

Research Article

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Collective Action Clauses in Sovereign Bond Contracts and Investment Treaty Arbitration – An Approach to Reconcile the Irreconcilable

Abstract: Among various attempts to achieve swift and orderly sovereign debt restructuring (“SDR”), the approach to include collective action clauses (“CACs”) in bond contracts has been widely adopted. CACs are expected to reduce the holdout litigation risk as they allow a specified supermajority of creditors to impose changes to the restructuring terms on holdout creditors. Meanwhile, SDR faces a new challenge in the sphere of the law on foreign investment: recent investment arbitration tribunal decisions on SDR opened the gate to investment treaty arbitration for holdout creditors. Investment arbitration has potential to surpass the contractual restrictions set by CACs and therefore undermine the primary purpose of CACs to reduce the risk of holdout litigation. This may cause delay in the SDR process, which is not in the best interest of either the creditors or the debtor state’s economic recovery. The protection of foreign investments should be, therefore, balanced against the need for a swift SDR. Against this background, this article argues that a way to achieve the balance is to set limits on the use of investment treaty arbitration by holdout creditors, and defaults and restructurings of international bonds and/or the implementation of CACs should be excluded from the scope of investment treaty arbitration. This is because while liabilities under investment treaties arise from the exercise of sovereign power of the host state, such acts do not constitute acts of a sovereign with respect to the bondholders but remain in the realm of commercial transactions. To demonstrate this, this article first examines the distinction between *acta jure gestionis* and *acta jure imperii*, which has been developed in the context of the doctrine of restrictive state immunity, and finds that issuance and default of international sovereign debts have been treated as commercial activities by English and US courts, the two major dispute settlement forums for disputes arising from international sovereign bonds. Bearing in mind the difference between (a) the question these courts face (i.e. whether they have jurisdiction over contractual claims) and (b) the question before investment treaty arbitration (i.e. whether there are treaty claims to be protected by investment treaties), this article then argues that investment arbitration tribunals should reach the same conclusion as to the nature of the host state’s acts concerning international sovereign

bonds/implementation of CACs. The criterion to delimit the boundaries is therefore as follows: the protection under investment treaties should not be extended to situations where the creditors' rights are not subject to the exercise of the sovereign power of the debtor state, and where the relevant acts in the SDR process are the good faith implementation of CACs included in the original bond terms. It is hoped that the theory proposed by this article helps both SDR and the investment treaty regime to operate in harmony, without compromising each other's interests.

Keywords: law on foreign investment, sovereign debt restructuring, law on state immunity

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1 Introduction

1.1 A brief history of the modern SDR

Sovereign debt¹ restructurings ("SDR") have undergone significant changes in the long history of the sovereign debt crisis.² The modern SDR is rooted in the

1 In this article, sovereign debt refers to both public and public-guaranteed debt.

2 See generally Sturzenegger and Zettelmeyer (2007, Chapter 1).

Bretton Woods Conference, which initiated the International Monetary Fund (“IMF”),³ although current SDRs differ dramatically from those at that time. The Paris Club provided the framework for restructuring external bilateral sovereign debt, when sovereign debt of a state was owned by other governments.⁴ The rapid growth of private lending to developing countries in the late 1970s resulted in the emergence of a negotiating procedure for the restructuring of commercial bank debt called the London Club process.⁵ Although the London Club process required unanimity to conclude a deal, i.e. changes to negotiated payment terms, it is observed that in the 1970s “[c]ases of holdout litigation against the debtors were very rare”.⁶ This changed in the 1980s, however. For example, in *Allied Bank International v. Banco Credito Agricola de Cartago*, the U. S. Court of Appeals held that as a matter of interpretation of United States policy, in SDR procedure, “while parties may agree to renegotiate conditions of payment, the underlying obligations to pay nevertheless remain valid and enforceable”.⁷ The court thus confirmed the possibility that a minority of creditors might “hold out”.⁸ Moreover, a major policy shift into the nature of sovereign debt was introduced in 1989, by the so-called Brady Plan.⁹ The essence of this plan includes the exchange of outstanding bank loans into sovereign bonds as tradable instruments. The most significant impact of this policy shift is that it brought changes to the creditor structure. As bonds can be sold to retail investors, they may be held by a dispersed group of creditors.¹⁰ For the restructuring of sovereign bonds, a bond exchange is used, the success of which depends on the participation rate by bondholders.

3 Articles of Agreement of the IMF provide that one of the purposes of the IMF was “[t]o promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation” – Article I(iii). Available at: <http://www.imf.org/external/pubs/ft/aa/#art1>

4 The Paris Club, which emerged in 1956, is an informal group of creditors and provides an *ad hoc* negotiation forum. It consists of governments of the largest world economies, plus additional creditor governments that are invited to participate in the negotiations on a case by case basis. Das, Papaioannou, and Trebesch (2012).

5 The process is led by the Bank Advisory Committee, a group of representative banks which negotiate on behalf of all banks affected by the restructuring.

6 Sturzenegger and Zettelmeyer (2007, p. 13).

7 *Allied Bank International v Banco Credito Agricola de Cartago*, 757 F.2d 516 (1985)

8 Rogoff and Zettelmeyer (2002, p. 475).

9 This plan was announced by U.S. Treasury secretary Nicholas Brady and widely supported by the IMF and the World Bank.

10 For example, Argentina’s 2005 SDR, which is the object of examination in this Article, involved 600,000 estimated retail investors. Das et al. (2012, p. 21).

1.2 Widespread adoption of CACs

In the course of these changes to the structure and nature of SDR, various proposals have been made to achieve swift and orderly SDR.¹¹ Of these, the two major proposals are the “statutory proposals”, aimed at the creation of sovereign bankruptcy mechanisms; and the “contractual approach”, which attempts to address sovereign debt problems by improving the terms of individual bonds.¹² The former has not seen the light of day – the “Sovereign Debt Restructuring Mechanism” (“SDRM”) proposed by IMF management and staff in 2002 failed to obtain political support and has not yet been launched. In its place, the contractual approach, which does not require statutory reform, has been widely adopted.¹³ One of the innovations of the contractual approach is the inclusion of collective action clauses (“CACs”) in bond contracts.¹⁴ While the inclusion of CACs addresses narrower scope of problems than the statutory approach,¹⁵ it does address the issue shared by all the proposals to improve the SDR process – the “concern with a creditor collective action problem in some form”.¹⁶ That is, CACs allow a specified supermajority of creditors to impose changes to the restructuring terms on a dissenting minority, or holdout creditors. Sovereign bonds issued under English law, New York law¹⁷ and Japanese law¹⁸ generally include CACs.¹⁹ By contrast, most sovereign bonds of EU countries

11 These proposals include, for example, the use of Article VIII(2) of the IMF Articles to extend legal protections to debtor countries declaring a unilateral payments moratorium and the creation, of a new “International Debt Restructuring Agency”. See Debevoise (1984–1985, p. 157); Rogoff and Zettelmeyer (2002).

12 Rogoff and Zettelmeyer (2002, p. 495).

13 See Krueger (2002); Das et al. (2012, pp. 274–275).

14 Other techniques include an “exit consent” clause, by which holders of bonds in default grant their consent to amend certain non-payment terms of the bonds that are being exchanged. This makes the defaulted bonds subject to the exchange offer less attractive and forces a number of bondholders to accept the exchange offer. See Das et al. (2012).

15 Sturzenegger and Zettelmeyer argue that the sovereign bankruptcy mechanisms “would have to deal not just with the holdout problem, but legitimize payments moratoria, and most likely other measures, such as capital controls...” (2007, p. 276).

16 Rogoff and Zettelmeyer (2002, p. 495).

17 Following the proposal by the Under Secretary of the Treasury John Taylor, since 2003 “the inclusion of CACs in New York bonds has become the norm” (Das et al. 2012). In *NML Capital Ltd v The Republic of Argentina* (26 October 2012), the United States Court of Appeals for the 2nd circuit noted that 206 out of 211 New York law governed sovereign bond issues made between 2005 and 2010 included CACs (at 27). See also Quarles (2010, p. 29); Gallagher (2011).

18 Liu (2002, p. 6).

19 According to the IMF, “[i]n 2005, more than 95 percent of new issues, in value, included CACs” (IMF Global Financial Stability Report, April 2006).

(other than international bonds under English law) had not included CACs until recently. However, in November 2010, the Eurogroup announced a proposal to require the inclusion of CACs for all euro-zone sovereign debt securities issued after June 2013 (later accelerated to January 2013).²⁰ On 18 November 2011, the Economic and Financial Committee (“EFC”) agreed upon standardized and identical CACs (“standardized CACs”).²¹ According to the standardized CACs, “the terms and conditions of the Bonds or of any agreement governing the issuance or administration of the Bonds” may be modified by a supermajority (for reserved matters) or a simple majority (for non-reserved matters), and “[a]ny conversion or exchange undertaken to implement a duly approved modification will be binding on all Bondholders”.²² It follows that, where the terms are modified by the exercise of CACs, holdout creditors may not invoke the original bond terms for their portion of the claims. CACs are thus expected to reduce the litigation risk from, and other disruptive influence of, holdout creditors.²³ In the current situation, where statutory reform is not likely to be forthcoming, the contractual approach, especially with CACs, is widely accepted as the best feasible option at this juncture, as indicated by the nearly universal adoption of CACs by the major economies.

1.3 ‘Holdout’ investment treaty arbitration

Meanwhile, SDR faces a new challenge in the sphere of the law on foreign investment that bears on the claims of holdout creditors. Following Argentina’s default on its foreign debt in late 2001, a number of Italian holders of the defaulted bonds filed claims against Argentina under the Argentina/Italy bilateral investment treaty (“BIT”). Three investment arbitration tribunals were constituted under the International Centre for Settlement of Investment Disputes (“ICSID”) to

20 See: the website of the Economic and Finance Committee of the EU (http://europa.eu/efc/sub_committee/cac/index_en.htm); Das et al. (2012). This obligation is stipulated in paragraph 3 of Article 12 of the Treaty Establishing the European Stability Mechanism (Article 12(3): “3. Collective action clauses shall be included, as of 1 January 2013, in all new euro area government securities, with maturity above one year, in a way which ensures that their legal impact is identical”). The treaty entered into force on 27 September 2012 (for Estonia 3 October 2012).

21 Available at: http://europa.eu/efc/sub_committee/pdf/cac_-text_model_cac.pdf.

22 Article 2.10. Also, a resolution by the requisite majority of bondholders “will be binding on all Bondholders, whether or not the holder was present at the meeting, voted for or against the resolution or signed the written resolution” (Article 4.12).

23 IMF Policy Development and Review, International Capital Markets and Legal Departments, “Collective Action Clauses in Sovereign Bond Contracts – Encouraging Greater Use” available at: <http://www.imf.org/external/np/psi/2002/eng/060602a.pdf>

hear such claims,²⁴ two of which issued decisions on jurisdiction and admissibility in 2011 (*Abaclat v. Argentina*) and 2013 (*Ambiente v. Argentina*). In both of these cases, the sovereign bonds in question had been issued in international markets under laws other than that of Argentina such as New York law, and the claimants bought these bonds through secondary market transactions. The common characteristic of these cases is that they were multi-party proceedings in which the interests of the claimants were represented by a representative (*l'Associazione per la Tutela degli Investitori in Titoli Argentini* (“TFA”)²⁵ for the *Abaclat* case, and *North Atlantic Société d'Administration* (“NASAM”)²⁶ for the *Ambiente* case). While the claimants' bonds were governed by different laws and subject to jurisdiction of the court of different countries, they all had common features: the claimants were (allegedly) Italian nationals; and there was a BIT between Argentina and Italy. Thus, multi-party proceedings were possible (insofar as the tribunal found it to be permissible under the ICSID Convention), if the Claimants invoked claims under the BIT.²⁷ This might explain why they had recourse to investment treaty arbitration – investment treaty arbitration was a “handy” forum for the TFA and NASAM, which represent holdout creditors, because it could encompass all of their claims regardless of the difference in bond terms.

For the first time in the history of investment arbitration, the gate was opened for holdout creditors of international sovereign bonds in both tribunals, by their concluding that the general prerequisites for jurisdiction had been met and that the claims were admissible. However, both decisions are accompanied by strong dissenting opinions by Professor Abi-Saab (*Abaclat*) and Judge Bernárdez (*Ambiente*), an indication of the controversial nature of these decisions.

²⁴ *Abaclat and others v. Argentina*, ICSID Case No. ARB/07/5; *Ambiente Ufficio and others v. Argentina*, ICSID Case No. ARB/08/9; and *Giovanni Alemanni and others v. Argentina*, ICSID Case No. ARB/07/8 (registered on 27 March 2007).

²⁵ TFA consists of Italian major banks and the aim of its establishment was to “represent the interests of the Italian bondholders in pursuing a negotiated settlement with Argentina” (*Abaclat and Others v. Argentina*, Decision on Jurisdiction and Admissibility of 4 August 2011) (“the *Abaclat* Decision” para. 61). It formed, together with other organisations, the Global Committee of Argentine Bondholders as an informal negotiating body for the Argentina’s SDR in 2005.

²⁶ NASAM is a company established in Monaco and then acquired by a Swiss-based trust company. It decided to coordinate, organize and fund a legal action of holders of Argentine bonds against Argentina in 2006 (*Ambiente and others v. Argentina*, Decision on Jurisdiction and Admissibility of 8 February 2013 (“the *Ambiente* Decision” para. 274). Unlike TFA, NASAM was not involved in the placing of Argentine bonds with any investors (*Ibid.* paras. 275–276).

²⁷ The availability of such multiple proceedings under the ICSID Convention and the existence of the claimants' consent to arbitration in these cases were highly controversial. See Dissenting opinion of Abi-Saab in *Abaclat* (“Abi-Saab Dissenting Opinion”); Dissenting opinion of Bernárdez in *Ambiente* (“Bernárdez Dissenting Opinion”); and de Luca (2011).

As will be examined below (Section 4), the use of investment treaty arbitration in the *Abaclat* and *Ambiente* cases is neither supported by the Argentina-Italy BIT nor consistent with the object and purpose of investment treaties. More importantly, the *approach* adopted by these tribunals has the effect of undermining the primary purpose of CACs, i.e. to facilitate the SDR process by reducing the risk of holdout litigation (see Section 3.1). This article addresses the potentially disruptive effect of the expansive use of investment arbitration in the SDR process. The underlying theory is that a swift and orderly SDR also serves the purpose of investment treaties to enhance the economic development of states and therefore the investment treaty regime should respect the need to conduct the SDR process in an orderly and efficient manner. In other words, while investment treaties provide protection of foreign investment that goes beyond contractual protection, such protection must be balanced against the need for sovereign debt renegotiation.

1.4 Structure of this article

Against this background, this article examines the limits on the use of investment treaty arbitration in the context of SDR. A summary of the *Abaclat* and *Ambiente* decisions is presented first (Section 2), followed by a section demonstrating that, while the bonds at issue in these cases did not include CACs, the *reasoning* adopted by the majority of these tribunals has the effect of neutralizing the function of CACs (Section 3). Having thus demonstrated that these tribunals' approach may lead to a protracted sovereign debt crisis, the discussion then examines the negative impact of the delay in the SDR process on both the creditors and the debtor state. Having demonstrated the problems caused by an excessive/improper use of investment arbitration in this context, Section 4 proceeds to examine how the limits on such use should be determined, focusing on the nature of the debtor state's acts in the SDR process. The essence of the argument is as follows. While liabilities under most investment protection obligations arise from the exercise of sovereign power of the host state, defaults and renegotiations of international bonds and/or the implementation of CACs do not constitute acts of a sovereign, but rather, commercial activities. Such acts therefore are incapable of constituting a violation of the treaty obligations. Accordingly, in light of the *prima facie* standard for jurisdiction, disputes arising out of such acts lack jurisdiction *ratione materiae*, i.e. subject matter jurisdiction, in most cases. This article concludes by arguing that the clear recognition of/respect for the limits of investment treaty arbitration in this context helps both SDR and the investment treaty regime to operate in harmony, without compromising each other's interests.

2 *Abaclat v. Argentina* and *Ambiente v. Argentina* decisions

2.1 *Abaclat* and others *v. Argentina*

This case stems from Argentina's default over US \$100 billion of international bond in December 2001. From 1991 to 2001, Argentina issued 179 sovereign bonds in international capital markets, 173 of which were denominated in foreign currency. The claimants are (allegedly) holders of 83 of the 173 foreign currency bonds.²⁸ In 2005, Argentina launched the first exchange offer ("Exchange Offer 2005").²⁹ In the same year, it enacted Law 26,017 ("Emergency Law") which provides, *inter alia*:

...with regard to those bonds which were eligible for but were not exchanged in the Exchange Offer 2005 (i) the Executive Branch of the government shall not reopen the exchange process; and (ii) the national government is prohibited from entering into any juridical, extra-juridical or private transaction.³⁰

In the United States, a number of court actions were initiated by creditors who were unsatisfied with the terms and conditions of Exchange Offer 2005. According to Argentina, in two of these actions, many of the plaintiffs were the claimants to the *Abaclat* arbitration.³¹ In 2006, a U.S. law firm filed a Request for Arbitration with ICSID on behalf of over 180,000 Italian bondholders.³² Subsequently, a considerable number of the claimants tendered into the second exchange offer made in 2010 ("Exchange Offer 2010") and withdrew from arbitration. As a result, on the date of the Decision on Jurisdiction and Admissibility, the number of remaining claimants was approximately 60,000.

Argentina contested the tribunal's jurisdiction on various grounds. For the purposes of this article, the most pertinent is that the claims are not treaty claims, but rather, contract claims "for which the relevant contractual

²⁸ The *Abaclat* Decision (note 25), paras. 50–51.

²⁹ The second exchange offer was made in 2010. The two exchange offers resulted in the restructuring of 92% of the bonds that were targeted in the exchange offers.

³⁰ The *Abaclat* Decision (note 25), para. 78.

³¹ The *Abaclat* Decision (note 25), para. 82.

³² The two court proceedings were stayed by the New York District Court in favour of the pending ICSID proceeding (*Ibid.*).

instruments provide non-Argentine legal rights and remedies that could not be and were not affected by any act of Respondent”.³³

On 4 August 2011, the tribunal issued its decision on jurisdiction and admissibility, in which the majority concluded that, while leaving the examination of jurisdictional issues in relation to individual claimants to the merits phase, the general prerequisites for the jurisdiction of ICSID tribunals had been met, and the claims were admissible.

The majority rejected Argentina’s objection that the claims may not be considered as treaty claims, stating that the facts alleged by the claimants, if established, were “susceptible of constituting a possible violation of at least some of the provisions of the BIT invoked by the claimants”.³⁴ Likewise, the majority rejected Argentina’s argument that the claims were purely contractual, stating that the promulgation of the Emergency Law entitling it not to perform part of the obligations under the bonds:

...derives from Argentina’s exercise of sovereign power. Thus, what Argentina did, it did based on its sovereign power; it is neither based on nor does it derive from any contractual argument or mechanism.³⁵

The majority thus concluded that, as a *prima facie* case, the claims presented in the case were treaty claims based on acts of a sovereign.³⁶

2.2 Ambiente and others v. Argentina

In February 2013, another ICSID tribunal issued the decision on jurisdiction and admissibility on the case stemming from Argentina’s sovereign debt default in 2001. The facts³⁷ and arguments presented by Argentina before the *Ambiente* tribunal³⁸ were very similar to those of the *Abaclat* case, except

33 para. 234. Other grounds for objection include: neither the ICSID Convention nor the Argentina-Italy BIT would permit a “collective claim” and it has not consented to such a proceeding; the claimants’ purported consent is invalid; and the claimants are not “investors” under the BIT as they have not satisfied the nationality requirements of the BIT.

34 para. 314. The tribunal referred to the fair and equitable treatment, expropriation and national treatment provisions.

35 para. 323.

36 paras. 316–326.

37 para. 61: “...this succinct description of the factual background in the *Abaclat* Decision can also be usefully applied regarding the present case.”

38 para. 11: “the Respondent used to a large extent the same or similar arguments to those it put forward in the present case...”

that the number of the claimants was substantially smaller in *Ambiente* than in *Abaclat*.³⁹

In its decision on jurisdiction and admissibility, the *Ambiente* tribunal reached the same conclusion as the *Abaclat* tribunal. With respect to the issue of whether or not the claims constituted treaty claims, the tribunal provided a more detailed analysis than its “sister tribunal”⁴⁰ had in the earlier case. In *Ambiente*, Argentina argued that it acted not in the exercise of its sovereign authority, but merely as a commercial party, on the grounds, *inter alia*, that: (a) it was impossible for it to exercise sovereign authority in regard to the claimants’ security entitlements that were governed by foreign law and beyond the scope of Argentina’s legislative jurisdiction and (b) non-payment in itself was no violation of international law and therefore may not constitute a basis for treaty claims.⁴¹

The tribunal first rejected the latter argument, stating that:

...it was not so much the failure to pay, but the use of the Respondent’s sovereign prerogatives when restructuring its debt ... which qualify the Respondent’s acts as potential breaches of the Argentina-Italy BIT and thus as treaty claims.⁴²

The tribunal also rejected the former argument:

[I]nsofar as the Respondent seeks to conclude from the existence of such choice of law and forum selection clauses that those instruments were, by definition, beyond the scope of Argentina’s legislative jurisdiction, the present Tribunal cannot follow this reasoning. While the Respondent could obviously not alter the terms of legal rights and obligations as arising from different laws and jurisdictions, it could nonetheless influence those bonds/security entitlements within the reach of the Respondent’s (notably territorial) jurisdiction, for instance by legally forbidding the executive authorities to enter into any settlement of the claims in question or by ordering the domestic judicial authorities, should an “old” bond come before them, to replace *ipso jure* the old bonds by the newly issued bond instruments.⁴³

The tribunal, applying the *prima facie* test for jurisdictional purposes,⁴⁴ therefore concluded that Argentina’s acts “can plausibly be understood as having

39 Following certain claimants’ acceptance of the Exchange Offer 2010, the number of remaining claimants was 90, as of the date of the decision (the *Ambiente* Decision (note 26) paras. 336–347).

40 The *Ambiente* tribunal called the *Abaclat* tribunal its “sister tribunal” (the *Ambiente* Decision (note 26) para. 12).

41 paras. 523, 525.

42 para. 543.

43 para. 547.

44 In investment treaty arbitration, the *prima facie* test is widely recognised as the standard that, at the jurisdictional phase, the tribunal needs only to evaluate “whether the facts alleged may be capable, if proved, of constituting breaches of the BIT” (*Noble Energy Inc. and MachalaPower Cia Ltd. v Ecuador and Consejo Nacional de Electricidad*, ICSID Case No. ARB/05/12, Decision on Jurisdiction, 5 March 2008, para. 153).

unilaterally altered the contractual equilibrium and having transcended the realm of purely non-sovereign action”, which may be capable, if proved, of constituting breaches of the BIT.⁴⁵

3 Policy implications of the *Abaclat* and *Ambiente* decisions

The sovereign bonds at issue in the *Abaclat* and *Ambiente* cases did not include CACs. However, the tribunals’ approach to the issue of whether or not the claims constituted treaty claims suggests that even if these bonds had included CACs, the tribunals would have reached the same conclusion. The following section demonstrates this point.

3.1 The potential effect of the *Abaclat* and *Ambiente* approaches on CACs: treaty claims vs. contract claims

In investment treaty arbitration, it is well established that treaty claims may arise from a contractual relationship between foreign investors and the host state, independently of the existence of a breach of the contract. The tribunal in *Vivendi v. Argentina II* stated that:

Articles 3 (fair and equitable treatment) and 5 (expropriation) of the BIT do not relate to breach of a municipal contract. Rather, they set an independent standard. A state may breach a treaty without breaching a contract; it may also breach a treaty at the same time it breaches a contract.⁴⁶

This distinction between a contract claim and a treaty claim has been accepted by a number of tribunals.⁴⁷ Treaty claims do not arise if the investor’s claim is based solely on the alleged breach of the contract by the host state. The *Abaclat* tribunal itself stated that “[a] claim is to be considered a pure contract claim

⁴⁵ paras. 548–549.

⁴⁶ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina*, ICSID Case No. ARB/97/3, Award of 20 August 2007, para. 7.3.10.

⁴⁷ See e.g. *Enron Creditors Recovery Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction (Ancillary Claim) of 2 August 2004, paras. 48–50; *Camuzzi International S.A. v. Argentina [I]*, ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction of 11 May 2005, paras. 83–90; *Helnan International Hotels A/S v. Egypt*, ICSID Case No. ARB/05/19, Award of 3 July 2008, paras. 102–104.

where the Host State, party to a specific contract, breaches obligations arising by the sole virtue of such contract”.⁴⁸

The only exception to this is the so-called umbrella clause, which requires a host state to respect any obligation assumed by it with regard to a specific investment. It is largely accepted that a broadly drafted umbrella clause “elevates” a breach of contracts, including commercial contracts, to the level of a treaty breach.⁴⁹ Applying this to the SDR process, however, in situations where the relevant bond includes CACs and a supermajority agrees to accept the restructuring plan, this “treaty claim” will also be barred. This is because, in such cases the modification of the terms and conditions of the bonds is legally binding on all creditors by the application of the CAC, and accordingly, holdout creditors may not raise contractual causes of action for full payment. In other words, insofar as the obligations under the contract are concerned, and the debtor state implements the CAC in good faith, it is highly unlikely that the debtor state’s “failure to pay” constitutes a violation of the umbrella clause. The United Nations Conference on Trade and Development (“UNCTAD”), in its report on the relationship between SDR and investment treaty arbitration, aptly observed that “it would appear that ... dissenting bondholders cannot succeed in their IIA (International Investment Agreement) claims, given that their contractual rights have been duly modified”.⁵⁰

Therefore, the *identification* of the host state’s acts relating to sovereign debt default and restructuring that form the basis of the investor’s claim is crucial. If the tribunal finds that the holdout creditors’ claims are based solely on the debtor state’s default and renegotiation of bond terms (1) there will be no basis of treaty claims apart from an umbrella clause claim and (2) the umbrella clause claim, even if invoked, will be barred by virtue of any successful implementation of CACs. Yet this is not what the *Abaclat* and *Ambiente* tribunals did. Both tribunals considered that Argentina’s acts that were alleged by the claimants to be violations of treaty claims were beyond Argentina’s default and

48 The *Abaclat* Decision (note 25) para. 318.

49 E.g. *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004, para. 126; *SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction of 12 February 2010, para. 168. It should however be noted that the tribunal in *El Paso Energy v. Argentina* took a different view, that “the umbrella clause in Article II of the BIT ... will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign – such as a stabilization clause – inserted in an investment agreement” (*El Paso Energy v. Argentina*, ICSID Case No. ARB/03/15, Decision on Jurisdiction of 27 April 2006, para. 81).

50 UNCTAD, *Sovereign Debt Restructuring and International Investment Agreements*.

renegotiation of bond terms.⁵¹ The *Abaclat* tribunal found that not only Argentina's failure to perform its payment obligations but also its intervention as a sovereign to "justify its failure" and to "modify its payment obligations towards its creditors", constituted potential breaches of the BIT.⁵² In particular, it stated that "[t]he arbitrary promulgation and implementation of regulations and laws can ... under certain circumstances, amount to an unfair and inequitable treatment".⁵³ The *Ambiente* tribunal went further, stating that "it was not so much the failure to pay, but the use of the Respondent's sovereign prerogatives when restructuring its debt ... which qualify the Respondent's acts as potential breaches of the Argentina-Italy BIT and thus as treaty claims".⁵⁴ Both tribunals therefore identified the enactment and implementation of regulations and laws such as Law 26,017 as acts that were independent of Argentina's conduct as a party to the bond contracts, thereby constituting potential breaches of treaty obligations. According to these tribunals' identification of the acts that gave rise to the claims, irrespective of the contractual position of the debtor state under the relevant bond, the state may still be found responsible for a breach of treaty obligations.⁵⁵ It follows that, even where the bond includes CACs and a supermajority agrees to accept the restructuring plan, holdout creditors, who are bound by such decision as a matter of contract law, may still be able to resort to investment treaty arbitration by claiming that the debtor state exercised its sovereign power in the SDR process and it amounts to a breach of treaty obligations. This approach therefore does leave treaty claims "untouched" by CACs.⁵⁶

Against this backdrop, the remainder of this section first examines how such an approach disrupts the SDR process. It then demonstrates the negative consequences of the delay in the process for the creditors and the debtor countries.

51 The *Abaclat* Decision (note 25) para. 313; the *Ambiente* Decision (note 26) para. 542.

52 The *Abaclat* Decision (note 25) paras. 320, 324.

53 The *Abaclat* Decision (note 25) para. 314.

54 The *Ambiente* Decision (note 26) para. 543.

55 The tribunals' *classification* of these acts as acts of a sovereign is misplaced, as will be examined in Section 4. Yet for the purpose of demonstrating the potential effect of the *Abaclat* and *Ambiente* tribunals' approach to CACs, what is crucial is the *identification* of the acts. The identification of the state's acts and the classification of the acts are separate matters; the former comes before the latter. Crawford (1985, p. 96): "it is essential to locate, to identify with precision, the act or series of acts giving rise to the particular claim, so that that particular act or series of acts can be classified".

56 Waibel (2007, p. 736).

3.2 Investment arbitration and the creditor coordination problem

As noted earlier, CACs are designed to address the creditor coordination problem of reaching agreement among creditors. In the process of sovereign bond restructuring, the borrowing country makes a “take-it-or-leave-it” offer to exchange the existing bonds for new ones with less favourable terms than the original bond terms.⁵⁷ Holdout risks arise in this phase – in particular, the risk manifests itself in the form of litigation initiated by holdout creditors “who oppose a settlement hoping to secure better terms for their portion of the claims at the expense of the rest of the creditor group (free riding)”.⁵⁸ It is observed that the “threat of being tied up for years in litigation ... might encourage sovereigns to pay holdouts, which will in turn encourage parties to hold out and make restructurings harder to achieve”.⁵⁹ The creditor coordination problem thus causes significant delay in the SDR process. To address this problem, CACs bar contractual causes of action by holdout creditors, thereby effectively reducing the risk of holdout litigations.

To be sure, it remains controversial whether or not CACs actually expedite the SDR process.⁶⁰ Still, the benefit of avoiding the holdout problem for debt renegotiations is clear. At the least, it eliminates an important factor that discourages intra-creditor strategic play that results in unfair/unequal treatment.⁶¹ The almost universal adoption of CACs for international sovereign

57 “Distressed debt exchanges” is defined as “restructurings at terms less favourable than the original bond or loan terms”. Das et al. (2012).

58 Tsatsaronis (1999). Wright also observes that “with the widespread adoption of collective action clauses in sovereign bond contracts making it possible, in principle, to impose common settlement terms on all holders of a given bond through a super-majority vote of bondholders, thus reducing the litigation risk from holdout creditors” (2011–2012, p. 112). In *NML Capital Ltd v Argentina* (note 17), the United States Court of Appeals for the 2nd circuit observed that due to the wide adoption of CACs, which “effectively eliminate the possibility of ‘holdout’ litigation”, in New York-law bonds, “it is highly unlikely that in the future sovereigns will find themselves in Argentina’s predicament” (at 27).

59 James (2012, p. 7).

60 Pitchford and Wright argue that CACs may increase delay by encouraging “free riding on negotiation costs” (2012a, p. 812). Shin et al. also argue that in a world of incomplete information, CACs may not resolve the bargaining inefficiency: “[u]ncertainty over payoffs creates incentives for strategic behaviour that market-based coordinating devices may need time to resolve” (2003). It is also argued that CACs without “aggregation clause” are insufficient for an SDR that involve multiple bond issuances, because “CACs only cover individual bond issues but have no effect on the holders of other issues” (Gallagher, 2011).

61 It is observed that CACs are particularly important when sovereign debts are traded in the secondary market. This is because “[w]ithout CACs, creditors are likely to use secondary markets to buy cheap debt and litigate for full repayment” (Lanau, 2011).

bonds (see Introduction) suggests that CACs are considered to be an effective means to achieve a swift and orderly SDR⁶² under current conditions, where a comprehensive regime for SDR does not exist. However, if investment arbitration by holdout creditors has potential to surpass the contractual restrictions set by CACs (as examined above), the creditor coordination problem continues to exist. Moreover, while the terms of the offer have to be more attractive than “the alternatives faced by creditors”⁶³ in order for the “take-it-or-leave-it” exchange offer to invite wide participation, investment arbitration offers a very attractive “alternative” to creditors. This is because investment arbitration awards, in particular ICSID arbitration awards, are more advantageous than municipal judgments in terms of enforcement. Enforcing a local court’s judgment against a state presents obstacles (as explained below). By contrast, there is a strong enforcement mechanism in the ICSID arbitration regime: Article 54 of the ICSID Convention provides that each contracting state must enforce the pecuniary obligations imposed by ICSID arbitration awards “within its territories as if it were a final judgment of a court in that State”.⁶⁴ Certainly, state immunity from execution of assets is preserved even under the ICSID Convention: Article 55 of the Convention provides that “[n]othing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution”. Yet in practice, the rate of compliance with ICSID awards is very high⁶⁵ – indeed, in the ICSID arbitration system “only a small number of awards have not been complied with”⁶⁶ (important exceptions are Russia and Argentina).⁶⁷ Thus, if holdout creditors may still resort to investment arbitration and obtain *full and practically enforceable* compensation, this will undoubtedly discourage creditors from participating in a restructuring offer. Creditors will not be willing to take a loss knowing that holdouts may receive full payments elsewhere.

62 E.g. Directorate General for Internal Policies Policy Department of the European Parliament (2011, p. 47): “(introducing a standardized CAC in bond contracts) would make any debt default or restructuring simpler and shorter”.

63 Sturzenegger and Zettelmeyer (2007, p. 14).

64 Article 54(1) of the ICSID Convention.

65 Reed, Paulsson, and Blackaby (2011, p. 186).

66 Fouret (2012, p. 327).

67 Bjorklund (2009, p. 303).

3.3 Consequences for the creditors and the debtor states

There is little doubt that defaults and debt restructuring are costly for both the creditors and the borrower,⁶⁸ and delays in the SDR process causes negative consequences. Benjamin and Wright examined haircuts for all countries that defaulted in the period 1980–2004 and concluded that longer delay is associated with “larger haircuts”.⁶⁹ Reinhart and Rogoff observe that “international debt reschedulings typically saddle investors with illiquid assets that may not pay off for decades”.⁷⁰ Tsatsaronis explains the costs incurred by creditors as a result of prolonged negotiations as follows:

Investors typically see the secondary market value of their claims plummet during the renegotiation period, with distressed securities specialists representing the sole source of liquidity in the market. The longer a bond spends in default, the lower its recovery rate.⁷¹

It is also observed that the harms caused to the creditors by a default are “made up by positive returns in normal times”.⁷² This indicates that returning debt to sustainable levels – allowing the debtor state to experience normal times – by accepting a workable debt deal, ultimately serves the interests of the creditors.⁷³ To be sure, the creditors’ conduct is shaped by different strategies. For example, Pitchford and Wright observe that, in an unstructured negotiation environment, a strategic motivation to “wait until others have settled, in an attempt to extract a larger settlement” arises. It should be noted, however, that the inclusion of CACs is “one policy response” to address the problem of an unstructured negotiation environment.⁷⁴

As to default costs to the debtor, Sturzenegger and Zettelmeyer identify categories of costs that have empirical support: loss of capital market access, adverse effects on international trade, borrowing costs and reputational spillovers.⁷⁵ First, when a country defaults on its debts, it is practically excluded

68 Sturzenegger and Zettelmeyer (2007, p. 49).

69 Benjamin & Wright (pp. 6–7). See also Ghosal, Miller, and Thampanishvong (2010).

70 Reinhart & Rogoff (p. 19).

71 Tsatsaronis (1999, p. 22).

72 Sturzenegger and Zettelmeyer (2007, p. 23).

73 Sturzenegger and Zettelmeyer (2007, p. 18).

74 Pitchford and Wright (2012b). It should be noted, however, that they also argue that CACs actually introduce another strategic motivation of creditors that causes significant delay in the SDR process: a free-rider motivation. Though the detailed examination of this argument is outside the scope of this article, for the purpose of this article, it suffices to demonstrate that given the status quo of the current SDR regime, the contractual approach is the only widely accepted and feasible way to achieve an SDR in an orderly and timely manner.

75 Pitchford and Wright (2012b, pp. 49–51).

from the market until it reaches a satisfactory arrangement in negotiation with the creditors of such debts.⁷⁶ Secondly, a country in default will be “forced to conduct its trade in roundabout ways to avoid seizure”.⁷⁷ The same will apply to foreign direct investments, which are by nature transnational. Lenders may cut off the country’s access to trade credit during the period of default.⁷⁸ Thirdly, it is very difficult and expensive for the country to obtain new loans if there remains the possibility that its credit capacity is materially affected by claims by holdout creditors.⁷⁹ Lastly, the loss of confidence in the debtor state caused by a default will lead to capital flight and a large reversal of inflows.⁸⁰ Protracted SDR process thus prevents the country in default from resolving its financial crisis and restore financial, economic and political stability that were undermined by sovereign debt crisis.

4 How to delimit the boundaries for investment treaty arbitration

The need to limit the use of investment treaty arbitration in this context has been recognised. One approach to set outer jurisdictional limits is to focus on the definition of an “investment” under Article 25(1) of the ICSID Convention, which sets out the conditions for ICSID jurisdiction. Indeed, the issue of whether or not the contractual entitlements of the claimants qualify as “an investment” under Article 25(1) ICSID Convention was extensively discussed in both the *Abaclat* and *Ambiente* decisions. Waibel, as well as arbitrators Abi-Saab and Bernárdez (in their dissenting opinions in *Abaclat* and *Ambiente*) argue that sovereign bonds do not qualify as investments under Article 25(1) and therefore disputes arising from sovereign bond defaults are excluded from the scope of ICSID arbitration. A detailed examination of this approach is outside the scope of this article, but the reasons for excluding sovereign bonds from the scope of Article 25(1) include: capital for the purchase of sovereign debt instruments “might not be committed

76 The capital market exclusion story includes the rule adopted by London Stock Exchange in 1876, which prevented the listing of new bond issues by sovereign countries that were in default and had not reached a settlement with its creditors. It is also observed that “Argentina has not raised money on the international bond markets since its 2001 default” (James, 2012). See also Sturzenegger and Zettelmeyer (2007, p. 50).

77 Bulow and Rogoff (1989, p. 158).

78 Kohlscheen and O’Connell (2006).

79 Tsatsaronis (1999).

80 Sturzenegger and Zettelmeyer (2007, p. 51).

long enough to fall under Article 25”; debt instruments traded on secondary markets lack the territorial link; and they do not have any association with a commercial undertaking in the host state.⁸¹ While these arguments provide strong support for denying ICSID jurisdiction, they may not be applied to non-ICSID arbitration, especially where the relevant investment treaty explicitly includes sovereign bonds⁸² or contains a provision on government debt (thus making clear that government debt is included in the scope of the treaty).⁸³

This section proposes an alternative complementary way to set “jurisdictional” limits on both ICSID and non-ICSID arbitration. It focuses on the commercial nature of the acts of the state as a criterion for delimitation.

4.1 The commercial activities of the debtor state

This section first demonstrates that Argentina’s international sovereign bonds at issue in the *Abaclat* and *Ambiente* cases should be excluded from the scope of investment treaty protection at the jurisdictional phase for the following reasons. While most investment treaty obligations may be breached only by sovereign acts of the host state, default and restructuring of these *international* bonds do not constitute acts of a sovereign, and therefore are “*incapable of falling within*” most investment protection obligations. Accordingly, in light of the *prima facie* standard for jurisdiction, the claims lack jurisdiction *ratione materiae*. It then argues that even where domestic bonds are at issue, insofar as the debtor state implements the CACs contained in the relevant bonds in SDR, such acts of the state do not constitute the acts of a sovereign in relation to the bonds,

81 Waibel (2007, pp. 725–728; 2011, Chapter 10). *Abi-Saab* and *Bernárdez* argued that the claimants’ security entitlements were not qualified as investments under the Argentina-Italy BIT also, stating *inter alia* that while the BIT requires a territorial link between the alleged investment and the host country, the security entitlements at issue did not have such a link (*Bernárdez* Dissenting Opinion (note 27) paras. 75–87, 108; *Bernárdez* Dissenting Opinion (note 27) paras. 298–317). In this context, *Abi-Saab* argues that the claimants’ security entitlements in Argentinean bonds do not meet both legal and material requirements to establish such a link, because there were sold in international financial markets with choice of law and forum selection clauses subjecting them to laws and *fora* foreign to Argentina and do not form part of, or are issued in support of, an economic project, operation or activity in Argentina (*Abi-Saab* Dissenting Opinion (n27) paras. 78, 108).

82 E.g. Article 1 of the Jamaica/Korea BIT includes “government-issued securities” in the definition of “investments”.

83 UNCTAD (p. 4). Some investment treaties contain provisions that exclude a claim that a SDR breaches certain obligations under the treaty from the scope of investment treaty arbitration. e.g. Article 10.18 of the Peru/Singapore Free Trade Agreement.

and the tribunal should therefore reach the same conclusion with regard to international sovereign bonds.

To demonstrate these arguments, the following section first demonstrates the “sovereign acts” requirement for a breach of investment protection obligations (Section 4.1.1). Sections 4.1.2 and 4.1.3 examine the distinction between sovereign acts and commercial activities. Section 4.1.2 considers how criteria for the distinction have been developed in the law of state immunity. Section 4.1.3 then turns to the question of whether/how such criteria should also be applied in investment treaty arbitration. It will demonstrate that the criteria widely accepted in the law of state immunity have also been adopted in investment arbitration in the context of distinguishing between contract claims and treaty claims. On the other hand, the “borrowing” of the criteria comes with the proviso that the purpose and context of distinguishing these two types of acts in investment treaties is different from those in the law of state immunity, and therefore, when relying on these criteria, factors particular to investment treaties must be taken into account. Having thus established the criteria applicable to investment treaties, Section 4.1.4 applies the criteria to the debtor state’s sovereign debt default and restructuring. It first describes how such criteria have been applied by domestic courts to the cases of sovereign debt default. For this purpose, the current analysis focuses on English and U.S. courts as the two jurisdictions most often chosen for international sovereign bonds.⁸⁴ Section 4.1.5 proceeds to demonstrate that the application of the (modified) criteria to investment treaties leads to the conclusion that Argentina’s acts at issue in the *Abaclat* and *Ambiente* cases with regard to international bonds do not amount to the acts of a sovereign, but remain in the realm of commercial transactions. It also argues that in cases of SDR of domestic sovereign bonds, insofar as the debtor state implements the CACs contained in the relevant bonds, such acts also remain in the realm of commercial transactions.

4.1.1 “Sovereign acts” requirement for a breach of investment protection obligations

It has been recognised by a number of tribunals in the context of the distinction between contract claim and treaty claim that investment treaty obligations may

84 Loeb (2004, pp. 1–2) (citing Int’l Capital Mkts. Dep’t & Legal & Policy Dev. & Review Dep’t, IMF, Collective Action Clauses: Recent Developments and Issues 16 fig. 1, 17 fig. 2, 18 tbls.2-3 (25 March 2003) (unpublished manuscript) available at: <http://www.imf.org/external/np/psi/2003/032503.pdf>; Sturzenegger and Zettelmeyer (2007, p. 59).

be breached by the host state's sovereign acts only.⁸⁵ For example, the tribunal in *Impregilo v. Pakistan* clearly stated that “[o]nly the State in the exercise of its sovereign authority (*‘puissance publique’*), and not as a contracting party, may breach the obligations assumed under the BIT”.⁸⁶ The tribunal in *Duke Energy v. Ecuador* likewise stated that:

Establishing a treaty breach is a different exercise from showing a contract breach. Subject to the particular question of the umbrella clause, in order to prove a treaty breach, the Claimants must establish a violation different in nature from a contract breach, in other words a violation which the State commits in the exercise of its sovereign power.⁸⁷

This is widely established in investment treaty arbitration in the context of both expropriation and fair and equitable treatment (“FET”) standard.⁸⁸ The only exception is the umbrella clause, which arguably encompasses any obligation assumed by a host state with regard to a specific investment, including one based on its commercial conduct (see Section 3.1). Yet it has already been demonstrated that this clause does not operate where the bonds are duly modified by the operation of a CAC (Section 3.1).

Based on these considerations, the following sections examine whether the debtor state's acts related to SDR should be considered as sovereign acts for the purpose of determining subject matter jurisdiction over the claim, focusing on Argentina's case of SDR as an example. In this regard, the distinction between *acta jure imperii* (acts in public authority) and *acta jure gestionis* (commercial or private acts), which developed in the context of the doctrine of restrictive state immunity, is suggestive and therefore will be examined in the next section.

85 E.g. *Waste Management, Inc. v. Mexico* (“Number 2”), ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, para. 174 (expropriation); *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award of 14 July 2006, para. 315 (expropriation); *Burlington Resources Inc. v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction of 2 June 2010, para. 204 (FET); *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Paraguay*, ICSID Case No. ARB/07/9, Further Decision on Objections to Jurisdiction of 9 October 2012, para. 211 (FET).

86 *Impregilo S.p.A. v. Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction of 22 April 2005.

87 *Duke Energy Electroquil Partners & Electroquil S.A. v. Ecuador*, ICSID Case No. ARB/04/19, Award of 18 August 2008, para. 345.

88 E.g. *Waste Management, Inc. v. Mexico* (“Number 2”), ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, para. 174 (expropriation); *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Pakistan*, ICSID Case No. ARB/03/29, Award of 27 August 2009, para. 125 (FET); *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award of 14 July 2006 para. 315 (expropriation); *Burlington Resources v. Ecuador and PetroEcuador* (note 85) para. 204 (FET); *Bureau Veritas v. Paraguay* (note 85) para. 211 (FET). See also, Salacuse (2010, p. 236).

4.1.2 Criteria for distinguishing *acta jure imperii* and *acta jure gestionis* under the law of state immunity

The doctrine of restrictive sovereign immunity, now widely established, is codified in international instruments (e.g. the European Convention on State Immunity,⁸⁹ the United Nations Convention on Jurisdictional Immunities of States and Their Property⁹⁰) and national laws of many states (e.g. The Foreign Sovereign Immunities Act of 1976 (“FSIA”, U.S.), The State Immunity Act 1978 (“SIA”, UK)).⁹¹ These international instruments and domestic legislations adopt the same approach to provide a general rule of immunity with exceptions of non-immune activities, the most important of which is the “commercial exception”.

In the development of the theory of restrictive sovereign immunity, the most important question has been how to distinguish between *acta jure imperii* (acts in public authority) and *acta jure gestionis* (commercial or private acts).⁹² In addressing this question, the following two tests are discussed: the purpose test and the nature test. The approach using the purpose test as a primary criterion has encountered the problem that it is nearly always possible for the host state to claim the existence of some public purpose, as the concept of public purpose is “not subject to effective reexamination by other states”.⁹³ In a similar vein, the difficulty of reviewing public purpose by international tribunals was recognised as early as 1961, in the Harvard Draft Article.⁹⁴ The purpose test may therefore

89 European Convention on State Immunity, 16 May 1972, Europ. TS No. 74, 11 ILM 470 (1972) (entered into force 11 June 1976).

90 United Nations Convention on Jurisdictional Immunities of States and Their Property, New York, 2 December 2004 (not yet in force).

91 For a list of domestic legislations, see Schreuer (1988, pp. 2–3). In Japan, more than 30 year later than the U.S. and the UK, the Act on the Civil Jurisdiction of Japan with respect to a Foreign State was enacted in 2009. Article 8(1) of the Act provides that: “A Foreign State, etc. shall not be immune from jurisdiction with respect to Judicial Proceedings regarding commercial transactions (meaning contracts or transactions relating to the civil or commercial buying and selling of commodities, procurement of services, lending of money, or other matters (excluding labor contracts).)”

92 Higgins (1994, p. 79).

93 American Law Institute (ed), *Restatement (Third) of the Foreign Relations Law of the United States*, vol. 2, 200 (§712, Comment (e)).

94 Harvard Draft Article No. 12, 18 February 1961: “[I]t is extremely difficult to conceive of a situation where an international tribunal would undertake to review a state’s determination of what is a dominating public purpose except in a situation so flagrant that the procedure involves a manifest denial of procedural justice”. See also, Schreuer (1988, p. 15): “The problem with the purpose test is, of course, that once we start inquiring into the underlying motives of the State partner to a transaction we will most probably end up with some political purpose somewhere”.

significantly broaden the scope of immune acts, making the application of the theory of restrictive sovereign immunity nearly impossible.⁹⁵ The purpose test was rejected by the German Constitutional Court as early as 1963, when the court clearly stated that for the distinction “one should rather refer to the nature of the state transaction or the resulting legal relationships, and not to the motive or purpose of the state activity”.⁹⁶ This statement was later cited by Lord Wilberforce in *I Congreso del Partido*,⁹⁷ in which the UK House of Lords also rejected the purpose test. Lord Wilberforce explained the nature test as follows: “a private act means ... an act of a private law character such as a private citizen might have entered into”.⁹⁸ Although the SIA is silent on this point, it is widely accepted under English law that it is the nature of the activity that determines whether or not it is immune.⁹⁹ In the United States, the primacy of the nature test is expressly provided in Article 1603 (d) of the FSIA:

A “commercial activity” means either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.

Article 2(2) of the UN Convention on State Immunity confirms the primacy of the nature test, while acknowledging that the purpose test has a subsidiary role to play. It reads:

In determining whether a contract or transaction is a “commercial transaction” under paragraph 1 (c), reference should be made primarily to the nature of the contract or transaction, but its purpose should also be taken into account if, in the practice of the State which is a party to it, that purpose is relevant to determining the non-commercial character of the contract or transaction.

This “two-pronged approach” is explained in its commentary as follows:

[I]f after the application of the “nature” test, the contract or transaction appears to be commercial, then it is open to the defendant State to contest this finding by reference to the purpose of the contract or transaction if in its practice, that purpose is relevant to determining the non-commercial character of the contract or transaction.

⁹⁵ Schreuer (1988, p. 16).

⁹⁶ *Claims against the Empire of Iran*, 45 ILR (1963) 57 at 62; cited in *I Congreso del Partido* [1978] 1 QB 500. See also Higgins (1994, p. 83).

⁹⁷ *I Congreso del Partido* [1983] 1 AC 244.

⁹⁸ *Ibid.*, at 262.

⁹⁹ Higgins (1982, p. 268): “there is nothing to suggest that the silence of the 1978 Act on this point would allow a ‘purposes’ argument to succeed in a case brought under the Act”; Fox (2010, p. 273).

Therefore, it may be safely concluded that the approach to primarily examine the nature of the transaction (“the nature-oriented approach”) is widely accepted as a criterion for determining if the act is *acta jure imperii* or *acta jure gestionis*.

However, the application of this approach, that is, the determination of the nature of the transaction, is not an easy task. The determination based solely on whether the state’s act is one which an ordinary private person might also do or not has been “shown to be an over-simplification” when applied, for example, to “the purchase of boots or the more modern instance of cigarettes for the army”.¹⁰⁰ Determining the nature of a transaction is a complex process that involves the consideration of various factors.¹⁰¹ In this regard, it should be emphasised that the nature of the transaction must be considered “in the whole context in which the claim against the State is made”.¹⁰² Schreuer explains this with an example:

For instance, the fact that property for diplomatic purposes was acquired through a commercial contract does not mean that the property should henceforth be treated as commercial in other context such as property tax.¹⁰³

In other words, the nature of the transaction is determined by reference to the claims of the other party (parties) to the transaction. This being so, recognition on the part of the private party as to the nature of the transaction should be one of the factors to consider in determining the nature of a transaction.

4.1.3 Application of the criteria to investment treaties

In investment treaty arbitration, the approach of focusing primarily on the nature of the transaction has been recognised for the purpose of distinguishing contract claims and treaty claims. In the recent *Bureau Veritas v. Paraguay* case, the tribunal observed that investment arbitration tribunals have adopted the following two-step process:

100 Fox (2010, p. 506).

101 Schreuer identifies a list of criteria for determining the nature of the transaction (1988, p. 42).

102 In *I Congreso del Partido* (note 97), Lord Wilberforce clearly adopted a contextual approach: “... in considering, under the restrictive theory, whether State immunity should be granted or not the court must consider the whole context in which the claim against the State is made, with a view to deciding whether the relevant acts on which the claim is based should, in that context, be considered as fairly within an area of activity, trading or commercial or otherwise of a private law character, in which the State has chosen to engage or whether the relevant acts should be considered as having been done outside that area and within the sphere of governmental or sovereign activity” (*I Congreso del Partido* (note 97) at 267). See also Schreuer (1988, p. 1): “this process of identification should always remain in close relation with the claim put forward”.

103 Schreuer (1988, pp. 21–22).

...first they address the nature of conduct; second, assuming the conduct to be such as to give rise to the possibility of a breach of the obligation to provide fair and equitable treatment, they address whether it meets the requirement not to be arbitrary or discriminatory or otherwise unfair or inequitable. That second element necessarily requires an assessment of motive, but it is plain that the motive that explains particular conduct is treated as being distinct from, and informing of, its nature.¹⁰⁴

The tribunal then adopted the nature test, stating that “[i]n the present case the real issue the Tribunal is faced with is the determination of whether a refusal to pay an outstanding contractual debt can by its nature constitute a sovereign act, in the sense of being conduct that an ordinary contracting party cannot engage in”.¹⁰⁵ The nature test is also clearly adopted by the *Duke Energy v. Ecuador* tribunal, in its conclusion that the acts of the state and state entity including the irregular imposition of contract fines did not constitute the exercise of sovereign power, on the grounds that “[t]hese acts constitute conduct which any contract party could adopt; they are thus not capable of amounting to a breach of fair and equitable treatment”.¹⁰⁶

It should be noted, however, that the nature-oriented test is applied in a different context here. In the context of restrictive state immunity, the purpose of distinguishing between *acta jure gestionis* and *acta jure imperii* is to determine the availability of state immunity as a matter of case law or statutory interpretation. On the other hand, in investment arbitration, the purpose of the distinction is to determine subject matter jurisdiction over the dispute, in light of international law. As this is a question of to what extent the protection under the relevant investment treaty applies, in applying the nature-oriented test in investment treaty arbitration, the rationale behind investment protection by investment treaties should also be taken into account. The primary object and purpose of investment treaties is to promote economic relations between contracting states by offering protection to investors of the other state who are subject to domestic regulations on foreign investment.¹⁰⁷ In this regard, Professor Waelde’s following statement in his dissenting opinion in *Thunderbird v. Mexico* is suggestive:

...international investment law is aimed at promoting foreign investment by providing effective protection to foreign investors exposed to the political and regulatory risk of a foreign country in a situation of relative weakness.¹⁰⁸

104 *Bureau Veritas v. Paraguay* (note 85) para. 268.

105 *Ibid.*, para. 269.

106 *Duke Energy v. Ecuador* (note 87) para. 348.

107 For the relationship between host state sovereignty and the rules of foreign investment, see Dolzer and Schreuer (2008, pp. 7–11).

108 Dissenting Opinion of Professor Waelde of 26 January 2006 in *International Thunderbird Gaming Corporation v. Mexico* (Award of 26 January 2006), para. 4.

Certainly, states are free to undertake commitments that go beyond this rationale under investment treaties by, for example, according certain treatment to a national of the other state who “seeks to make” investment,¹⁰⁹ or by extending treaty protection to commercial activities of the state (see Section 3.1). Yet most investment protection obligations, such as the obligation to accord FET/full protection and security and the prohibition of expropriation without compensation, remain in the traditional framework of investment treaties described above. This rationale for investment protection should be considered, when applying the nature-oriented test in investment arbitration.

Having demonstrated the criteria for distinguishing commercial activities and acts of a sovereign in the context of investment arbitration, the following section examines the application of the nature-oriented approach to sovereign debt default.

4.1.4 Application of the nature-oriented test to sovereign debt default in English and U.S. law

This section first examines the question of how sovereign debt default has been treated under the law of state immunity. As noted, it focuses on English and U.S. courts as the two major dispute settlement forums for disputes arising from international sovereign bonds.

In English law, the SIA expressly provides that a commercial transaction as a non-immune act¹¹⁰ includes “any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation”.¹¹¹ The commentary to the SIA provides that the phrase “transaction for the provision of finance” would “certainly encompass any bond or other bearer debt instrument, derivative transaction, letter of credit, bill of exchange or promissory note as well as the provision of security for indebtedness”.¹¹² Under English law, therefore, it is clear that sovereign immunity from jurisdiction does not apply to the issuance of sovereign bonds.

109 *E.g.* Article 1139 NAFTA. The use of the so-called admission model of investment treaties that provide obligations of the host state at the phase of the admission of foreign investments has increased since NAFTA. See generally, Gomez-Palacio and Muchlinski (2008).

110 Article 3(1)(a).

111 Article 3(3)(b).

112 Commentary to the SIA, reproduced in Dickinson, Lindsay, Loonam, and Clifford Chance LLP (2004).

In U.S. law, § 1605(a)(2) of the FSIA provides that sovereign immunity does not apply where:

...the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States;

As to what constitutes a commercial activity, the FSIA does not define the categories of acts that fall within its definition.¹¹³ However, in *Weltover v. Argentina*, the Supreme Court confirmed that the issuance of the Bonods (international bonds issued by Argentina) was a “commercial activity” under the FSIA, and the rescheduling of the maturity dates on those instruments was taken “in connection with a commercial activity” that had “a direct effect in the United States” within the meaning of § 1605(a)(2). In concluding so, it stated, *inter alia*, that:

The Bonods are in almost all respects garden-variety debt instruments, and, even when they are considered in full context, there is nothing about their issuance that is not analogous to a private commercial transaction. The fact that they were created to help stabilize Argentina’s currency is not a valid basis for distinguishing them from ordinary debt instruments, since, under § 1603(d), it is irrelevant why Argentina participated in the bond market in the manner of a private actor. It matters only that it did so.¹¹⁴

It is observed that, following this case “under U.S. law, international bond issues by a sovereign, and a subsequent default, are almost always considered commercial activities, regardless of the purpose of the issue, or the reason behind the payments interruption”.¹¹⁵

To be sure, these standards are concerned with immunity from adjudication. Immunity from execution is a different matter.¹¹⁶ Enforcement of a municipal judgment against a state requires a further determination of immunity, to which

113 § 1603(d) “A ‘commercial activity’ means either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose”.

114 *Republic of Argentina v. Weltover* (1992), 504 U.S., 604 at 617.

115 Sturzenegger and Zettermeyer (2007, p. 57).

116 State immunity from execution is distinguished from state immunity from jurisdiction, because while the latter depends on the characteristics of the claim (or the relationship underlying it), the former depends on “the characteristics of the assets that the judgment creditor is trying to levy execution upon” (Zdobnõh & Värk, 2009/2010, p. 161). The UN Convention on State Immunity (Article 19), the SIA (Article 13) and FSIA (Article 1609) all treat immunity from adjudication and immunity from execution separately.

different criteria than those applied at the adjudicative stage are applied.¹¹⁷ Yet this does not change the fact that the issuance of sovereign bonds has been regarded as a “commercial transaction” under English law and “commercial activity” under U.S. law. Moreover, in international bond contracts, debtor states often explicitly waive sovereign immunity from jurisdiction in order to “foreclose any ambiguity”.¹¹⁸ While it is possible that investment arbitration tribunals, which face a different question from that before English and U.S. courts (Section 4.1.3), come to a different conclusion in determining whether the issuance of sovereign bonds is a commercial or non-commercial act, the reasons provided by these courts for their application of the nature-oriented test to sovereign bonds are suggestive to investment arbitration. Moreover, the justiciability of the creditors’ rights under the sovereign bond before these courts affects the determination of the nature of the debtor’s state’s acts in relation to SDR, as will be explained below.

4.1.5 Sovereign debt default in investment treaty arbitration

In applying the nature-oriented test, taking into account the factors particular to investment treaties (see Section 4.1.3), to Argentina’s acts at issue in the *Abaclat* and *Ambiente* cases, it should be noted that the sovereign bonds in question were international bonds. International sovereign bonds include a choice of law clause subjecting the bonds’ contractual obligations to one governing system of

117 Fox (2010, p. 246); Sturzenegger and Zettelmeyer (2007, pp. 57–58). It should however be noted there are several cases where holdouts succeeded in enforcing the claims or settled “at substantially better terms than the average creditor” (Panizza, Sturzenegger, & Zettelmeyer, 2009, p. 659). Such cases include *Elliott Assocs. v. Banco de la Nacion*, 194 F.3d 363, 365 (2d Cir. 1999) (Court of Appeals for the Second Circuit granted a \$56 million judgment in favour of Elliott) and *Elliott Assocs., General Docket No. 2000/QR/92* (Ct. App. Brussels, 8th Chamber, 26 September 2000) (the Brussels Court of Appeal authorized its execution through an order that requires Euroclear to block any cash payments from Peru associated with its Brady arrangement) (see Monteagudo, 2010). In 2011, the Supreme Court of the UK permitted the claimant to seize Argentina’s assets in the UK based on the New York judgment, stating that the recognition and enforcement of the New York judgment were proceedings “relating to” a “commercial transaction entered into by” Argentina within the meaning of section 3(1)(a) (*NML Capital Ltd v Argentina* [2011] 3 W.L.R. 273, para. 26). By contrast, the recent series of judgments by French Cour de Cassation upheld Argentina’s argument that it did not renounce its immunity of execution over the claims arising from the New York judgment for *NML Capital Ltd v Argentina* (Cour de cassation, Chambre civile 1, 28 mars 2013, 11–10450; 10–25938).

118 Loeb (2004). Such waiver is allowed by Article 2(1)(2) SIA and § 1605(a)(1) FSIA. See also *Libra Bank Ltd v. Banco Nacional de Costa Rica*, 676 F.2d 47 (2d Cir. 1982); Debevoise (1984–1985, p. 162).

law, not the debtor state's own law.¹¹⁹ New York law and English law are the most commonly used as governing laws for international bond issues.¹²⁰ With regard to such international bonds, the issuing state's acts may not constitute acts of a sovereign *in relation to* the creditors, for the following reasons. First, as international bonds are governed by foreign law, the debtor state may not alter the terms of the bonds. The debtor state's incapacity to modify the terms of international bonds is clearly recognised by the EFC Sub-Committee in the drafting process of the standardised CAC, which stated that:

The standardised CAC treats a change in the law governing a bond as a reserved matter only if a bond is governed by a law other than the law of the issuer. The Committee believes there is no need to treat a change from the issuer's own domestic law as a reserved matter because the issuer already has the power, at least in theory, to adopt any desired modification by means of domestic legislation without changing the law governing its bonds.

Accordingly, the creditor's legal rights under the bonds¹²¹ are not subject to the law of the host state. As far as such rights are concerned, therefore, the host state may not exercise its sovereign power over them,¹²² but acts in the manner of a private player in the international bond market.

That the host state adopted laws and regulations in the SDR process does not change the nature of the state's acts *by reference to the creditors' claim*. Certainly, adoption of legislation or regulatory acts, in itself, is "the exercise of powers that are simply not available to the ordinary contracting party".¹²³ The *Abaclat* tribunal stated that treaty claims may arise where "the equilibrium of

119 Wood (2007, p. 193); Esho, Kollo, and Sharpe (2004, pp. 1–2). International bonds include Eurobonds, *i.e.* "bonds that are issued in countries other than the one in whose currency the bond is denominated" (Sturzenegger & Zettelmeyer, 2007, p. 59). It should be noted that domestic bonds are denominated either in foreign currency or in local currency. Sturzenegger and Zettelmeyer (2007, pp. 58–59).

120 Das et al. (2012, p. 41); Liu (2002).

121 As is clear from the *Abaclat* and *Ambiente* cases, since holdout creditors have recourse to investment arbitration for the recovery of the bond money, it is these rights alone which arguably constitute "investments" protected by investment treaties. As noted above, whether or not these rights do amount to "an investment" under Article 25 ICSID Convention is controversial.

122 Waibel aptly observes that in the Argentina case, "[t]he legal framework for debt issuance and debt service ... was beyond the reach of Argentina's police powers, given that the bonds were governed by a foreign municipal law" (2011, p. 280). In this sense, the *Abaclat* and *Ambiente* cases are distinguished from *Fedax v. Venezuela*, in which the transactions at issue (which involved issuance of the promissory notes by the government and their assignment) were governed by the law of the debtor state (*Fedax N.V. v. Venezuela*, ICSID Case No. ARB/96/3, Decision on Jurisdiction, 11 July 1997, para. 42). See also, Waibel (*ibid.*), p. 225.

123 *Bureau Veritas v. Paraguay* (note 85) para. 241.

the contract and the provisions contained therein are unilaterally altered by a sovereign act of the Host State. This applies where the circumstances and/or the behaviour of the Host State appear to derive from its exercise of sovereign State power”.¹²⁴ Yet this does not apply where the rights of creditors of international bonds are not subject to such power – despite the adoption of such laws or regulations, the binding contractual rights of creditors remain. Moreover, these rights are “justiciable” in English and U.S. courts as those arising from “loan or other transaction for the provision of finance”¹²⁵ or those under “ordinary debt instruments”.¹²⁶ It is aptly observed that “Argentina’s sovereign acts appear to be immaterial in respect of the merits of the bonds cases before the national courts indicated in bonds documents.”¹²⁷ In this sense, the host state is incapable of unilaterally altering the equilibrium of the contract.

The *Ambiente* tribunal appears to have recognised this when it stated that “even when a State acts through laws and decrees, this would not necessarily imply the exercise of governmental or sovereign authority”¹²⁸ and that “the Respondent could obviously not alter the terms of legal rights and obligations as arising from different laws and jurisdictions”.¹²⁹ Still, the tribunal proceeded to acknowledge that the law “could nonetheless influence those bonds/security entitlements within the reach of the Respondent’s (notably territorial) jurisdiction”¹³⁰ and could therefore give rise to a breach of treaty obligations. However, this disregards that the distinction between sovereign and commercial acts is made by reference to the nature of the acts, rather than by the factual impact of the acts on the creditors’ rights. Even where the law made it effectively impossible for creditors to seek satisfaction of their claims in Argentina, this is not different in nature from a default as a contractual breach on the part of the borrower (which undoubtedly affects those bonds/security entitlements) if the creditors’ rights were not subject to the law. In this regard, it should be recalled that in applying the nature-oriented test in the context of the distinction between a contract claim and a treaty claim, the rationale for the protection of foreign investments by investment treaties should also be considered and that the primary object and purpose of investment treaties is to protect and promote foreign investment by offering protection to investors of the other state who are

124 The *Abaclat* Decision (note 25) para. 318.

125 Article 3(3)(b) of the SIA.

126 *Argentina v. Weltover* (note 114) at 617.

127 de Luca (2011, p. 219).

128 The *Ambiente* Decision (note 26) para. 546.

129 para. 547.

130 *Ibid.*

subject to domestic regulations on foreign investment (Section 4.1.3). This being so, investment treaties need not, and should not, operate where the foreign investors and their investments are not subject to the regulatory framework of the host state.

Secondly, as demonstrated above (Section 4.1.4), the creditors' rights under sovereign bonds are justiciable before at least two major dispute settlement forums for disputes arising from international sovereign bonds, i.e. English and U.S. courts. This is not to argue that there is no subject-matter jurisdiction where the rights at issue are justiciable in courts or tribunals other than those in the host state. Nevertheless, the fact that the issuance/default of sovereign bonds has been regarded as a "commercial transaction" under English law and "commercial activity" under U.S. law does indicate that the debtor state, as the issuer of the bonds, stands on equal footing with the creditors. The debtor state may be brought to courts or tribunals outside its own jurisdiction, where the state immunity defence is not available.

Lastly, holders of international bonds acquire the bonds on the basis that their rights under the bonds are governed by a law other than that of the debtor state, e.g. New York law, and their claims are subject to foreign jurisdiction. In other words, the bondholders fully expect, when acquiring the bonds, that their rights under the bonds are not subject to the sovereign power of the debtor state. As examined in Section 2, for commercial exception to sovereign immunity, the recognition, or "legitimate expectations",¹³¹ of the creditors as to their relationship with the state must be considered in determining the nature of the state's acts.

It should be noted that the above analysis on international sovereign bonds does not apply to domestic sovereign bonds governed by the issuing state's own law and subject to its own jurisdiction. Here, the debtor state has the power of legal rights under the bond, and thereby unilaterally alter "the equilibrium of the contract and the provisions contained therein"¹³² by, for example, enacting and implementing a law. This does not mean, however, that the state's acts related to SDR constitute its sovereign acts. On the contrary, in situations where the relevant bond includes CACs and the debtor state's acts are in accordance with the offer accepted by the required majority of the CACs, it is highly unlikely that such acts would be regarded as sovereign acts, for the following reasons. The issuance and default of the sovereign bonds have generally been regarded

131 One of the criteria Schreuer identifies for distinguishing immune and non-immune acts is: "[w]hat could be regarded as the claimant's legitimate expectations towards the defendant State?"

132 The *Abaclat* Decision (note 25), para. 318.

as commercial activities of the debtor state (Section 4.1.4). While it is possible to argue that the state's acts concerning SDR following default may assume a different character from the default itself for the purpose of determining the existence of treaty claims,¹³³ insofar as the debtor state implements the CACs contained in the relevant bonds in SDR, there is no difference in nature between the default and such subsequent acts. When the debtor state acts within the framework of bond terms, there is no reason why the commercial nature of the original transaction should be changed. Therefore, the latter also remains in the realm of commercial transactions.

Having discussed the commercial nature of Argentina's acts relating to sovereign debt default and restructuring in the *Abaclat* and *Ambiente* cases, this analysis demonstrates in the following section that in light of the *prima facie* standard for jurisdiction applied in investment treaty arbitration, there is no subject-matter jurisdiction over the claims in these cases.

4.2 The prima facie test for jurisdiction

It is well established that for jurisdiction *ratione materiae* (subject matter jurisdiction) to be established, the tribunal must satisfy itself that the facts alleged by the claimant, if ultimately proved, would be capable of “falling within (or coming within) (or constituting a violation of) the provisions of the investment treaty” (the *prima facie* test).¹³⁴ In other words, the tribunal must satisfy itself at the jurisdictional stage that the *connexion* between the alleged facts and their legal characterization, i.e. the legal foundation of the claims, is established.¹³⁵ The tribunal in *Pan American Energy v. Argentina* provides a strong reason for this proposition:

...if everything were to depend on characterisations made by a claimant alone, the inquiry to jurisdiction and competence would be reduced to naught, and tribunals would be bereft

133 While it remains controversial whether or not “a State, once it has entered into a commercial transaction, (can) recover its immunity by a subsequent governmental act” in the law of state immunity (Schreuer, 1988, p. 22), in investment arbitration, an initial categorization as commercial transaction does not preclude a subsequent treaty claim (this is because treaty claims may arise independently of contract claims). See Fox (2010, pp. 276, 515); Higgins (1982, pp. 269–270); Bankas (2005, pp. 225–228). See also *1 Congreso del Partido* (note 73) and *Arango v. Guzman Travel Advisors Corporation* (U.S. Court of Appeals 5th cir. Judgment of 25 July 1980, 621 F. 2d 1371).

134 Sheppard (2008, p. 960).

135 Douglas (2009, Rule 27).

of the *compétence de la compétence* enjoyed by them under Article 41(1) of the ICSID Convention.¹³⁶

Applying this objective examination on the legal foundation to the *Abaclat* and *Ambiente* cases, the appropriate conclusion would be that, insofar as the investment protection obligations (save the umbrella clause) are concerned, Argentina's acts as commercial activities are incapable of falling within these provisions and therefore the disputes lack subject-matter jurisdiction.

This is not to argue that *any* disputes arising from SDR are always excluded from the scope of investment arbitration. The subject matter jurisdiction may be established with regard to disputes over the host state's acts relating to SDR in exceptional circumstances where, for example, the relevant BIT explicitly includes sovereign debts (see introduction of Section 4) and the dispute involves an exercise of the debtor state's sovereign power.¹³⁷ Yet it should be emphasised that the establishment of subject-matter jurisdiction does not mean that the state's acts are found to constitute a breach of investment treaty obligations at the merits phase.¹³⁸ This naturally requires a fact-specific assessment, a detailed examination of which is a subject for future study. It is, however, worth emphasising that in relation to CACs, investment arbitration tribunals, in conducting this assessment, should appreciate that excessive interference by investment arbitration with a carefully structured SDR process may well undermine the

136 *Pan American Energy LLC and BP Argentina Exploration Company v. The Argentine Republic*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections of 27 July 2006, para. 50. See also *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Decision on Jurisdiction of 22 February 2006, paras. 61–63; *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Decision on Jurisdiction of 19 December 2012, para. 57; *Noble Energy Inc. and MachalaPower Cía. Ltd. v. Republic of Ecuador and Consejo Nacional de Electricidad*, ICSID Case No. ARB/05/12, Decision on Jurisdiction of 5 March 2008, paras. 151–152; *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability of 27 December 2010, para. 52; Vasani and Fooden (2010, p. 271).

137 For example, it is observed that the enactment of the “Greek Bondholder Act” by the Greek government in 2012, which retroactively introduced CACs into the *Greek* law bonds, “undoubtedly would be recognized as the state working within its governmental capacity, and therefore the sovereign would not be granted the ‘commercial activity’ exception in this prong of the expropriation analysis” (Boudreau, 2012). It should be noted that even in such cases other jurisdictional requirements such as the existence of consent to arbitration by the disputing parties have to be satisfied.

138 *Ibid.* In this regard, it should be emphasised that the SDR by Greece was a success. It achieved a very high participation rate by bondholders (96.9%). Except for one Greek law guaranteed bond, “all other Greek-law sovereign and sovereign guaranteed bonds were amended and exchanged in full” (Zettelmeyer, Trebesch, & Gulati, 2012; IMF Global Financial Stability Report, April 2013).

future implementation of CACs. When the SDR process is conducted in good faith, investment treaty arbitration should not be used as a side door by holdout creditors seeking to evade the contractual restrictions posed by the CAC.

5 Conclusion

Given the current lack of uniform international rules and procedures managing sovereign debt crisis, the inclusion of CACs is the most prevalent approach for achieving swift and orderly SDRs. Yet the objective of CACs may be undermined by the approach adopted by the investment arbitration tribunals in the recent *Abaclat* and *Ambiente* cases, and the expansive use of investment arbitration may indeed have the potentially disruptive effect of in the SDR process. In order for investment treaties and contractual innovations in sovereign bond contracts operate in tandem, the investment treaty protection has to be balanced against the need for a swift and orderly sovereign debt renegotiation. The theory is that the protection under investment treaties need not, and should not, be extended to situations where the creditors' rights are not subject to the exercise of the sovereign power of the debtor state, and where the relevant acts in the SDR process are the good faith implementation of CACs included in the original bond terms.

There is little doubt that a swift and orderly SDR not only benefits the creditors but also contributes to the economic development of the debtor state by helping it to return to a path of economic growth. Therefore, to contribute to its economic development by achieving a swift and orderly SDR also serves the primary objective of investment treaties. It is hoped that the approach proposed herein offers a way to achieve this shared goal.

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