**Chapter Five: Sovereign Debt as Investments: Dispute Resolution and Restructuring in Times of Crises**

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**Abstract:**

*In this chapter, we highlight the controversial expansion of IIAs to include sovereign debt instruments as protected investments, leading to increased litigation and arbitration following sovereign debt defaults. We are particularly concerned that the wide definition of "investments" under financial service chapters of investment-related agreements may expose countries in the Global South to judicial challenges from holdout creditors. To contextualize our arguments, we map the approaches of the United States and the European Union to conceptualizing sovereign debt in their FTAs. The objectives of the chapter are to evaluate the acknowledgement and safeguarding of sovereign debt as an investment in US and EU FTAs and to scrutinize the obligations and potential consequences for Global South countries during sovereign debt crises and restructurings. We advocate for Global South countries to be vigilant in their FTAs with these countries and ensure that future agreements incorporate the protective measures adopted in EU and US FTAs with other Global North partners. Furthermore, there is support for eliminating ISDS from IIAs due to the extensive powers it grants private corporations, including opportunistic private creditors, to challenge and override democratically enacted laws and regulations that protect public health, the environment, and workers' rights during debt restructuring.*

## **Introduction**

Over the years, a patchwork of International Investment Agreements (IIAs), including Bilateral Investment Treaties (BITs), Free Trade Agreements (FTAs), and Economic Partnership Agreements (EPAs) with clauses or chapters on investment and financial services, have played a crucial role in shaping the international investment protection landscape for foreign investors.[[1]](#footnote-2) These IIAs often contain provisions for dispute resolution between investors and host governments.[[2]](#footnote-3) Controversially, the scope of IIAs has widened over the years to cover sovereign debt instruments as investments to be protected.[[3]](#footnote-4) It is imperative to unpack the link between investment protection under IIAs and sovereign debt because the traditional shield of sovereign immunity has been eroded over time, leading to an increase in litigation and arbitration following sovereign debt defaults and exposing countries to potential risks in the context of international dispute resolution.[[4]](#footnote-5)

This controversial trend has significant ramifications for the global sovereign debt restructuring mechanism. As UNCTAD pointed out in a 2011 issue note, ‘investor-state dispute settlement (ISDS) mechanism allowing individual bondholders to arbitrate against the State, especially where the majority have agreed to a restructuring, can pose an obstacle to efficient debt restructuring’.[[5]](#footnote-6) This policy advice by UNCTAD remains instructive today and is particularly pertinent in the current terrain where the coronavirus (COVID-19) pandemic has triggered a series of defaults by sovereign states.[[6]](#footnote-7) As the global community attempts to find amicable solutions to the debt crises, there is a danger that countries in the Global South may face judicial challenges from holdout creditors who may seek to exploit the wide berth given to the definition of “investments” under financial service chapters of extant investment-related agreements.

Given the abovementioned issues, this paper maps the United States of America’s (US), and the European Union’s (EU) approaches to conceptualising sovereign debt in their FTAs. These two jurisdictions have been selected for appraisal because they are critical stakeholders in the international debt architecture.[[7]](#footnote-8) Although the primary focus of this paper is on FTAs, BITs have been at the center of the controversial expansion of investment protection measures to sovereign debt instruments. As such, this paper will also briefly explore the issues that emerge in interpreting sovereign debt issues in BITs.

The central objectives of this paper can be broken down into two: firstly, to evaluate the degree to which the US and EU acknowledge and safeguard sovereign debt as a form of investment in their FTA practice, and secondly, to scrutinise the obligations and potential consequences for Global South countries, particularly regarding the protection of their interests during sovereign debt crises and restructurings.

A key finding of the paper is that the US and the EU have been selective in applying safeguards against ISDS for sovereign debt issues. Accordingly, we advocate for vigilance on the part of Global South Countries contemplating FTAs with these countries to ensure that future agreements model the generous carve-outs adopted in EU and US FTAs with other Global North partners. In addition, we support the growing calls for eradicating ISDS from IIAs due to the broad powers it gives private corporations, including opportunistic private creditors, to challenge and override democratically enacted laws and regulations that protect *inter alia* public health, the environment, and workers' rights during debt restructuring.

## **Sovereign debt instruments as protected instruments under ICSID and BITs.**

When considering the scope of protection offered under international investment agreements (IIAs), ‘sovereign debt’ does not immediately come to mind. Instead, cross-border investments in enterprises, shares, stocks, or other forms of equity participation typically dominate the discussion.[[8]](#footnote-9) To better understand the connection between sovereign debt and investment/finance chapters of IIAs, examining the controversial interpretation of "investment" under BITs and Article 25 (1) of the ICSID Convention is an important starting point. This is important because the definition and conceptualisation of "investment" under the BIT/ICSID Convention regime have played a crucial role in determining whether creditors were entitled to protection under specific IIAs and the application of investor-state dispute resolution mechanisms.[[9]](#footnote-10) Conventionally, IIAs adopt a broad asset-based definition of investment that covers “every kind of asset” owned or controlled by an investor.[[10]](#footnote-11) This is quite nebulous and can be interpreted narrowly or widely. In other instances, IIAs are more specific in what is covered under the definition of investment, i.e., a closed list approach. Where the scope of "investment" is interpreted to be broad enough to include sovereign debt instruments, creditors have sought to rely on ICSID or international commercial arbitration as adjudication forums for sovereign debt claims.[[11]](#footnote-12) This requirement establishes what is known as the 'double-barrelled test', which necessitates fulfilling the applicability requirements stipulated in both the ICSID Convention and the invoked BIT.[[12]](#footnote-13)

Although the ICSID Convention does not define the term “investment”, there have been attempts in several ICSID cases to stretch the scope of Article 25(1) of the ICSID Convention, which states that the International Centre for the Settlement of Dispute Resolution (Centre) has jurisdiction, *ratione materiae* (subject-matter jurisdiction)*,* over “any legal dispute arising directly out of an investment, between a Contracting State (…) and a national of another Contracting State” to include sovereign debt cases.[[13]](#footnote-14) The variations in the interpretation of Article 25(1) are encouraged by the treatment of the so-called “Salini test” (i.e. a list of requirements that emanated from the *Salini v. Morocco* case), which tribunals have been used in a prescriptive way to determine whether the ICSID Convention should be regarded as applicable to disputes involving sovereign debt issues.[[14]](#footnote-15)

The implications of this interpretation of sovereign debt instruments as investments under the BIT/ICSID regime have played out prominently during sovereign debt crises in the last two decades. Notably, during the restructuring operations undertaken by Argentina at the turn of the millennium, “holdout bondholders” pursued different dispute resolution strategies to secure their interests.[[15]](#footnote-16) In particular, the Argentine debt crisis of 2001 marked a seismic shift in the international sovereign debt default landscape as investors filed a series of lawsuits against Argentina in the US and UK alongside arbitration proceedings following Argentina’s default.[[16]](#footnote-17) These lawsuits and arbitration proceedings culminated in a second default in 2014 and repayment of approximately USD$9.3 billion to hold out creditors in 2016.[[17]](#footnote-18) The domestic cases which were filed against Argentina over 14 years had significant implications for resolving sovereign debt disputes, as they demonstrated the willingness of domestic courts, especially in New York and London, to enforce the rights of holdout bondholders and the potential challenges faced by sovereign nations in restructuring their debt.

In addition to domestic litigation cases, some holdout bondholders commenced investment treaty arbitration proceedings against Argentina “*…arguing that the 'haircut' amounts to a violation of international obligations arising out of the applicable investment treaty.”'*[[18]](#footnote-19) Several ICSID arbitration cases focused on this, including *Fedax v. Venezuela*, *Abaclat v. Argentina, Ambiente Ufficio v. Argentina, Giovanni Alemanni v. Argentina*, *Poštova Banka SA and Istrokapital SE v the Hellenic Republic*.

In the *Abaclat v Argentina*, Italian holdout bondholders initiated ICSID proceedings against Argentina under the Argentina-Italy BIT. They argued that Argentina's restructuring of its sovereign debt amounted to violating the State's obligations arising from the BIT. The Tribunal did not apply the Salini test to determine whether the bondholders' contributions qualified as "investments" under the ICSID Convention. Instead, the Tribunal concluded that the Salini test was unnecessary to decide the case because the bondholders' claims fell within the scope of the Argentina-Italy BIT.[[19]](#footnote-20) The Tribunal also noted that if the bondholders were not considered investors under the Convention, they would be deprived of the procedural protections afforded by the ICSID Convention, which could create a risk of unequal treatment and unfairness in the proceedings. In the *Ambiente v* *Argentina* case, which also concerned claims by Italian nationals against Argentina for purported violations of the Argentina-Italy BIT in connection with the respondent State's default on paying its sovereign debt in 2001, the Tribunal reached similar conclusions as to the *Abaclat* tribunal, holding that the term 'investment' is to be given a broad meaning encompassing sovereign bonds and security entitlements.

Although the decisions from these two cases support an interpretation that sovereign debt is an investment for protection under IIAs, it is instructive to note that there was a sharply worded dissent in the *Abaclat* decision by Georges Abi-Saab who argued *inter alia* that the definition of investment emerging from financial markets was too broad.[[20]](#footnote-21) Abi-Saab argued in his dissenting judgment that the lack of an explicit definition of investment in the ICSID Convention did not justify an expansion of the ambit of the definition to cover sovereign bonds. In Abi-Saab’s words, “sovereign debt instruments (whether we call them “bonds”, “obligaciones”, “security entitlements” or otherwise”) that are at the basis of these claims, do not constitute a “protected investment” under the ICSID Convention.[[21]](#footnote-22) He explained that the types of investments contemplated by the ICSID Convention contributed to the host country’s economic development, i.e., to expand its productive capacity. According to him, foreign direct investment is the ideal investment contemplated for ICSID purposes, not sovereign bonds. While he did not suggest that all portfolio-style financial investments are outside ICSID's protective scope, he argued that they are not necessarily covered.

He also raised concerns that the majority decision in the *Abaclat* case had failed to distinguish between purchases on the primary market, involving the issuer (Argentina) and the first buyers of the issue (the underwriters), and the secondary market, where previously issued securities are traded, without any involvement of the sovereign debtor. In his words, “an ICSID Tribunal cannot look only at the economics of a transaction, without taking into consideration its legal framework and structure, to determine whether it qualifies as a protected "investment" or not.”'[[22]](#footnote-23) This informative argument emphasises the implications of interpreting secondary market transactions involving intricate intermediation chains as covered investments under BITs and other IIAs. Such a broad interpretation exposes sovereigns to numerous potential claimants, regardless of their distance from the initial investment envisioned by the State Parties under the IIA. This type of decision by an ISDS tribunal incentivises vulture funds and other predatory practices by rogue creditors. These types of creditors are typically profit-driven and often target the securities of vulnerable countries.[[23]](#footnote-24)

Abi-Saab was also critical of the majority's decision to use a 'mass claim' procedure, which allowed over 60,000 investors to bring a single claim against Argentina. He argued that this procedure was inappropriate for the case, violating Argentina's due process rights and was incompatible with the ICSID arbitration rules. Specifically, he argued that an ICSID tribunal could not accept jurisdiction over mass claims without consent from the State Parties to the BIT. This is particularly instructive because the majority decision in the Abaclat case attempted to expand the treaty's scope beyond what the state parties intended. The broader concern is that the majority decision effectively allowed the claimants to use ISDS to challenge measures taken by Argentina to address its economic crisis, which was not the original intention of the treaty. As we would see with the case study countries discussed later, this could encourage holdout creditors to use ISDS mechanisms to challenge legitimate measures taken by states in response to economic crises, thereby undermining the ability of states to govern in the public interest.

Subsequently, in *Poštova Banka SA and Istrokapital SE v Hellenic Republic*, the debate took another decisive turn when an arbitral tribunal in a landmark decision dismissed a claim brought by private creditors against the Hellenic Republic (the "Respondent" or "Greece") during the Greek financial crisis for lack of jurisdiction. This is a critical case because it has cast significant doubt on the viability of arbitration (ICSID and/or International Commercial Arbitration) as the appropriate forum for resolving disputes relating to sovereign debt restructurings. In this case, a claim was brought against Greece by a Slovak bank - Poštová Banka, a.s. ("Poštová banka"). Moreover, its shareholder Istrokapital SE ("Istrokapital"), a European Public Limited Liability Company, organised under the laws of Cyprus pursuant to the Slovak Republic-Hellenic Republic BIT ("Slovakia-Greece BIT") and the Cyprus-Hellenic Republic BIT. The claimants sought compensation for illegal expropriation, failure to accord fair and equitable treatment, and violating umbrella clauses regarding the bank's interests in Greek government bonds ("GGBs") exchanged in 2012. Greece objected to the jurisdiction of the Tribunal on the grounds *inter alia* that the Tribunal lacked jurisdiction ratione materiae because (a) Poštová banka's interests in GGBs were not protected investments under the Slovakia-Greece BIT and the ICSID Convention; and (b) Istrokapital never made an investment protected under Article 1(1) of the Cyprus-Greece BIT or Article 25(1) of the ICSID Convention.[[24]](#footnote-25)

In considering whether it had jurisdiction ratione materiae over the dispute, the Tribunal had to determine if the interests in the GGBs held by Poštová banka met the definition of a protected investment under Article 1(1) of the Slovakia-Greece BIT. Specifically, the Tribunal considered the chapeau for Article 1 of the Slovakia-Greece BIT, which provides that "[i]nvestment means every kind of asset." Article 1(1)(b) refers to "shares in and stock and debentures of a company and any other form of participation in a company." Furthermore, Article 1(1)(c) refers to "loans, claims to money or any performance under contract having a financial value."[[25]](#footnote-26) The Tribunal noted a variation in the terminology and scope used across several BITs signed by Greece. As such, the Tribunal was hesitant about ascribing a blanket interpretation to Greece's treaty practice, noting that in some Greek BITs, there is a reference to the term "loans." In contrast, there is a reference to "long-term loans" or loans "connected to an investment" in others. It was also noted that some of Greece's BITs excluded the term "loan" in its entirety (para 292). Given this, the Tribunal was keen to interpret the Slovakia-Greece BIT on its merits to determine if the State parties intended to include 'sovereign debt' within the scope of definition for investments under the Slovakia-Greece BIT.

Even though Article 1 of the Slovakia-Greece BIT provided a broad asset-based definition instead of a closed list (para 286), the Tribunal held that the careful drafting of protected investments in the Slovakia-Greece BIT indicated that there were limits to the definition (para 294). Following this line of reasoning, the Tribunal argued that there was a difference between the language of the Slovakia-Greece BIT and the Argentina-Italy BIT discussed in the prior Argentina cases (i.e. [Abaclat](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC5312_En&caseId=C95) and [Ambiente Ufficio](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2992_En&caseId=C340)) (paras 306-308). As such, the Tribunal was persuaded to reach a different conclusion from the Argentina cases. In doing so, the Tribunal dealt extensively with the differences between private and sovereign debt, making the latter a particular type of indebtedness that should not be bunched up with the kind of investments envisaged under Article 1 of the Slovakia-Greece BIT (paras 318-338). According to the Tribunal, 'in sum, sovereign debt is an instrument of government monetary and economic policy. Its impact at the local and international levels makes it an important tool for handling a State's social and economic policies. *It cannot, thus, be equated to private indebtedness or corporate debt* (emphasis added)'.[[26]](#footnote-27)

## **The Treatment of Sovereign Debt in FTAs by the US and the EU**

From the preceding analysis, it is evident that the conceptualisation of sovereign debt as an investment for protection remains a highly contentious and problematic issue, mainly because of interpretive difficulties regarding the coverage of sovereign debt instruments as covered investments, especially in first-generation BITs. Up to this point in the analysis, we have discussed the debates surrounding this issue concerning BITs. That raises the obvious question: Is there a different approach to conceptualising sovereign debt under FTAs compared to BITs? The answer to the above question depends on the generation of FTAs under consideration. The process adopted also varies from country to country, depending on the general attitude to investment protection and the use of ISDS mechanisms in their international economic interactions. There is also a noticeable difference when the FTA involves two or more developed country partners.

Like BITs discussed in the previous section, investment and financial services chapters of FTAs have similar wordings on what constitutes investment which may therefore include sovereign bonds. FTAs signed by countries the US or the EU either explicitly list bonds as covered by the treaty or exclude them from their scope. For example, in his analysis of several BITs and FTAs, Kevin Gallagher found that “almost all of the agreements by major capital exporters from industrialised nations include "any kind of asset" as covered investments and thus likely cover sovereign bonds.”[[27]](#footnote-28) He also found that 'some treaties, such as the 1994 North American Free Trade Agreement (NAFTA), the majority of Peru's IIAs and others (such as the Australia-Chile FTA) exclude or safeguard sovereign debt*.'[[28]](#footnote-29)* Gallagher's observation proves true across several FTAs signed by the US, which includes Financial Services and/or Investment Chapters. A perusal of these investment agreements/FTAs reveals some inconsistency in conceptualising debt as an investment, which bears the hallmark of issues that have proved problematic under BITs discussed previously.

### **US FTAs**

The US approach to conceptualising sovereign debt in its Free Trade Agreements (FTAs) reflects the country's broader stance on investment protection and investor-state dispute settlement mechanisms.[[29]](#footnote-30) One of the critical features of the US approach is the inclusion of financial services chapters in its FTAs.[[30]](#footnote-31) These chapters are designed to facilitate cross-border trade in financial services with FTA partners while providing a framework for protecting investments in sovereign debt instruments.[[31]](#footnote-32) Across several US FTAs, sovereign debt is acknowledged as a form of investment, and the provisions on investment protection cover sovereign debt instruments.[[32]](#footnote-33) For instance, the US-Singapore FTA contains a financial services chapter that recognises sovereign debt as a form of investment and provides investment protection.[[33]](#footnote-34) However, the US approach often includes specific exclusions and limitations related to sovereign debt, which can limit the applicability of investor-state dispute settlement mechanisms to sovereign debt-related disputes (Waibel, 2011).[[34]](#footnote-35) The US also employs a model BIT, which serves as a template for its negotiations on investment protection and investor-state dispute settlement provisions in FTAs (U.S. Department of State, 2012). The 2012 U.S. Model BIT contains provisions related to sovereign debt, recognising it as a form of investment and providing investment protection. However, the Model BIT also includes an annexe that sets out exceptions and limitations for sovereign debt-related disputes, which can limit the scope of investor-state arbitration in addressing such disputes (U.S. Department of State, 2012; Gallagher, 2012).

Focusing on a sample of US FTAs, there is a consistent pattern in the conceptualisation of debt across the board. For example, the US-Morocco FTA, the US-Oman FTA, and the US-Columbia FTA had identical language related to debt. The only noticeable difference was that for the US-Columbia TPA, the definition of investment under Article 10.28 (c): which stipulates forms that investment could take (i.e., bonds, debentures, other debt instruments, and loans), includes a footnote (footnote 13) explanation stating that: *Loans issued by one Party to another Party are not investments.*[[35]](#footnote-36)

Although NAFTA provided stipulations safeguarding sovereign debt restructuring in its annexe, these annexes are not standard options across US treaties post-NAFTA. The US was initially very reluctant to include such annexes in its agreements. More recent FTAs such as the US-Australia, US-South Korea, US-Morocco, US-Oman, US-Panama, and US-Singapore agreements expressly include bonds and debt as covered investments, without the NAFTA-type annexe addressing the issue of sovereign debt restructuring. Gallagher points out that the “absence of such a safeguard in the US-South Korea agreement is striking given that South Korea engaged in a historic restructuring of its sovereign debt following its financial crisis in the late 1990s.[[36]](#footnote-37)” Drawing from interviews with US negotiators for his report, Gallagher notes that the US does not initiate discussions regarding sovereign debt but only responds to them when raised by negotiating partners.[[37]](#footnote-38) This observation should be a point of caution for Global South countries, especially African countries, who are contemplating negotiating FTAs and other IIAs with the US. It demonstrates the shrewd nature of US negotiators, who will only remove these clauses if the negotiating team from the other side raise issues with their inclusion.

Chile and Uruguay are examples of nations that expressed such concerns when negotiating FTAs with the US. The concerns expressed by negotiators from these South American countries forced the US to agree to a ban on claims by creditors during restructuring. These provisions were included in the US-Chile FTA[[38]](#footnote-39) and later the US-Dominican Republic-Central America Free Trade Agreement or DR-CAFTA.[[39]](#footnote-40) However, these bans came with caveats because they do not preclude claims if the restructuring by the sovereign violates National Treatment or Most Favored Nation clauses.[[40]](#footnote-41) The US strongly opposed including a provision for "negotiated restructuring" in the US-Uruguay BIT negotiations.[[41]](#footnote-42) This issue proved to be a deal-breaker for Uruguay, which forced the US negotiators to eventually agree for provisions on "negotiated restructuring" to be included in the US agreements with Uruguay.[[42]](#footnote-43) Similar clauses are found in the US-Peru TPA[[43]](#footnote-44) and US-Colombia FTAs, respectively stipulating that *'any country can engage in a "negotiated restructuring" without being liable for the losses of foreign investors.'*[[44]](#footnote-45)

The USMCA (NAFTA 2.0) carries on with this approach stipulating in Chapter 14 Annex 2 that:

*1. For greater certainty, no award shall be made in favour of a claimant for a claim under Article 14.D.3.1 (Submission of a Claim to Arbitration) concerning default or non-payment of debt issued by a Party28 unless the claimant meets its burden of proving that such default or non-payment constitutes a breach of a relevant obligation in the Chapter.*

*2. No claim that a restructuring of debt issued by a Party, standing alone, breaches an obligation in this Chapter shall be submitted to arbitration under Article 14.D.3.1 (Submission of a Claim to Arbitration), provided that the restructuring is effected as provided for under the debt instrument’s terms, including the debt instrument’s governing law.*

From the preceding, the U.S. approach to conceptualising sovereign debt in its FTAs is summarised below:

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| **Key Features** | **Description** |
| The conceptualisation of debt and Inclusion of sovereign bonds as covered investments | The conceptualisation of debt across US FTAs/TPAs depends on the era and the dynamics of each negotiated deal. For example, the US-Morocco FTA, the US-Oman FTA, and the US-Columbia FTA had identical language related to debt. More recent FTAs such as the US-Australia, US-South Korea, US-Morocco, US-Oman, US-Panama, and US-Singapore agreements expressly include bonds and debt as covered investments. The US-Peru TPA, 1994 NAFTA exclude sovereign debt as covered investments. |
| Presence of safeguards for sovereign debt | Although the 1994 NAFTA provided stipulations safeguarding sovereign debt restructuring in its annexe, these annexes are not standard options across US treaties post-NAFTA. The US was initially very reluctant to include such annexes in its agreements. |
| Responding to issues on sovereign debt during negotiations | The US does not initiate discussions regarding sovereign debt but only responds to them when raised by negotiating partners. |
| Negotiated restructuring of sovereign debt | US agreements with Uruguay, Peru, and Colombia include provisions for "negotiated restructuring" that allow countries to engage in a restructuring without being liable for the losses of foreign investors. These agreements also have caveats that do not preclude claims if the restructuring violates NT or MFN clauses. |
| Ban on claims during the restructuring | The US-Chile FTA and US-Dominican Republic-Central America Free Trade Agreement or DR-CAFTA include bans on claims by creditors during restructuring. However, these bans do not preclude claims if the restructuring violates NT or MFN clauses. |
| Opposition to "negotiated restructuring." | The US vehemently opposed including a provision for "negotiated restructuring" in the US-Uruguay BIT negotiations but eventually agreed to include it due to Uruguay's insistence. |
| The USMCA’s approach  | The USMCA (NAFTA 2.0) includes provisions that no award shall be made in favour of a claimant for a claim under Article 14.D.3.1 concerning default or non-payment of debt issued by a Party and that no claim that a restructuring of debt issued by a Party breaches an obligation shall be submitted to arbitration. |

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| **IIAs** | **Scope of Debt as Covered Investment** | **Safeguard for Sovereign Debt Restructuring** |
| US-Morocco FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-Oman FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-Colombia FTA | Includes bonds, debentures, other debt instruments, and loans | No specific annexes for sovereign debt restructuring; loans issued by one Party to another Party are not investments |
| NAFTA | Excludes sovereign bonds | Included specific annexes for sovereign debt restructuring safeguards |
| US-Peru TPA | Excludes sovereign bonds | No specific annexes for sovereign debt restructuring |
| US-Australia FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-South Korea FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-Panama FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-Singapore FTA | Includes bonds and debt | No specific annexes for sovereign debt restructuring |
| US-Chile FTA | It has the scope to include bonds and debt.  | Specific provisions for a ban on claims by creditors during a restructuring with exceptions for NT and MFN clauses |
| US-DR-CAFTA | It has the scope to include bonds and debt.  | Specific provisions for a ban on claims by creditors during a restructuring with exceptions for NT and MFN clauses |
| US-Uruguay BIT |  | Negotiated restructuring provisions included after Uruguay insisted |

### **EU-FTAs**

Like the US, the EU includes financial services and cross-border trade in services chapters in its FTAs and other IIAs. These agreements often contain provisions addressing sovereign debt. Several prominent EU FTAs, such as the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the EU-Singapore Investment Protection Agreement (EUSIPA), include provisions that classify sovereign bonds as investments to be protected within their financial services and cross-border trade in services chapters. Chapter Eight of CETA covers investment, and Annex 8.1 defines "investment" as including debt securities issued by a Party, which would encompass sovereign bonds. Conversely, the EUSIPA is a standalone investment protection agreement that complements the EU-Singapore Free Trade Agreement. The agreement defines "investment" in Article 1.2, which includes debt securities issued by a Party, thus covering sovereign bonds. Like the EUSIPA, the EU-Vietnam Investment Protection Agreement (EVIPA) also has a standalone investment protection agreement that complements the EU-Vietnam Free Trade Agreement. The definition of "investment" under Article 1.2 of the Agreement includes debt securities issued by a Party, classifying sovereign bonds as protected investments.

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| **Agreement** | **Type of Agreement** | **Definition of "investment."** |
| CETA | FTA (Mega-regional) | Debt securities issued by a Party are considered "investments." |
| EUSIPA | Investment Protection Agreement | Debt securities issued by a Party are considered "investments." |
| EVIPA | Investment Protection Agreement | Debt securities issued by a Party are considered "investments." |

Due in part to the sovereign debt crises experienced by some EU member states and the broader implications for the stability of the European financial system, in recent years, the EU has paid greater attention to the issue of sovereign debt in its FTAs.[[45]](#footnote-46) As a result, the EU has sought to incorporate more detailed provisions related to sovereign debt in its agreements to provide a more robust framework for treating sovereign debt and resolving related disputes.[[46]](#footnote-47)

While the EU widely acknowledges sovereign debt within its FTAs, Agreements such as the CETA contain specific exclusions and reservations, such as excluding disputes arising from the restructuring of sovereign debt from the scope of the agreement's investor-state dispute settlement mechanism.[[47]](#footnote-48) This means that investors cannot use the ISDS mechanism to challenge sovereign debt restructuring measures the host state takes. In addition, CETA includes other safeguards to protect the regulatory sovereignty of the parties, such as a requirement that investors exhaust local remedies before initiating an ISDS claim and a "right to regulate" clause that affirms the right of the parties to regulate in the public interest. Under the EU-Singapore FTA, although less comprehensive than the CETA, specific provisions limit the role of investor-state arbitration in addressing sovereign debt-related disputes.

Like the US, the EU’s approach to conceptualising sovereign debt in its FTAs is characterised by an increasing focus on incorporating detailed provisions related to sovereign debt while maintaining specific exclusions and reservations to limit the role of investor-state arbitration in addressing sovereign debt-related. However, these safeguards are more detailed in some FTAs, such as the CETA and less so in FTAs, such as the EU-Singapore FTA. It is also evident that the EU has varying treatment on safeguard mechanisms for sovereign debt issues across different agreements; for example, although the EU-Cariforum Economic Partnership Agreement (EPA) contains safeguards (under Article 234) from measures relating to public health, safety, and the environment, it does not appear to extend to disputes relating to sovereign debt. The absence of a specific safeguard against ISDS for sovereign debt issues in some EU-FTAs and EPAs, especially with Global South partners, is problematic, particularly given the controversies around the use of ISDS mechanisms to challenge sovereign debt restructurings.

## **An Inconsistent Approach to Safeguards against ISDS for Sovereign Debt Issues**

From the preceding analysis, it is evident that IIAs without safeguards from ISDS mechanisms for sovereign debt disputes provide an avenue for legal recourse for uncooperative creditors seeking full repayment of their distressed sovereign debt instruments. This can undermine debt restructuring efforts and limits an indebted country's ability to address its socioeconomic priorities during a sovereign debt crisis.[[48]](#footnote-49) The possibility of claims being brought by uncooperative creditors using ISDS mechanisms in FTAs creates a disincentive for debt restructuring, discouraging countries from undertaking necessary debt restructuring, prolonging the crisis, and delaying the economic recovery of the indebted nation. Invariably, this also leads to unequal treatment of creditors, as those who have access to ISDS would be less inclined to negotiate during restructuring and could potentially gain preferential treatment over those who do not.

The analysis in the previous section shows that the US has not been consistent in its negotiating tactics with several countries. While agreements like the US-Mexico-Canada Agreement (USMCA) include explicit carve-outs for sovereign debt restructuring, others do not.[[49]](#footnote-50) It is plausible to argue that, unlike the older generation FTAs, the carve-outs in the USMCA reflect advancements in the thinking around the potential problems posed by sovereign debt disputes subject to ISDS mechanisms. However, it remains to be seen if this progressive stance in the USMCA will be reflected in future US-FTA practices, especially FTAs with Global South partners.

Conversely, including carve-outs may be more reflective of the specific circumstances of the USMCA negotiations and the parties’ negotiating positions rather than a broader shift in approach to FTAs. Furthermore, the carve-outs may only apply to a limited range of situations, which may not fully address the complex issues involved in sovereign debt restructuring. The US may also revert to a more traditional approach to FTA negotiations, particularly in negotiations with Global South partners. In these negotiations, the US may seek to include more conventional ISDS provisions, which could limit the policy space of Global South countries to address their socio-economic priorities during a sovereign debt restructuring. Therefore, while the USMCA may represent a positive step forward in safeguarding policy space during sovereign debt restructuring, it remains to be seen if this approach will be reflected in future US-FTA practices, particularly concerning Global South partners.

The EU may have to a greater degree, taken a more consistent approach to safeguarding against ISDS for sovereign debt issues in its FTAs, such as the CETA and the EU-Singapore FTA;[[50]](#footnote-51) however, the EU-Cariforum Economic Partnership Agreement (EPA) does not explicitly exclude sovereign debt restructuring from the scope of ISDS. Like the US, could this be excused with the argument that more recent FTAs, including FTAs with global South countries, will benefit from the approach adopted in the CETA?

Like the US, the fact that the EU has included explicit carve-outs in some agreements, such as the CETA and the EU-Singapore FTA, is a positive step forward. However, the lack of similar carve-outs in other agreements, such as the EU-Cariforum EPA, raises questions about the consistency and reliability of the EU's approach to safeguarding policy space in sovereign debt restructuring. Like the USMCA, it is again possible that the EU's approach to safeguarding against ISDS for sovereign debt issues may be influenced by various factors, including the negotiating positions of the parties involved, the political context of the negotiations, and the specific circumstances of each agreement. Therefore, while the EU may have taken a more consistent approach to safeguarding against ISDS for sovereign debt issues in some of its FTAs, it is essential to carefully examine the specific provisions of each agreement to determine the extent to which they provide sufficient safeguards for policy space during sovereign debt restructuring.

## **Conclusion**

Stakeholders seeking reforms to the international debt architecture must maintain vigilance on potential crises that could emanate from future North-South IIA relationships. This is imperative because, as Park and Samples remind us, ‘the absence of a formal bankruptcy regime or binding regulatory oversight [for sovereign debt issues] makes it …fertile ground for rogue behaviour by opportunistic debtors and creditors alike.’[[51]](#footnote-52) As such, future IIAs without safeguards against ISDS mechanisms for sovereign debt issues open the door for predatory ‘tribunalization’ of sovereign debt issues. Global South countries negotiating FTAs with Global North trade and investment partners must insist on safeguards against applying ISDS mechanisms to sovereign debt disputes, as seen in the approaches taken by South American countries such as Chile and Uruguay, to protect their policy space and legitimate investor rights. Recalling the point made by Gallagher that the US does not initiate discussions regarding sovereign debt but only responds to them when raised by negotiating partners, it is imperative for Global South Countries negotiating FTAs with the US to be aware of the complications that can arise if safeguards are not built in to exclude the application of ISDS mechanisms to sovereign debt disputes. Although there is a need to attract foreign investment and access international capital markets, Global South countries must have the requisite policy space to address economic crises without fear of investor challenges while also protecting the legitimate rights of investors.

Alternatively, ISDS should be eliminated entirely from Agreements of this nature to discourage predatory and opportunistic ‘tribunalization’ of sovereign debt issues. This stance is supported by a growing number of US lawmakers who advocate for the removal of ISDS from US trade agreements due to private corporations' predatory use of the ISDS regime.[[52]](#footnote-53) In light of the mounting scepticism regarding the efficacy of ISDS provisions in facilitating beneficial investment in host countries[[53]](#footnote-54) and the broad powers it gives private corporations to challenge and override democratically-enacted laws and regulations that protect public health, the environment, and workers' rights, these group of lawmakers are calling on the US Trade Representative Office to avoid including ISDS in future trade negotiations and to address the exploitative use of existing ISDS mechanisms by private corporations.[[54]](#footnote-55) Over 30 US lawmakers made this call in reaction to a case brought against the Honduran government by a US company Honduras Próspera under the ISDS system.[[55]](#footnote-56) These US Lawmakers are supporting the Honduran government’s call for eliminating ISDS provisions in the Central America Free Trade Agreement (CAFTA) because they undermine the ability of governments to regulate in the public interest.[[56]](#footnote-57) These concerns apply in the context of sovereign debt restructuring, with holdout creditors less keen to join negotiations for debt restructuring if they have the ISDS option available.

As such, eliminating or implementing safeguards against ISDS mechanisms for sovereign debt disputes is crucial and essential for Global South countries negotiating IIAs with Global North trade and investment partners. Failure to do so will discourage holdout creditors from joining debt-restructuring negotiations. As recent events have shown, holdout creditors' reluctance to participate in debt restructuring negotiations is due to the availability of ISDS options, which inevitably prolong economic crises and hamper efforts to promote economic recovery. Overall, Global South countries must carefully consider how to balance the competing concerns they confront: access to capital versus the risk of ISDS.

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2. See generally, Stephan W Schill, THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW (Cambridge University Press 2009). [↑](#footnote-ref-3)
3. According to Park and Samples, ‘Many IIAs expressly include debt instruments as an investment, and a broad definition of investment that does not expressly exclude sovereign bonds (or similarly defined debt instruments) qualifies.’ See Stephen K. Park and Tim R. Samples, *Tribunalizing Sovereign Debt: Argentina's Experience with Investor-State Dispute Settlement* 50 (4) VANDERBILT JOURNAL OF TRANSNATIONAL LAW, 1033, 1041 (2017). [↑](#footnote-ref-4)
4. Sovereign debtors have traditionally been shielded from litigation and arbitration through the international law principle of sovereign immunity, which recognises the equality of sovereign countries and prevents dispute resolution procedures against sovereigns without their consent Stratos Pahis, *The African Debt Crisis and the Perils of International Arbitration* Paper IV AFRICAN SOVEREIGN DEBT JUSTICE NETWORK PAPER SERIES (2021); Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*. 101(4) THE AMERICAN JOURNAL OF INTERNATIONAL LAW, 711–759 (2007); David Gaukrodger Gaukrodger and Kathryn Gordon *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*. OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT, 2012); Ugo Panizza, Federico Sturzenegger and Jeromin Zettelmeyer (2009). *The Economics and Law of Sovereign Debt and Default*. 47(3) JOURNAL OF ECONOMIC LITERATURE 651-698 (2009); Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt.* 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 299–402 (2004). [↑](#footnote-ref-5)
5. See UNCTAD, Sovereign Debt Restructuring and International Investment Agreements’ IIA Issue Note, No 2, (July 2011) <https://unctad.org/system/files/official-document/webdiaepcb2011d3_en.pdf> p. 8 accessed 13 May 2023. [↑](#footnote-ref-6)
6. According to Fitch Ratings, ‘there have been 14 separate default events since 2020, across nine different sovereigns, a marked increase compared with 19 defaults across 13 different countries between 2000 and 2019..’ see Fitch, Sovereign Defaults Are at Record High’ (29 March, 2023) [Sovereign Defaults at Record High](https://www.fitchratings.com/research/sovereigns/sovereign-defaults-at-record-high-29-03-2023) (accessed 13 May 2023). [↑](#footnote-ref-7)
7. These two countries also play a crucial role in financing development projects and providing economic support to Global South countries through concessional loans. [↑](#footnote-ref-8)
8. Dolzer, Kriebaum and Schreuer, *supra* note 1 and Salacuse, *supra* note 1. [↑](#footnote-ref-9)
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16. Julian Schumacher, *Sovereign Debt Litigation in Argentina: Implications of the Pari Passu Default* 1 (1) Journal of Financial Regulation 143 – 148 (2015), Giselle Datz and Katharine Corcoran, *Deviant Debt: Reputation, Litigation, and Outlier Effects in Argentina’s Debt Restructuring Saga* 25 (2) NEW POLITICAL ECONOMY 300 – 313(2020); Mark C Weidemaier and Anna Gelpern *Injunctions in Sovereign Debt Litigation* 31 Yale Journal on Regulation 189 (2014), Benjamin Hebert and Jesse Schreger The *Costs of Sovereign Default: Evidence from Argentina* 107 AMERICAN ECONOMIC REVIEW (2017). [↑](#footnote-ref-17)
17. For more details of Argentina’s settlement of the 14-year-long legal battle with holdout creditors, see Alexandra Stevenson, How Argentina Settled a Billion-Dollar Debt Dispute With Hedge Funds, NEW YORK TIMES (25 April 2016) <https://www.nytimes.com/2016/04/25/business/dealbook/how-argentina-settled-a-billion-dollar-debt-dispute-with-hedge-funds.html> accessed 15 May 2023. [↑](#footnote-ref-18)
18. See Abaclat v. Argentina, Ambiente Ufficio v. Argentina and Giovanni Alemanni v. Argentina. [↑](#footnote-ref-19)
19. The Tribunal declined to apply the Salini test to resolve the problem of the applicability *ratione materiae* of the ICISD Convention, justifying its refusal on the basis that if the bondholders' contributions were to fail the Salini test, they would be deprived of the procedural protections afforded by the ICSID Convention. [↑](#footnote-ref-20)
20. Abaclat Paragraph 42. In light of the above, Pietro Ortolani questions whether sovereign debt instruments qualify as investments for the purposes of Article 25 of ICSID. He believes that the notion of 'investment' currently enshrined in international investment law is overbroad and should be re-modulated.' [↑](#footnote-ref-21)
21. Dissenting opinion, Professor Georges Abi-Saab. Paragraph 2(a). [↑](#footnote-ref-22)
22. Abaclat Paragraphs 71-72. [↑](#footnote-ref-23)
23. Jonathan I Blackman and Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna* 73 (4) LAW AND CONTEMPORARY PROBLEMS 47, 49 (2010). Vulture funds are hedge funds or other investment funds that buy the debt of poor countries at a discount, often from other creditors who have lost patience with the debtor country's inability to pay. The vulture fund then sues the debtor country for the full amount of the debt, plus interest and penalties, using the ISDS mechanism if available. This can lead to the debtor country being forced to pay much more than it would have if it had negotiated a settlement with the original creditor. Vulture funds have been widely criticized for their practices, which are seen as exploiting the debt problems of poor countries for profit. [↑](#footnote-ref-24)
24. Paragraph 91 *Poštová.* [↑](#footnote-ref-25)
25. See Paragraph 278 *Poštová* Award. [↑](#footnote-ref-26)
26. See Paragraph 324 *Poštová* Award. see also Laurie Achtouk-Spivak and Paul Barker, *Landmark Sovereign Debt Restructuring Award* OPINIOJURIS 30 April 2015. [↑](#footnote-ref-27)
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30. See <https://ustr.gov/issue-areas/services-investment-digital-trade/services/free-trade-agreements> [↑](#footnote-ref-31)
31. David Gaukrodger and Kathryn Gordon (2012). *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*. OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT (02), 1–60 (2012). [↑](#footnote-ref-32)
32. Robert Howse T*he Concept of Odious Debt in Public International Law*. United Nations Conference on Trade and Development Discussion Papers, No 185, 1–38 (2007). [↑](#footnote-ref-33)
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34. Waibel, *supra*, note 11. [↑](#footnote-ref-35)
35. US-Colombia FTA

<https://ustr.gov/sites/default/files/uploads/agreements/fta/colombia/asset_upload_file630_10143.pdf> accessed 15 May 2023. [↑](#footnote-ref-36)
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37. Gallagher, *supra* note 26. [↑](#footnote-ref-38)
38. See Annex 10-B of the Investment Chapter of the Chile-US FTA which states that: *The rescheduling of the debts of Chile, or of its appropriate institutions owned or controlled through ownership interests by Chile, owed to the United States and the rescheduling of its debts owed to creditors in general are not subject to any provision of Section A other than Articles 10.2 (NT) and 10.3 (MFN).* [↑](#footnote-ref-39)
39. See Annex 10-A of the Investment Chapter of the CAFTA-DR which states that: The rescheduling of the debts of a Central American Party or the Dominican Republic, or of such Party’s institutions owned or controlled through ownership interests by such Party, owed to the United States and the rescheduling of any of such Party’s debts owed to creditors in general are not subject to any provision of Section A other than Articles 10.3 (NT) and 10.4 (MFN). [↑](#footnote-ref-40)
40. Id. [↑](#footnote-ref-41)
41. See Senate Executive Report 109-17, which describes the objections raised by Uruguay and its insistence on the inclusion of Annex G, which was consider a departure or at least an exception to the 2004 US Model BIT. <https://www.govinfo.gov/content/pkg/CRPT-109erpt17/html/CRPT-109erpt17.htm> [↑](#footnote-ref-42)
42. See Annex G [↑](#footnote-ref-43)
43. Under Article 10:28 of the US-Peru TPA, negotiated restructuring means the restructuring or rescheduling of a debt instrument that has been effected through (i) a modification or amendment of such debt instrument, as provided for under its terms, or (ii) a comprehensive debt exchange or other similar process in which the holders of no less than 75 percent of the aggregate principal amount of the outstanding debt under such debt instrument have consented to such debt exchange or other processes. [↑](#footnote-ref-44)
44. Id. [↑](#footnote-ref-45)
45. Giuseppe Bianco, European Union’s Investment Agreements and Public Debt. 28(2) European Business Law Review 119 – 133 (2017). [↑](#footnote-ref-46)
46. Giuseppe Bianco, *The European Union, Sovereign Debt Crises and Investment Agreements*. 28 (2) European Business Law Review (2017). [↑](#footnote-ref-47)
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48. Matthias Goldmann, *Foreign Investment, Sovereign Debt, and Human Rights* (August 24, 2018). In Ilias Bantekas and Cephas Lumina (eds.), SOVEREIGN DEBT AND HUMAN RIGHTS, (Oxford University Press 2018). [↑](#footnote-ref-49)
49. Specifically, Article 17.6.3 of the USMCA states that a Party may adopt or maintain non-discriminatory measures that are designed and applied to ensure the equitable treatment of creditors in the context of a sovereign debt restructuring and that such measures shall not be considered a breach of the investment-related obligations of the agreement. [↑](#footnote-ref-50)
50. CETA provides for the adoption of non-discriminatory measures to ensure the equitable treatment of creditors in the context of a sovereign debt restructuring. Article 13.7 of the CETA states that such measures shall not be considered a breach of the investment-related obligations of the agreement. [↑](#footnote-ref-51)
51. Park and Samples, *supra* note 2. [↑](#footnote-ref-52)
52. See ‘Senator Warren, Representative Doggett Call for Elimination of Investor-State Dispute Settlement System, Action on Behalf of Honduran Government’, May 03 2023 <https://www.warren.senate.gov/oversight/letters/senator-warren-representative-doggett-call-for-elimination-of-investor-state-dispute-settlement-system-action-on-behalf-of-honduran-government> accessed 11 May 2023. [↑](#footnote-ref-53)
53. See Mavluda Sattorova, Mustafa Erkan, Ohiocheoya Omiunu, ‘How Do Host States Respond to Investment Treaty Law? Some Empirical Observations’ in John D. Haskell and Akbar Rasulov (eds) New Voices and New Perspectives in International Economic Law, European Journal of International Economic Law [↑](#footnote-ref-54)
54. Ibid. [↑](#footnote-ref-55)
55. ibid. See also Honduras Próspera Inc., St. John’s Bay Development Company LLC, and Próspera Arbitration Center LLC v. Republic of Honduras, ICSID Case No. ARB/23/2 [↑](#footnote-ref-56)
56. Ibid. [↑](#footnote-ref-57)