Yannis Manuelides - Partner Allen & Overy LLP, London, *11th UNCTAD Debt Management Conference. State-Contingent Debt Instruments for Sovereigns: Can they be made «to Work»* (Palais des Nations, Geneve: , 2017).

25 Bank of England, "*Bank of England Workshop on GDP Linked Bonds*," ©2017 Bank of England;, https://goo.gl/gt6F6h (accessed 12/14, 2017).

26 International Capital Market Association, "Collective Action Clauses - Standard Collective Action and Collective Paris Passu Clauses for the Terms and Conditions of Sovereign Notes," Copyright © 2017, https://goo.gl/gCFR1x (accessed 12/14, 2017).

27 Prepared by: Yan Liu et al., *Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts* (Washington D.C.: © 2017 International Monetary Fund;,[2017]).

lem remains uncontested. Accordingly, two overlapping factors make future sovereign bond defaults highly probable: the *financial rationale* of the sovereign bonds market and the sovereigns' economic policy. The former is based on the current international bonds market, which does not follow the traditional commodities supply and demand rationale so, creating a bond expenditure disorder (for example, the demand for copper wire would depend on the IT industry needs; therefore, the possibility of bond issuances by copper industries would increase because of capitalization purposes[28]). As pointed out by C. Bamford "[t]he market has to develop taking into account the practical limitations of the commodity with which it is dealing. In the case of international bond markets, however, there has not been such a constraint"[29]. With respect to sovereigns' economic policy, states can borrow and, even, over-borrow money from international markets because sovereign bonds do not depend on a constraint. Hence, the lack of borrowing limitations in international market regulation may enhance the risk of suffering from "financial bulimia"[30].

States which have defaulted are more likely to default again than non-defaulting states[31], so it is probable that states which have experienced debt distress recently, like Argentina in 2001, Grenada in 2014, Mozambique in 2016, Chad in 2017, Gambia in 2017, Republic of Congo in 2017 and Venezuela in 2017[32] could default on their financial obligations again. More interestingly, the People's Republic of China has recently opened its public debt market[33] and has sold sovereign dollar bonds to investors, insurers and global fund managers, implying a remarkable increase in sovereign bond transactions. Finally, the United Nations General Assembly has expressed concern for debt distress problems in developing economies[34]; nonetheless, some OECD countries have also been threatened by the debt crisis, particularly euro member countries[35].

Considering the three previous disputes and negotiation settlement scenarios and the new era of sovereign bonds, which will mature in the coming decades, bondholders (holdout creditors) looking for full enforcement will have to analyze the best suitable forum for enforcing sovereign bond terms.

The ICSID seems to be the most effective path for holdout creditors looking for full enforcement of bond terms since, on the one hand, the last contractual developments in sovereign bonds have limited the possibility of accessing domestic courts and eventually getting a favourable ruling before domestic courts. On the other hand, the market-based approach avoids litigation and arbitration.

The general objective is to identify the best forum for full enforcement of sovereign bond terms by comparing issues related to jurisdiction, merits, and enforcement of awards in the contractual, statutory, and market-based approaches.

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28 Colin Bamford, *Principles of International Financial Law*, second edition published in 2015 ed. (United States of America by Oxford University Press: ©Oxford University Press 2015, 2015) 157.

29 Ib.

30 L. Buchheit taking at: *Max Planck Lecture Series on Sovereign Debt: Proposals for Reform of Sovereign Debt Restructuring: The Statutory Approach,* 53'50''.

31 Prepared by Tamon Asonuma, Authorized for distribution by Atish Rex Ghosh, "*IMF Working Paper: Serial Sovereign Defaults and Debt Restructurings*," *International Monetary Fund*, no. WP/16/66 (March 2016, 2016). *"Emerging countries (EM) that have defaulted on their debt repayment obligations in the past are more likely to default again in the future than are non-defaulters with the same external debt-to-GDP ratio." p. 4.*

32 Mark Flanagan, *11th UNCTAD Debt Management Conference. State-Contingent Debt Instruments for Sovereigns: Can they be made «to Work»* (Palais des Nations , Geneva: , 2017). P.3.

33 David Francis, "China Opens its Bond Market to International Investors," *Foreign Policy*2017.

34 Resolution *71/216. External Debt Sustainability and Development,* A/RES/71/216, Seventy-first session sess., (25 January 2017, 21 December 2016).

35 Juan Pablo Bohoslavsky and Kunibert Raffer, "*Introduction: We Need to Learn from Experience* ," in *Sovereign Debt Crises what have we Learned?*, eds. J. Bohoslavsky and K. Raffer (United States of America: © Cambridge University Press 2017, 2017) 5.).

The chapters of the thesis will analyze the main substantive and procedural issues that bondholders (holdout creditors) must deal with and consider when looking to enforce sovereign bond terms.

Chapter 1: Firstly, the contractual law approach to litigation studies the Pari-passu clause's current role, considering the Argentine experience before the N.Y. Second Court. Secondly, the chapter goes deep into the kind of CACs implemented into sovereign bonds and their consequences for holdout creditors. Thirdly, what would be the consequences of implementing GDP-linked bonds for holdout creditors? Finally, the chapter analyses critical issues related to sovereign immunity and waiver of immunity in domestic courts.

Chapter 2: The international investment law approach to arbitration is intended to answer the following questions: firstly, what are the legal problems related to jurisdiction before the ICSID? Then, what is the relationship between treaty shopping and the International Central Securities Depositories (ICSD)? Thirdly, what would be the compensation for secondary bondholders in case of an award? Finally, what are the main issues related to enforcing ICSID awards?

Chapter 3: This Chapter analyses the market-based approach to debt restructuring and dispute resolution. Firstly, the role played by principles developed by the UN in relation to sovereignty is studied. Secondly, the critical issues related to rules of international finance are evaluated; thirdly, the proposal for creditors' committees and dispute resolution mechanism will be studied. Finally, the relevance of trust structures and fiscal agencies throughout debt restructuring will be analyzed.

Chapter 4: Chapters 1, 2 and 3 are balanced. Accordingly, the main features of the contractual law, investment law, and market approaches will be tested to identify the best approach to solve the research's question. Specifically, it will be checked if the international investment law approach is the best forum to enforce sovereign bond terms.

CHAPTER I: THE CONTRACTUAL LAW APPROACH

"I used to think that if there was reincarnation, I wanted to come back as the President or the Pope or as a 400 baseball hitter," he said. "But now I would like to come back as the bond market. You can intimidate everybody."[36]
James Carville, Clinton campaign strategist

1. DOMESTIC COURTS: WHAT ABOUT PARI-PASSU[37]

1.1 Sovereign bonds and Pari-passu[38]: what has changed?

When analyzing legal obstacles to enforcing sovereign bond terms before national courts, some crucial facts should be clarified before describing some legal problems. Sovereign bonds experienced a significant change after the Argentina default in 2001. Before the Argentine crisis, plenty of sovereign defaults happened; however, none was as controversial as the litigation between NML Capital Limited (NML)[39] and The Republic of Argentina, which lasted over a decade. The main important feature of the Argentine case was the *pari-passu* clause, which made the litigation in New York courts complex and controversial.

After Argentina had tried to accomplish a debt restructuring with its bondholders, some holdout creditors decided not to negotiate with the Argentinean government and instead decided to sue them before US courts, looking for full payment.

The United States District Court for the Southern District of New York (S.D.N.Y.) faced two different interpretation theories regarding the *pari passu* clause. Argentina used the classical and narrow interpretation of the clause[40]. This understanding is explained by George Affaki as follows: "This means that the debtor is not entitled to alter the legal ranking of the pari passu debt by subordinating it to other debts so that, in the event of insolvency, the pari passu bonds or debt rank equally with other unsecured debt". Accordingly, there are no preferences among debts, and bonds must be equally managed concerning all debts. On the contrary, NML supported its argument in the new broad interpretation of the clause, which "postulates that an insolvent debtor must pay all of its creditors rateably, regardless of any priority order that may be imposed by the bankruptcy laws." Under this interpretation, the imperative 'rank' becomes 'pay'[41]. As explained, equal treatment focuses on "pay"; consequently, if a State has reached a debt restructuring but not all creditors have agreed on it, the dissenting creditors may undermine the debt restructuring, arguing that (settled) payments cannot be made to a selected number of creditors because it would violate the pari-passu provision.

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36 The quote was retrieved from the article: Louis Uchiletelle, "Ideas & Trends: The Bondholders are Winning; Why America Won'T Boom," © 2018 The New York Times Company, https://goo.gl/nwCGpB (accessed 01/02, 2017).

37 Nowadays, the Pari-passu clause is known as the "legal ranking clause".

38 *"Side by side; at the same rate or on an equal footing. Origin-Latin, Literally 'with equal step'"* Retrieved from: Oxford University Press, "Oxford Living Dictionaries," © 2017 Oxford University Press, https://goo.gl/vo2ekg (accessed December/29).

39 An American incorporated company.

40 Today, two radically different interpretations of the pari passu clause are pitted against each other. The classical, narrow interpretation requires that the obligations within the scope of the pari passu clause rank equally and ratably. See: Georges Affaki, "Part I, Sovereign Debt Restructuring: 4. Revisiting the Pari Passu Clause," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014) - pag. 42.

41 Ib.

The judge accepted the new broad theory and consequently ruled that Argentina could not restructure its debt until it paid to NML equally compared to the other debtors. As a result, the Pari-passu clause became the "entrance" for holdout creditors looking for full payment of interest and principal of sovereign bonds.

The S.D.N.Y ruling was appealed, and the Second Circuit Court of New York affirmed the judgement. However, some essential features were pointed out by the Court. The Court stated that in addition to violating the clause, the executive declarations and the legislative enactment carried by the Argentinian governmental and legislative powers have ensured that NML rights were not treated equally[42].

According to the Second Circuit's view, Argentinean (i) executive declarations and (ii) legislative enactments did not guarantee direct, unconditional, unsecured and unsubordinated obligations from Argentina with respect to the plaintiff's rights. Accordingly, the Court affirmed the breach of the *pari-passu* clause.

After the rule of the Second Circuit and other remarkable events[43], the S.D.N.Y. faced a new lawsuit by holdout creditors who did not participate in the 2005 and 2010 restructurings and the 2016 settlement. The claimant argued that Argentina had not paid principal and interests, albeit Argentina had paid to other bondholders. Consequently, the claimants stated that full payment must be made according to the pari-passu clause.

Notwithstanding the previous *pari-passu* interpretation, on the 22nd of December 2016, the S.D.N.Y in White Hawthorne LLC v. Argentina ruled that in addition to the Argentinian failure to make equal payments, the extraordinary conduct of the republic known as "uniquely recalcitrant debtor." was also essential to apply the *pari passu* legal precedent. Consequently, as the same facts did happen in this case, the court did not find a violation of the *pari passu clause*[44].

The New York Court's interpretation of the pari-passu clause has not changed[45] Yet, sovereign bond terms have experienced a legal metamorphosis since (mainly) the Argentina experience.

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42 *NML Capital, Ltd. V. Republic of Argentina, 699 F.3d 246 (2d Cir. 2012), NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246 (2d Cir. 2012)* (United States Court of Appeals, Second Circuit. a). *"In short, the combination of Argentina's executive declarations and legislative enactments have ensured that plaintiffs' beneficial interests do not remain direct, unconditional, unsecured and unsubordinated obligations of the Republic and that any claims that may arise from the Republic's restructured debt do have priority in Argentinean courts over claims arising out of the Republic's unstructured debt. Thus we have little difficulty concluding that Argentina breached the Pari Passu Clause of the FAA".*

43 Argentina and NML and other bondholder reached a Settlement in 2016. According to the New York Times a payment of $9.3 billion was made to the holdout creditors. See: Alexandra Stevenson, "*how Argentina Settled a Billion-Dollar Debt Dispute with Hedge Funds*," *The New York Times* 25 April, 2016.

44 *Opinion, White Hawthorne, LLC V. Republic of Argentina, 16 CV 1042(T.P.G) (S.D.N.Y. Dec. 22, 2016). Opinion, White hawthorne, LLC v. Republic of Argentina, 16 CV 1042(T.P.G) (S.D.N.Y. Dec. 22, 2016).* (United States District Court for the Southern District of New York b). "(...) Although the meaning of the pari passu clause has been hotly disputed, the Republic's "extraordinary conduct" during its prior administration led this court to find breach of the clause in December 2011(...) The Republic's failure to make scheduled payments on its debts was part of this conduct, but it was only one element in a complicated set of circumstances. In subsequent orders, the court emphasized that what constituted breach was the Republic's "entire and continuing course of conduct," including harmful legislation like the Lock Law and incendiary statements by the former administration". In addition, the court cited what the Second Circuit had stated in relation to the Argentina conduct: "(...) Likewise, the Court of Appeals held that it was the "combination of Argentina's executive declarations and legislative enactments" and its entire "course of conduct" that constituted breach of the pari passu clause"

45 See *Bugliotti v. Republic of Argentina*, 952 F.3d 410 (2d Cir. 2020); *and Bison Bee LLC v. Republic of Arg.*, 18-3542-cv (2d Cir. Oct. 4, 2019)

1.2 New Pari passu clauses

New *pari passu* clauses have been recommended by the UNCTAD and ICMA after the US court's broad interpretation of "payment". Accordingly, the ICMA suggests the following clause for sovereign bonds:

In bonds governed by N.Y law:

> "(...) The Bonds rank and will rank without any preference among themselves and equally with all other unsubordinated External Indebtedness of the Issuer. It is understood that this provision shall not be construed so as to require the Issuer to make payments under the Bonds ratably with payments being made under any other External Indebtedness."

The last sentence emphasizes that under no circumstances should the term "payment" be extended to the understanding of the clause. Considering the recommended version of the clause, any other external indebtedness could be paid, and it would be possible to make non-ratable payments to bondholders.

Bondholders in the Argentinean case had bought their bonds in the secondary market; however, N.Y. courts do not discriminate the market where the bonds were bought for enforcement purposes.

To sum up, from all the legal arguments a claimant could argue to look for payment of principal and interest of a sovereign bond, the *pari passu* clause interpretation of "payment equally" should be the last legal argument. Firstly, because of recent decisions of the SDNY, which ruled that a series of unique events were needed to apply the broad interpretation of the *pari passu* clause. Additionally, since new ranking terms have been included to avoid the Argentinean experience, the broad interpretation of the clause seems pointless.

2. LEGAL ASSESSMENT: THE INCLUSION OF CACS

After the Argentinean default, the United Nations (UN), the United Nations Conference on Trade and Development (UNCTAD), the International Monetary Fund (IMF), the Paris Club, the Institute for International Finance (IIF) and the G20[46] , among others[47] focused on a multilateral legal framework for sovereign debt restructuring to solve the concerns that holdout creditors have raised in the market. Even though, a Sovereign Debt Restructuring Mechanism (SDRM)[48] was considered in 2001, it did not receive enough support to be implemented in the last fifteen years[49]. Relevant stakeholders disagreed with the SDRM; nevertheless, countries and the financial market agreed to implement a contract-based development, especially the Collective Action Clauses (CACs)[50]. In addition, the fact that before 2003, the sovereign bond market did not contain CACs[51] (including Argentinean bonds), made their inclusion necessary. Considering the changes in the sovereign bond market, the following ideas show how new CACs avoid holdout risk.

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46 Drafted by Benu Schneider, *Sovereign Debt Restructuring: Further Improvements in the Market Based Approach* (New York: Financing for Development Office, Department of Economic and Social Affairs, United Nations.,[2017]) 6.

47 Personally, I think that international organizations like the Work Bank, and private entities like Euroclear and Clear Stream, and domestic central banks might have been concerned is some way about the way that the Argentina case was evolved.

48 Some reasons that supported that approach were: making an international instrument for debt restructuring could enhance the default cases due to the availability of a legal mechanism.

49 Other mechanism known as the Debt Workout Institution was proposed in 2015. However, the multilateral framework is going to be analyzed in Chapter 2.

50 Technical Study Group Report, *Sovereign Debt Restructuring, 2.*

51 Michael Bradley and Mitu Gulati, "Collective Action Clauses for the Eurozone," *Review of Finance* (2013) - P.2

2.1 Collective Action Clauses

In general, CACs stipulate that a decision to restructure sovereign debt taken by the state and at least 75%[52] of the bondholders will be extended to all bondholders (including holdouts creditors).

CACs are clauses taken from United States corporate law[53]. Interestingly, bonds issued under New York law[54] usually did not contain CACs as the U.S. implemented sophisticated court procedures for imposing debt restructuring (for example, the Trust Indenture Act of 1939); nevertheless, this procedure was not applied to sovereign bonds. The main U.S. concerns were: "if a bond could be altered with a majority vote, it would cease to be a negotiable instrument under the Negotiable Instruments Law" and "concerns that CACs could be manipulated by corporate insiders at the expense of ordinary 'mom and pop' investors"[55].

Even though some attempts to implement CACs in sovereign bonds were made by the G-10 in 1995 due to the Mexican crisis of the 90s, it was not until 2003 that CACs started to be included in sovereign bonds by emerging markets[56]. Two main reasons which could have led to the inclusion[57] of CACs into bonds governed by N.Y law were: firstly, the difficulty of restructuring the Argentinean debt due to the lack of CACs into the bond terms; and secondly, issuers concluded that bonds which had included CACs, like those of the UK law, had not been trading in a lower price because of this model[58].

However, CACs' metamorphosis has also depended on holdout creditors' risk capacity. In short, the higher the budget holdout creditors want to invest in sovereign bonds, the higher the probability they will buy bonds from the bondholders who want to restructure their debt. Accordingly, holdouts might eventually succeed in blocking the threshold required to restructure the debt, and subsequently, they will look for full payment of principal and interest.

To summarize, both the financial crisis and distressed countries, on the one hand, and the investment capacity of holdout creditors, on the other hand, have caused many CACs models to be traded in the financial market. For this thesis, the N.Y CACs will be studied, as they are the most common securities traded in the financial market[59].

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52 This is a general threshold. Later in this chapter it will be explained in detail how thresholds are designed in the sovereign bond market.

53 D. Billington, *Sovereign Debt Management, 402*.

54 D. Billington, *Sovereign Debt Management, 402*. On the contrary, sovereign bond issues under English law did contain CACs.

55 Ib.

56 Ib. 403.; See also: Andrés de la Cruz, Cleary Gottlieb Steen & Hamilton LLP, *Deuda Soberana Y Cuasi-Soberana: Últimos Avances En Materia De Cláusulas De Acción Colectiva Y Pari Passu* (Banco Central de Uruguay: , 2015) - p. 9 - 14. A. de la Cruz classified Latin American CACs as follows: 1st CACs' generation issued by Chile and Mexico between 1992 and 2003, 2nd CACs' generation issued by Uruguay, Argentina, Dominican Republic in after 2003, and 3rd CACs' generation issued by Mexico, Chile, Dominican Republic and Provincia de Buenos Aires among others after 2013.

57 D. Billington, *Sovereign Debt Management, 405*. With respect to Europe, concerns related to sovereign default were not on the agenda in the earlies 2000's because the last default country had taken place in 1945 by Austria (However, countries which have sovereign bond governed by US law, like Italy and Hungary, included CACs into its bonds.). After 2007, when the financial crisis started, the Republic of Ireland needed financial support by the European Central Bank and the IMF. The absence of CACs into European bonds turned up the alarms of Europe. Therefore, the Euro group issued a statement in 2011 establishing the basics for an European Stability Mechanism and the implementation of standardized and identical CACs starting in June 2013; The Euro Area Model CAC 2012 can be checked in: https://goo.gl/4KnQ7b

58 Ib. 405.

59 English CACs are not analysed since the United Kingdom enacted the Debt Relief (Developing Countries) Act 2010 which looked for preventing creditors from exploiting the poorest countries in the world in UK

2.2 Thresholds in CACs

The main important feature in CACs might be the threshold because its arrangement will determine whether a holdout can look to litigate before national courts. In this sense, the threshold might have a paradoxical rationale. If it is too high, it might be challenging to reach the required percentage to trigger a debt restructuring, but if it is too low, investors might not be interested in purchasing bonds because a small percentage of bondholders could potentially change the bonds' terms[60].

The CACs models

The following description is based on the model published by the International Capital Market Association in 2015[61], which has included U.S. and U.K. procedures in the model CACs. Aspects related to (i) the kind of consensus required, whether in writing or meetings or (ii) the governing instrument, whether a trust indenture, a trust deed or a fiscal agency[62], can vary from bond to bond. However, this information shows the threshold holdout creditors would have to deal with in both models.

Approval Thresholds in the N.Y. CACs

First scenario: Modifications not requiring the consent of holders.

- The issuer and the trustee can modify matters for specific purposes in the bond[63]. These specific purposes can be resumed in aspects which (i) do not affect the rights of the bondholders or (ii) correct technical errors of minimal importance[64].

Second scenario: Single series (non-reserve matter) modifications.

- Non-reserved matters which, according to the terms and conditions, are neither reserved matters covered by the third, fourth and fifth scenarios (explained ahead), nor a situation covered in the first scenario, *require written consent of the Issuer and the affirmative vote (if approved at a Bondholders' meeting) or consent (if approved by a written action) of holders of more than 50% of the aggregate principal amount of the outstanding Bonds of that series*[65].

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courts.

60 D. Billington, *Sovereign Debt Management, 406.* "For the draftsman, the approval threshold in a CAC is both the most important and the most difficult part (...) Set the threshold too high and the usefulness of the CAC is diluted; set it too low and investors may be reluctant to subscribe for fear of the ease with which the other bondholders could approve changes to the terms of the bond."

61 International Capital Market Association, *Stadard Aggregated Collective Action Clauses ("CACS") for the Terms and Conditions of Sovereign Notes Governed by New York Law*.

62 Technical Study Group Report, *Sovereign Debt Restructuring, 13.* Holdout creditors have preferred to use fiscal agency because it allows them to go before the court if they do not want to participate in a debt restructuring. On the contrary, supporters of the Market Based Approach have incentive the use of trust structures to reduce the possibilities of holdout creditors in sovereign debt restructures process. The pros and cons are of each legal vehicle are studied in chapter 3.

63 *ICMA, CACS for the Terms and Conditions*. 18-19.

64 Ib. 19.

65 Ib. 19.

Third scenario: single series reserve[66] matter modifications.

- Modification, constituting of including a reserved matter of the bond terms of a single series, *may be made (...) with the written consent of the Issuer and the affirmative vote or consent of holders of more than 75% of the aggregate principal amount of the outstanding Bonds of that series*[67].

Fourth scenario: cross-series reserved matter modifications with single aggregated voting.

- This kind of modification requires a high compliance standard as two or more series of sovereign bonds are involved in the modification. The condition states that the modification must be "Uniformly Applicable to the terms and conditions of the bonds of two or more series". According to the ICMA model, the modification "may be made (...) with the written consent of the Issuer and the affirmative vote or consent of holders of more than 75% of the aggregate principal amount of the outstanding Bonds of all the series affected by the proposed Modification (taken in the aggregate)"[68].

Fifth scenario: cross-series reserved matter modifications with two-tier voting.

- This modification also requires a higher compliance standard than the fourth scenario. The clause allows to constitute or modify a reserved matter modification, prior to accomplishing the following requirements:

  "(i) the affirmative vote or consent of holders of more than 66⅔% of the aggregate principal amount of the outstanding Bonds of all the series affected by that proposed Modification (taken in the aggregate), and

  (ii) the affirmative vote or consent of holders of more than 50% of the aggregate principal amount of the outstanding Bonds of each series affected by that proposed Modification (taken individually)"[69].

At the end of the clause is stated that modifications that are not "uniformly applicable must be effected" in accordance with the fifth scenario. However, then the clause stipulates that a " uniformly applicable" modification *may be effected"* in accordance with the fourth or the fifth scenario "at the issuer´s option"[70].

To summarize, the required threshold for a single series of bonds or multiple series of bonds governed by U.S. law has implemented five legal methods to complete a debt restructuring process. Depending on the scenario, creditors who do not want to participate in the restructuring but instead want to litigate would have

66 G. Affaki, *Sovereign Debt Management,* 414. Basically, a reserved matter is closely related to the essentials of the bond. It might differ from bond to bond; though, some typical fundamentals are: *"(a) changing the timing or amount of any payment due; (b) changing the currency of any payment due; and (c) changing the consent thresholds, quorum provisions, or disenfranchisement provisions."*; *ICMA, CACS for the Terms and Conditions, 19-20.* The document stipulates eleven events that are "reserved matters" in NY bonds. Generally, they are related to: change due dates, reduction of principal amounts and interest rates of the bonds, methods used to calculate payments, currency of the bonds, governing law, legal ranking etc.

67 *ICMA, CACS for the Terms and Conditions.* 21.

68 Ib.

69 Ib.

70 Ib.

to hold a percentage of bonds that may not enable the threshold.

Before requesting full enforcement before a court, holdouts should study carefully the fourth and fifth scenarios. These scenarios are designed to group two or more series of bonds. In the fourth scenario, creditors would require at least 26% of all outstanding bonds of all the series affected to become a holdout creditor. In the fifth scenario, creditors would require (i) at least 33⅓ % of the aggregate principal amount of the outstanding bonds of all the series affected by the proposed modification and (ii) at least 50% of the aggregate principal amount of the outstanding bonds of each series affected by the proposed Modification. Each process must be analyzed on a case-by-case basis as CACs are designed to cover as much possible holdout risk as possible. New York law CACs seem to be a difficult obstacle for prospective claimants. Due to their specialized design, bondholders would require enough principal (capital) to reach a blocking position or enough bargaining power to persuade other bondholders not to negotiate. Finally, CACs should be analyzed as a transversal issue due to their capacity to block litigation and arbitration.

3. SOVEREIGN IMMUNITY AND WAIVE OF IMMUNITY AFTER A SOVEREIGN DEFAULT

3.1 Sovereign immunity

Sovereign immunity has been a problem that law firms have experienced due to the impossibility of enforcing awards against states. States renounce to their sovereign special protection by a waiver of (i) sovereign immunity from jurisdiction and (ii) sovereign immunity from execution[71]. The former means that the sovereign renounces its own jurisdiction, and consequently, a dispute can be submitted to a foreign jurisdiction. The latter implies that the sovereign renounces the immunity of its assets so that a foreign judgment can be enforced or executed in a foreign jurisdiction. Despite their similarity, both immunities request express consent to be waived[72]. The reason for sovereign immunity from execution lies in the idea that essential state assets like central bank reserves and military and diplomatic property require special protection due to their close relationship with sovereign wealth[73].

The Argentinean case before the US courts involved both aspects of immunity; nonetheless, the controversy focused on sovereign immunity from execution, as the bond terms were mainly governed by N.Y. law, among others[74]. The following information analyses the legal obstacles bondholders faced when trying to attach assets from Argentina in the Federal Reserve Bank of New York (FRBNY) and the *Banco Central de*

71 For the purposes of this explanation execution and enforcement mean the same thing.

72 Andrea K. Bjorklund, "*State Immunity and the Enforcement of Investor-State Arbitral Awards*," in *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, ed. Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (Oxford: © Oxford University Press, 2009) - 302. doi:- 10.1093/acprof:oso/9780199571345.003.0017. https://goo.gl/4f1rMs.

73 Ib. 303. *"The rationale for maintaining immunity from execution is that certain State assets, such as central bank reserves and military and diplomatic property, are integral to the business of government and should not be subject to seizure."*

74 *Press Summary: NML Capital Limited (Appellant) V Republic of Argentina (Respondent) [2011] UKSC 31 on Appeal from [2010] EWCA Civ 41, Press Summary: NML Capital Limited (Appellant) v Republic of Argentina (Respondent) [2011] UKSC 31 On appeal from [2010] EWCA Civ 41* (Supreme Court of the United Kingdom 2011). With respect to sovereign immunity, the Argentina bond terms even *showed* that they have waived immunity of jurisdiction to other courts like the British. in the Press Summary of *NML Capital Limited v Republic of Argentina* published by the Supreme Court of the United Kingdom, the court stated: *"The High Court had correctly held that the agreement in the bond was more than a mere waiver and amounted to a submission to jurisdiction (…). It was the only meaning the provision could sensibly bear(…)."*. The court concluded that because of the broad manner the clause of submission to jurisdiction had been drafted (see: Norton Rose Fulbright, "UK Supreme Court: Sovereign Immunity Judgment," Norton Rose Fulbright, https://goo.gl/kJzHht (accessed 01/02, 2018).

la República de la Argentina (BCRA)[75].

3.2 The State Immunity before U.S. Courts

The U.S. approach to sovereign immunity dates back to 1952 with the Tale Letter, which regulated aspects of litigation against foreign countries in U.S. Courts. Specifically, The Tale Letter introduced rules concerning commercial and sovereign acts, which international law has classified as *jure gestiones* and *jure imperi*[76]. Then, in 1976, the Congress of the United States enacted the Foreign Sovereign Immunities Act (FSIA)[77], which stipulated the terms for foreign immunity and specially adopted the rule of the commercial activity exception.

After the Argentinean default, some bondholders who had received payment of neither interest nor capital sued Argentina in the Southern District of New York in 2003. The judge found for the plaintiffs and ordered Argentina to pay more than US$700 million[78].

The plaintiff sought to attach funds owned by the *Banco Central de la República Argentina*, which were deposited into the FRBNY. The plaintiffs argued that because the Argentinean Republic controlled the BCRA, the latter was the alter ego of the Republic; therefore, the assets owned by the BCRA could be attached and executed[79].

The Second Circuit concluded that the exception of commercial transactions and the waiver of immunity contained in sections 28 USC § 1610 (a)(1)–(2))[80] and § 1610(d)[81] of the FSIA did not apply *"because the*

75 Diego Devos, "Special Immunities: Bank for International Settlements ," in ***Sovereign Debt Management***, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014) - p. 130-133. Even though the purpose of this article is focused on the FRBNY and the BCRA, the attachment of assets in the Argentinian case extended to International Organizations such as The Bank for International Settlements. In this case, NML Capital Ltd and EM Ltd went to the Swiss jurisdiction looking for the assets of the BCRA which were held in the Bank for International Settlements (BIS). NML Capital Ltd and EM Ltd argued that Argentina was abusing of the BIS' immunities; Never the less, it was rule by the Basel City Supervisory Authority and confirming by the Federal Tribunal that the BIS were not holding asset from the Republic of Argentina but from the BCRA; and second that Swiss courts could not settled issues of sovereignty because article 22 of the Headquarters Agreement stipulated that such controversies had to be established in common agreement between the BIS and the Swiss Federal Department of Foreign Affairs.

76 Jr Carmine D. Boccuzzi, Michael M. Brennan and Jacob H. Johnston, "Part II, Enforcement of Sovereign Debt: 8. Defences," in ***Sovereign Debt Management***, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: ©Oxford University Press, 2014) - 105.

77 Ib.

78 Pag 119.

79 Jr Thomas C. Baxter and David Gross, "Part II, Enforcement of Sovereign Debt: 9. Special Immunities: Central Bank Immunity," in ***Sovereign Debt Management***, eds. Rosa M. Lastra and Lee Buchheit, First edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: ©Oxford University Press, 2014) - 119.

80 *Foreign Sovereign Immunities Act of 1976,* Public Law Public Law 94-583, (1976): ."«§ *1610. Exceptions to the immunity from attachment or execution " (a) The property in the United States of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act, if— "(1) the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, or ^ "(2) the property is or was used for the commercial activity upon which the claim is based."*

81 Ib. *"(d) The property of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment prior to the entry of judgment in any action brought in a court of the United States or of a State, or prior to the elapse of the period of time provided in subsection (c) of this section, if— " (1) the foreign state has explicitly waived its immunity from at-*

funds at the FRBNY were funds of BCRA, which the Court determined was a separate juridical entity from the Republic of Argentina."[82]. Furthermore, the Second Circuit stated that if the assets had been of the Republic, they could not have been attached as they did not satisfy the requirement of being used for commercial activity[83].

The contractual approach to sovereign immunity in the U.S. courts has applied the theory of state immunity from attachment and execution. The court ruling demonstrated that waiver on immunity for attachment and execution requires to be stipulated expressly on the bond terms otherwise a waiver for execution cannot arise from the contract.

tachment prior to judgment, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, and "(2) the purpose of the attachment is to secure satisfaction of a judgment that has been or may ultimately be entered against the foreign state, and not to obtain jurisdiction."

82 Jr Thomas C. Baxter and David Gross, *Part II, Enforcement of Sovereign Debt, 120.*

83 Jr T. Baxter, D. Gross, *Sovereign Debt Management, 120.*

CHAPTER II: INTERNATIONAL INVESTMENT LAW APPROACH

"It is only at a rudimentary stage of legal development that society permits the unchecked used of rights without regard to its social consequences."[84]
Sir Hersch Lauterpacht, 1958.

1. FROM CONTRACTUAL LAW TO INTERNATIONAL INVESTMENT LAW

As seen in Chapter 1, bondholders can go before national courts to look for full repayment of principal and interest if the sovereign issuer defaults on its financial obligations. Moreover, the governing law and jurisdiction will be decided according to the bond terms, typically New York or English law.

In addition to domestic law, international investment law has been applied to sovereign bond disputes. Up to now, the International Centre for Settlement of Investments Disputes (ICSID) has dealt with four cases related to sovereign bonds disputes: *Abaclat*[85], *Ambiente Ufficio*[86] and *Giovanni Alemanni*[87], against the Argentine Republic, and *Poštová banka*[88] against Greece. Interestingly, in all the Argentinean cases, the tribunal accepted jurisdiction. In December 2016, the Abaclat case ended with a settlement agreement in the form of an award. However, *Ambiente Ufficio* and *Allemani* were dismissed because of the agreement reached with the bondholders by the Argentinean president Mauricio Macri[89]. Moreover, the tribunal in the Greek case rejected jurisdiction unanimously[90]. As a result, no final award has been ruled on the merits by an ICSID tribunal.

1.1 Jurisdiction

Concerning jurisdiction, two main approaches have emerged about sovereign bonds. The first approach considers sovereign bonds as investments. Consequently, they can be the subject of investment arbitration.The second approach maintains that sovereign bonds go far away from the "outer limits" of the international investment law as they cannot be qualified as an investment.

(a) *Sovereign bonds as investments in the subjectivist school*

The analyses carried out by tribunals have focused on the BIT definition of investment. Sovereign bonds have been included in some BITs expressly, while in other cases, it has been inferred from the concept of *"claims to money"*[91], or, as it was stated in Fedax, from *"every kind of asset"(...), "all assets," (...) "claims to*

84 Sir Hersch Lauterpacht, *The Development of International Law by the International Court* (London: © Stevens & Sons Limited 1958, 1958). 162.
85 *ICSID Case No. ARB/07/5, Abaclat and Others (Case Formerly Known as Giovanna A Beccara and Others*) (Claimants) and the Argentine Republic (Respondent), Decision on Jurisdiction and Admissibility.*
86 *ICSID Case No. ARB/08/9, Ambiente Ufficio S.P.A. and Others V. Argentine Republic, (formerly Giordano Alpi and Others V. Argentine Republic) (8 February 2013).*
87 *ICSID Case No. ARB/07/8. Giovanni Alemanni and Others V. the Argentine Republic. Decision on Jurisdiction and Admissibility (17 November 2014).*
88 *ICSID Case No. ARB/13/8. Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic, ICSID. Award.*
89 Alexandra Stevenson, "*How Argentina Settled a Billion-Dollar Debt Dispute with Hedge Funds*," *New York Times,* 25 April 2016.
90 An annulment request was then dismissed by the tribunal.
91 See: David W. Rivkin and Mark W. Friedman, "*5. Financial Products as Investments Under Bilateral Investment Treaties and Other Multilateral Instruments with Consents to Arbitration*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed.

money" (...) any performance having a financial value"[92]. However, since the Argentinean experience, some countries have excluded sovereign debt from the scope of BITs[93].

D. Rivkin and M. Friedman sustained[94] that cases like *Fedax v. Venezuela*[95], *CSOB v. Slovakia*, *Abaclat v Argentina*, *Ambiente Ufficio v Argentina* and *Deutsche Bank v Sri Lanka* have indicated that tribunals will "(...) construe the elements of a qualifying 'investment' broadly enough to encompass financial instruments (...)"[96]. This approach focuses on the legal provisions stipulated by the parties, and then it analyzes whether financial assets derive from the investment definitions agreed by the parties. The scope of the tribunal's interpretation is limited.

In *Abaclat*, the tribunal supported the theory of the subjectivist school, which holds that *"it is for the parties to the consent instrument -most commonly, the States parties to a BIT- to set out what they mean by an investment."*[97] D. Rivkin and M. Friedman explain the position of the tribunal as follows "BIT's definition of an investment need not "fit" within the confines of ICSID Article 25 (1), but rather 'it is the investment at stake that has to fit into' two 'different aspects' of 'the concept of an investment': '(i) the contribution that constitute the investment, and (ii) the rights and the value that derive from that contribution"[98]. This means that the investment's definition in the BIT stands by itself; therefore, it is neither attached nor conditioned to Article 25 ib., although the investment at stake must make a qualified contribution because compensation requires identifying at least the rights infringed and their current and expected value.

In addition to the qualification of investment, the tribunal faced the following question: "whether the connection between the security entitlements and the bonds could be seen as so remote as to consider that the dispute is not -directly- related to an investment, since the dispute related primarily to the rights arising from Claimants "security entitlements"[99] the question was related to the requirement of article 25 (1) of the ICSID convention that states "the jurisdiction of the Centre shall extend to any legal dispute arising directly[100] to out of an investment(...)"[101]. The arbitrators[102] stipulated that because the bonds were always meant to be divided into negotiable economic values, and the bonds and the security entitlements had no separate

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(United Kingdom: © Oxford University Press 2015, 2015). 5.28.

92 *ICSID Case no. ARB/96/3. Fedax N.V. V. the Republic of Venezuela (11 July 1997).* Par. 34. 'A broad definition of investment such as that included in the Agreement is not at all an exceptional situation. On the contrary, most contemporary bilateral treaties of this kind refer to "every kind of asset" or to "all assets," including the listing of examples that can qualify for coverage; claims to money and to any performance having a financial value are prominent features of such listings.40 This broad approach has also become the standard policy of major economic groupings such as the European Communities.'

93 See Annex 1.

94 D. Rivkin and M. Friedman, "*Financial Products as Investments".* 5.26.

95 *ICSID Case no. ARB/96/3. Fedax N.V. V. the Republic of Venezuela,* Par. 29 "The Tribunal considers that the broad scope of Article 25 (1) of the Convention and the ensuing ICSID practice and decisions are sufficient, without more, to require a finding that the Centre's jurisdiction and its own competence are well founded. In addition, as explained above, loans qualify as an investment within ICSID's jurisdiction,38 as does, in given circumstances, the purchase of bonds."

96 D. Rivkin and M. Friedman, "*Financial Products as Investments".* 5.27.

97 Ib. 5.17 *"On the subjective theory, there is no need to look outside the particular treaty for any free-standing definition of 'investment' arising out of or implied by article 25 of the ICSID Convention. The inquiry begins and ends with the BIT- in which case (...) financial instruments will often fall within the plain text of the treaty definition."*

98 Ib. 5.52

99 *ICSID Case no. ARB/07/5, Abaclat and Others,* par. 358.

100 Underling added.

101 In subsection 2 (2.1) (a) the relation between the secondary market and treaty shopping will be examined.

102 Professor Abi-Saab disagreed with this argument. His argument will be studied further on this chapter.

values (among other technical nuances), contesting that they were two separate economic operationswas impossible.

(b) ***Sovereign bonds as an investment in the objectivist school***

The second approach to sovereign bonds was developed by M. Waibel[103], later developed by Abi-Saab in the Abaclat dissenting opinion, and to some extend in the *Poštová banka* case. These experts and, in some way, the tribunal have empathized with the objectivist school[104], which has established that international investment law has "outer limits". Hence, they have proposed that the investment's definition must qualify under the language of the BIT and under the definition adopted in article 25 ib[105].

M. Waibel supports the view that ICSID jurisdiction has "outer limits", and accordingly, parties to an investment dispute cannot go before the ICSID based on their desires[106]. In his view, the parties cannot determine the concept of investment given by the ICSID Convention, but the transaction under controversy must fall within article 25 of the ICSID Convention.[107] Accordingly, despite the decision in *Fedax* where promissory notes and loans were qualified as "investments", cases involving sovereign bonds cannot be treated equally[108], mainly because of three facts: (i) bonds are traded in the secondary market with no "formality or relation to the debtor government"[109], (ii) bonds are traded at a substantial discount from their face value frequently, (iii) and the possibility of frequent change of bondholders' nationality. Consequently, the abovementioned reasons make *Fedax's* rationale on loans useless to sovereign bond disputes[110].

Arbitrator G. Abi-Saab, in the Abaclat Dissenting opinion, stated, " Quoting M. Waibel, he maintained that despite the flexibility of article 25 of the ICSID Convention, the scope of the concept is not "infinitely elastic"[111]. The arbitrator questioned if "portfolios investment" and other financial products (like shares, bonds, loans, and credit default swap) could be considered investment in terms of article 25, taking into consideration that they were different than the "ideal type" of investment for ICSID purposes[112]. Moreover, he highlighted that the high velocity of circulation of financial products and the absence of connection with the territory and the state's law, among other specificities, limited the possibility of classifying them into the direct foreign investment model[113]. Finally, G. Abi-Saab stipulated that they are excluded from the covered investment under

103 In 2007 M. Waibel published a distinguished article called "*Opening Pandora's Box: Sovereign Bonds in International Arbitration"* which stipulated important grounds for future sovereign bond arbitration before the ICSID. First, it was cited in the dissenting opinion of Judge Abi Saab; second, it was cited by the *Poštová banka* tribunal (see par. 364).

104 With respect to Waibel's view see position 6567 at Michael Waibel © Michael Waibel 2011, *Sovereign Defaults before International Courts and Tribunals*, eds. J. Crawford and J. S. Bell, Vol. 1 (United States of America: Cambridge University Press, 2011).

105 David W. Rivkin and Mark W. Friedman, "*5. Financial Products as Investments Under Bilateral Investment Treaties and Other Multilateral Instruments with Consents to Arbitration*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015). 5.18. *" (...) there is an independent, objective set of criteria that must be applied to define the 'investment' to which the ICSID Convention extends jurisdiction (...) this is known as the 'outer limits' principle, and has given rise to a two-step jurisdictional inquiry in which an investment must qualify both subjectively under the language of the relevant treaty and objectively according to a definition developed for purposes of article 25."*

106 Michael Waibel, "*Sovereign Defaults before International Courts and Tribunals*", pos. 6569.

107 Ib. 6515.

108 Ib. 6842.

109 Ib.

110 Ib. 6842, 6848.

111 Ib. 46.

112 Ib. 55 - 56.

113 Ib. 57 *"Such widely dispersed off-the shelf financial products, with their high velocity of circulation*

the Convention because of their intrinsic characteristics[114].

In the *Poštová banka* case, the ICSID tribunal denied jurisdiction to *Poštová* and *Istrokapital*. The jurisdiction for the former was denied due to the claimant's inability to proof that there was any right to the assets of *Poštová banka*. *Istrokapital* claimed that as a shareholder of *Poštová banka*, he had made an indirect investment in the Greek government bonds (GGB) to protect his investment by the Cyprus-Greece BIT. However, the tribunal concluded that, as it was analyzed before, shareholders did not have claims because of their shares in the claimant´s company[115].

However, *Poštová Banka's* denial of jurisdiction was based on different grounds. The tribunal stipulated that no conditions demonstrated certainty about the rights to claim money from Greece.

First, the tribunal highlighted that the Abaclat and Greek cases were substantially different regarding the treaty language. They pointed out that even though the BIT between Greece and Slovakia had a broad definition of investment, upon analyzing article 31 of the Vienna Convention of the Law of Treaties (VCLT), it was impossible to conclude that sovereign bonds were included in the BIT[116]. They emphasized the fact that the language used by the two BITs was remarkably different. Secondly, the tribunal stated that the purpose of the Greece-Slovakia BIT was not to include sovereign debt into its scope of application because it was an "instrument of government monetary and economic policy"[117] which cannot be included in the category of "private indebtedness or corporate debt."[118]. Thirdly, the tribunal stipulated that the *Poštová banka* had acquired its securities in the secondary market, so they had not made a direct monetary contribution to Greece. According to the tribunal's view, it was clear from the record that Greece subscribed to a contractual agreement with the persons who had acquired bonds in the primary market; however, the fact that *Poštová banka* had not purchased the bonds in the primary market but in the secondary market made no contractual relation between the latter and Greece. Hence, the tribunal concluded that *Postová banka* did not have legal standing to issue a claim against Greece[119].

The tribunal did not analyze if the investment under dispute accomplished the objective criteria (accomplishment of the BIT and ICSID article 25) because they found that it was unnecessary since the treaty language did not intend to include sovereign bonds as an investment. Interestingly, the tribunal stated that the decision would be the same if the objective test were applied because even though the duration element

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and their remoteness, the same as their holders, from the State in whose territory the investment is supposed to take place (being traded within seconds at the touch of a button in capital markets, with no involvement or knowledge of the borrowing country, nor passage through the territory or the legal system of that State), seem at first blush to be worlds apart from the direct foreign investment model, which is usually long negotiated and extensively embedded in the legal environment of the host State."

114 Ib. 58.

115 *Case no. ARB/13/8. Poštová Banka, a.s. and ISTROKAPITAL SE V. Hellenic Republic, ICSID. Award. (9 April 2015).* Par. 229. *"Moreover, prior case law, discussed by the Parties, supports the opposite proposition, that is, that shareholders do not have claims arising from or rights in the assets of the companies in which they hold shares."*

116 Ib.287, 304-307.

117 Ib. 324.

118 Ib. 318-324.

119 Ib. 344. *"Greece had a contractual relationship with the Participants and the Primary Dealers for the issuance and distribution of the GGBs. It is undisputed that Poštová banka was not a Participant or a Primary Dealer, and that it therefore had no contractual relationship with Respondent in connection with such issuance and distribution."*

was satisfied[120], the elements of contribution[121] and risk[122] were not fulfilled.

In my view, the objectivist school has weak legal roots. On the one hand, formal sources of international law are treaty law, customary international law and principles of law, for which if the parties agree on a financial asset as an investment, the arbitrator should interpret it accordingly and not look beyond what had been negotiated. On the other hand, the "outer limits approach" has been a concept developed by some tribunals, but it has not been applied consistently and strictly by all; therefore, it has not become a norm of international customary law. On top of that, article 59 of the ICJ Statue excludes the stare decisis doctrine, so it would not be legally correct to sustain that the outer limits theory can be extrapolated to cases involving sovereign bonds.

In brief, the most critical problem facing a sovereign bond arbitration could be its qualification as an investment for jurisdictional purposes. Even though three ICSID tribunals have accepted jurisdiction, the tribunal in *Poštová banka* adopted a dissimilar position. Accordingly, holdout creditors looking for a favourable investment arbitration award should seek to appoint arbitrators who sympathise with the subjectivist school.

Notwithstanding the different approaches adopted by tribunals related to what constitutes an investment in terms of ICSID jurisdiction, special attention has been paid to how the BIT was drafted. In addition, academics tend to support the two approaches as well. On the one hand, M. Waibel has contributed to limiting the scope of ICSID jurisdiction on sovereign bonds cases like *Abaclat* and *Poštová banka*, and D. Rivkin and M. Friedman have supported the consistency and fundamental reasoning of the cases involving financial product as an investment[123].

The writer's opinion supports the subjective school about investment qualification. Firstly, the role of the arbitrator should not go as far as to be capable of stipulating limits to what the parties have previously agreed upon. So, the arbitrators should focus on the redaction of the treaty to decide whether the BIT covers financial assets. In addition, no international treaty or customary law rules stipulate that financial products are not investments; thus, their qualification should not depend on arbitral legal discretion. If the arbitrates can disqualify investments by applying the objective test over the parties' agreement, the contractual relationship between the states would be at risk of being distorted.

2. TREATY SHOPPING THROUGH INTERNATIONAL CENTRAL SECURITY DEPOSITORIES (ICSD)

Corporate structuring permits the diversification of bondholders' nationalities, thus making investors

120 Ib. 366.

121 See par. 364 ib. According to he tribunal there was not proofs that the money received by Greece has been used in economically productive activities, but for Greece's budgetary needs. The Tribunal supported its argument in the two mixed commission cases referred by M. Waibel in which "*jurisdiction was found only for those sovereign bonds used for public works or services rendered to the government, as opposed to those issued for general budgetary purposes of the issuing country*".

122 See par. 367-370 ib. According to the tribunal default risk were in the scope of commercial risk rather than operational risks.

123 David W. Rivkin and Mark W. Friedman, "*5. Financial Products as Investments Under Bilateral Investment Treaties and Other Multilateral Instruments with Consents to Arbitration*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015). 5.103. "New disputes Will arise in the future and tribunal will undoubtedly continue to refine and to clarify the law, but they will undoubtedly do so in light on the line of cases preceding them and the logic of those cases. Given the consistency of these prior cases and the fundamental reasoning on which they rest, financial instruments presumptively will continue to enjoy the protection of treaties".

eligible for protection under more favourable investment treaties. Treaty shopping might appear in disputes related to sovereign bond arbitration; nevertheless, its rationale might differ from the classic functioning of treaty shopping[124]. This idea is based on the fact that a trader from an inclusive sovereign debt treaty would buy, through an ICSD, a sovereign bond from a bondholder whose country does not have a BIT covering sovereign debt instruments. Consequently, once traders have bought the sovereign bond, they would have legal standing to issue a claim against the defaulting country.

2.1 Introduction to treaty shopping: The current state of the art of BITs

Since *Abaclat´s* case, some countries started to exclude sovereign debt from their BITs[125]. Furthermore, special provisions[126] were designed to protect countries from lawsuits related to public debt. Likewise, the United Kingdom of Great Britain, Northern Ireland, and the Republic of Colombia BIT provides that "investment does not include: public debt operations"[127]; the *Southern African Development Community Model Bilateral Investment Treaty Template*[128] has also excluded debt securities issued by states' parties. In addition, some BITs have included annexes dealing with sovereign debt restructuring, establishing that invoking expropriation under specific circumstances would be possible. Waibel has explained that special annexes included in BITs provide that if a country restructures its sovereign debt, investors cannot argue FET or expropriation[129]; nevertheless, the MFN treatment would arguably be available[130].

Consequently, the scope of public indebtedness has been reduced constantly in the last 15 years. Even though some MFN strategies might have granted access to investment arbitration, treaty shopping would be another path to dispute arbitration. This is because the operational structure of the secondary market allows the trade of public bonds so that groups of investors could benefit from treaties that still qualify public bonds as investments or provide a broader interpretation of investment. However, *when* the investor has acquired the bond, it would be significant for jurisdiction purposes, mainly for the *ratione temporis* requirement.

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124 Jorun Baumgartner, ©Jorun Baumgartner 2016, "*1. Understanding the Practice of Treaty Shopping*," in *Treaty Shopping in International Investment Law.*, first edition published in 2016 ed. (United States of America: © Oxford University Press, 2016a). 6. doi:10.1093/acprof:oso/9780198787112.001.0001. "Treaty shopping should thus be understood to include all legal operations aimed at invoking or creating a qualifying nationality and/ or a qualifying investment, for example by structuring or restructuring an investment or by otherwise conferring an entitlement or property right to an investment, with a view to benefitting from a particular international investment agreement30 granting an investor direct standing (ius standi)".

125 For a list of sovereign debts exclusion from BIT see Annex 1.

126 Karen Halverson Cross, "*Part II Enforcement of Sovereign Debt. Chapter 12 Sovereign Arbitration*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). 12.51. "In 2005, the International Institute for Sustainable Development (IISD) developed a model investment agreement designed to promote sustainable development, and to achieve a balance of rights and duties among investors, home countries, and host countries. To that end, the IISD model agreement excludes sovereign debt and state enterprise debt from the treaty's definition of 'investment'".

127 See Article 1 (2) (b) (i) *Bilateral Agreement for the Promotion and Protection of Investments between the Government of the United Kingdom of Great Britain and Northern Ireland and Republic of Colombia* , Entered into force on 10 October 2014).

128 Southern African Development Community, *SADC Model Bilateral Investment Treaty Template -with Commentary-* (SADC Headquarters: © 2012 Souththern African Development Community, 2012). 9.

129 See Waibel talking at: *Max Planck Lecture Series on Sovereign Debt: Investment Arbitration as a Means of Resolving Sovereign Debt Disputes - 9 Nov 2016,* directed by Max Planck Institute for Procedural Law Luxembourg (Max Planck Institute Luxembourg 4, rue Alphonse Weicker L-2721 Luxembourg: YouTube, LLC., 2017a) 58'20''.

130 Karen Halverson Cross, "*Part II Enforcement of Sovereign Debt. Chapter 12 Sovereign Arbitration*," 12.48-12.49.

As was stated by J. Baumgartner (2016)[131], investors might use treaty shopping for various reasons: "(i) to seek to ensure treaty protection where none would otherwise be available; (ii) to seek to benefit from specific substantive protections in particular treaties; or (iii) to seek to benefit from certain procedural or other aspects of the dispute settlement provisions of a particular treaty". Why are these ideas important? As pointed out before, not all BITs cover financial assets; some countries have expressly limited the coverage of sovereign bonds in BITs. Furthermore, even though a BIT covers financial assets, it would be possible for other BITs to have more favourable provisions for the prospective claimant. Finally, a menu of treaties opens a wide range of legal strategies to litigate that otherwise would not have existed.

(a) **How does the Secondary Market work?**

The bond market experienced a tremendous change before and after implementing the International Central Securities Depository (ICSD); currently, the main ICSDs are Clearstream[132] and Euroclear[133]. This change consisted of a transition from *negotiability* to *immobilization*[134]. The main functions of ICSD are settling trades in international bonds and other securities, recording the effects of transfers between buyers and sellers, showing the ownership(s) of the securities, and paying and transferring securities simultaneously[135].

Likewise, after launching a bond series, the issuer (the state) signs a New Global Note (NGN)[136] for a sum equal to the bond amount.[137] A commercial bank holds the NGN called the "Depository", appointed by the ICSD.[138] The ICSD, as pointed out before, has electronic records of the entitlement of the bonds. The transfers of bonds or entitlements are carried out by intermediaries who have accounts in the ICSD.

The issuer appointed a bank as a Paying Agent, overseeing paying interest and principal according to the terms negotiated between the issuer and the bondholder. However, according to its record, the paying agent does not pay directly to the bondholders but through the ICSD[139].

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131 Jorun Baumgartner, "*1. Understanding the Practice of Treaty Shopping*", 21.

132 Clearstream Deutsche Börse Group, "*about Clearstream: Who we are*," © Clearstream, https://goo.gl/Kvfz4H (accessed 01/13, 2018). "The world's entire financial system is built on trust. When assets are traded, both parties must be sure they will receive their part of the transaction. Given the complexity, speed and quantity of assets involved, a fast, secure and trusted third-party is absolutely essential for settling transactions. Clearstream is a leading European supplier of post-trading services. The wholly owned subsidiary of Deutsche Börse ensures that cash and securities are promptly and effectively delivered between trading parties. It also manages, safekeeps and administers the securities that it holds on behalf of its customers. Over 300,000 domestic and internationally traded bonds, equities and investment funds are currently deposited with Clearstream".

133 Euroclear, "*Euroclear: Our History*," © 2018 Euroclear, https://goo.gl/uunGft (accessed 01/13, 2018). "Before Euroclear, the mechanics of settlement remained complex, requiring physical delivery of certificates and cash. Trading was hampered by long delays in the delivery of securities, the loss of certificates, and excessive counterparty and market risks. The market urgently required a settlement environment that was rapid, efficient and risk-controlled.
Responding to market need, the Brussels office of Morgan Guaranty Trust Company of New York (Morgan Guaranty) founded the Euroclear System in December 1968. The use of the system minimised risk as transactions within the system settled, and still do, delivery versus payment (DVP). This means that cash and securities are exchanged simultaneously, in electronic book-entry form".

134 Colin Bamford, *Principles of International Financial Law*, 6.115.

135 Ib. 6. 63.

136 Ib. 6.64 – 6.71. Prior to June 2010, a permanent global note was used instead of a New Global Note. The former was held by a commercial bank appointed by the issuer; however, the European Central Bank considered that "if the instrument itself is held by the settlement systems, there is no-one who might compete with the interests of the owners who hold through the records of one of the systems".

137 Ib. 6.58.

138 Ib. 6.58, 6.69.

139 Ib. 6.57.

Before implementing the ICSD, the paper bonds were traded physically. This operation was known as "negotiability"; nevertheless, sovereign bonds, which represented large sums of money, were impossible to trade because, in practice, the mobilization of bonds was not easy. After the entrance of ICSD, the operation evolved to "immobilization" *which implied that individual parts of the bond could be traded without requiring either physical movement of the bond* or individual notes at the bond[140] (in short, there was no hand-to-hand trade).

The *immobilization* functioning of the secondary market allowed traders and investors worldwide to trade sovereign bonds in seconds. Moreover, they could buy full or individual parts of the bonds. Most importantly, these operations could be executed on the same platform.

(b) **Abuse of rights and timing of the purchase**

Notwithstanding the transactions that investors can carry out in the secondary market, objections related to the abuse of rights could be argued because of its similarity to corporate structuring. The invocation of the abuse of rights in recent years has increased due to corporate transactions, which have made specific BITs available to creditors[141].

Invoking the doctrine of the abuse of rights might have limited application in international law, especially in sovereign bond arbitration. Sir H. Lauterpacht (1958) stated that writers and arbitrators had adopted the doctrine of abuse of rights before the International Court of Justice pronounced about them[142]. In addition, in his view, the doctrine of abuse of rights required "the activity of courts drawing the line in each particular case"[143] because its determination of the exercise of a legal right which might have degenerated into an abuse of right could not be "decided by an abstract legislative rule"[144]. Furthermore, Sir H. Lauterpacht (1958) emphasized that the doctrine of abuse of rights "must be wielded with studied restraint"[145]. Accordingly, to what extent investment tribunals have accepted the doctrine of abuse of rights is essential to determine whether the tribunals' active decision-making has applied this theory.

J. Baumgartner (2016) identified that a few arbitral decisions have "looked at whether the former owner of an investment transferred claims or rights on the investment in order to establish jurisdiction where otherwise none would have existed[146]". However, she clarified that these decisions have blurred "the lines between different legal approaches[147]".

Twelve cases[148], most of them under ICSID and some under UNCITRAL rules, concluded that the doc-

140 Ib. 6.64.

141 Jorun Baumgartner, ©Jorun Baumgartner 2016, "*7. Objections on Grounds of an Abuse of Rights Or Abuse of Process*," in *Treaty Shopping in International Investment Law.*, first edition published in 2016 ed. (United States of America: © Oxford University Press, 2016b). 1. doi:10.1093/acprof:oso/9780198787112.001.0001.

142 Sir Hersch Lauterpacht, *The Development of International Law,* 162. *"Prior to its appearance in the judgement and opinions of the Court, the substance of the doctrine of abuse of rights had been recognized by a number of writer and in some arbitral decision".*

143 Ib.

144 Ib.

145 Ib. 164

146 Jorun Baumgartner, *7. "Objections on Grounds of an Abuse of Rights",* 205.

147 Ib.

148 The cases under analysis were: ICSID Case no ARB(AF)/ 06/ 2*, Cementownia "Nowa Huta" SA V Republic of Turkey, Award (17 September 2009);* ICSID Case no ARB/ 06/ 5*, Phoenix Action Ltd V Czech Republic, Award (15 April 2009);* ICSID Case no ARB/ 02/ 3*, Aguas Del Tunarí SA V Plurinational State of Bolivia, Decision on Respondent's Objections to Jurisdiction (21 October 2005);* ICSID Case No. ARB/07/27*, Venezuela Holdings, B.V., et al (case formerly known as Mobil Corporation, Venezuela Holdings, B.V., et al.) v. Bolivarian Republic*

trine of abuse of rights was aimed to determine whether it fall under "legitimate corporate planning" or "treaty abuse"[149]. The timing of the transaction has been a remarkable trend towards arbitral decisions[150].

Accordingly, the line developed by tribunals has focused on "whether at the time of the change of nationality, a dispute existed or was (sufficiently) foreseeable."[151] additionally, two kinds of foreseeability can be identified: on the one hand, a high and subjective standard, described as "foreseeability as a very high probability", and on the other hand an objective standard named "reasonably foreseeable"[152].

This approach is closely related to the default event within the sovereign bond market. Financial crises are difficult to predict; accordingly, whether a financial crisis and a later sovereign bond default were reasonably foreseeable or highly probable would require experts' reports[153]. However, the information provided by rating agencies like Standard & Poor's (S&P), Moody's, and the Fitch Group, as well as the IMF reports, should be a source to provide some forecasting.

Treaty shopping in sovereign debt disputes was pointed out by K. Halverson (2015). She explained that the possibility that creditors would treaty shop towards debtor European countries remains open because of the European debt crisis.[154] (For an example of how treaty shopping would be executed, see Annex 1 on treaty shopping through the secondary market).

This kind of transaction does not follow the traditional approach of treaty shopping to the extent that the operation is not aimed at "invoking or creating a qualifying nationality and/ or a qualifying investment"[155]; instead, it would be envisioned to change the bondholder himself. Therefore, the new bondholder would be

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of Venezuela. Decision on Jurisdiction (10 June 2010); ICSID Case No ARB/ 10/ 5,*Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v. The Bolivarian Republic of Venezuela, Decision on Jurisdiction (8 February 2013);* ICSID Case no ARB/ 07/ 30, *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV V Bolivarian Republic of Venezuela, Decision on Jurisdiction (3 September 2013);* ICSID Case no ARB(AF)12/ 6, *Lao Holdings NV V the Lao People's Democratic Republic, Decision on Jurisdiction (21 February 2014);* ICSID Case no ARB/ 13/ 2, *Cervin Investissements SA & Rhone Investissements SA V La República De Costa Rica, Decisión Sobre Jurisdicción (15 December 2014);* ICSID Case no ARB/ 11/ 17, *Renée Rose Levy and Gremcitel SA V Republic of Peru, Award (9 January 2015);* PCA Case no 2012- 12, *Philip Morris Asia Limited V Commonwealth of Australia, UNCITRAL, Award on Jurisdiction and Admissibility (17 December 2015);* ICSID Case No ARB/ 09/ 12, *Pac Rim Cayman LLC v Republic of El Salvador, , Decision on the Respondent's Jurisdictional Objections (1 June 2012);* LCIA Case No UN 7927, *Société Générale in Respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, SA ('EDE Este') v Dominican Republic, , Award on Preliminary Objections to Jurisdiction (19 September 2008).*

149 Jorun Baumgartner,"*7. Objections on Grounds of an Abuse of Rights",* 232.

150 Ib. Accordingly, J. Baumgartner stated: "Of particular importance is in factual terms the increased focus on the timing of the transaction, being an objectifiable element in the question of whether the purpose pursued with the claim based on a strategic change of nationality constitutes an abuse of rights/abuse of process."

151 Ib.

152 Ib. 233

153 Jeffrey Golden, "*10. the Particular Role of Experts in Arbitrating International Financial Disputes*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015). *10.*11 "Since the crisis that followed the collapse of Lehman Brother in September 2008, there has been a significant increase in the number of complex product disputes that have been arbitrated or litigates, and the roles of exerts appears to be , in anything no more prominent in such cases" See also par. 10.12 "So, in the resolution of many international financial disputes, experts witnesses have played a key role. In fact in more than a few of the published decision or awards, the role of the experts appears to have been dispositive of the outcome."

154 Karen Halverson Cross, "*Part II Enforcement of Sovereign Debt. Chapter 12 Sovereign Arbitration*," 12.44.

155 Jorun Baumgartner, "*1. Understanding the Practice of Treaty Shopping*", 6.

covered by a friendly sovereign debt BIT[156].

Even though the secondary market operation permits the move of sovereign bonds from various bondholders from different nationalities as a method of treaty shopping[157], incorporation or corporate restructuring would also be possible, albeit requiring more time and legal and administrative paperwork.

To summarize, treaty shopping in the sovereign bond market is easily executable; however, it would face counterarguments related to the doctrine of the abuse of rights. In addition, whether a sovereign default was reasonably foreseeable or highly probable would be another obstacle to accomplishing jurisdiction before an ICSID tribunal.

3. LIMITED COMPENSATION

Under international investment law, compensation of sovereign bond purchases through the secondary market has been a limited practice. According to Waibel (2011), among other reasons, was the fact that "the secondary market in sovereign debt began to develop in earnest only in the mid-1980s with the wave of defaults in Latin America and the attempts by banks to on-sell their debt to willing buyers at often steep discounts[158]" and also because "This was also the first time that banks sold parts of their sovereign loan portfolio to non-bank investors as part of a wholesale asset disposition programme[159]". Nonetheless, an overview of the award of damages in international financial disputes would, at least, show some current trends.

A. Menaker and S. Paliwal state that a tribunal might face rules of customary international law, treaty law, governing law of the financial product and law of the respondent state when dealing with compensation arising from a financial dispute[160].

Under international investment law, tribunals have awarded damages "in the amount of unmet payment obligations under the contract terms"[161]. For example, in *Fedax V. Venezuela,* the tribunal ordered the principal and interest payment due under the contractual terms[162].

However, academics have analyzed compensation under sovereign bonds acquired in the secondary market differently. Waibel (2011) maintains that appropriate compensation for bonds traded in the secondary market is in accordance with the "generally recognized market value" or "fair market value"[163].

Waibel's arguments have strong support. First, he mentioned that the "World Bank Guidelines on de-

156 This practice was remarkably criticized by Prof. Abi-Saab. See foot-note 130.

157 Michael Waibel © Michael Waibel 2011, *Sovereign Defaults before International Courts and Tribunals*, eds. J. Crawford and J. S. Bell, Vol. 1 (United States of America: Cambridge University Press, 2011). 9367-9368).

158 M. Waibel, "*Sovereign Defaults before International Courts and Tribunals*", 9369.

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160 Andrea J. Menaker, Suyash G. Paliwal, "*14. Remedies - Damages*," in *International Financial Disputes -Arbitration and Mediation-*, ed. Edited by J. Golden and C. Lamm, first edition publish in 2015 ed. (United Kingdom: © Oxford University Press 2015, 2015). 14.03.

161 Ib. 14.54.

162 *ICSID Case no. ARB/96/3. Fedax N.V. V. the Republic of Venezuela, Award 9 March 1998, "For the reasons stated above the Tribunal unanimously decides that: (1) The Republic of Venezuela shall pay Fedax N. V. the amount of U.S. $598,950 representing the principal of the promissory notes due. (2) The Republic of Venezuela shall pay Fedax N.V. the amount of U.S. $161,245.14 for the regular and penal interest due on the promissory notes."*

163 M. Waibel, "*Sovereign Defaults before International Courts and Tribunals*", 9371-9372 *"This section sharpens the argument that the appropriate standard of compensation for debt instruments traded on the secondary market in default is the 'generally recognised market value' or 'fair market value'."*

termining fair market value should be deemed a reasonable replacement value"[164]. Subsequently, he supports this approach on the principle of unjust enrichment.[165] Secondly, this rationale was also argued by K. Halverson, when stating that "In the sovereign debt context, awarding recovery of the debt's full nominal value would be unlikely to reflect its fair market value at the time of acquisition and thus arguably would provide the investor with a windfall."[166] The former idea is argued in the case concerning *Rosinvestco UK Ltd* v. Russian Federation[167]. The tribunal did not grant the compensation requested by the claimant because it was clear that the latter was a company specialized in "purchasing shares at such moments of market distress"[168] and that the argument related to an allegation of "optimistic expectations regarding the future development of the value of the investment.[169]" could not be accepted.

The tribunal denied the requirement due to its relation to a speculative investment. The tribunal stated that the "Claimant made a speculative investment in Yukos shares. The Tribunal must take this into account when awarding damages (if any)."[170] Accordingly, the tribunal stipulated that the damages should have been determined according to the purchase date for the shares[171].

4. THE ENFORCEMENT OF INVESTMENT AWARDS

After a tribunal has rendered an award, parties can look for recognition and enforcement before national courts. However, the execution might eventually deal with sovereign immunity protection in domestic jurisdiction, as seen in Chapter One. However, some essential features of enforcement rules in investment law would lead to the successful execution of the award after a sovereign bond arbitration.

Firstly, the ICSID rules of enforcement and recognition of awards are provided in Article 54 of the ICSID Convention, which states that contracting states shall award as a domestic judgment[172]. Consequently, investment awards are independent of any treaties of domestic law. This is the main difference with the New York Convention, which requires recognition of national courts and is subject to certain exceptions[173]. Nonetheless, the New York Convention would be applicable if the state parties have not ratified the ICSID Convention or when the dispute was under the rules of the ICSID Additional Facility[174].

Secondly, investors can access diplomatic protection under Article 27 of the ICSID Convention[175]. This is

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164 M. Waibel, "*Sovereign Defaults before International Courts and Tribunals*", 9371.

165 This theory can be questioned as the bond holder might argue that the state, by no paying its financial obligation is also committing an unjust enrichment.

166 Karen Halverson Cross, "*Part II Enforcement of Sovereign Debt. Chapter 12 Sovereign Arbitration*", 12.42

167 *Rosinvestco UK LTD., Claimant, V. the Russian Federation, Respondent. (Final Award - 12 September 2010). Rosinvestco UK LTD., Claimant, V. The Russian Federation, Respondent. (Final Award - 12 September 2010).*

168 Ib. Par. 666.

169 Ib.

170 Ib.668.

171 Ib. 673 and 674.

172 Article 54 ICSID Convention. "Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State."

173 *Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), (New York, 1958)* . Art. 5.

174 Andrea K. Bjorklund, "*State Immunity and the Enforcement of Investor-State Arbitral Awards*," in *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, ed. Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (Oxford: © Oxford University Press, 2009). 305. doi:- 10.1093/acprof:oso/9780199571345.003.0017. https://goo.gl/4f1rMs.

175 ICSID Convention, article 27**: "**(1) No Contracting State shall give diplomatic protection, or bring an in-

when a state does not comply with the ICSID award. Consequently, investors can seek diplomatic protection from their states before the International Court of Justice[176].

Thirdly, ICSID awards have the reputation of being complied by state parties. Its close relationship with the World Bank has made the ICSID a trustworthy scenario for seeking remedies. Waibel (2011) stated, "That ICSID is part of the World Bank Group is one attraction of the ICSID arbitral process. Potential claimants in ICSID perceive this institutional association as an advantage, in that it encourages states to comply with awards voluntarily and more readily than they might otherwise."[177].

Finally, not complying with an ICSID award can turn into a breach of an international obligation. Therefore, states can acquire a negative reputation in international markets and eventually be excluded from market access[178] or restrictions on loans by the IMF[179].

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ternational claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute. (2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute."

176 Andrea K. Bjorklund, *"State Immunity and the Enforcement (...)"*. 305.

177 M. Waibel, *"Sovereign Defaults before International Courts and Tribunals"*, 9648-9650.

178 Ib. 9655.

179 Ib. 9657-9659 "Countries refusing to pay ICSID awards may also be prevented from accessing World Bank or IMF funding. Neither institution has publicly stated its policy on whether it would lend to a government that refused to pay an ICSID award."

CHAPTER III: THE MARKET-BASED APPROACH

> *"Eighty-five years later, the law on sovereign debt remains underdeveloped. The time has come for lawyers to re-energise the field".*[180] Michael Waibel referring to sovereign debt arbitration (2011).

1. BETWEEN INTERNATIONAL PUBLIC LAW AND FINANCIAL LAW

The market-based approach has evolved since the early 2000s, although no specific body has been created yet. It was Anne Krueger, former deputy manager director of the International Monetary Fund (IMF), who proposed a Sovereign Debt Mechanism able to deal with distressed debt; however, due to a lack of support from mainly U.S. shareholders, the mechanism did not succeed [181]. In 2009, during the financial crisis, UNCTAD launched a set of principles that guided the circumstances related to sovereign lending and borrowing [182]. Since then, UNCTAD scholars and experts have been working on legal designs[183] to manage sovereign debt crises, yet a political and legal framework has not been agreed upon.

Furthermore, public international law and international financial law have contributed to sovereign debt's concerns in a more perdurable manner, as some rules have been digested by the international markets, at least to some extent. In the former, the principles for responsible sovereign lending and borrowing (PRSLB) and principles on sovereign debt restructuring process (PSDRP) have emerged. The latter has been developing in a series of "best practices, codes of conduct, and standards and principles"[184] that have been applied throughout the sovereign debt market[185], particularly the Belize restructuring of 526.5 million interna-

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180 Michael Waibel © Michael Waibel 2011, *Sovereign Defaults before International Courts and Tribunals*, eds. J. Crawford and J. S. Bell, Vol. 1 (United States of America: Cambridge University Press, 2011). 9847.

181 Lee C. Buchheit and Elena L. Daly, "*Part I, Sovereign Debt Restructuring: 2. Minimizing Holdout Creditors - Sticks*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). 2.27-2.28.

182 Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt Systems: 27. UNCTAD Principles on Responsible Sovereign Financing*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). 447. "In 2009, on the heels of the worst global financial crisis since the Great Depression, UNCTAD launched the initiative to formulate a set of global principles to promote more responsible behaviour, and to introduce a pertinent institutional set-up and necessary procedures to backstop responsible culture from the sides of sovereign lenders and borrowers."

183 See in general: United Nations Conference on Trade and Development Prosperity for All, "Sovereign Debt Workout Mechanism," https://goo.gl/uk8LD1 (accessed 12/14, 2017).

184 Chris Brummer and Matt Smallcomb, "*Institutional Design: The International Architecture*," in *The Oxford Handbook of Financial Regulation*, eds. Niamh Moloney, Eilís Ferran and Jennifer Payne, © The several contributors 2015 ed. (Published in the United States of America by Oxford University Press: © Oxford University Press, 2015., 2015). 4.

185 Rosa M. Lastra, *11th UNCTAD Debt Management Conference. Responsible Financing: The Role of 'soft Law' in Promoting Sustainable Lending and Borrowing Practice* (Palais des Nations , Geneva: , 2017). 7. "Globalization has challenged the traditional law-making process. The need for international soft law in finance is a logical response to the 'vacuum' in this important area of economic regulation."

tional Belize bond in 2017[186]and the Mozambique external debt restructuring of loans and bond up to 17% of its GDP in 2016[187]. These principles have not become *hard law* as no treaty directly regulated sovereign debt issues. If the principles are stipulated in an international treaty or become international customary law, they would play an essential role in international tribunals and domestic courts.

Finally, after the COVID-19 pandemic, G-20 members endorsed the *Common Framework for Debt Treatments* in November 2020, a mechanism for dealing with overindebtedness in middle and low-income countries. The Common Framework allows eligible countries to receive particular debt treatment and restructuring from public and private creditors, provided that the IMF and the World Bank approve a *Debt Sustainability Analysis* and the debt relief complies with the *Comparability of Treatment* principle.

1.1 Principles for Responsible Sovereign Lending and Borrowing (PRSLB) and Principles on Sovereign Debt Restructuring Processes (PSDRP)

The PRSLB proposed by the UNCTAD should help face the global effects of financial and economic crises and promote more responsible behaviour. It provides for the following:

In charge of the lenders: (i) agency, related to the recognition by lenders about the fact that sovereign officials have to procure for the public interest; (ii) informed decisions, based on the information provision between lenders and borrowers; (iii) due authorization, related to the lender obligation to determine that the financing has been appropriately authorized; (iv) responsible credit decisions, based on the lender responsibility of identifying the borrower capacity to service a loan; (v) project financing related to the ex-ante investigation on behalf of the lender about the social, financial, operation, cultural, civil and environmental implications of the project financed; (vi) international cooperation with UN decisions; and (vii) debt restructurings, which stipulated that lenders have to act in good faith towards countries[188].

In charge of the borrowers: (viii) agency, related to the protection of the citizens' interests; (ix) binding agreements, which stipulates the binding effects of sovereign debt contracts (invoking a state of *economic necessity* should be exceptional); (x) transparency, focuses on clear procedures, responsibilities and accountabilities; (xi) disclosure and publication, which states that financial agreements should be published and easily accessible; (xii) project financing, related to the social, environmental, cultural, financial, operational and civil implications of the project and its funding; (xiii) adequate management and monitoring, which guarantee that the debt management is adequate; (xiv) avoiding incidences of over-borrowing, based on cost and benefits analysis of the sovereign loan; and (xv) restructuring, which stipulates that it should be carry on a prompt, efficient and fair manner[189]. Interestingly, The PRSLB did not address the Secondary Market or the Credit Rating Agencies[190].

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186 Institute of International Finance, Inc., *Principles for Stable Capital Flows and Fair Deb Restructuring - Report on Implementation by the Principles Consultative Group - with Comprehensive Update on Investor Relations Programs and Data Transparency.* (Washington, D.C.: Institute of International Finance, Inc.,[2017]). 8.

187 Ib. 9.

188 United Nations Conference on Trade and Development, "Principles on Promoting Responsible Sovereign Lending and Borrowing," (Amended and Restated as of 10 January 2012). 5-8.

189 Ib. 8-13; see also Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt System", 2748.* Bohoslavsky states that: *"From a transnational administrative law perspective, the establishment of global principles would ultimately help to harmonize and facilitate transactions between public and private actors."*

190 Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt System", 2731.* Referring to the Secondary Market and the credit rating Agencies Bohoslavsky states *"These two issues are intrinsically linked to sovereign financing. One possible explanation for these absences in the PRSLB might be related to the fact that domestic laws are not really developed in these two realms, which obviously has implications for a body of principles that tries to mirror domestic legal systems."*

These principles are essential to sovereign debt restructuring because, before 2012, guide principles had not existed in international law, specifically for debt restructuring. Juan P. Bohoslavsky (2013) stated that the PRSLB may become *soft law* and even (emerging) *hard law*[191]. He explained that the legal basis for the principles was in the sources of international law, specifically those established in article 38 of the statue of the International Court of Justice, though in a minimal manner.

Bohoslavsky pointed out that the scope of international conventions relating to sovereign debt has been limited to article 25 of the UN Convention because lenders and borrowers are not allowed to violate UN Sanctions and to Articles 9 and 34 of the Convention against corruption[192] , which stipulates the wrongfulness of corruption in sovereign financing on the one hand, and the obligation of transparency and accountability in state contracting on the other. Additionally, in 2015, Resolution 69/319 of the General Assembly stipulated the Basic Principles on Sovereign Debt Restructuring Processes[193] (PSDRP), which are recommendations according to article 10 of the Charter of the United Nations[194]. Next, Bohoslavsky refers to international customary law. He points out that this approach might be restricted "by the public law defence of state of necessity, based on the economic or political circumstances that render impossible the full or timely repayment of the debts"[195]. The scope of case law is also limited. According to Matthias Goldmann, up to November 2017, only one court, the Federal Court of Justice (Bundesgerichtshof, BGH), had referenced the UNCTAD PRSLB[196]. In its judgement, the BGH denied the application of principle 7 (related to good faith and cooperative spirit in debt restructuring) because it was not recognized as international law.

Because of the limited sources available to the UNCTAD principles, Bohoslavsky points out that general principles of law are required to fill the gap of "insufficiency of legal guidance regulating sovereign lending and borrowing"[197]. Thus, he argued that comparative law is a "strong legal tool" that may connect national principles of law to international law principles. Hence, he mentioned that principles from the European and

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191 Juan P. Bohoslavsky and Carlos Espósito, "*4. Principles Matter. the Legal Status of the Principles on Responsible Sovereign Financing*," in *Sovereign Financing and International Law*, ed. C. Espósito, Y. Li and J. Bohoslavsky (Published 2013 by Oxford University Press.: © Oxford University Press 2013, 2013). 81.

192 J. Bohoslavsky and C. Espósito, "*4. Principles Matter. the Legal Status of the Principles", 76; see also: United Nations Convention Against Corruption, New York, 2004* .

193 Nine principles were stipulated: (i) right to design its macroeconomic policy, (ii) good faith by creditor and debtors, (iii) transparency, (iv) impartiality, (v) equitable treatment and the duty to refrain from arbitrarily, (vi) sovereign immunity from jurisdiction and execution, (vii) legitimacy, (viii) sustainability and (ix) majority restructuring.

194 The purpose of the thesis is not focus on determining the binding effects of the General Assembly resolutions; however, in the "Voting procedure on questions relating to reports and petitions concerning the territory of south-west Africa advisory opinion of June 7th, 1955 the International Court of Justice stipulated that *"It is to be recalled that the Court, in its previous Opinion, stated that "The competence of the General Assembly of the United Nations to exercise such supervision and to receive and examine reports is derived from the provisions of Article IO of the Charter, which authorizes the General Assembly to discuss any questions or any matters within the scope of the Charter and to make recommendations on these questions or matters to the Members of the United Nations"* (page. 13); See in general: Marko Divac Öberg, "*the Legal Effects of Resolutions of the UN Security Council and General Assembly in the Jurisprudence of the ICJ*," *The European Journal of International Law* Vol. 16, no. 5 (2006), 879–906.

195 J. Bohoslavsky and C. Espósito, "*4. Principles Matter. the Legal Status of the Principles", 76.*

196 See: Matthias Goldmann, *11th UNCTAD Debt Management Conference. Responsible Financing: The Role of «soft Law» in Promoting Sustainable Lending and Borrowing Practice* (Palais des Nations , Geneva: , 2017). 4. ; see also: Juan P. Bohoslavsky and Matthias Goldmann, "*an Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*," *The Yale Journal of International Law Online* Vol. 41, no. 2 (2016). 28. *"In 2015, the German Federal Court of Justice rejected not only the view that there was a rule of customary international law making majority restructurings binding even for the dissenting minority. It also held that good faith did not constitute a defense against holdout litigation".*

197 J. Bohoslavsky and C. Espósito, "*4. Principles Matter. the Legal Status of the Principles",* 77.

American legal orders like "Due diligence, good faith, transparency, fiduciary duty, and pacta sunt servanda"[198] might be the raw material to identify general principles of law in sovereign financing.

Nevertheless, good faith and transparency principles appear to have a higher legal weight than other principles in sovereign financing. The preamble of the Vienna Convention of the Law of the Treaties supports the former, which states, "the principles of free consent and of good faith and the pacta sunt servanda rule are universally recognized." Article 26 stipulates that they must perform treaties in good faith, and finally, article 31 establishes that treaties shall be interpreted in good faith in accordance with the ordinary meaning to be given to the treaty's terms in their context and in the light of its object and purpose.[199] However, the fact that good faith applies to creditor-debtor relations does not necessarily mean that creditors are bound to accept majority decisions unless the contractual terms of the bonds stipulate it[200]. Accordingly, what good faith aims to cover is the debt purchases of troubled states for the sole purpose of "extracting a preferential treatment act abusively"[201]. M. Goldmann describes the latter as *an emerging general principle of law*[202] because it has been implemented in some international conventions and international organizations[203]. The importance of transparency lies in the fact that creditors expect to be treated comparably[204]. Transparency in debt workout negotiations permits guarantee that individual and group interests are protected.

As pointed out before, even though the UN and UNCTAD have been working in an international framework for sovereign debt restructuring, no compulsory mechanism has been designed yet. Furthermore, the Report of the United Nations Independent Expert in July 2017[205] indicated that "The fact that most developed countries did not support the resolution shows the continuous failure of the international community to set up a robust, comprehensive and sustainable legal and institutional framework to deal adequately with debt restructuring"[206].

In brief, the principles have a limited role in sovereign debt arbitration and litigation because they are not binding yet. Good faith and transparency might be the exception when referring to principles applicability. Hypothetically, if the principles would be agreed in an international treaty, it would be a thorn in holdouts' side. Remarkably, the principles could eventually play a role in domestic courts, international courts and international tribunals. So, from a forum shopping perspective, holdout creditors should have to study whether the tribunal ruling a sovereign debt dispute would be bound to apply principles for responsible sovereign lending and borrowing or principles on sovereign debt restructuring processes. If the principles would bind

198 Ib. 78.

199 Matthias Goldmann, "*Good Faith and Transparency in Sovereign Debt Workouts: Paper Prepared for the Second Session of the UNCTAD Working Group on a Debt Workout Mechanism (Revised Version of 23 January 2014)*," *2014* (. 8. ; see also: Matthias Goldmann, "*Putting Your Faith in Good Faith: A Principled Strategy for Smoother Sovereign Debt Workouts*," *The Yale Journal of International Law Online* 41, no. 2 (2016). 125.

200 Matthias Goldmann, *Good Faith and Transparency in Sovereign Debt Workouts, 15.*

201 Ib. 16; For a sub-categorization of the abuse of rights see also: Matthias Goldmann, 2016, "*Putting Your Faith in Good Faith", 126.*

202 Matthias Goldmann, "*Good Faith and Transparency in Sovereign Debt Workouts* ", 21 .

203 Ib. 19. Likewise, the "Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters" of 1998 which stipulated some rights related to access to information; article x of GATT which obliged the parties to publish its rules on the classification of goods; and transparency provision on NAFTA. Additionally, he mentioned that the World Bank adopted a "sound transparency policy" in 1993, and to some extend the IMF which ha been developed a trend "toward more transparency", though limiting some information access. Finally, M. Goldman pointed out that the Treaty of the European Union "stipulate transparency as foundational principles for the governance of the UE".

204 Ib. 22.

205 United Nations Human Rights Office of the High Commissioner, "*Independent Expert on the Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of all Human Rights, Particularly Economic, Social and Cultural Rights*," © OHCHR 1996-2017;, https://goo.gl/zSkqGh (accessed 12/14, 2017).

206 Ib. 21.

the tribunal, holdouts should look for another forum, because the principles would undermine full terms enforcement of bonds.

1.2 International financial law – a soft law approach

(a) The emerging principles for stable capital flows and fair debt restructuring

The Institute of International Finance (IIF) launched the "Principles for Stable Capital Flows and Fair Debt Restructuring" aimed at crisis prevention and resolution. These principles were agreed in 2004 and were also endorsed by the G20 Ministerial Meeting held in Berlin[207]. Until 2010, the principles had only been applied to emerging markets[208].

Two main institutions monitor the principles: (i) the Group of Trustees[209] (ii) and the Principles Consultative Group (PCG)[210]. The PCG and the Group of Trustees focus on stabilizing the capital flows to emerging markets, through transparency, dialogue, good faith negotiations and equal treatment of creditors[211]. In addition, the IIF supports both organs.

The PCG has encouraged implementing the ICMA model for aggregated Collective Actions Clauses[212], Model Pari Passu and Creditor Engagement[213]. This approach has also been adopted by the Technical Study Group Report of the Department of Economic and Social Affairs of the United Nations[214]. Nevertheless, including new CACs has been impossible as "it has proven to be more difficult to encourage their incorporation in the sizeable stock of previously issued sovereign bonds, many of which will not expire for another decade. Updating the outstanding bond stock with new contractual language is impeded by inertia, as well as significant economic costs and potential reputational issues"[215].

The principles, which were the outcomes of creditors and emerging markets discussions, are: (i) transparency and timely flow of information[216], (ii) close debtor-creditor dialogue and cooperation to avoid restruc-

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207 Institute of International Finance, Inc., *Principles for Stable Capital Flows and Fair Deb Restructuring - Report on Implementation by the Principles Consultative Group - with Comprehensive Update on Investor Relations Programs and Data Transparency.* (Washington, D.C.: Institute of International Finance, Inc.,[2017]). 3.

208 Ib.

209 Ib. 4, 6. The group of trustees are made of 41 current and former leaders in global finance, and 3 co-chair. "The current co-chairs of the Group are Axel Weber, Chairman of the Board of Directors, UBS Group AG and former President of the Bundesbank; François Villeroy de Galhau, Governor of Banque de France; Zhou Xiaochuan, Governor of the People's Bank of China".

210 Ib.6. "[The] Principles Consultative Group (PCG), [are] a select group of finance and central bank officials with senior representatives of the private financial community tasked with monitoring and encouraging the practical application of the Principles." Currently the PCG has 22 members, "including finance ministry and central bank officials."

211 Ib. 7.

212 Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt System", 27.66.* "It is also necessary to highlight that collective action clauses (CACs) have demonstrated that, while helpful, they cannot be a substitute for a debt workout mechanism".

213 Institute of International Finance, Inc., "*Principles for Stable Capital Flows and Fair Deb Restructuring" (2017), 49.*

214 Drafted by Benu Schneider, *Sovereign Debt Restructuring: Further Improvements in the Market Based Approach* (New York: Financing for Development Office, Department of Economic and Social Affairs, United Nations.,[2017]). 5.

215 Institute of International Finance, Inc., *Principles for Stable Capital Flows and Fair Deb Restructuring - Report on Implementation by the Principles Consultative Group - with Comprehensive Update on Investor Relations Programs and Data Transparency.* (Washington, D.C.: Institute of International Finance, Inc.,[2016]). 11.

216 Institute of International Finance, Inc., *Principles for Stable Capital Flows and Fair Deb Restructuring - Report on Implementation by the Principles Consultative Group - with Comprehensive Update on Investor Relations Programs and Data Transparency.* (Washington, D.C.: Institute of International Finance,

turing[217], (iii) good-faith actions[218], and (iv) fair treatment[219]. Importantly, the "Report on Implementation by the Principles Consultative Group" establishes that principles "should be applied flexibly on a case by case basis". The report highlights that no party is legally bound by any provision of the principles "whether as a matter of contract, comity or otherwise"[220].

In brief, the IIF principles are guidelines for creditors and debtors, though not binding. As pointed out by M. Lastra, the principles have entered the legal atmosphere because "Globalization has challenged the traditional law-making process. The need for international soft law in finance is a logical response to the 'vacuum' in this important area of economic regulation"[221].

(b) **Creditor Committees and the Steering Group**

M. Waibel (2017) drafted the "Guidance on setting up Creditor Committees"[222]. Basically, it is the further development of the principle of "good faith actions of the Principles for Stable Capital Flows and Fair Debt Restructuring[223]. The guide highlights that the main advantages of creditor committee implementation are efficiency gains, higher participation rates, procedural fairness, quicker results, and maximalization of funds available to the debtors to pay creditors[224]. The document is supported by comments of stakeholders and experts, the contractual approach developed by ICMA and the (*soft*) rules settled by the IIF[225].

In addition, the creditor committee is based on symmetrical obligations. Accordingly, it covers crucial issues as good faith[226] and obligatory negotiations; disclosure of relevant information[227]; robust conflict of interest rules and payment of creditor committees, expenses and a proposal for settlement of disputes.

The guide for negotiations proposed that bondholders of at least 30% of the aggregate principal amount of the outstanding debt should appoint a person or a group of persons as a Committee who represent the bondholder interests.[228] In case more than one Committee exists, they may appoint a Steering Group to represent the bondholders in debt restructuring negotiations. The Creditor Committee or the Steering Group would be created in cases of (i) default, (ii) public announcement by the issuer of a forthcoming debt restructuring and (iii) with the agreement of the issuer[229].

Inc.,[2017]).32. The principle comprises general disclosure practice and specific disclosure practice.

217 Ib. 32. This principle is made up: regular dialogue, best practices for investor relations, policy action and feedback, consultations and creditors' support of debtor reform efforts.

218 Ib. 33. This principle includes: voluntary, good-faith process, sanctity of contracts, vehicles for restructurings, creditor committee policies and practices, and debtor and creditor actions during restructuring.

219 Ib. 33-34. This principle includes avoiding unfair discrimination among affected creditors, and fairness of voting.

220 Ib. 33.

221 Rosa M. Lastra, *11th UNCTAD Debt Management Conference. Responsible Financing: The Role of 'soft Law' in Promoting Sustainable Lending and Borrowing Practice* (Palais des Nations , Geneva: , 2017). 7.

222 See in general: Drafted by Michael Waibel, with extensive inputs and comments from stakeholders and experts participating in the study group., *Engagement between Creditors and Sovereign Debtors: Guidance on Setting Up Creditor Committees* (New York: Financing for Development Office, Department of Economic and Social Affairs, United Nations.,[2017]).

223 Institute of International Finance, Inc., "*Principles for Stable Capital Flows and Fair Debt Restructuring" (2017),* 35.

224 Drafted by Michael Waibel, "*Engagement between Creditors and Sovereign Debtors",* 1.

225 Ib. 2.

226 Ib. 8-9. Waibel points out that good faith is presumed by both parties. He also emphasizes that the burden of proving the absence of it falls on the party that alleges the breach of good faith.

227 Ib. 11-13. The information may be disclosure before the negotiation had commenced. Relevant data like macro-economic statistics, data on its public debt, fiscal performance, and treatment given to different creditors are particularly important.

228 Ib. 4.

229 Ib. 5.

The aim of the Creditor Committee and or the (eventual) Steering Group will be to facilitate the negotiation process by designating a member to act as the main point of contact[230], to work with the debtor to resolve its financial difficulties expeditiously, to show how the creditor's proposal might affect medium and long-term debt sustainability, and to accept the terms of the restructuring[231].

Though the procedure looks for successful debt restructuring, it stipulates some situations where a conflict of interest might arise. First, "holding a plaintiff or claimant position against the issuer in pending litigation arbitration or other legal procedures"[232]. Second, credit default swaps or similar financial hedging instruments should be used if the issuer defaults partially or entirely on the affected debt securities[233].

The guidance stipulates that payment of fees and expenses of the Creditor Committee or the Steering Committee shall be reimbursed by the issuer in case of a successful debt restructuring process[234].

The role of the creditor committee or the steering committee in sovereign debt litigation or arbitration is still limited as both are based on emerging soft law. Nevertheless, the bondholder interested in arbitration or litigation should be cautious with the committees' contractual terms as they might eventually limit his capacity to sue before courts and tribunals.

(c) Settlement of disputes between the Creditor Committee/Steering Group and the issuer

The mechanism designed to deal with legal problems proposes that a dispute may be filed before (i) the court of the forum appointed in the bond terms (United Kingdom and New York mainly), or (ii) a supervising body. The latter would be an independent and impartial group of arbitrators deciding the dispute. The report suggests a simplified and adapted version of the UNCITRAL arbitration as rules for the supervising body[235].

2. FINANCIAL LAW AND BASIC PRINCIPLES ON SOVEREIGN DEBT RESTRUCTURING PROCESSES

This chapter aims to point out what holdout creditors should have taken into account when taking part in a creditor committee for looking payment of their sovereign bonds. It has been described, in general, the kind of principles adopted in the soft rules of financial law; however, the writer considers it essential to make some considerations between the UN principles of sovereign debt restructuring and the soft law rules of international financial law.

The applicability of the Principles of Sovereign Debt Restructuring remains uncontested in the market-based approach. However, the Study Group has mentioned in its report that the "Official sector and industry efforts should facilitate understanding of contract parameters that will be relevant at the time of a rescheduling/restructuring. The UN Principles on Sovereign Debt Restructuring Processes are a recent step in this direction."[236]. Accordingly, it seems like the UN principles might, eventually, play a controversial role in future sovereign debt disputes. However, transparency and good faith have a higher level of recognition in debt restructurings.

230 Ib. 4, 7- 8.
231 Ib. 8.
232 Ib. 9
233 Ib.
234 Ib. 13.
235 Ib. 14-15.
236 Drafted by Benu Schneider, "*Sovereign Debt Restructuring: Further Improvements in the Market Based Approach",* 4.

Sovereign bond disputes are characterized by their case-by-case analysis. Nevertheless, the tribunal, which eventually would decide the dispute, would decide on different grounds depending on its legal culture and human rights understanding. This takes the discussion to a scenario of "distributive fairness and procedural fairness"[237]. Thus, the judge or arbitrator will face the following problem: to legitimate a creditor enrichment due to an indebted defaulted country on the one hand or to compensate the creditor with full payment of principal and interests according to the bond terms[238].

This dilemma has been remarkably discussed among scholars and experts. It is indeed a matter of justice and fairness[239] (as all law cases are), but it would turn the discussion on legal philosophy rather than international law[240]. Indeed, the PRSLB and the PSDRP contributed to the direction in which sovereign debt rules should aim; nonetheless, until treaty law or customary law reaches a sovereign debt framework, judges and arbitrators would have less than a few arguments to apply these principles. Moreover, even though the principles would eventually become guidelines for debt restructuring, they could also bring uncertainty and unpredictability because of their subjective nature. Finally, the principles tend to favour states rather than bondholders because, in the end, it will not be possible to enforce bond terms (at least in total); however, from a corporal social responsibility perspective, it would be conceivable to expect awards which consider the state's sustainability.

3. TRUST STRUCTURES V. FISCAL AGENCIES

The market-based approach has supported the idea of a trustee structure rather than a fiscal agent structure, because the latter allows bondholders to litigate individually while the former limits arbitration and litigation possibilities[241].

On the one hand, fiscal agents are agents of the issuer countries, and they allow the latter to issue their international bonds[242]. The benefits of a Fiscal Agency Agreement are lower costs, quicker issuances, and better credit standing for the issuer[243]. However, payments made through a fiscal agency would be attached by a third-party creditor (unless the fiscal agent had an "express promise to hold funds in trust for the bondholders"[244]).

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237 See: Rosa M. Lastra, "*11th UNCTAD Debt Management Conference. Responsible Financing:",* 5. In this slice Prof. Lastra cited Hayk Kupelyants who develops the idea of "distributive fairness and procedural fairness" in "*Sovereign Defaults before domestic courts* (OUP 2018)". Though at the time of writing the book has not been published.

238 Ib. "Courts should never consider broader policy arguments to override contractual language and established legal rules'. "Rendering a decision by reference to vague policy reasons, bordering on judicial legislation, would defy the commercial predictability of English and New York laws".

239 For a concept of fairness and Justice in the financial markets see in general: Rosa M. Lastra and Alan H. Brener, "*Part 1. Normative Foundation - Justice, Financial Markets and Human Rights*," in *Just Financial Markets?: Finance in a just Society*, ed. Lisa Herzog, Vol. 1 (Published in the United States of America: © Oxford University Press 2017, 2017).

240 Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt System",* See footnote 2. for instance, Bohoslavsky indicates that "*considering that legality consists not only of statutes, but also of general principles of justice and fairness— yes, even in financial law— the horizontal and robust discussions stimulated by Lee within the Expert Group and with governmental officials strengthened the normative degree of the PRSLB."*

241 David Billington, "Part V, Proposals to Reform Sovereign Debt Systems: 25. European Collective Actions Clauses," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). 25.19.

242 Drafted by Benu Schneider, "*Sovereign Debt Restructuring: Further Improvements in the Market Based Approach", 11.*

243 Ib. 12.

244 Ib. 12.

On the other hand, the trustee represents the bondholders. The sovereign issuer deposits the bondholder rights in favour of the trustee.[245] Hence, the trustee has the right to initiate, under certain circumstances[246], legal proceedings against the sovereign borrower[247].

Even though fiscal agencies have been used more frequently in sovereign debt markets, since the Argentinean and Greece cases, this trend has changed as fiscal agencies allow holdout creditors to initiate proceedings against sovereign debtors[248]. As mentioned before, trust structures allow initiating legal proceedings under specific circumstances, though the outcomes of successful litigation might not be so attractive for holdout creditors as the recovered money would be paid pro-rata amongst bondholders.[249] However, the use of trust structures implies "extra levels of costs and administration"[250] with which sovereign issuers are not comfortable[251].

In brief, for forum shopping purposes, the bondholder who might consider receiving full payment of principal and interests should avoid constituting a trust structure because it will limit their capacity to sue the sovereign. Conversely, during a bond emission, bondholders should try to negotiate through a fiscal agency as they will keep their autonomy for suing the sovereign.

245 Ib.
246 Ib. These circumstances are: *"if: (i) it is requested to do so by a requisite percentage of bondholders (typically 25 percent of the principal amount) and (ii) it has received adequate indemnification"*.
247 Ib.
248 Ib.
249 Ib.
250 David Billington, "Part V, Proposals to Reform Sovereign Debt System", 25.20.
251 Ib.

CHAPTER IV: FORUM SHOPPING FOR SOVEREIGN BONDS CLAIMS

> *"Public debts, Jefferson reasoned, are a form of encumbrance that deplete the ability of future generations to enjoy the fruits of their labours. Why? Because those later generations will spend a portion of their income paying back the debts they inherited from their progenitors. '[B]y the law of nature,' Jefferson wrote, 'one generation is to another as one independent nation to another.'"*[252]
>
> Mr. Lee Buchheit (2014) commenting an extract from Thomas Jefferson (1789).

Firstly, it must be considered that developments in international investment law, international public law, international financial law and contractual law have been aimed at designing legal provisions that restrict the possibility of litigation and arbitration for bondholders and, particularly, holdout creditors. Thus, the current trend is to create legal conditions that aim at debt restructuring negotiations.

Before showing the thesis results, it is essential to highlight that the following paragraphs are just general considerations about the best forum for getting full enforcement of sovereign bonds. Not considering other variables when analyzing the best possible forum would be naïve and inconvenient; however, the parameters adopted in this investigation have a remarkably legal weight.

As explained earlier, sovereign bond contracts vary from country to country and from issuance to issuance. Though more aspects remain, these factors are essential when analyzing the best possible forum. For example, whether national courts agree on the theory of *defence of necessity* between states and private individuals would be another essential consideration[253]. In addition, the governing law is fundamental. Though New York Law and English Law are the most common ones, it might be possible that other laws might have been stipulated in sovereign bonds, consequently adding other legal variables for forum election.

1. JURISDICTIONAL CONSIDERATIONS

Jurisdiction before national courts is available because of a waiver of jurisdiction included in sovereign bond terms. This is remarkably important as litigators do not have to discuss whether the court has jurisdiction over a dispute, but they can argue directly about the case's merits; however, before enforcing the full terms of the bonds, holdouts must overcome three kinds of Collective Action Clauses: single series CACs,

252 Lee C. Buchheit, "*Part V, Proposals to Reform Sovereign Debt Systems: 28. Sovereign Debt in the Light of Eternity*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). 28.06.

253 Andrea K. Bjorklund, "*Emergency Exceptions: State of Necessity and Force Majeure*," in *The Oxford Handbook of International Investment Law*, eds. Peter Muchlinski, Federico Ortino and Christoph Schreuer (Oxford: © Oxford University Press, 2008). 516-518. doi:- 10.1093/acprof:oso/9780199571345.003.0017. https://goo.gl/4f1rMs;. In 2007, the German Constitutional Court faced the following question "ought the customary international law defence of necessity to play a role in proceedings governed by municipal law that are asserted by private claimants?" According to A. Bjorklund the court concluded that the defense of necessity could not be invoked by a state vis-à-vis private individuals, as it was a rule recognized for states vis-à-vis other states. However, she mentioned that the Judge Dr Lübe-Wolff in her dissenting opinion stipulated " (...)a necessity defence is available to a State as a general principle of law, regardless of the law governing the proceedings and regardless of the identity of the claimant" (...) "Judge Lübbe-Wolff also suggested that enforcing a State's payment obligations to foreign creditors would be contrary to human rights norms requiring the State to discharge elementary obligations it owes to its nationals."

cross series CACs (single limb), and cross series CACs (double limb). Remarkably, holdouts' monetary budget might play to their advantage if they can buy the required amount of outstanding bonds for paralyzing a sovereign debt restructuring[254], therefore, going to litigation.

Unlike national courts, the ICSID has analyzed whether sovereign bonds can be qualified as investments under objective or subjective criteria. Up to now, the ICSID caseload has conceived jurisdiction in three cases under the subjective criteria and denied jurisdiction in one case under the same criteria. However, since the Argentinean crisis, some BITs have excluded sovereign bonds from the treaty text, reducing the scope of available treaties. Finally, treaty shopping and the secondary market have developed a novelty way to gain access to various BITs. Consequently, the IIL approach is a flexible scenario for jurisdictional access purposes.

Different from the latter two approaches, the market-based approach is designed to satisfy the market's and sovereigns' financial, social and, even, political interests. Accordingly, accessing dispute settlement is not encouraged. Furthermore, trust structures are recommended as they limit the power of holdouts who want to litigate. Trust structures work differently from jurisdiction to jurisdiction; however, they are based on enacted laws that domestic tribunals follow. On the contrary, creditor committees have been proposed for restructuring negotiations and, eventually, for initiating arbitral procedures under market rules; nonetheless, these rules are considered soft law and, therefore, not binding, and on top of that, they are still under development.

2. MERITS AND COMPENSATION CONSIDERATIONS

The CL approach, primarily the N.Y. courts, is well known for its rule of law enforcement tradition, particularly with financial products. These courts do not distinguish bondholders from the primary or secondary markets. Consequently, their awards tend to order full payment of principal and interests for either primary or secondary bondholders; however, as seen in the case concerning NML v. Argentina, it would take more than a decade, among other issues, to execute a judgement successfully.

Conversely, the IIL approach has tended to recognize the market value of the bonds. Accordingly, two situations might happen: firstly, if bondholders acquired the securities from the primary market, they would eventually be able to look for full principal and interest, considering their legitimate expectations. Secondly, if bondholders have acquired the securities from the secondary market, they might be awarded the bonds' market value at the time of purchase. Additionally, bondholders might face arguments about the abuse of rights.

The market-based approach is not aimed at enforcing full bond terms. On the contrary, financial law rules have been working on stabilizing capital flows and debt restructuring. Nevertheless, the market-based approach to arbitration proposes choosing between the UK and the US courts on the one hand or the supervising body on the other in case of disagreements between creditor committees and sovereign issuers. Moreover, the principles suggested by the IIF, the UNCTAD[255] and the General Assembly[256] would eventually become determinative in both scenarios. Furthermore, if these principles were included in the bond terms, the judges must determine the scope and form of applicability. However, as this arbitration proposal is under development, it is not developed enough to make further considerations.

254 Sometimes it might be required to be considerably high because of double limbs CACs.
255 Principles for responsible sovereign lending and borrowing (PRSLB)
256 Principles on sovereign debt restructuring process (PSDRP)

3. EXECUTION AND ENFORCEMENT CONSIDERATIONS.

Immunity from execution has been the most challenging task bondholders must overcome when dealing with sovereign debt litigation. The Abaclat case has shown that finding public assets capable of being executed is challenging. Investor-state litigation in New York courts has shown that looking for assets from a state central bank has been unsuccessful due to their separate legal personalities. Additionally, though state commercial assets can be seized, they are not frequently found. Moreover, new improvements in pari-passu clauses have made the chance to obtain full payment by stopping a debt restructuring highly unlikely. Even before non-modified pari-passu clauses, it was conceivable but improbable that common law judges would adopt this broad interpretation of the clause again[257].

The IIL approach provides a broader range of alternatives for enforcing awards. First, according to article 54 of the ICSID convention, ICSID awards shall be recognized as a national judgement by a national court; secondly, if a state does not recognize the ICSID award, the investor would look for diplomatic protection; thirdly, ICSID awards have a traditional reputation of partys' compliance. Accordingly, states observed awards for maintaining their good standing with the World Bank; finally, because non-payment of ICSID awards will constitute a breach of international law and eventually turn into a limitation for market access, countries would prefer to comply with ICSID awards so that they can participle in international markets.

The market-based approach does not look for full compensation. The proposal for creditor committees establishes that the sovereigns should afford the costs and expenses related to restructuring processes in case it has been successful, but full payment of principal and interests is not encouraged. In addition, the MB approach has been supported by international institutions like the IMF, the European Central Bank, the ICMA, and the IIF, which might enhance the effectiveness of the restructuring and encourage compliance with sovereign arrangements.

4. FINAL REMARKS

Considering the previous considerations, the best forum for looking for full enforcement of sovereign bond terms seems to be based on the type of bondholder (holdout creditor). The suggested path would be different for a primary market bondholder or a secondary market bondholder.

On the one hand, if bondholders (holdouts) have acquired sovereign bonds from the primary market, the most suitable forum would be ICSID tribunals. Though the lawsuit would have dealt with the jurisdictional debate between the subjective and objective theory, compensation might be based on the value that the primary investor paid for the sovereign bond plus interests. More attractively, the bondholder would have access to ICSID award enforcement options. On the contrary, bondholders from the secondary market would not be encouraged to seek enforcement before ICSID because of the eventual limited compensation received and the heavy argument of abuse of rights they would face.

On the other hand, if bondholders (holdouts) have purchased sovereign bonds from the secondary market, the most effective forum would be national courts. Firstly, the waiver of immunity allows bondholders to sue before national courts automatically. Secondly, national courts (mainly N.Y. and London courts) are recognized for full enforcement of financial products, regardless of the market where they were purchased. Secondary market bondholders will not be treated less favourably or receive a better judgment from courts. Finally, though remarkably difficult, the possibility of finding attachable commercial assets is still available,

257 *Interview with Lee C. Buchheit on Restructuring Greek and International Debt,* directed by ifo Institute – Leibniz Institute for Economic Research at the University of Munich YouTube, LLC., 2014).

and the broad pari-passu clause interpretation remains, arguably, open for limiting sovereigns' market access. Additionally, national courts would be an appropriate forum for bondholders of the primary market, though ICSID would be better for them because of the abovementioned remedies.

Lastly, for bondholders (holdouts) looking for full enforcement of bond terms, the MB approach is not a suitable scenario as it aims to achieve debt restructuring rather than working as a dispute settlement forum. Moreover, it is still under construction, and its law framework is made of soft law rules, so it is not binding for either sovereign or market participants. However, holdouts would receive some extra benefits from this approach:

Firstly, it allows for unifying bondholders' requests to negotiate faster and easier. Secondly, international organisations support the processes of settling negotiations under creditor committees. This is particularly important as the IMF would be a guarantor of sovereign obligations. Third, it is possible to maintain the stability of capital markets by negotiating comprehensive restructurings. Finally, as was pointed out by Bohoslavsky, referring to the discussion with all the stakeholders and the view adopted by Lee Buchheit, the PRSLB would help to consolidate the legitimacy of a debt restructuring framework[258]. Therefore, it would be feasible to expect bondholders' pleas to be legitimized.

258 Juan Pablo Bohoslavsky and Yuefen Li, "*Part V, Proposals to Reform Sovereign Debt Systems: 27. UNCTAD Principles on Responsible Sovereign Financing*," in *Sovereign Debt Management*, eds. Rosa M. Lastra and Lee Buchheit, first edition published in 2014 ed., Vol. 1 (United States of America by Oxford University: © Oxford University Press, 2014). See footnote 2.

CONCLUSION

> *"There is no sphere of human thought in which it is easier to show superficial cleverness and the appearance of superior wisdom than in discussing questions of currency and exchange."* Winston Churchill, 1949.

The current state of the art of sovereign debt, particularly sovereign bonds, has made litigation, arbitration and negotiations after defaults possible. Since the Argentina crisis, the international bond market has implemented new sovereign bond clauses that have made it more difficult for bondholders (holdout creditors) to look for full enforcement of sovereign bond terms. Traditionally, the contractual law approach to litigation has been the most effective scenario when looking for full enforcement. However, this trend has experienced some critical changes.

If bondholders (holdout creditors) from the secondary market want full enforcement, they should have better possibilities before national courts. However, if bondholders have acquired the securities in the primary market, they may have better expectations before the ICSID. The former idea is based on the fact that national courts do not distinguish between primary or secondary bondholders so judges will enforce the bond terms without discrimination. The latter idea is supported by the fact that ICSID tribunal might favour primary bondholders as they may have legitimate expectations rather than speculative expectations. In addition, the ICSID has different scenarios that may play a role in favour of full award enforcement. Lastly, the market-based approach is the less effective forum for looking for full enforcement. Firstly, it is aimed at negotiation settlements, which implies money cuts, and secondly, it has no binding force as most of the normative body consists of soft law rules of emerging international financial law.

Finally, though this thesis studied essential features related to sovereign debt disputes (jurisdiction, governing law, and enforcement of awards) that must be considered when analyzing forum shopping opportunities, some other features could change the outcomes of a sovereign bonds dispute, like domestic legal precedent on sovereign debt, national laws, and bilateral investment treaties legal terms among others.
The thesis outcomes contribute to sovereign debt litigation and arbitration by providing essential information for legal strategy purposes.

GLOSSARY

Approval threshold: the minimal percentage required to trigger CACs.

Collective Actions Clause (CAC): clauses designed to bind all bondholders to a debt restructuring with a majority voting.

Corporate debt: corporate or private debts owed to third parties, usually commercial banks.

Credit Default Swaps: a financial contract by which a buyer of sovereign bonds tries to eliminate possible losses from eventual defaults.

Creditor Committee: a group of creditors arranged for debt restructuring negotiation purposes.

Cross-default clause: a contractual term that triggers defaults in all bond series if any other series has defaulted.

Debt restructuring: The process of reforming contractual terms and due dates of a debt.

Debt securities: especially debt instruments, e.g. sovereign bonds.

Default: non-payment of financial obligations.

Double limb voting: a voting system that requires approval in both single series and mixed series of bond issues.

Due diligence: obligation of conduct of the part of a subject of law.

External Indebtedness: sovereign debt owed to foreigners.

Fiduciary duty: in common law systems, a fiduciary duty is the highest standard of care on behalf of the fiduciary.

Financial hedging instruments usually refer to financial instruments whose value depends on another financial asset, e.g., derivatives.

Fiscal agency: an agent of the sovereign issuer through whom payments of the bonds are made.

GDP link bond: sovereign bonds which payments depend on the performance of the gross domestic product of the sovereign issuer.

Holdout creditors: bondholders who do not participate in sovereign debt restructuring.

Institute for International Finance (IIF): a global association of the financial industry that supports risk management and provides advice on policy design, among others.

International Capital Market Association (ICMA): a membership association in the capital market sector.

International Central Securities Depositories (ICSD): trade platform for negotiating securities.

Negotiability to immobilization: transition from bond physical negotiation to electronic negotiation through computer records.

Negotiable instrument: financial instrument able to be traded throughout financial markets.

New Global Note (NGN): an instrument representing the loan the issuer owes.

New rank clauses: the new version of pari-passu clauses that was designed after Judge Thomas P. Griesa's interpretation of equal payment terms.

Non-reserved matters: non-substantial terms and conditions requiring a low modification approval threshold.

Outer limits: legal theory. It stipulates that investment law has its own limits and it is based on an objective interpretation of the law. On the contrary, the subjective theory stipulates that the extent of the investment concept should be determined depending on the circumstances.

Outstanding bonds: sovereign bonds that have been issued but have not matured yet.

Paris passu Clause: a sovereign bond clause that stipulates that bondholders should receive equal ranking rights.

Paying agent: a bank appointed by the issuer which oversees payments of the bonds.

Primary market: where securities are created in order to make an initial public offering.

Rating agencies: companies that assign credit ratings.

Reserved matters: substantial term conditions that require a higher approval threshold for modifications.

Secondary market: where securities that have already owned are traded again. The secondary market is also known as the stock market. The secondary market in the present thesis are the ICSDs.

Security entitlements: rights arising from securities.

Security: any form of financial instrument.

Single limb voting: a voting system that requires approval in a single series of bond issues.

Sovereign: state.

Sovereign Debt Restructuring Mechanism (SDRM): mechanism proposed at the IMF in the early 2000 to reorganize sovereign debt efficiently and timely.

Stable capital flows: normal and steady functioning of international capital markets.

Steering Committee: representatives of two or more creditor committees arranged for debt restructuring negotiation purposes.

The Group of Trustees: 41 current and former leaders in global finance.

The Principles Consultative Group: a select group of finance and central bank officials.

Trust indenture and Trust deed: agreement of bond contract, by which the trust represents the bondholder's interests.

Writing resolution: written consent.

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Annex 1 Treaty shopping through the secondary market

The following hypothetical situation might help us understand the practice of treaty shopping through the secondary market.

In January 2015 the Republic of Arcadia issued sovereign bonds of 10 Arkadins (**K$**) maturing in 2020 and interests payable annually in January of each forthcoming year. The country issued sovereign bonds to finance national capital-intensive IT projects.

The bond is launched in the International Central Security Depository, and in **February 2015** traders from the Republic of Acaya bought 5 K$ of Arkadins bonds. Due to the steady increase in the IT industry in Arkadia, foreign investors find that investing in it is a lucrative opportunity. In addition, Arkadia has an A1 Moody's rating, which is qualified as an "investment grade".

In July 2019, Arkadia might likely experience a financial crisis due to mismanagement of public funds. In addition, governmental corruption exposures have made foreign investors take their investments out of the country.

Due to these events, it is expected that the principal and interests of sovereign bonds will not be paid once they mature. Acayan bondholders are concerned because Arkadia and Acaya do not have a BIT. Consequently, Acayan bondholders are advised to sell their bonds to a bondholder whose nationality is covered by a BIT with Arcadia so they can file an eventual lawsuit against Arcadia before the ICSID.

In August 2019 Acayan bondholders sell their bonds to a Corintian hedge fund, whose nationality is covered by a BIT with Arcadia (especially public debt securities).

In September 2019, Moody´s rating was downgraded to B3 (highly speculative).

In February 2020, Arkadia paid neither principal nor interests of the 2015 sovereign bonds issue; consequently, the country is rated in Default by Moody´s.

Interesting facts and features

Corintian bondholders would be covered by the Arkadia-Corintia BIT. Consequently, they would have legal standing before ICSID.
Corintian bondholders had acquired the bonds before Arkadia was downgraded to B3 Moody´s rating (Highly speculative). Eventually, the ICSID would have to analyse whether it was reasonably foreseeable or highly probable that Arkadia would default.
The sovereign bonds trade made by bondholders from Acayan and Corintia in August 2019 took place when Arkadian rating was A1; however, it was highly probable that the grade might have been downgraded in the forthcoming days. Accordingly, it seems conceivable to argue the abuse of rights theory.[259]

259 The case concerning "Treaty shopping through the secondary market" was fully developed by the thesis' author.

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