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# BITs & Bonds: The International Law and Economics of Sovereign Debt

*By Stratos Pahis*[*]

Abstract

*Recent jurisdictional decisions suggest that sovereign debt will be subject to bilateral investment treaties (BITs) for the foreseeable future. This Article argues that applying BITs to sovereign bonds threatens to undermine the core economic function of those treaties by encouraging inefficient state and creditor behavior and raising the overall cost of sovereign debt. It further argues that this concern can be addressed through an interpretative approach that leads to the equal treatment of like creditors.*

## I. Introduction

Sovereign defaults are a recurring feature of the global economy. Nearly every state has defaulted on its debt at least once; several have done so multiple times.[1] According to one measure, there have been over three hundred sovereign defaults since 1800.[2] According to another, over six hundred sovereign debt instruments have been subject to default or restructuring since 1950.[3] Sovereign defaults tend to happen in waves, with multiple countries entering into debt crises at the same time.[4]

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[1] Carmen M. Reinhart & Kenneth S. Rogoff, This Time Is Different: Eight Centuries of Financial Folly xxx, 99 (2009).

[2] *Id.* at 34.

[3] Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts*, at 30. (IMF Working Paper WP/12/03, Aug. 2012).

[4] *Id.* at 33.

A new wave of sovereign defaults appears to be approaching.[5] In the wake of COVID-19, public spending needs have surged and economic activity has collapsed.[6] Over one hundred countries have petitioned the International Monetary Fund (IMF) for emergency assistance.[7] Several countries that were previously teetering on the edge—including Argentina, Ecuador, and Lebanon—have defaulted or begun the process of restructuring their debts.[8] As emergency measures enacted at the start of the pandemic "are fast becoming insufficient,"[9] several other countries are expected to follow close behind.[10]

Like the hundreds of defaults that have preceded them, the next sovereign debt crises will occur in the absence of a comprehensive sovereign bankruptcy mechanism. They will instead be subject to a number of interdependent and uncoordinated institutions that have governed previous debt crises, including national contract law, restructuring agreements, holdout litigation, and lenders of last resort. Due to a series of recent jurisdictional decisions by investor-state arbitral tribunals, the next wave of debt crises is also likely to be governed by international investment law.

International investment law is a creature of treaties, mostly bilateral, entered into by states. There are nearly three thousand such bilateral investment treaties (BITs) in force today, creating a web of protections that cover an expansive set of economic assets and transactions.[11] Through investment treaties, states promise certain protections to investors of counterparty states, including protections against discrimination, uncompensated expropriation, unfair and inequitable treatment, and, in some cases, contractual breach. Importantly, investment treaties grant covered foreign investors the right to commence international arbitration directly against states and claim damages for treaty violations.[12]

[5] *See e.g.*, Carmen M. Reinhart and Kenneth Rogoff, *The Coronavirus Debt Threat*, WALL STREET J. (Mar. 26, 2020), *at* https://www.wsj.com/articles/the-coronavirus-debt-threat-11585262515 (the "unprecedented" economic stop, increase in health expenditures, and the "halt" of private financing mean that debt restructuring will be "inevitable" "in many corners of the global economy"); Colby Smith & Robin Wigglesworth, *Why the Coming Emerging Market Debt Crisis Will Be Messy*, FIN. TIMES (May 11, 2020), *at* https://www.ft.com/content/f7157356-e773-47c4-b05d-8624a5ccfd03?shareType=nongift.

[6] Patrick Bolton, Lee Buchheit, Pierre-Olivier Gourinchas, Mitu Gulati, Chang-Tai Hsieh, Ugo Panizza & Beatrice Weder di Mauro, *Born Out of Necessity: A Debt Standstill for COVID-19*, Policy Insight No. 103, CTR. ECON. POL'Y RES. (Apr. 2020), *available at* https://cepr.org/sites/default/files/policy_insights/PolicyInsight103.pdf.

[7] *Which Emerging Markets Are in Most Financial Peril?*, ECONOMIST (May 2, 2020), *at* https://www.economist.com/briefing/2020/05/02/which-emerging-markets-are-in-most-financial-peril.

[8] *See* Katie Linsell, *Lebanon Debt Swaps Set to Pay $215 Million After Default*, BLOOMBERG NEWS (Apr. 23, 2020), *at* https://www.bloomberg.com/news/articles/2020-04-23/lebanon-debt-swaps-set-to-pay-traders-210-million-after-default; Gideon Long & Colby Smith, *Ecuador Reaches Deal to Postpone Debt Repayments Until August*, FIN. TIMES (Apr. 17, 2020), *at* https://www.ft.com/content/e1622284-102c-48f0-b45d-dadb81579d9d; Eliana Raszewski & Walter Bianchi, *Argentina Misses Payment, Decides to Use Grace Period, Bond Prices Fall*, REUTERS (Apr. 22, 2020), at https://www.reuters.com/article/us-argentina-debt/argentina-misses-debt-payment-decides-to-use-grace-period-bond-prices-fall-idUSKCN22439Y.

[9] *See* Colby Smith, *IMF Calls for Urgent Action to Prevent Debt Crisis in Emerging Economies*, FIN. TIMES (Oct. 1, 2020), *at* https://www.ft.com/content/b61c8dea-58bc-476d-ae9f-c2de104808de (quoting IMF Managing Director, Kristalina Georgieva).

[10] Angola, Argentina, Ecuador, Gabon, Lebanon, Sri Lanka, Suriname, and Tajikistan are facing "debt distress," with Zambia expected to immediately default. *See* ECONOMIST, *supra* note 7. Credit rating agencies have downgraded the credit of thirty countries, including Argentina, Mexico, and South Africa. *Id.*

[11] *See* UN Conf. Trade & Dev., *International Investment Agreements Navigator*, *at* https://investmentpolicy.unctad.org/international-investment-agreements.

[12] NIGEL BLACKABY & CONSTANTINE PARTASIDES (WITH ALAN REDFERN AND MARTIN HUNTER), REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION, paras. 8.58, 8.59, 8.75, 8.79 (2009) [hereinafter REDFERN AND HUNTER].

In 2006, Argentina became the first state to be subject to such claims for sovereign debt. It faced three separate investment arbitrations, brought by thousands of Italian creditors, for breaches of the Italy-Argentina BIT allegedly arising out of Argentina's 2001 default and subsequent restructuring.[13] An investment arbitration against Greece followed in 2013, alleging similar breaches of the Slovak-Greece and Cyprus-Greece treaties arising from Greece's 2012 bond restructuring.[14]

At the time these claims were asserted, it was unclear whether international investment tribunals would accept jurisdiction over sovereign debt. Greece and Argentina each argued that sovereign bonds did not constitute protected "investments" as defined by the applicable investment treaties and the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention).[15] They further argued that, even if sovereign bonds were investments, they were not made in the territory of the respondent states, and (in the case of Argentina) that mass claims were disallowed by ICSID.[16] These arguments were consistent with the weight of the commentary at the time.[17]

Today, those arguments no longer appear persuasive. Three of the four tribunals presented with the Argentine and Greek sovereign debt disputes accepted jurisdiction, and the one tribunal that did not employed questionable reasoning and interpretative methods.[18] None of these decisions is binding in future cases, and some were issued with dissents.[19] They nevertheless signal that—whether directly through investor-state claims or indirectly in the shadow of potential claims—international investment law will continue to be a factor in sovereign defaults for the foreseeable future. Yet because all claims brought to date have been settled or dismissed before reaching a final decision on the merits, basic legal questions remain unresolved.

With a new wave of debt crises in view—and new treaty claims potentially on the horizon—this Article considers how the application of investment treaties to sovereign

[13] Abaclat and Others v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, para. 1 (Aug. 4, 2011) [hereinafter *Abaclat* Jurisdictional Decision] (180,000 creditors); Ambiente Ufficio S.P.A. and Others v. Argentine Republic, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, para. 93 (Feb. 8, 2013) [hereinafter *Ambiente Ufficio* Jurisdictional Decision] (sixty-four creditors); Giovanni Alemanni and Others v. Argentine Republic, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility, para. 1 (Nov. 17, 2014) [hereinafter *Alemanni* Jurisdictional Decision] (initially 183 creditors).

[14] Poštová Banka A.S. and Istrokapital S.E. v. Hellenic Republic, ICSID Case. No. ARB/13/8, Award, para. 1 (Apr. 19, 2015) [hereinafter *Poštová Banka* Jurisdictional Award].

[15] Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 UST 1270, 575 UNTS 159 (*entered into force* Oct. 14, 1966) [hereinafter ICSID Convention]. Under prevailing practice in ICSID arbitration, investors must show that their investments satisfy both the definition of investment in the applicable BIT, as well as under the ICSID Convention. However, tribunals and commentators have nevertheless imposed their own definitions as to what constitutes an "investment" under that Convention. *See* Stratos Pahis, *Investment Misconceived: The Investment-Commerce Distinction in International Investment Law*, 45 YALE J. INT'L L. 69, 81–85 (2020).

[16] *See Poštová Banka* Jurisdictional Award, *supra* note 14, at 26–37; *Abaclat* Jurisdictional Decision, *supra* note 13, at 123–47, 183–95; *Ambiente Ufficio* Jurisdictional Decision, *supra* note 13, at 29–34, 116–23; *Alemanni* Jurisdictional Decision, *supra* note 13, at 116–62,

[17] *See, e.g.*, Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 AJIL 711, 717 (2007); Josef Ostřanský, *Sovereign Default Disputes in Investment Treaty Arbitration: Jurisdictional Considerations and Policy Implications*, 3 GRONINGEN J. INT'L L. 27, 44 (2015).

[18] *See*, Pahis, *supra* note 15, at 104.

[19] *Abaclat* Jurisdictional Decision (diss. op., Abi-Saab, J.), *supra* note 13; *Ambiente Ufficio* Jurisdictional Decision (diss. op., Torres Bernardez, J.), *supra* note 13.

bonds is likely to impact states, creditors, and the institution of international investment law itself, and, moreover, how those impacts should inform the adjudication of sovereign debt disputes on the merits. The Article makes two principal claims.

The first claim is that while most investment treaties appear to cover sovereign debt, that coverage threatens to undermine the core economic purpose of international investment law. Investment treaties and arbitration enforce state compliance with investment commitments *ex post*, in order to reduce the cost of capital and thus promote investment *ex ante*.[20] But the predominant problem with respect to sovereign debt is *over*-, not under-compliance. Multiple studies have led to a consensus that states rarely default on their debts opportunistically; instead, they resist restructuring unsustainable debts even when it is efficient to do so.[21] BITs threaten to worsen this inefficient behavior by both impeding the restructuring of unsustainable debt and by exacerbating the market imperfections that lead states to over-comply in the first place.

Investment treaties are likely to create inefficiencies in other ways as well, including by exacerbating holdout problems, increasing litigation costs, and creating uncertainty. All of these inefficiencies increase the cost of borrowing for states or the cost of lending for creditors, and thus undermine, rather than advance, the core economic purpose of international investment law. Sovereign debt thus poses a "BITs and bonds dilemma" for investment tribunals, who face the choice between giving effect to BITs' coverage of sovereign debt or the fundamental purpose of those treaties.

The Article's second claim is that this dilemma can be resolved through the equal treatment of like creditors. Because, as explained below, equal treatment would only allow claimants to recover damages that placed them in the same relative position as other like creditors, it would not increase the leverage of creditors in general and thus would not worsen the *ex post* over-compliance problem. Nor would it empower holdouts in a way that undermines necessary restructurings, creates uncertainty, or leads to wasteful proceedings. The equal treatment of like creditors would instead prevent states from discriminating against creditors, which, as this Article demonstrates, is the one positive role that international investment law can play in sovereign debt markets.

The equal treatment of like creditors can be achieved through treaty reform, but it need not be. Standard nondiscrimination provisions in investment treaties directly support the equal treatment of creditors. In addition, and as explained below, other provisions—such as prohibitions against uncompensated expropriations or contractual breaches—can also be reasonably interpreted to lead to a similar result.

Ultimately, whether or not such equal outcomes are achieved—and thus whether or not the BITs and bonds dilemma is resolved—depends upon four ongoing debates in international investment law, to which this Article contributes, including: What constitutes a sovereign act (and is thus compensable under major treaty norms)? How should fair market value

[20] *See* Alan O. Sykes, *The Economic Structure of International Investment Agreements with Implications for Treaty Interpretation and Design*, 113 AJIL 482, 491 (2019).

[21] *See, e.g.*, IMF, *Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework*, at 1 (Apr. 26, 2013) [hereinafter IMF, *Sovereign Debt Restructuring*]; Lee C. Buchheit, Anna Gelpern, Mitu Gulati, Ugo Panizza, Beatrice Weder di Mauro & Jeromin Zettelmeyer, Revisiting Sovereign Bankruptcy 2 (2013) [hereinafter Revisiting Sovereign Bankruptcy].

compensation for sovereign debt be calculated? What is the nature of "umbrella" clause violations? And what is the proper measure of compensation for such violations?

More broadly, resolution of the BITs and bonds dilemma depends upon a debate over the basic nature of investment law itself, including whether it creates mandatory rules that cannot be contracted out of, and, relatedly, whether tribunals should prioritize the stability or flexibility of investment norms. As the case of sovereign debt illustrates, there may be serious perils to imposing a set of mandatory one-size-fits-all rules on a wide range of assets and transactions. As it further illustrates, if such mandatory rules are nevertheless imposed, flexibility in their application may be needed to avoid their most harmful effects.

The remainder of this Article proceeds as follows: Part II situates BITs and bonds in the context of the broader international economic order. Part III lays out the BITs and bonds dilemma. Part IV proposes an interpretive solution to that dilemma. Part V concludes with an analysis of recent treaty developments and recommendations for both states and creditors.

## II. BITs and Bonds in the International Economic Order

### A. *The Sovereign Debt "Regime"*

Sovereign debt—defined as debt issued or guaranteed by a central government—measures in the tens of trillions of dollars.[22] And, as noted above, sovereign defaults are reoccurring, if irregular, events.[23] Nevertheless, there is no international sovereign bankruptcy law that allows states to declare bankruptcy or discharge their debt.[24] Nor is there a central forum for managing creditor claims or rationally distributing sovereign assets.[25] Sovereign defaults are instead governed by a number of interdependent yet uncoordinated institutions.

#### 1. *National Contract Law and Courts*

First among these institutions are national contract law and national courts. Most sovereign debt is issued in the form of bonds.[26] A significant portion of sovereign bonds, including the "lion's share" of bonds issued by advanced economies,[27] are domestic bonds, meaning that they are governed by the issuer country's contract law and domestic courts.[28] The

[22] *See Global Sovereign Debt to Jump to $50 Trillion – S&P Global*, Reuters (Feb. 21, 2019), *at* https://www.reuters.com/article/us-global-debt-s-p/global-sovereign-debt-to-jump-to-50-trillion-sp-global-idUSKCN1QA1L0.

[23] See text at notes 1–4 *supra*.

[24] *See* UN Conf. Trade & Dev., *Sovereign Debt Restructuring and International Investment Agreements*, 2 Int'l Invest. Arb. Issues, at 2 (July 2011) [hereinafter UNCTAD *Sovereign Debt Restructuring*]. A proposal was made by the IMF in the early 2000s to establish such a regime, but it went nowhere. *See* Anne O. Krueger, A New Approach to Sovereign Debt Restructuring (2002). *See also* Mitu Gulati & Robert E. Scott, The Three and a Half Minute Contract: Boilerplate and the Limits of Contract Design 19 (2013).

[25] *See* International Law Association (ILA), Sovereign Insolvency Study Group, Philip Wood, QC, Brian Hunt & Michael Waibel, *Report: State Insolvency: Options for the Way Forward* (Aug. 2010).

[26] *See* Mauro Megliani, Sovereign Debt: Genesis – Restructuring – Litigation 205 (2015).

[27] Reinhart & Rogoff, *supra* note 1, at 103. *See also* Sophia Chen, Paola Ganum, Lucy Qian Liu, Leonardo Martinez & Maria Soledad Martinez Peria, Debt Maturty and the Use of Short-Term Debt 13 (2019); Das, Papaioannou & Trebesch, *supra* note 3, at 41–42.

[28] In contrast to economic definitions, I define domestic and foreign debt by virtue of its governing law, not the currency it is issued in or the residency of its holder. Thus, while most domestic debt (debt subject to local law) is issued in local currency and held by local residents, it need not be. *See* Reinhart & Rogoff, *supra* note 1, at 13.

remainder are foreign or external bonds, meaning that they are subject to foreign laws and jurisdictions, often New York or English law and often New York or London courts.[29] In the event of default, creditors can bring claims for breach of contract under these laws and in these forums.

Enforcement of sovereign debt contracts through national courts is rarely successful, however.[30] The enforcement of domestic debt faces a "high[] probab[ility]" of failure because of changes in law or resistance by the state and its judiciary.[31] The enforcement of foreign debt—which is insulated from these risks[32]—faces a different obstacle: the execution of foreign judgments.[33]

The execution of foreign judgments in the debtor state faces the same obstacle as the enforcement of domestic debt: namely, changes to domestic law and reluctant local courts.[34] Execution outside of the debtor state, on the other hand, is impeded by the limited number of government assets located abroad,[35] and foreign sovereign immunity protections that shield many such assets from attachment.[36] It is, in fact, so difficult to recover damages in the case of default that bond prospectuses often expressly warn creditors of the challenges of doing so.[37]

### 2. *Restructuring Agreements*

Due in part to the difficulty of enforcing sovereign debt contracts, restructuring plays a critical role in resolving sovereign debt crises. Sovereign debt restructurings, which typically take the form of an exchange of old bonds for new bonds, can include the deferral of interest or principal payments, or "haircuts" of the face value of the bond.[38] Depending on the applicable law and contract terms, restructurings can be voluntary—whereby only those creditors who agree to the exchange receive the new bonds—or they can be mandatory—whereby even the bonds of creditors who reject the offer are subject to the

Likewise, according to the definition used herein, external debt is not necessarily issued in foreign currency or held by foreign residents.

[29] REINHART & ROGOFF, *supra* note 1, at 10, 13; Das, Papaioannou & Trebesch, *supra* note 3, at 41; GULATI & SCOTT, *supra* note 24, at 28; MEGLIANI, *supra* note 26, at 225, 523. *See also* Rodrigo Olivares-Caminal, *Litigation Aspects of Sovereign Debt*, *in* DEBT RESTRUCTURING 389, 391 (Olivares-Caminal, et al. eds., 2011).

[30] Sadie Blanchard, *Courts as Information Intermediaries: A Case Study of Sovereign Debt Disputes*, 3 B.Y.U. L. REV. 497, 506 (2018); Julian Schumacher, Christoph Trebesch & Henrik Enderlein, *What Explains Sovereign Debt Litigation?* 58 J. L. & ECON. 585, 591 (2015).

[31] Olivares-Caminal, *supra* note 29, at 392. *See also* PHILLIP WOOD, PROJECT FINANCE, SUBORDINATED DEBT AND STATE LOANS 99 (1995) (noting that states can change their laws to favor themselves in the case of default); HAYK KUPELYANTS, SOVEREIGN DEFAULTS BEFORE DOMESTIC COURTS 142 (2018) ("The lesson to be learned from the Greek debt restructuring of 2012 is that in cases when the law of the borrowing State governs sovereign bonds, the State may seek to amend its law in a unilateral and retrospective fashion.").

[32] Olivares-Caminal, *supra* note 29, at 389, 391.

[33] Schumacher, Trebesch & Enderlein, *supra* note 30, at 591.

[34] Olivares-Caminal, *supra* note 29, at 392.

[35] Blanchard, *supra* note 30, at 506; Olivares-Caminal, *supra* note 29, at 392; Das, Papaioannou & Trebesch, *supra* note 3, at 50.

[36] Olivares-Caminal, *supra* note 29, at 392.

[37] GULATI & SCOTT, *supra* note 24, at 45; *see also* Blanchard, *supra* note 30, at 508.

[38] Das, Papaioannou & Trebesch, *supra* note 3, at 34.

exchange.[39] Restructuring can occur prior to a default, or it can occur after a default has already occurred.[40]

Creditors may agree to restructure sovereign debt not only because of the obstacles to enforcing sovereign debt instruments, but also because of the impact that unsustainable debt can have on states' capacity to service future debt obligations. High debt loads can place a state in a debt "spiral," in which burdensome debt payments crowd out other investments, lead to lower growth, less revenue, and the need to assume further debt, which in turn leads to lower growth, less revenue and so on.[41] As macroeconomic conditions deteriorate and debt-to-GDP levels rise, the cost of continued debt service can rise in a dynamic fashion.[42] As the IMF explains:

> Allowing an unsustainable debt situation to fester is costly to the debtor, creditors and the international monetary system. For debtors, a situation of debt overhang depresses investment and growth and creates a sense of financial uncertainty that can raise the eventual magnitude of the debt problem. . . . Delays that magnify the scale of economic dislocations also tend to reduce the economic value of creditors' claims. . . .[43]

Where debt becomes unsustainable, agreeing to a collective restructuring, whereby each creditor agrees to accept less in future payments than they had contracted for, may make all creditors better off.[44]

### 3. *The Holdout Problem and Solutions*

Even where creditors as a group recognize that debt restructuring is in their own interest, some creditors may nevertheless demand full payment on their bonds. These "holdout" creditors count on a restructuring agreement to reduce the state's overall debt burden to a sufficient degree to allow the state to pay the holdouts in full.[45] Holdout creditors, in other words, attempt to free-ride on the agreement of other creditors.[46]

[39] Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *Greek Debt Restructuring: An Autopsy*, ECON. POL'Y 513, 527 (July 2013) (comparing the Greek restructuring, in which change to domestic law retroactively imposed a collective action clause that bound all creditors to a restructuring agreement, with the Argentine restructuring, which involved external debt without binding collective action clauses).

[40] *See* IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 22.

[41] Mehmet Caner, Thomas Grennes & Fritzi Koehler-Geib, *Finding the Tipping Point – When Sovereign Debt Turns Bad* (Policy Research Working Paper WPS5391, July 1, 2010) (carrying large public debt has significant costs in terms of GDP); IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 20.

[42] Nouriel Roubini, *Debt Sustainability: How to Assess Whether a Country Is Insolvent* 17 (Dec. 20, 2001), *available at* http://people.stern.nyu.edu/nroubini/papers/debtsustainability.pdf. As the ratio of debt-to-GDP rises, the cost of borrowing for the state will rise to price in the increased risk of default, thus further increasing the debt-to-GDP ratio, further increasing the risk of default, and further increasing the cost of servicing debt. As Roubini explains: "Such an increase in spread may trigger a perverse debt dynamics in which, if the country tries to service its debt in full at current high spreads, debt ratios grow even if the country/government is following policies that are sound. One may also end up in situations of 'self-fulfilling solvency traps.'" *Id.*

[43] IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 20.

[44] *Id.* at 12.

[45] *Id.* at 12, 20.

[46] *See* Rohan Pitchford & Mark L. J. Wright, *Holdouts in Sovereign Debt Restructuring: A Theory of Negotiation in a Weak Contractual Environment*, 79 REV. ECON. STUDIES 812, 813 (2012); Anna Gelpern, *Sovereign Debt: Now What?*, 41 YALE J. INT'L L. 45, 57 (2016).

Where too many creditors hold out, however, the strategy may backfire, as the restructuring can fail, leaving no agreement on which to free-ride. Even the possibility that certain creditors may hold out can be enough to scuttle or delay a restructuring. Indeed, "[i]f creditors know that a 'holdout' can obtain full repayment conditional on a previous debt restructuring, everyone will want to be that holdout, and no one will want to restructure."[47] Paying off holdouts or even signaling a willingness to pay holdouts can thus undermine necessary debt restructurings and make all creditors worse off.[48] At the same time, not paying holdouts can lead to protracted creditor litigation with costs to both states and creditors alike.[49]

States and creditors have devised certain contractual solutions to address the holdout problem. For example, exit consents allow a qualified majority of creditors to amend the nonfinancial terms of bonds not subject to an exchange in order to make the prospect of holding out less favorable.[50] Collective action clauses, on the other hand, allow a supermajority of creditors to agree to a restructuring in a way that binds all creditors and thus renders litigation futile.[51]

While collective action clauses are "now a well-established market practice" in foreign bonds[52] and have "played a useful role in achieving high creditor participation,"[53] they are not a complete solution to the holdout problem. They are not found in all foreign sovereign bonds, and are they relatively rare in domestic bonds.[54] Moreover, even where they are included, their functionality is limited where they only bind bondholders of the same debt series. In that case, "a creditor, or a group of creditors, can obtain a 'blocking position' in a particular series and effectively nullify the operation of CACs in that series."[55]

### *B. Introduction of International Investment Law to the Sovereign Debt Regime*

Subjecting sovereign debt to investment treaties can be expected to both enhance creditors' enforcement rights and, relatedly, exacerbate the holdout problem.

[47] FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 64 (2006).

[48] Lee C. Buchheit, G. Mitu Gulati & Ignacio Tirado, *The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings*, at 6 (paper prepared for presentation at the European University of Cyprus (Nicosia), Jan. 22, 2013); Ran Bi, Marcos Chamon & Jeromin Zettelmeyer, *The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings*, at 4 (IMF Working Paper WP/11/265, 2011).

[49] Buchheit, Gulati & Tirado, *supra* note 48, at 6.

[50] Das, Papaioannou & Trebesch, *supra* note 3, at 46, 47.

[51] *Id.* at 43, 45.

[52] *Id.* at 44.

[53] IMF Staff Report: *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, at 16 (Oct. 2014) [hereinafter IMF, *Strengthening the Contractual Framework*].

[54] As of June 2014, the IMF estimated that about 80% of the approximately US$ 900 billion in outstanding foreign law bonds contained CACs. IMF, *Strengthening the Contractual Framework*, *supra* note 53, at 17. Of the US$ 420 billion in foreign sovereign bonds governed by New York law, approximately 75% are estimated to include CACs. *Id.*

[55] IMF, *Strengthening the Contractual Framework*, *supra* note 53, at 18. The introduction of so-called aggregation clauses have recently been introduced to address the limitations of collective action clause. Aggregation clauses allow a supermajority of creditors across issuances to amend the payment terms of all such issuances. The use of such clauses, however, remains limited. Das, Papaioannou & Trebesch, *supra* note 3, at 48.

### 1. *Strengthening Creditor Enforcement*

Investment treaties strengthen enforcement rights in two ways. First, with respect to domestic debt, they protect against *ex post* changes to governing laws, which may violate the treaties' provisions on expropriation or fair and equitable treatment. The investment arbitration claims against Greece—which retroactively changed the terms of its domestic debt—were brought for precisely this reason.[56] Moreover, investor-state arbitration—which allows parties to choose the arbitrators who hear the dispute[57]—is likely to provide a friendlier forum than the courts of the defaulting sovereign, even in the absence of a change to governing law.[58]

Second, with respect to both domestic and foreign debt, investor-state arbitral awards provide certain enforcement advantages over national court judgments. The claims brought against Argentina—which concerned debt subject to foreign law and jurisdiction[59]—appear to have been motivated by these advantages.

While investor-state arbitral awards are subject to the same major limitations as foreign judgments—namely, sovereign immunity and the lack of attachable assets[60]—their enforcement is facilitated by two global "pro-enforcement" regimes.[61] Investor-state awards can be enforced under either the ICSID or New York Convention.[62] The ICSID Convention requires that each of its 153 contracting states enforce ICSID awards as "as if [they] were a final judgment of a court in that State."[63] The New York Convention, likewise, requires its 161 members to recognize and enforce arbitral awards except in "narrow" and limited exceptions.[64] Foreign judgments, by contrast, do not benefit from any comparable global enforcement regime.[65] Their enforcement

[56] *Poštová Banka* Jurisdictional Award, *supra* note 14, paras. 51, 67.

[57] *See* Gary B. Born, International Arbitration: Law and Practice 129, 130 (2d ed. 2015).

[58] Though in what is, to date, an outlier decision, the tribunal in the Greek arbitration also refused to hear the claims. *Poštová Banka* Jurisdictional Award, *supra* note 14.

[59] *See, e.g.*, *Abaclat* Jurisdictional Decision, *supra* note 13, para. 52.

[60] An agreement to arbitrate waives state immunity from adjudication, but does not generally waive immunity from execution of any eventual arbitral award. *See* Olga Gerlich, *State Immunity from Execution in the Collection of Awards Rendered in International Investment Arbitration: The Achilles' Heel of the Investor-State Arbitration System?*, 26 Am. Rev. Int'l Arb. 47, 60, 67, 68 (2015) (noting that France and Switzerland are the exceptions to this general rule).

[61] Born, *supra* note 57, at 9.

[62] Most investment treaties provide investors the option to choose between ICSID arbitration and arbitration pursuant to the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). *See* W. Michael Reisman & Anna Vinnik, *What Constitutes an Investment and Who Decides?*, *in* Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 50, 70 (Arthur W. Rovine ed., 2010). Where the investor-claimant chooses an UNCITRAL arbitration, the enforcement of the resulting award is subject to the New York Convention or other similar regional conventions. Where the investor-claimant initiates an ICSID arbitration, the enforcement of the award is subject to the ICSID Convention.

[63] ICSID Convention, *supra* note 15, Art. 54(1).

[64] *See, e.g.*, Int'l Trading & Indus. Inv. Co. v. Dyncorp Aerospace Tech., 763 F. Supp. 2d 12, 20 (D.D.C. 2011) (Because "the New York Convention provides only several narrow circumstances when a court may deny confirmation of an arbitral award, confirmation proceedings are generally summary in nature."); Chevron Corp. v. Republic of Ecuador, 949 F. Supp. 2d 57, 64 (D.D.C. 2013) ("The party resisting confirmation bears the heavy burden of establishing that one of the grounds for denying confirmation in Article V applies.").

[65] Born, *supra* note 57, at 9. *See also* Gary B. Born & Peter B. Rutledge, International Litigation in United States Courts 1074 (6th ed. 2018) ("There is no uniform practice among foreign states regarding the recognition of foreign judgments.").

instead depends upon bilateral or less comprehensive multilateral treaties, or, absent that, local law, "which often makes it difficult, if not impossible, to effectively enforce them."[66]

### 2. *Exacerbating the Holdout Problem*

International investment law may also exacerbate the holdout problem. Creditors litigate where the expected net gains of doing so are greater than the expected net gains of agreeing to a restructuring.[67] Thus, to the extent investment treaties make enforcement less costly or more effective, they increase the expected net gains of litigating, and, all else being equal, increase the likelihood that creditors do so.[68]

International investment law may also exacerbate the holdout problem by elevating the enforcement rights of some creditors above others. While there are almost three thousand investment treaties in force and investors can structure their investments to satisfy nationality requirements,[69] it is unlikely that all creditors—particularly unsophisticated or small domestic creditors who are less likely to employ such creative legal tactics—can avail themselves of these advantages. Investment treaties could thus be expected to confer a type of "secured" status on covered creditors, placing them in a superior position to others.[70] The resulting heterogeneity could make agreement among creditors more difficult, increase the marginal cost of avoiding holdout litigation,[71] or both, and thus lead to more such litigation.

Finally, investment treaties may exacerbate the holdout problem by providing an end-run around collective action clauses. As noted above, such clauses are unlikely to preclude all holdout litigation, both because of their incomplete coverage and because they leave open the possibility of holdouts gaining a blocking position in a particular debt series.[72] However, as Waibel notes, even where collective action clauses bind all creditors and preclude litigation for breach of contract in national courts, state actions relating to restructurings facilitated by collective action clauses may still give rise to investment treaty claims.[73] For example,

[66] BORN, *supra* note 57, at 9–10; BORN & RUTLEDGE, *supra* note 65, at 1074. While the Convention of 2 July 2019 on the Recognition and Enforcement of Foreign Judgments in Civil or Commercial Matters (Hague Judgements Convention) would increase the enforceability of foreign judgments, it has not yet entered into force and has only been signed by a limited number of states.

[67] Schumacher, Trebesch & Enderlein, *supra* note 30, at 595–96.

[68] *Id.*

[69] In general, tribunals have allowed investors to structure their investments for the purpose of obtaining future treaty protection by, for example, incorporating in a state that has a treaty with the host state. *See, e.g.*, Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction (Apr. 29, 2004). On the other hand, restructuring an investment for the purpose of obtaining treaty protection for a claim that has already arisen or that is anticipated is widely considered impermissible. *See, e.g.*, Pac Rim Cayman LLC v. Republic of El Sal., ICSID Case ARB/09/12, Decision on the Respondent's Jurisdictional Objections, para. 2.99 (June 1, 2010). For a critical analysis of these questions, see Kathleen Claussen, *The International Claims Trade*, 41 CARDOZO L. REV. 1743 (2020).

[70] This security would run with the holder and not with the instrument.

[71] *See* Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LIT. 651, 671 (2009). Assuming states cannot discriminate between creditors in an exchange offer, avoiding litigation would require paying all creditors according to that last creditors' demands. To the extent investment treaties increased the difference between that creditor's cost-benefit equation and the remaining creditors, the more it would cost the state to meet the last creditor's demands and avoid litigation, and the less likely they would be able to or choose to do so.

[72] *See* Section II.A.3 *supra.*

[73] *See* Waibel, *supra* note 17, at 736.

creditors could plausibly claim that a repudiation or threat of nullification committed prior to such a restructuring constituted an expropriation or a violation of fair and equitable treatment, even if it does not give rise to a breach of contract.[74]

### 3. *Jurisdiction*

While the potential for international investment law to enhance creditor enforcement rights and increase holdout litigation appears significant, only four arbitrations against two states and pursuant to two treaties have been brought to date. That heretofore limited use may be partly explained by the time and cost associated with investor-state arbitration.[75] Another likely cause, however, is the uncertainty that until recently surrounded threshold jurisdictional questions, including whether sovereign bonds were even covered under investment treaties and the ICSID Convention.

That jurisdictional uncertainty now appears to have been resolved largely in favor of creditors. As noted above, the weight of arbitral precedent has concluded that sovereign bonds are in fact protected investments. While not binding, those decisions are relevant because most BITs contain definitions of investments similar to the treaties at issue in those arbitrations, and encompass, as those treaties did, "every kind of asset" or "all assets," including claims to money.[76] Indeed, it is difficult to argue that sovereign bonds do not constitute a "kind of asset" or an "investment" under the plain meaning of those terms.[77]

Following these decisions, some states have negotiated new investment treaties that either expressly exclude sovereign debt or limit applicable substantive and procedural protections.[78] Those treaties remain a small minority, however, and many have not yet come into force.[79] Moreover, older treaties may continue to apply to previously issued sovereign debt under sunset provisions, which ensure terminated treaties apply to investments made while those

[74] *See* Section IV.B.1 *infra*.

[75] *See* Jeffery Commission, *The Duration Costs of ICSID and UNCITRAL Investment Treaty Arbitrations* (Vannin Capital, Funding in Focus Content Series Report Three, Julcy 2016), *available at* https://www.lexology.com/library/detail.aspx?g=1cd4f7b6-204b-45bb-8728-e494d0d69082 (average costs for a claimant in an ICSID arbitration between 2011 and 2015 was approximately $USD 5.6 million and approximately $USD 5.5 million for respondents; average duration was 3.75 years). *See also* CHRISTOPH SCHREUER, THE ICSID CONVENTION: A COMMENTARY, Art. 59, at 1215. (2d ed. 2009) (obtaining awards in investor-state arbitration can cost several million dollars in legal fees). By contrast, foreign court judgments can sometimes be obtained "within a matter of months." Buchheit, Gulati & Tirado *supra* note 48, at 6.

[76] *See* Fedax v. Republic of Venezuela, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, para. 34 (July 11, 1997) (*citing* Antonio R. Parra: *The Scope of New Investment Laws and International Instruments*, *in* ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW 27, 35–36 (Robert Pritchard ed., 1996)).

[77] *See* Pahis, *supra* note 15, at 101–02.

[78] *See, e.g.*, Agreement Between the Argentina Republic and Japan for the Promotion and Protection of Investment, Art. 1, Dec. 1, 2018 (not in force) [hereinafter Argentina-Japan BIT] (excluding sovereign debt); Agreement Between Australia and the Oriental Republic of Uruguay on the Promotion and Protection of Investments, Art. 1(a)(ii), Apr. 5, 2019 (not in force) (excluding sovereign debt). *See also* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP, ch. 9 (Investment), Annex 9-G, Mar. 8, 2018, *entered into force* Dec. 30, 2018 (Canada, Australia, Japan, Mexico, New Zealand, and Singapore), Jan.14, 2019 (Vietnam) (limiting substantive and procedural protections for sovereign debt).

[79] According to the UNCTAD Investment Policy Hub, out of 2,575 treaties that provide for investor-state arbitration, at most 136 reference sovereign debt specifically. *See* Investment Policy Hub, *at* https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping.

treaties were still in force, often for a decade or more.[80] These new treaties nevertheless signal a movement toward differentiating sovereign bonds from other investments.

The next Part—which analyzes the impact of applying BITs to bonds from an efficiency perspective—helps to explain and evaluate those treaty reforms. It moreover provides the basis for a proposal for adjudicating sovereign debt disputes under the vast majority of treaties that still cover sovereign debt without distinction.

## III. The BITs and Bonds Dilemma

The impact of international investment law on sovereign debt has been the focus of only limited commentary. Waibel, who has conducted the most comprehensive legal analysis,[81] has observed that investment treaties have the potential to increase holdout litigation and undermine collective action clauses.[82] Ostřanský has observed that investment law is likely to introduce uncertainty into sovereign debt pricing and restructurings.[83]

This Part builds on those observations to examine the impact of international investment law, not just on the restructuring process, but on the social (or aggregate) cost of sovereign debt. To date, no empirical studies have directly addressed this issue.[84] However, as explained below, existing empirical studies, together with economic models, strongly suggest that that investment treaties are likely to increase, rather than decrease, the social cost of sovereign debt and thus undermine, rather than advance, the core economic function of investment law.

### *A. The Efficiency Function of Investment Law*

The promotion of economic efficiency is a—if not *the*—core function of international investment law.[85] Investment treaties provide investors substantive and procedural protections against state action for the purpose of reducing risk and thus promoting foreign investment.[86] From a social welfare perspective, investment treaties should protect and promote investment only to the point where the marginal benefits of doing so are greater than the marginal costs. They should, in other words, incentivize states to act efficiently with respect to investment.

[80] The U.S. and Netherlands Model BITs provide for prospective application for ten and fifteen years respectively. *See* 2012 U.S. Model Bilateral Investment Treaty, Art. 22; Netherlands Model Investment Agreement, Art. 26, Oct. 19, 2018.

[81] *See* Waibel, *supra* note 17; Michael Waibel, Sovereign Defaults Before International Courts and Tribunals (2011).

[82] Waibel, *supra* note 17, at 718, 736.

[83] Ostřanský, *supra* note 17, at 55. *See also* UNCTAD *Sovereign Debt Restructuring*, *supra* note 24; Alison Wirtz, *Bilateral Investment Treaties, Holdout Investors, and Their Impact on Grenada's Sovereign Debt Crisis*, 16 Chi. J. Int'l L. 249 (2015) (discussing the holdout problem).

[84] Multiple empirical studies have analyzed the question of whether BITs increase foreign direct investment generally, and "on balance, although the evidence is not conclusive, one may say that the more recent of these studies tend to show a positive correlation" between BITs and foreign investment flows. *See* Jeswald W. Salacuse, *Of Handcuffs and Signals: Investment Treaties and Capital Flows to Developing Countries*, 58 Harv. Int'l L.J. 127, 132 (2017).

[85] *See* Sergio Puig & Gregory Shaffer, *Imperfect Alternatives: Institutional Choice and the Reform of Investment Law*, 112 AJIL 361, 362 (2018) (the normative goals of international investment law are conventionally described as fairness, efficiency, and peace).

[86] Sykes, *supra* note 20, at 491; Salacuse, *supra* note 84, at 130.

### 1. *Credible Commitments*

According to the classic contract theory of investment law, investment treaties promote efficiency by enabling states to make enforceable commitments to investors.[87] States and investors, like two private commercial parties, may desire to enter into a cooperative relationship that is mutually beneficial. But because states face an incentive to renege on their commitments after the investment is made,[88] investors may refuse to invest in the first place, leaving both investors and states worse off.[89]

The domestic legal system may not be sufficiently credible to assure foreign investors. States can change legislation and nullify contracts, and their judicial systems may not provide a fair hearing.[90] Investment treaties, on the other hand, allow states to make international commitments that cannot be unilaterally altered or nullified, and whose enforcement does not depend upon domestic courts. By strengthening enforcement, investment treaties reduce the risk that states will renege on their commitments *ex post*, and thus enable mutually beneficial investment transactions *ex ante*.[91]

### 2. *An Imperfect Market Theory of BITs*

The contract theory of investment law, however, overlooks that states are quintessential repeat players. As such, states have an incentive to abide by their commitments, since reneging could jeopardize their ability to enter into other beneficial transactions in the future.[92] As Sykes observes, under perfect market conditions, states would internalize the cost of any adverse investment action in the form of increased capital costs.[93] Where investors have perfect information and capital is perfectly elastic, any adverse investment action would lead investors to demand a higher rate of return or withdraw from the market. Where states seek to maximize overall long-term welfare, they therefore have "a unilateral incentive to steer clear of policies" whose marginal cost (in terms of increased capital costs or lost investment) exceeds their benefit. In other words, under perfect market conditions, states would act efficiently toward foreign investment and there would be "no problem [for investment treaties] to solve."[94]

[87] *See* Stephan W. Schill, *Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties*, 18 MINN. J. INT'L L. 1, 18–19 (2009).

[88] Sykes, *supra* note 20, at 498. Investors would be particularly vulnerable with respect to investments that entail large sunk costs, such as those associated with infrastructure or extraction projects, that cannot be extricated easily from the country once made. *Id.* at 497.

[89] *Id.* at 498; Henrick Horn & Pehr-Johan Norback, *A Non-technical Introduction to Economic Aspects of International Investment Agreements*, at 5-6 (Research Inst. Industrial Econ. IFN Working Paper No. 1250, 2018), *available at* https://www.ifn.se/wfiles/wp/wp1250.pdf.

[90] Horn & Norback *supra* note 89, at 5–6; Sykes, *supra* note 20, at 497–98 (describing this as a "time-inconsistency" problem).

[91] *See* Anne van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 J. INT'L ECON. L. 507 (2009); Schill, *supra* note 87, at 18–19.

[92] *See, e.g.*, Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 CAL. L. REV. 1823 (2002); MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007). *See also* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 185, 275–78, 291–92, 293–96 (3d ed. 2000).

[93] Sykes, *supra* note 20, at 493.

[94] *Id.*

Investment law has an economic role to play only because perfect market conditions do not exist. Among other things, high discount rates may lead states to take actions that increase short-term gains even where they lead to greater long-term costs.[95] Agency problems may lead officials to maximize their own self-interest at the expense of the state.[96] And information asymmetries may allow states to take adverse actions without internalizing the costs, and thus keep investors from allocating capital efficiently.[97]

As such, investors cannot rely on rational self-interest to restrain states from breaching their investment commitments. By offering creditors compensation in the event of such actions, investment treaties enforce compliance *ex post*, thereby reducing the cost of capital and promoting investment *ex ante*.[98]

### *B. The Effect of BITs on States' Costs of Sovereign Borrowing*

Applying BITs to bonds, however, threatens to undermine rather than advance those objectives. That is because, as explained below, the predominant problem with respect to sovereign debt is inefficient *over-*, not under-, compliance. In fact, the same market imperfections that lead states to inefficiently breach other investment commitments likely lead states to inefficiently *over*-comply with sovereign debt. In this context, investment treaties threaten to increase the cost of sovereign debt in two ways. First, they threaten to do so directly, by impeding the restructuring process and adding to the deadweight losses associated with unsustainable debt. Second, they threaten to do so indirectly, by exacerbating the market imperfections that lead states to inefficiently resist restructuring unsustainable debt in the first place.

#### *1. The Restructuring Process*

As discussed above, unsustainable debt can lead to deadweight losses that harm states' economic growth, reduce their capacity to pay creditors, and cause economic costs for society as a whole.[99] In such situations, restructuring debt in a timely and sufficient manner can benefit both states and their creditors.[100]

Yet multiple studies have found that states resist restructuring debts even when it is efficient to do so. For example, an IMF review of nine sovereign debt restructurings from 2000 to 2013 found that "debt restructurings often took place a considerable period after Fund staff had assessed that the [country's] debt was no longer sustainable" and that "[w]hen debt restructurings do occur, they often do not restore debt sustainability."[101] Other studies have come to similar conclusions,[102] including finding that states resist restructuring

[95] *See, e.g.*, ALAN M. JACOBS, GOVERNING FOR THE LONG TERM: DEMOCRACY AND THE POLITICS OF INVESTMENT (2011).

[96] Sykes, *supra* note 20, at 494–95.

[97] *See* Salacuse, *supra* note 84, 140–41.

[98] Notably, investment treaties can only be expected to increase overall social welfare by correcting the market imperfections that lead to inefficient action. Otherwise, the benefits of additional investment are simply offset by the compensation paid to investors. *See* Sykes, *supra* note 20, at 495; Horn & Norback *supra* note 89, at 14.

[99] IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 15.

[100] *Id.* at 20.

[101] *Id.* at 15, 23.

[102] *See e.g.*, Eduardo Borensztein & Ugo Panizza, *The Costs of Sovereign Default*, at 23 (IMF Working Paper, WP/08/238, Oct. 2008) (finding states tend to sub-optimally postpone defaults until the economy is weak and

unsustainable debts "even if that implies running down reserves, shortening the maturity of the debt, and ceding part of their economic policy sovereignty to multilateral institutions."[103]

Conversely, the empirical evidence shows that it is "rare"[104] or "extremely rare"[105] for states to default when they have the capacity to pay their debts. As such, a consensus has emerged that the predominant public policy problem with respect to sovereign debt is not inefficient under-compliance, but rather inefficient *over*-compliance.[106] Indeed, according to the IMF—hardly an apologist for debtor states—the problem is not that states renege on their sovereign debt commitments too often or too much, but that they often do "too little and too late."[107]

BITs threaten to further increase the deadweight losses associated with unsustainable sovereign debt by impeding the restructuring process. By exacerbating the holdout problem, BITs threaten to undermine or delay the completion of restructurings, thus making them even *later* than they already would have been.[108] By strengthening creditor enforcement, BITs force states to choose between assuming additional litigation costs and the execution of additional assets, or increasing exchange offers to avoid litigation in the first place—either one of which would reduce the effective relief provided by restructurings, thus making them even *littler* than they already would have been.

The additional deadweight losses from these *littler* and *later* restructurings would fall directly on states and thus effectively raise their cost of borrowing. Notably—in contrast to any additional payments to creditors themselves—these additional deadweight losses would confer no benefit on creditors and thus no *ex ante* benefit on the cost of capital. To the contrary, these losses would indirectly harm creditors by reducing states' capacity to pay.[109]

### 2. *State Behavior* Ex Post

In addition to impeding the restructuring process, BITs threaten to increase costs by incentivizing states to resist restructuring unsustainable debt even more than they already do. This is supported by empirical studies, discussed below, that suggest that the same market imperfections that lead states to breach their other investment commitments are driving states' over-compliance with sovereign debt. Instead of correcting those market imperfections, as one would expect with respect to other investments, BITs threaten to exacerbate them in the context of sovereign debt.[110]

defaults are widely anticipated); Eduardo Levy Yeyati & Ugo Panizza, *The Elusive Costs of Sovereign Defaults*, 94 J. Dev. Econ. 95 (2011) (states postpone default until the costs of default have already accrued).

[103] Mark Kruger & Miguel Messmacher, *Sovereign Debt Defaults and Financing Needs*, at 3 (IMF Working Paper WP/04/53, Mar. 2004).

[104] Gulati & Scott, *supra* note 24, at 167.

[105] Jerome Roos, Why Not Default? 22 (2019).

[106] Revisiting Sovereign Bankruptcy, *supra* note 21, at 2 ("The consensus seems to have shifted away from the fear that countries might restructure opportunistically to the fear that they might restructure too late, and these restructurings might not be deep enough."). *See also* Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz eds., 2016).

[107] IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 1.

[108] *Id.* at 8.

[109] *Id.* at 20.

[110] While it is possible that international investment law is already influencing state behavior in a way that is reflected in the studies below, it is reasonable to assume that any impact has been minimal. There have only been

*a. High discount rates and the economic costs of default*

With respect to investments in general, we expect states to inefficiently breach their investment commitments where they overvalue the short-term benefits of the breach, while discounting its long-term costs in terms of lost investment. Even in the case of sovereign debt, we might expect high discount rates to lead to excessive defaults to the extent such actions produced immediate economic gains (in terms of reduced debt servicing) despite greater long-term costs (in terms of higher borrowing costs).

Yet not only is excessive default rarely observed, empirical studies suggest that breaches of sovereign debt commitments reverse the timeline on gains and losses expected of typical breaches. Instead of short-term gains and long-term costs, sovereign debt restructurings produce short-term costs and long-term gains. Indeed, multiple studies have shown that breaches of sovereign debt commitments are associated with immediate economic costs, including declines in economic output,[111] foreign direct investment,[112] other private capital flows,[113] and international trade;[114] risks of banking and currency crises;[115] the exclusion from international capital markets;[116] and, upon return to those markets, increased borrowing costs.[117] State compliance with sovereign debt is widely attributed to these costs in the economic literature.[118]

At the same time, many of these costs have been found to be short-lived. A review of empirical studies shows that defaulting states "have regained access to international capital markets fairly quickly,"[119] and that there is no detectable effect on growth or risk spreads after one or two years.[120] Moreover, while the costs of default diminish over time, gains increase as the benefits of reduced debt payments begin to accumulate.[121]

The timeline of short-term costs and long-term gains suggests that—in contrast with other investments—high discount rates may be contributing to over-compliance with sovereign

four investment arbitrations for sovereign debt involving two states, the first jurisdictional decision was issued in 2011, and a later decision contradicted it. Moreover, no arbitration reached a final award or provided clarity as to how investment treaties may apply on the merits. *See* text at notes 13–19 *supra*.

[111] Das, Papaioannou & Trebesch, *supra* note 3, at 61 (noting studies show an average of 2–5% declines in GDP lasting up to ten years); Davide Furceri & Aleksandra Zdzienicka, *How Costly Are Debt Crises?* (IMF Working Paper WP/11/280, Dec. 2011) (finding declines of 10% after eight years).

[112] Das, Papaioannou & Trebesch, *supra* note 3, at 64 (noting study showing 2% reduction in FDI flows).

[113] *Id.* at 65 (noting studies show 20% to 40% drop in external borrowing by private firms). Moreover, financial and legal fees associated with restructuring have been between .25% and 2.25% of the amount restructured. *Id.*

[114] Andrew K. Rose, *One Reason Countries Pay Their Debts: Renegotiation and International Trade*, 77 J. DEV. ECON. 189 (2005).

[115] *See* Bianca De Paoli, Glenn Hoggarth & Victoria Saporta, *Output Costs of Sovereign Crises: Some Empirical Estimates* (Bank of England Working Paper No. 362, 2009).

[116] G. Gelos, Ratna Sahay & Guido Sandleris, *Sovereign Borrowing by Developing Countries: What Determines Market Access?*, 83 J. INT'L ECON. 243 (2011).

[117] Borensztein & Panizza, *supra* note 102, at 14 (four hundred basis points on average the year following default).

[118] *See id.* at 1 ("There is a broad consensus in the economic literature that the presence of costly sovereign defaults is the mechanism that makes sovereign debt possible.").

[119] Panizza, Sturzenegger & Zettelmeyer, *supra* note 71, at 675.

[120] *Id.* at 677; Borensztein & Panizza, *supra* note 102, at 14; *but see* Das, Papaioannou & Trebesch, *supra* note 3, at 61 (noting that studies have shown increases in borrowing costs six to seven years after default and impacts on trade last about fifteen years).

[121] Das, Papaioannou & Trebesch, *supra* note 3, at 38; Levy Yeyati & Panizza, *supra* note 102, at 95–105.

debt. It moreover suggests that BITs, which are likely to increase the short-term costs of default—by increasing litigation costs, extending the duration of restructuring and its associated disruptions, and increasing payouts to creditors—are likely to exacerbate that over-compliance rather than correct it.[122]

### *b. Agency problems and the political costs of default*

The same appears to be true of agency problems, which, in contrast to how they affect other investments, appear to lead to over-, not under-, compliance with sovereign debt commitments.

In the case of investments generally, we expect agents to cause the state to inefficiently breach investment commitments where agents benefit personally or politically from breaches while avoiding responsibility for the costs. In the case of sovereign debt, we might expect political agents to be too willing to default where doing so produces political gains (whether that be through a boost to national pride or economic benefits) that outweigh political costs (which might not materialize or might fall on future agents).

But again, not only are opportunistic defaults rare, empirical studies suggest that sovereign defaults are associated with negative, not positive, political consequences, and therefore that agency problems may be contributing to the more significant problem of over-compliance. For example, Borensztein and Panizza have found that following sovereign defaults, political parties and politicians in power are more likely to suffer electoral losses,[123] and leaders are more likely to be removed from office.[124] These findings are consistent with previous studies showing the negative impact of currency crises on political fortunes.[125] They are further supported by the anecdotal experiences of Greece, which saw its prime minister resign and one of its two major political parties collapse, and Argentina, which cycled through five presidents in as many weeks during their last restructurings.[126]

[122] In theory, investment arbitration could help correct for high discount rates by making the costs associated with breach accrue more immediately through an arbitration award.

[123] Borensztein & Panizza, *supra* note 102, at 21–22 (out of nineteen countries examined, ruling coalitions lost votes in eighteen countries following default, experiencing on average a sixteen-point decrease in electoral support).

[124] *Id.* (in half of the episodes examined, there was a change in the chief executive either in the year of default or the year following default, representing a two-fold increase in the probability of executive change over normal times).

[125] *See* Richard N. Cooper, Currency Devaluation in Developing Countries, 86 Essays in International Finance (1971); Jeffrey A. Frankel, *Contractionary Currency Crashes in Developing Countries*, 149–92 (52 IMF Staff Papers, 2005).

[126] Greece's restructuring negotiations opened in the spring of 2011 and concluded in March 2012, with a bond exchange that implemented an effective haircut of around 59–65% off the face value of Greece's debt. *See* Zettelmeyer, Trebesch & Gulati, *supra* note 39, at 516. Prime Minister George Papandreou resigned in November 2011. *George Pandreou Resigns as Greece's Prime Minister*, Telegraph (Nov. 9, 2011), *at* https://www.telegraph.co.uk/finance/financialcrisis/8879647/George-Papandreou-resigns-as-Greeces-prime-minister.html. The prime minister's party, PASOK, collapsed shortly thereafter. *See* Mark Lowen, *How Greece's Once-Mighty PASOK Party Fell from Grace*, BBC (Apr. 5, 2013), *at* https://www.bbc.com/news/world-europe-22025714. Argentina, on the other hand, had a total of five presidents in the period between December 19, 2001 and January 2, 2002, just preceding and following the announcement of its 2002 default. *See Argentina Gets New President for a Day*, CNN (Jan. 1, 2002), *at* http://edition.cnn.com/2001/WORLD/americas/12/31/argentina.resign/index.html.

These political costs make sense in light of the economic and political costs of defaults. Legal and economic scholars have recognized that such costs may lead "self-interested agents" and "myopic policymakers" to delay restructuring as long as possible to avoid the costs of default, and then restructure too little in order to hasten the return to normal.[127] The IMF, likewise, has attributed states' reluctance to restructure unsustainable debt to "fear[] [of] the economic, financial and *political* fallout of a restructuring."[128]

In this context, instead of correcting for agency problems, international investment law is likely to exacerbate them.[129] For if political agents inefficiently delay and minimize restructurings in order to avoid the immediate economic—and thus political—costs that result, then a mechanism that increases those costs and lengthens their duration would likely incentivize further inefficient delays.

At the same time, agency problems also point to a potential positive role for investment treaties. While agency problems may incentivize compliance with sovereign debt obligations in general, they do not necessarily incentivize states to impose the burdens of any eventual default equitably among creditors. To the contrary, agency problems may incentivize imposing such costs on a select group of creditors—such as foreign creditors or other creditors without political clout. In fact, while the evidence shows that states are generally reluctant to default,[130] "some defaults appear to have successfully discriminated between foreign and domestic debtholders."[131] International investment law may thus still have a role in protecting creditors from discriminatory treatment. With respect to *ex post* compliance in general, however, investment law threatens to exacerbate the effects of agency problems, not correct them.

*c. Information asymmetry and access to courts*

Information asymmetries may also contribute to states' *ex post* over-compliance. In other contexts, we expect information asymmetries to lead to inefficient under-compliance because they allow states to surreptitiously take investment-adverse actions without facing the consequences of future lost investment. But not only do we rarely observe inefficient under-compliance, such information asymmetries are unlikely to exist in the context of sovereign defaults. Sovereign debt defaults are well-publicized events, and the market reacts quickly to defaults by decreasing demand for debt from the defaulting state.[132]

Instead, information asymmetries are likely to contribute to inefficiency in another way. Specifically, where creditors are not able to independently verify the sustainability of a state's debt stock or their capacity to pay, states may face an incentive to "postpone default to ensure

[127] REVISITING SOVEREIGN BANKRUPTCY, *supra* note 21, at 10.

[128] *See* IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 20 (emphasis added).

[129] Investment arbitration can in theory help correct for this problem by concentrating the form and timing of the costs associated with investment-adverse actions, making them more immediate, identifiable and thus more easily attributable to the decision (and decision maker) than future investment losses. *Cf.* Weijia Rao, *Domestic Politics and Settlement in Investor-State Arbitration* (draft, June 19, 2019), *available at* https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=CELS2019&paper_id=264 (finding that state agents enter into fewer investor-state settlements prior to elections, presumably because of the political costs of doing so).

[130] REVISITING SOVEREIGN BANKRUPTCY, *supra* note 21, at 10.

[131] Panizza, Sturzenegger and Zettelmeyer, *supra* note 71, at 681; FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 105–07, 122–24 (2007) (discussing the less favorable treatment afforded to nonresidents in Russia's and Ukraine's restructurings).

[132] Panizza, Sturzenegger, and Zettelmeyer, *supra* note 71, at 677.

that there is broad market consensus that the decision is unavoidable and not strategic,"[133] and thus obtain creditor support for a restructuring arrangement.

While international investment law is unlikely to worsen such information asymmetries, it not likely to effectively ameliorate them either. The adjudicative process can play a transparency-enhancing role with respect to sovereign debt,[134] but investor-state arbitration is poorly suited to play that role, at least where national courts exist as alternative forums.[135] This is so for several reasons.

First, disclosure in investor-state arbitrations is controlled by the tribunal and generally more limited than party-controlled discovery in national courts, at least in common law jurisdictions such as New York and London.[136] Second, investor-state proceedings are typically subject to a higher level of confidentiality than national litigation.[137] And third, because of the uncertainty and inconsistency associated with investment-arbitration, the ability of investor-state tribunals to make legal determinations that are accepted by the market and serve as an objective evaluation of state behavior is relatively weak.[138] Indeed, the current ad hoc system, which has no appeals mechanism and is not constrained by *stare decisis*, allows for two creditors holding the exact same debt and subject to the exact same treaty to be treated incongruously.[139]

At the same time, investor-state arbitration might play some role as an information intermediary where no other forum is available for creditors to pursue their claims. For example, in the event a state nullifies its domestic debt or otherwise forecloses access to its national courts, investor-state arbitration may still have some utility as an information intermediary (though that utility would have to be weighed against the costs of providing holdouts another forum to litigate). Outside of those circumstances, however, investment arbitrations are likely to be redundant and ineffective.

* * * *

[133] *Id.* at 23; *see also* REVISITING SOVEREIGN BANKRUPTCY, *supra* note 21, at 11 ("[P]olicymakers who believe that 'strategic' defaults can have large reputational costs but that 'unavoidable' defaults carry limited costs in terms of reputation may decide to postpone a needed default in order to signal that the default is indeed unavoidable.").

[134] Blanchard, *supra* note 30, at 503.

[135] *Id.* at 537.

[136] BORN, *supra* note 57, at 194.

[137] ICSID only publishes awards with the consent of the parties; where the parties do not consent, ICSID limits its publication to excerpts of the award of the legal reasoning. ICSID, *Confidentiality and Transparency – ICSID Convention Arbitration*, *at* https://icsid.worldbank.org/services/arbitration/convention/process/confidentiality-transparency.

The UNCITRAL Rules on Transparency in Treaty-Based Investor State Arbitration require the publication of certain filings. However, unless otherwise agreed by the parties, those rules apply only to disputes arising from treaties concluded after April 1, 2014, and moreover do not apply to exhibits, nor necessarily to witness or expert testimony. UNCITRAL Rules on Transparency in Treaty-Based Investor State Arbitration, Arts. 1, 3. *See also* Emelie M. Hafner-Burton & David G. Victor, *Secrecy in International Investment Arbitration: An Empirical Analysis*, 7 J. INT'L DISP. SETTLEMENT 161 (2016) (showing transparency reform efforts are failing to increase transparency in practice).

[138] According to Blanchard, providing an objective third-party assessment of the state's behavior is one of the key roles that courts play. Blanchard, *supra* note 30.

[139] *See, e.g.*, Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2004–2005).

In sum, in addition to impeding and increasing the costs of the restructuring process, international investment law threatens to exacerbate the market imperfections that lead states to inefficiently resist restructuring unsustainable debt in the first place. These effects could be expected to compound each other. By impeding and increasing the costs of restructurings, investment treaties would incentivize states and their agents to further delay and diminish the restructuring of unsustainable debt. Those same treaties would then impede the restructuring process when states finally do attempt to restructure. The end result would be even *littler* and *later* restructurings, more deadweight losses, and an increase in the effective cost of sovereign borrowing for states.

### 3. *State Behavior* Ex Ante

If states over-comply with sovereign debt obligations, something else must explain the recurring nature of sovereign defaults. Certainly, some of the factors that lead states to default are outside of their control and impervious investment law's effects. For example, individual debt crises are often instigated by broader global economic shocks.[140] This explains why defaults tend to happen in waves, with multiple countries entering into debt crises at the same time.[141] To cite one particularly grave example, nearly half of all countries defaulted during the years following the Great Depression and World War II.[142] Needless to say, international investment law would hardly be effective at reducing such risks.

Another possible explanation, however, is that states inefficiently overborrow *ex ante*.[143] There are, in fact, some indications that *ex ante* overborrowing is a driver of sovereign debt crises. First, borrowing by crisis-prone countries tends to be pro-cyclical, meaning that they tend to borrow more during periods of economic expansion than contraction,[144] which is the opposite one would expect of borrowers seeking to smooth consumption during economic downturns.[145] Second, there is wide variation in the debt stock of similarly situated nations, suggesting that borrowing is not driven by economic fundamentals, but rather by policy choices.[146] Finally, the IMF has found that most emerging countries' debt stocks are higher than those countries could repay by maintaining their respective average primary balances.[147]

Assuming that inefficient overborrowing *ex ante* contributes to debt crises, it is likely driven by the same market imperfections that cause states to inefficiently over-comply with sovereign debt obligations *ex post*. High discount rates and agency problems could be expected to lead states and their agents to overborrow in the near-term while discounting the costs of doing so in the long-term. Politicians, for example, could have an incentive to overborrow to boost the economy while they are in office, knowing (or hoping) that the consequences of doing so will fall on future governments. Additionally, opacity as to fiscal conditions may keep lenders from accurately assessing a state's capacity to pay.

[140] *See generally* Guillermo Calvo, Emerging Capital Markets in Turmoil: Bad Luck or Bad Policy? (2005); Revisiting Sovereign Bankruptcy, *supra* note 21, at 9.

[141] *See* Das, Papaioannou & Trebesch, *supra* note 3, at 33.

[142] Reinhart & Rogoff, *supra* note 1, at 71.

[143] Revisiting Sovereign Bankruptcy, *supra* note 21, at 8.

[144] Reinhart and Rogoff, *supra* note 1, at 80.

[145] Panizza, Sturzenegger & Zettelmeyer, *supra* note 71, at 664.

[146] Revisiting Sovereign Bankruptcy, *supra* note 21, at 8.

[147] IMF, 113 World Econ. Outlook: Public Debt in Emerging Markets 124 (2003).

Increasing *ex post* costs could be expected to have some impact on *ex ante* overborrowing. Rational states would reduce overborrowing on the front end to avoid the increased costs of default on the back end. This could ameliorate the negative effects of investment law on *ex post* over-compliance. However, any positive impact on overborrowing is likely to be limited by the market imperfections that drive that overborrowing in the first place. For example, the *ex ante* agency problem that leads to overborrowing is unlikely to be influenced by *ex post* enforcement, since that agency problem exists in spite of the costs that accrue *ex post.* High discount rates likewise, by definition, would lead states to discount any future additional *ex post* costs that international investment law may impose. And to the extent over-lending is a function of *ex ante* opacity, investor-state arbitration would be largely useless, as it is only available *ex post*, and in any event, as described above, is of limited utility as an information intermediary. Thus, while encouraging further inefficient state behavior *ex post*, international investment law is unlikely to have any significant impact on inefficient state behavior *ex ante.*[148]

### *C. The Effect of BITs on Creditors' Costs of Lending*

For all the above reasons, international investment law is likely to increase the deadweight losses associated with sovereign debt restructurings, by both impeding restructurings and by encouraging the inefficient behavior of states. The resulting losses can be expected to accrue to states, thus effectively increasing their cost of borrowing, without conferring any benefit on creditors. In fact, at least some of the deadweight losses can be expected to fall indirectly upon creditors by reducing states' overall capacity to pay.[149]

In addition to these indirect costs, investment law is also likely to impose other costs directly on creditors by creating incentives for inefficient *creditor* behavior. In particular, by incentivizing holdout arbitration in all the ways discussed above, investment treaties may directly increase creditors' costs in two ways.

First, holdout arbitration may increase litigation costs by leading to parallel filings in both national courts and investor-state arbitration.[150] A race to attach a limited number of assets could lead creditors to file arbitration claims to either gain an enforcement advantage or preserve a position relative to other creditors. Investment arbitration may thus place creditors in a prisoners' dilemma, whereby each faces the incentive to file a treaty claim, regardless of what other parties do, and regardless of whether it leaves all creditors worse off.[151]

[148] Increasing *ex post* costs can of course be expected to increase the cost of capital *ex ante* and thus potentially reduce the absolute amount borrowed. But for any given price of debt, the market imperfections identified above can be expected to lead states to borrow beyond what is efficient. For the reasons discussed above, investment law is unlikely to affect those incentives.

[149] IMF, *Sovereign Debt Restructuring, supra* note 21, at 20.

[150] Neither *lis pendens, res judicata,* nor "fork-in-the-road" treaty provisions that require investors to irrevocably choose to between investor-state arbitration are likely to prevent parallel claims. Each of these doctrines requires an "identity of the parties, object and cause of action in the proceedings pending before both tribunals," which will not exist between investor-state arbitration (in which the cause of action arises from a BIT) and national court litigation (in which the cause of action arises from national law). *See* Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Decision on Jurisdiction, para. 88 (Dec. 8, 2003); Katia Yannaca-Small, *Parallel Proceedings, in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 108, 113–15 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008); REDFERN AND HUNTER, *supra* note 12, at paras. 8.57–8.61.

[151] *See* Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 862 (1982).

Second, holdout arbitration may introduce uncertainty into the distribution of payments to creditors. In particular, BITs could be expected to shift payments to holdout creditors, who insist on full payment, from non-holdout creditors who do not. Relatedly, BITs could be expected to shift payments to creditors of certain nationalities who have access to investment-treaty arbitration, from creditors of other nationalities who do not. And finally, BITs may shift payments to domestic bonds from foreign bonds. As noted above, domestic bonds are likely to benefit more from investment-treaty protection than foreign bonds. In addition to the enforcement advantages that accrue to both domestic and foreign bonds, domestic bonds stand to benefit from protections against changes to governing law and from the provision of a more neutral adjudicative forum (both of which foreign bonds already enjoy). While sovereigns are less likely to default on domestic bonds than foreign bonds,[152] these additional protections may make domestic bond defaults even *less* likely, and thus, all else equal, make foreign bond defaults more likely.

If creditors could accurately anticipate these distributional effects *ex ante*,[153] they could price them into bond prices efficiently. But the unpredictable nature of investor-state arbitration is likely to impede creditors from doing so.[154] These distributional impacts are thus likely to impose uncertainty costs on creditors.[155]

* * * *

In theory, although suboptimal, the costs that accrue directly to creditors—as well as some of the costs that accrue directly to states—could be justified by other benefits that investment treaties produce. For example, empowering holdout creditors could discipline states that under-comply with their sovereign debt commitments.[156] The additional uncertainty and transaction costs that investment law creates could also be outweighed by the benefits created by marginally more efficient state behavior. Indeed, that is precisely the justification for applying international investment law—despite its associated transaction costs—in other contexts.

In reality, however, where states already inefficiently over-comply with sovereign debt commitments, and where investment law threatens to worsen that inefficient state behavior, the additional costs that investment treaties impose will only further increase the cost of sovereign debt and further undermine the economic purpose of international investment law.

[152] *See* REINHART & ROGOFF, *supra* note 1, at 111.

[153] All else being equal, we would expect covered investors to be willing to accept lower yields, such that covered investors would be willing to pay a higher price for the same instrument as noncovered investors, resulting in the concentration of debt in the hands of covered investors. Notably, as more debt found its way into covered investors hands, the relative benefits associated with being a covered investor would diminish for all holders until there was no relative benefit at all, as all creditors would be in the same relative position as they were in the absence of investment arbitration. This in turn could counteract some of investment law's exacerbation of the holdout problem.

[154] See text at note 139 *supra*.

[155] *See* FRANK KNIGHT, RISK, UNCERTAINTY AND PROFIT (1921) (on the costs of uncertainty and the difference between calculable risk and incalculable uncertainty).

[156] *See e.g.*, Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructurings*, 53 EMORY L.J. 1043, 1047 (2004) Andrei Shleifer, *Will the Sovereign Debt Market Survive?* 93 AM. ECON. REV. 85, 87 (2003); Ostřanský, *supra* note 17, at 37 (holdout creditors may serve "as a control on opportunistic defaults and unreasonable workout terms").

## IV. Resolving the BITs and Bonds Dilemma

The above analysis helps to explain recent reforms undertaken by some states to exclude sovereign debt from new investment treaties or impose procedural and substantive limitations on its protection.[157] However, the vast majority of treaties continue to define "investment" broadly in a way that includes sovereign debt. How should tribunals proceed when faced with claims under those treaties? Several imperfect alternative responses present themselves.[158]

One alternative is for tribunals to accept jurisdiction and proceed as if sovereign debt were any other contract. This approach would recognize that the plain language of the ICSID Convention and most BITs covers sovereign debt, but ignore that such coverage undermines international investment law's core goals as described above. That may have been the road the three tribunals hearing claims against Argentina would have taken had those arbitrations not settled or been discontinued before reaching a decision on the merits.[159]

A second alternative is to ignore the plain language of BITs and the ICSID Convention and reject jurisdiction. That is the path urged by commentators and by the tribunal seized of the Greek debt dispute. While having the virtue of avoiding all of the problems of subjecting BITs to bonds, this alternative relies an implausible interpretation of the term "investment," and moreover, strips BITs of their capacity to protect creditors from discrimination.

This Part proposes a third alternative. It argues that international investment law's fundamental norms can be advanced rather than undermined—and states and creditors made better not worse off—by guaranteeing the equal treatment of like creditors, but going no further. Moreover, it shows how the reasonable interpretation of current treaties can lead to that result.

### A. *Equal Treatment as the Solution to the BITs and Bonds Dilemma*

The equal treatment of like creditors solves the BITs and bonds dilemma in two ways. First, it prevents creditors from using BITs in a way that introduces inefficiencies and thus undermines the economic function of those treaties. As discussed above, by expanding creditor enforcement rights and exacerbating the holdout problem, BITs threaten to increase inefficiencies in four ways: (1) incentivizing states to further delay and diminish necessary restructurings; (2) impeding necessary restructurings once undertaken; (3) increasing litigation costs; and (4) introducing uncertainty. The equal treatment of like creditors would mitigate each of these effects.

If investor-state arbitration only put creditor-claimants in the same position as other similarly situated creditors—such that holdout creditors were compensated as much as, but no more than, non-holdouts—it would not increase the aggregate leverage of creditors. It would

[157] As explained below, it also demonstrates some deficiencies in those reforms. *See* text at notes 240–244 *infra*.

[158] *See* Puig & Shaffer, *supra* note 85, at 361, 379 ("all institutional alternatives are highly imperfect"; "the key question is: *compared to what?*").

[159] Abaclat v. Argentine Republic, ICSID Case No. ARB/07/5, Consent Award (Dec. 29, 2016) (discontinuing the arbitration in light of a settlement between the parties); Ambiente Ufficio v. Argentine Republic, ICSID Case No. ARB/08/9, Order of Discontinuance of the Proceeding (May 28, 2015) (discontinuing the arbitration for lack of payment); Giovanni Alemanni v. Argentine Republic, ICSID Case No. ARB/07/8, Order of the Tribunal Discontinuing the Proceeding (Dec. 14, 2015) (same). *See also Poštová Banka* Jurisdictional Award, *supra* note 14 (dismissing the claims against Greece on jurisdictional grounds).

not require the disbursement of additional resources, but rather the equitable distribution of whatever resources states do disburse. Moreover, it would effectively neutralize any benefit to holding out, except in the case of discriminatory treatment. By doing so, it would (1) eliminate the additional incentives for states to further delay and diminish restructurings, (2) prevent creditors from undermining restructurings, (3) reduce the proliferation of additional proceedings and the attendant litigation costs, and (4) minimize uncertain distributional shifts.

Second, the equal treatment of like creditors would preserve international investment law's capacity to play one of the key roles that the sovereign debt regime leaves for it to play: ensuring the nondiscriminatory treatment of creditors. As discussed above, the market imperfections that incentivize states to renege on commitments with respect to other types of investments—high discount rates, agency problems, and information asymmetries—actually incentivize compliance with sovereign debt obligations in general.[160] Nevertheless, agency problems may still incentivize states to spread the costs of default inequitably among creditors.[161] Guaranteeing the equal treatment of like creditors would protect against such discrimination.

In its most effective form, the equal treatment solution would keep the restructuring of sovereign debt out of investor-state arbitration entirely. States, knowing that discriminating among creditors would trigger liability—and having the capacity to avoid such liability—would steer clear of such actions. Creditors, knowing they could not recover more through investor-state arbitration than through a restructuring agreement, would be disincentivized from bringing such claims. Both states and creditors would thus have the incentive to resolve debt crises outside of investor-state arbitration, without the costs that it entails.

In that sense, the equal treatment solution would position investor-state arbitration where (at least ideally) it sits with respect to other investments: "in reserve," as a tool to ensure "processes function as intended,"[162] and whose use is obviated by its success in incentivizing efficient behavior. That contrasts with how investor-state arbitration would otherwise be used with respect to sovereign debt: as a rent-seeking tool that creditors could be expected to use regardless of whether states acted efficiently or not, and which, through that use, would undermine rather than advance the core function of international investment law.

### *B. A Path Toward Equal Treatment Through Four Debates*

The equal treatment of like sovereign bond creditors could most obviously be achieved by reforming BITs to limit their application to nondiscrimination protections. Specifically, treaties could be amended to guarantee sovereign creditor-claimants nondiscriminatory treatment—via national treatment, most favored nation treatment, and stand-alone nondiscrimination clauses—but to go no further. Such clauses would allow creditor-claimants to obtain damages only where they are offered less favorable restructuring terms than other like creditors, i.e., creditors holding the same or similar debt.[163] This should lead to the equal

[160] *See* Section III.B.2 *supra.*

[161] *See* Section III.B.2.b *supra.*

[162] Puig & Shaffer, *supra* note 85, at 407.

[163] Similar debt could be determined by maturities, currencies, or other factors. In the context of international investment law, differential treatment should not on its own be sufficient to violate nondiscrimination norms as

treatment of like creditors, because damages for discrimination would, at a minimum, undo the effects of discrimination,[164] or because states would themselves treat creditors equally in order to avoid such claims.

But BITs need not be reformed to achieve this outcome. Reasonable interpretations of current treaties can achieve it as well. Of course, nondiscrimination norms are not the only norms of the international investment law regime. Most BITs also contain absolute standards of treatment that do not depend upon the relative treatment of other creditors. For example, most BITs contain clauses requiring compensation for expropriation, the fair and equitable treatment of investors, and, in some cases, umbrella clauses that prohibit contractual breach.

As explained in this Section, however, these absolute standards of treatment do not preclude the equal treatment of both creditor and non-creditor claimants. To the contrary, reasonable interpretations of such standards may, counterintuitively, lead to relative equality in outcomes, even when applied to the benefit of only some creditors. As demonstrated below, the path toward equal treatment—and the resolution of the BITs and bonds dilemma—runs through four ongoing and fundamental debates in international investment law.

### 1. *What Amounts to a Compensable Sovereign Act?*

The first fundamental debate upon which the resolution of the BITs and bonds dilemma depends is over what amounts to a compensable sovereign act. As Waibel has observed, "[i]nternational courts and tribunals have repeatedly stressed that property rights and investment protection are no insurance against ordinary commercial risks."[165] International tribunals have likewise drawn a line between breaches of contract, which do not create treaty claims, and sovereign interference with a state's contractual obligations, which do.[166] In other words, a breach of contract does not amount to a breach of treaty "unless it [is] proved that the State or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign authority."[167]

long as there is a policy basis for any differences. For example, the differences between domestic debt and external debt—including in law, forum, currency, and relevance to the local economy—should reasonably justify the differential treatment of domestic and external bonds, as long as foreign and domestic nationals are accorded the same treatment. *See* Waibel, *supra* note 17, at 740.

[164] *See* Thomas W. Wälde & Borzu Sahabi, *Compensation, Damages, and Valuation*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW, *supra* note 150, at 1051, 1082–83 (noting the "little precedent and even less theoretical analysis" for calculating damages in discrimination claims, but arguing that the *Chorzów Factory* principles require "plac[ing] foreign investors in a financially equivalent position either as if they were treated as well as the best-treated domestic investors or as if the government's differentiation had gone as far as would be justified by legitimate reasons").

[165] Waibel, *supra* note 17, at 754. In the words of the *Maffezini* and *CMS* tribunals: "Bilateral Investment Treaties are not insurance policies against bad business judgments." Maffezini v. Argentina, ICSID ARB/97/7, Award on Merits, para. 64 ( Nov. 13, 2000); CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. Arb/01/8, Objections to Jurisdiction, para. 29 (July 17, 2003).

[166] *See, e.g.*, Waste Management v. Mexico, ICSID Case No. ARB/AF/00/3, Award, para. 174 (Apr. 30, 2004) ("The mere non-performance of contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation. Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts. . . .").

[167] Impregilo v. Pakistan, ICSID Case No. ARB/03/3, Jurisdiction, para. 278 (Apr. 22, 2005). *See also* Jalapa Railroad v. Mexico (U.S. v. Mex.) (American-Mexican Mixed Claims Comm'n 1976) (distinguishing between "an ordinary [breach of contract] involving no international responsibility" and a situation where a government "stepped out of the role of contracting party and sought to escape vital obligations under its contract by exercising its superior governmental power"); WAIBEL, *supra* note 81, at 279 (the question is whether a state "slip[s] into their

Pursuant to this principle, as Waibel shows, there is "ample authority" supporting that a mere default on debt—which amounts to a breach of contract—is a noncompensable commercial act.[168] The tribunal in *SGS v. Philippines*, for example, found that "[a] mere refusal to pay a debt is not an expropriation of property, at least where remedies exist in respect of such a refusal."[169] Likewise, with respect to a default on Polish bonds, the Foreign Claims Settlement Commission of the United States held that "[m]ere nonpayment of an obligation of this nature does not constitute a nationalization or other taking of property."[170]

The principle that sovereign default is a commercial, not sovereign, act is moreover consistent with U.S. Supreme Court jurisprudence on the Foreign Sovereign Immunities Act of 1976. In *Republic of Argentina v. Weltover*, the Court found that the issuance and restructuring of sovereign debt were covered by the Act's commercial activity exception.[171] In reaching that conclusion, the Court held that the distinction between commercial and sovereign actions depends upon "whether the particular actions that the foreign state performs (whatever the motive behind them) are the *type* of actions by which a private party engages in 'trade and traffic or commerce.'"[172] Because the payment and restructuring of debt are "the type of actions by which a private party engages in 'trade and traffic or commerce," they were found to constitute commercial activities under the Act.[173]

The principle that default is not a sovereign act is a fundamental milestone on the path toward equal treatment. It should prevent holdout creditors from claiming that a mere default breaches the major absolute protections of BITs, including expropriation and fair and equitable treatment. However, simply because default does not amount to a sovereign act does not eliminate the possibility of state liability. Tribunals and commentators have identified at least two other specific acts with respect to sovereign debt that could lead to state responsibility under expropriation or fair and equitable treatment clauses. First, nullifying a debt contract, by rendering it legally unenforceable, may amount to a compensable sovereign act. For example, the holding in *SGS v. Philippines* that "a mere refusal to pay a debt is not an expropriation of property" was dependent upon the existence of "remedies [] in respect of such a refusal." As

commercial or sovereign shoes"). *See also* ODETTE LIENEAU, RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE (2014).

[168] *See* Waibel, *supra* note 17, at 746; *see also* WAIBEL, *supra* note 81, at 278–87.

[169] Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case. No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, para. 161 (Jan. 29, 2004) [hereinafter *SGS v. Philippines* Jurisdictional Award].

[170] Pietrzak v. Poland, For. Claims Settlement Comm'n of U.S., Claim No. PO-1004, Decision No. PO-1 (Feb. 27, 1961). *See also* E.H. Feilchenfeld, *Rights and Remedies of Holders of Foreign Bonds*, *in* BOND AND BONDHOLDERS: RIGHTS AND REMEDIES 170 (S.E. Quindry ed., 1934) ("[A]s international law stands to-day a debtor state commits an international delinquency by annihilating a debt entirely through repudiation, confiscation, or virtual destruction (interference with the substance of the debt), but international law has not yet reached the point where all acts causing defaults and damage to creditors give rise to legal protests based on international law."); Olguin v. Paraguay, ICSID ARB/98/5, Award on Merits, para. 84 (July 26, 2001) (default on certain certificates of deposit did not amount to an expropriation, because "[e]xpropriation . . . requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place").

[171] 504 U.S. 607 (1992).

[172] 504 U.S. at 614. *But see* Stephen Schwebel, *On Whether Breach by a State of a Contract with an Alien Is a Breach of International Law*, *in* JUSTICE IN INTERNATIONAL LAW, SELECTED WRITINGS OF STEPHEN SCHWEBEL 425, 434 (1994). ("A State is responsible under international law if it commits not any breach, but an arbitrary breach, of a contract between that State and an alien." A breach is arbitrary if it is done "for governmental rather than commercial reasons.").

[173] *Weltover, Inc.*, 504 U.S. at 620.

the tribunal explained, there was no expropriation because "[w]hatever debt the Philippines may owe to SGS still exists; whatever right to interest for late payment SGS had it still has."[174] As a practical matter, states may only nullify domestic debt subject to their own laws, as states cannot alter foreign laws to render external debt unenforceable.

Second, commentators and tribunals have observed that governments are sovereign rather than commercial actors where they repudiate debt by signaling either explicitly or implicitly their intention to never service their debt obligations.[175] Because a state's capacity to reject its obligations is not dependent on the applicable governing law, states may repudiate both domestic and foreign debt. For example, the tribunal in *Abaclat* found that the passage of Argentina's Padlock Law, which precluded the government from making payments to foreign holdout creditors, thus "entitling it not to perform part of its obligations," amounted to a sovereign act.[176]

While the most critical principle for ensuring the equal treatment of creditors is that default does not amount to a compensable sovereign act, whether tribunals apply the nullification or repudiation standard may also affect whether BITs play a positive role in the sovereign debt regime. In particular, holding that repudiation is a sovereign act may constrain states from discouraging holdouts. As discussed above, efficient and successful restructuring depends on states' capacity to clearly and credibly signal to creditors that holdouts will not be paid.[177] Prohibiting the repudiation of debt would impede states from doing exactly that.

The policy implications of prohibiting nullification are mixed, although on balance they are more consistent with a positive role for BITs than a prohibition of default or repudiation. On the one hand, prohibiting nullification may lead to additional domestic litigation and increase the costs of restructuring domestic debt. On the other hand, it would not foreclose states' ability to send clear signals to holdouts and thus encourage participation in restructurings. Moreover, it would preserve creditors' access to courts and the information intermediary role courts can play.

The legal case that repudiation is a compensable sovereign act is likewise significantly weaker than the legal case for nullification. Holding that repudiation is a sovereign act is inconsistent with the principle that states act commercially when they engage in the "*type* of actions by which a private party engages in 'trade and traffic or commerce.'"[178] Clearly, private parties can signal an intent to never perform a contract or reject the contract's validity outright. They may do so to gain negotiating leverage and in good or bad faith. Regardless, a repudiation of one's contractual obligations is squarely commercial as that term has been defined.[179]

[174] *SGS v. Philippines* Jurisdictional Award, *supra* note 169, para. 161 ("There has been no law or decree enacted by the Philippines attempting to expropriate or annul the debt, nor any action tantamount to an expropriation.").

[175] *See e.g.*, Feilchenfeld, *supra* note 170, at 205 ("As long as the debt is omitted from the budget, [virtual destruction is] not treated differently from complete repudiation."); WAIBEL, *supra* note 81, at 290 ("Postponing payment indefinitely, such as a declaration or legislation never to service a particular series of bonds in the future, could constitute expropriation.").

[176] *Abaclat* Jurisdictional Decision, *supra* note 13, paras. 321–23. *See also* Feilchenfeld, *supra* note 170, at 170.

[177] *See* Zettelmeyer, Trebesch & Gulati, *supra* note 39, at 537.

[178] *See Weltover*, 504 U.S. at 614.

[179] *But see* Waibel, *supra* note 17, at 747 (the repudiation of or indefinite postponing of bonds could constitute an expropriation).

Arguments to the contrary confuse the *type* of act with its *source*. For example, the tribunal in *Abaclat* reasoned that the Argentine law "entitling it not to perform part of its obligations" was a sovereign act on the basis that it was a legislative act that "derives from Argentina's exercise of sovereign power . . . it is neither based on nor does it derive from any contractual argument or mechanism."[180] But that standard would define *any* legislative or executive act as sovereign, regardless of whether it is the type of action that a commercial actor could take. It would, taken to its logical end, define the issuance of and default on sovereign debt—which require the approval of some sovereign authority[181]—as sovereign acts, contradicting "ample authority" to the contrary.[182]

Nullification of debt, on the other hand, is plainly *not* the type "type of action[] by which a private party engages in 'trade and traffic or commerce.'"[183] While private parties may breach contracts, they do not have the power to render those contracts legally unenforceable. The better answer, therefore, both as a matter of law and policy, is that nullification of sovereign debt constitutes a compensable sovereign act, but that neither default nor repudiation does.

### 2. *How Is Fair Market Value Calculated?*

The second fundamental question upon which the resolution of the BITs and bonds dilemma depends is the calculation of compensation for sovereign acts. Compensation for expropriation is typically determined by reference to the fair market value (FMV) of the expropriated investment.[184] Calculating FMV requires assessing what a buyer would be willing to pay for the asset in an arm's length transaction, accounting for the commercial risk associated with that asset.[185] All else equal, where the commercial risk associated with the

[180] *Abaclat* Jurisdictional Decision, *supra* note 13, at paras. 321–23. *See also Ambiente Ufficio* Jurisdictional Decision, *supra* note 13, at para. 485 ("Respondent submits that the risk assumed by the Claimants of not being paid is not different from that involved in any commercial contract between a creditor and a debtor and that such ordinary commercial contracts cannot be considered an investment. However, given the risk of the host State's sovereign intervention, a risk that became manifest in Argentina's very default and restructuring, what is at stake is not an ordinary commercial risk.").

[181] The U.S. Constitution, for example, vests the power "to borrow Money on the credit of the United States" in the United States Congress. U.S. Const., Art. I, § 8. The Greek debt restructuring was likewise undertaken by way of an act of Parliament. *See Poštová Banka* Jurisdictional Award, *supra* note 14, para. 67.

[182] *See* note 168 *supra*. The standard articulated by the *Abaclat* tribunal harkens back to the "absolute" theory of sovereign immunity that did not distinguish between commercial and sovereign acts taken by a state. That view prevailed through the first-half of the twentieth century in the United States until the issuance of the "Tate Letter" by the U.S. Department of State. That letter marked the adoption of the "restrictive" view of sovereign immunity, which distinguished between sovereign and commercial acts and was later codified by the Foreign Sovereign Immunities Act of 1976. *See* Curtis A. Bradley & Laurence R. Helfer, *International Law and the U.S. Common Law of Foreign Official Immunity*, 2010 Sup. Ct. Rev. 213, 219; W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. Ill. L. Rev. 67, 77. Of course, in that context, the absolute theory served to limit sovereign's from liability in U.S. courts. An expansive view of what constitutes a sovereign act in the context of international investment law, however, would serve to expand sovereign liability by expanding the type of acts that violate treaty terms.

[183] *See Weltover*, 504 U.S. at 614.

[184] Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law 296–97 (2012). *See* Julian Arato, *The Logic of Contract in the World of Investment Treaties*, 58 Wm. & Mary L. Rev. 351, 388 (2016); Wälde & Sahabi, *supra* note 164, at 1070 ("There is largely an agreement that the 'going concern' as 'fair market value' should be the principal objective of valuing expropriated assets.").

[185] Dolzer & Schreuer, *supra* note 184, at 297.

asset has increased since its original purchase, FMV will be lower than the asset's sticker price.[186]

The principle that a mere default is a commercial act becomes highly significant in this context. First, it establishes that a creditor holding a defaulted bond would not have a claim for damages on account of the default itself. The FMV of defaulted bonds would simply be the price at which those bonds trade on the market (which incorporates the effect of the default), or, alternatively, the price of any new bonds that the creditor could have obtained through an exchange.[187] In other words, even if the creditor did have a cognizable claim for default, it could only obtain damages equivalent to what it could obtain on the market or in a bond exchange, and would thus have no incentive to hold out and bring a claim in a first place.

Second, treating default as a commercial act establishes that, where a state acts in its sovereign capacity—for example by nullifying its debt—creditors should be compensated only for losses due to the sovereign act, not any losses due to default. In other words, it establishes that the proper compensation for a sovereign act should not be the face value of the bond, but instead its fair market value, incorporating losses due to default. This should further reduce creditors' leverage and the holdout problem by reducing the damages available for cognizable claims and minimizing any difference between what is offered through an exchange and what is available through investor-state arbitration.

In practice, determining the FMV of an asset subject to a sovereign act such as an expropriation presents challenges, because both the act and the expected remedy can affect the asset's market price. Where less than complete compensation is expected, an expropriation or impending expropriation will reduce what buyers are willing to pay for the asset and thus its market value.[188] Where complete or above-market price compensation is expected, an expropriation or impending expropriation may actually increase the market price of the asset, creating a situation of moral hazard.[189] To minimize such distortions, international investment law often calculates the FMV of an asset by looking to the market value of the asset before the expropriation took place or was anticipated. For example, the World Bank Guidelines on the Treatment of Foreign Direct Investment calls for fair market compensation to be "determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known."[190]

[186] Where no competitive market exists—a situation that is common for many for the assets subject to expropriation—FMV may be calculated by way of the net present value of discounted cash flow that measures the net present value of expected income produced by the asset. These measures of value should be similar in well-functioning markets. *See* Wälde & Sahabi, *supra* note 164, at 1075; DOLZER & SCHREUER, *supra* note 184, at 297.

[187] These two values should be the same, at least as long as the exchange remains open to the creditor. *See* STURZENEGGER & ZETTELMEYER, *supra* note 47, at 89.

[188] Wälde and Sahabi, *supra* note 164, at 1081.

[189] *Id.* at 1065.

[190] Legal Framework for the Treatment of Foreign Investment, Vol. II, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, 41 (1992).The Argentina-U.S. BIT is likewise typical in requiring compensation "equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier." Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, Art. IV(1), Nov. 14, 1991, *entered into force* Oct. 20, 1994. While this approach offers a practical way to disaggregate commercial risk and sovereign risk, it is imperfect. Even before an expropriation occurs or is known, the risk of such an event will be factored into the market price (though the assessment of that risk will obviously rise once it is known to be imminent or after the event occurs).

In the case of sovereign debt, calculating the FMV of nullified debt is likely to be particularly challenging, because the (compensable) risks of nullification and the (noncompensable) risks of default are almost certainly correlated. As such, the risk of nullification can be expected to rise and fall with the risk of default, making it difficult to disentangle the two.

As a practical matter, however, FMV in this context could be determined by using a number of benchmarks. First, consistent with World Bank Guidelines, and assuming there is a delay between a default and a nullification, tribunals could determine FMV by way of the price of the bond after default but before the nullification occurs or becomes known. However, this method may misprice the FMV of the bonds, because, as discussed above, the price after default likely already incorporates a higher risk of nullification. Second, tribunals may look to the face value of new bonds that are offered in an exchange. This approach, too, may misprice the bonds if it takes place following a nullification or in the shadow of an expected nullification. On the other hand, because of the incentives faced by states and their agents discussed above, there is good reason to believe that the face value of exchange bonds would meet or exceed the state's capacity to pay, and thus effectively compensate for any nullification effects.[191] Third, tribunals could look to the change in market value of comparable debt instruments that have been subject to restructuring or default but not nullification, and compare that with the change in market value of bonds subject to default and nullification. This approach could more cleanly separate the price impact of nullification from that of default, although it would require that there be similar non-nullified debt to compare.[192]

None of these benchmarks is perfect, but together they provide practical ways to disentangle commercial from sovereign risk and preclude compensation for the former. By doing so, they minimize any differences in compensation between holdouts and non-holdouts and thus more fully achieve the equal treatment of like creditors.

### *3. Are Umbrella Clause Claims Allowed Notwithstanding an Exclusive Forum Selection Clause?*

In addition to claims for expropriation or fair and equitable treatment, creditors may also bring claims for contractual breach under so-called umbrella clauses. Umbrella clauses are not contained in all treaties,[193] are by no means uniform,[194] and are highly

[191] *See* Section III.B.1 *supra.*

[192] This contrasts with Waibel's proposal for calculating FMV. Waibel proposes to calculate the FMV of bonds in default by discounting their face value by the yield implicit in new exchange bonds. *See* Waibel, *supra* note 17, at 756–57. That method does not exclude compensation for default risk, because the default risk associated with newly issued bonds will be lower than the default risk associated with the old bonds (which will already be in default). By allowing creditor-claimants to benefit from that lower default risk, his proposal allows claimants to obtain compensation for the higher risk of default of the bonds they actually own. *Id.* at 757, 758 (citing STURZENEGGER & ZETTELMEYER, *supra* note 47, at 88–90).

[193] *See* Arato, *supra* note 184, at 372 (umbrella clauses are "relatively uncommon"); *but see* Judith Gill, Matthew Gearing & Gemma Birt, *Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases*, 21 J. INT'L ARB. 397, 403 n. 31 (2004) (approximately 40% of a sample of BITs contained umbrella clauses).

[194] *See* Katia Yannaca-Small, *Parallel Proceedings*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW, *supra* note 150, at 108, 1030 (noting different formulations of umbrella clauses, including promises by the state to "observe any obligation it may have entered to," "constantly guarantee the observance of the commitments it has entered into," and "observe any obligation it has assumed" with respect to investments.).

controversial.[195] But at least some tribunals have found that umbrella clauses allow investors to bring claims predicated on a contractual breach.[196] Where such a clause applies and is so interpreted, a creditor-claimant could establish liability by simply showing that the state breached its debt contract by defaulting.

Whether umbrella clauses end up playing a role in the arbitration of sovereign debt disputes hinges on a contested threshold question: do forum selection clauses that select a national court as the exclusive forum for contractual breach foreclose umbrella clause claims in investor-state arbitration? This question is relevant because external bonds often select New York or London as the designated forum.[197] If exclusive versions of such clauses effectively foreclosed contractual claims for default, then it will not be possible to assert umbrella clause claims for at least some sovereign debt. If, on the other hand, creditors can bring umbrella clause claims notwithstanding exclusive forum selection clauses, then the adjudication of such claims could be determinative as to whether international investment law plays a positive or negative role in the sovereign debt regime.

Two arbitrations involving the same claimant and a similar set of facts illustrate the divide on this question. In *SGS v. Paraguay*, the tribunal found that a contract with an exclusive forum selection clause did not foreclose investor-state arbitration of contract claims on the ground that the treaty's umbrella clause effectively converted any contract claims into treaty claims. Because the forum selection clause in the contract applied only to contract claims, it thus had no bearing on the adjudication of umbrella clause claims even if those claims were premised on a contractual breach.[198]

The tribunal in *SGS v. Philippines*, on the other hand, came to the opposite result. It reasoned that while umbrella clauses may "make it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments," they do "not convert the issue of the *extent* or *content* of such obligations into an issue of international law."[199] Because the "extent" and "content" of those obligations remained inherently contractual, the tribunal found that the exclusive forum selection clause applied, and it stayed the arbitration.[200]

There are good commercial and economic reasons to prefer the *SGS v. Philippines* approach to the approach taken in *SGS v. Paraguay*. Forum selection clauses are part of a contractual bargain and can impact the price of the contract. Limiting the parties' ability to contract out of investment arbitration thus limits party autonomy and may introduce inefficiency into the contracting process.[201] While it may be sensible to make access to investment arbitration a

[195] *See, e.g.*, Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 137 (2006).

[196] *See* Christoph Schreuer, *Travelling the BIT Route: Of Waiting Period, Umbrella Clauses and Forks in the Road*, 5 J. WORLD INV. & TRADE 231, 249–55 (2004); Schill, *supra* note 87, at 1.

[197] *See* MEGLIANI, *supra* note 26, at 523; *see also* Olivares-Caminal, *supra* note 29, at 391.

[198] SGS Société Générale de Surveillance S.A v. The Republic of Paraguay, ICSID Case No. ARB/07/29, Decision on Jurisdiction, paras. 131, 138–42 (Feb. 12, 2010) [hereinafter *SGS v. Paraguay* Decision on Jurisdiction].

[199] *SGS v. Philippines* Jurisdictional Award, *supra* note 169, para. 128.

[200] *Id.*, para. 177. *See also* James Crawford, *Treaty and Contract in Investment Arbitration*, 24 ARB. INT'L 351, 370 (2008) (arguing in favor of an "integrationist" approach).

[201] *See* Arato, *supra* note 184, at 375–78.

default rule under some circumstances—such as where the negotiation of access entails significant transaction costs and most parties are likely to agree to arbitration—those circumstances are unlikely to be present with respect to sovereign debt, where transaction costs are unlikely to be high (particularly in contracts that contain negotiated forum selection clauses).[202]

Moreover, any procedural economy concerns that could favor the *SGS v. Paraguay* approach are unlikely to materialize. In theory, accepting jurisdiction over umbrella clause claims could prevent parallel proceedings, in which parties litigate other treaty claims in investment arbitration and contract claims in national court. In reality, however, there is unlikely to be an "identity of the parties' object and cause of action" in the different proceedings, as contract claims will be based in national law and investor-state claims will be based on treaty law.[203] As such, neither *res judicata*, *lis pendens*, nor fork-in-the road provisions would prevent parallel proceedings and procedural waste.[204] In this context, the better answer is that exclusive forum selection clauses should foreclose the investor-state arbitration of umbrella clause claims predicated on contractual breach.

#### 4. *Do Contract or Fair Market Value Damages Apply to Umbrella Clause Claims?*

Assuming, however, that umbrella clause claims for sovereign default are admissible, their impact on sovereigns and their creditors will turn on the calculation of damages. Two obvious choices present themselves: FMV and contract damages. While tribunals "rarely properly distinguish[]" between the two,[205] which of these is applied will have a significant impact on the role that international investment law plays in the sovereign debt regime.

As noted above, the standard metric for the calculation of damages for treaty claims is FMV, and the FMV of sovereign bonds will drop below the face value of the bonds in the event of a default.[206] If FMV was also used to calculate damages for umbrella clause claims, the compensation claimants received under such claims would mirror the compensation for other claims. As with respect to other claims, such compensation would effectively lead to the equal treatment of like creditors.[207]

On the other hand, if normal contract damages were awarded for umbrella clause claims, creditor-claimants would be entitled to damages specified by the debt contract itself or by the applicable national law on contracts. Because contract damages do not account for changes in risk or fluctuations in the market value of the contract,[208] contract damages would be significantly higher than FMV in times of default.

The divergent approaches of *SGS v. Paraguay* and *SGS v. Philippines* provide a way forward. According to the tribunal in *SGS v. Paraguay*, because umbrella clauses effectively convert contract claims into treaty claims,[209] exclusive forum selection clauses do not preclude

[202] *But see* Gulati & Scott, *supra* note 24, at 29 (discussing the stickiness of existing sovereign bond terms).

[203] *Azurix*, *supra* note 150, para. 88 (*quoting* Benvenuti and Bonfant SRL v. The Government of the People's Republic of the Congo, Award, 1 ICSID Rep. 330, 340, para. 1.14 (Aug. 8, 1980)).

[204] *See* note 148 *supra*.

[205] Wälde & Sahabi, *supra* note 164, at 1090.

[206] *See* Section IV.B.2 *supra*.

[207] *Id.*

[208] Wälde & Sahabi, *supra* note 164, at 1091.

[209] *SGS v. Paraguay* Decision on Jurisdiction, *supra* note 198, paras. 131, 138–42.

the adjudication of umbrella clause disputes. According to the tribunal in *SGS v. Philippines*, umbrella clauses do not convert contract claims in treaty claims, and thus exclusive forum selection clauses preclude the investment arbitration of claims arising from a breach of contract. Following the logic of this split, to the extent that umbrella clause claims are admitted, such claims should be considered treaty claims, not contract claims, and therefore treaty damages, i.e., FMV, not contract damages, should apply. To the extent such umbrella clause claims are found to be contractual in nature, the exclusive forum selection clauses found in at least some bond instruments should preclude their arbitration, and questions regarding damages should not arise.

* * * *

The path toward equal treatment, and the resolution of the BITs and bonds dilemma, runs through the four debates reviewed above. In brief, if (1) defaults are commercial and not sovereign acts, and (2) the appropriate measure of compensation for treaty violations is FMV, then the damages for any treaty claim related to sovereign debt should not be the face value of the bond, but rather the FMV of the bond, accounting for the fact that it is in default. If (3) umbrella clause claims are admitted on the basis that such claims are treaty and not contract claims, then (4) the appropriate measure of compensation for umbrella clause claims should not be contract damages, but instead the FMV of the bond, again accounting for the default.

Because the FMV of a defaulted bond can be established by reference to the trading price of such bonds, the value of a bond exchange in a restructuring agreement or the value of comparable instruments, claimant-creditors should only be able to recover damages equivalent or similar to what is available to other like creditors.[210] This should prevent states from discriminating against creditors. Moreover, because it limits any increases in creditor leverage in the aggregate and the potential for claimants to fare better in arbitration than in restructuring, this interpretation would mitigate the holdout and over-compliance problems and the costs they create.

### C. *Objections and Responses*

Before concluding, two potential objections to the above proposal merit responses.

#### 1. *The Rare Case Versus the Typical Case*

The first objection could be put as follows: The analysis, conclusions, and proposal in this Article are based upon data and observations regarding the average or typical default. While most states may wait "too late" to restructure and then do so "too little," that does not preclude other states from defaulting too often or too much. Why should investment law be built around the typical or prevailing case, instead of protecting creditors against the rare case of opportunistic default?

There are three responses to that objection. First, unless investment law distinguishes between the rare case of opportunistic default and other more common defaults, building investment law around the rare opportunistic default will have all of the negative effects in

[210] *See* Section IV.B.2 *supra*.

other more common cases. With respect to those other cases, BITs will threaten to increase inefficiencies and deadweight losses, and thus undermine the core purpose of those treaties.

Second, to the extent international investment law attempts to distinguish between the rare case of opportunistic default and other more common defaults, it is likely to end up on a slippery slope toward the negative impacts described above. While some defaults may be obviously opportunistic, others are likely to be closer calls. Determining which is opportunistic would require assessing a state's ability to pay, something even the IMF—an institution equipped with teams of economists dedicated to doing precisely that—struggles to do effectively.[211] The notion that ad hoc international investment tribunals would be able to do any better is highly unlikely. Instead, a fragmented investment arbitration regime would almost certainly lead to conflicting, contradictory, and simply incorrect assessments.[212]

Finally, while it is true that the above proposal does not offer additional remedies to creditors in the event of rare opportunistic defaults, it supports other processes that could provide relief in such cases.[213] For example, the proposal protects creditors' other legal remedies, such as access to national courts, and contributes to the smooth functioning of restructurings by protecting against discrimination. It moreover leaves undisturbed other effective market-based tools for creditors to insure against risk, including through the purchase of credit default swaps.[214] In other words, the proposal supports, rather than supplants, existing functions.[215]

### 2. *Mandatory and Flexible Rules Versus Optional and Stable Rules*

The second objection is broader and could be put as follows: The analysis underlying this proposal depends on a set of costs, limitations, and redundancies created by other institutions, including, in particular, the costs of default, foreign sovereign immunity, and national courts. If any of these costs or institutions were to change, the optimal role for investment law could change as well. Why should tribunals tailor their interpretations to specific disputes and to the external institutions and dynamics that surround the dispute rather than apply them indifferently to all manner of disputes regardless of the consequences? In other words, why should tribunals prioritize the flexibility rather than the stability of investment treaty norms?

National courts, at least in the case of external debt, certainly prioritize the latter. As Buchheit, Gulati, and Tirado observe: "Nothing can realistically be done to keep a holdout from obtaining a judgment in a foreign court on a foreign law-governed debt instrument. Attempting to unseat basic tenets of contract law in countries like the United

[211] *See, e.g.*, IMF, *Greece:* Ex Post *Evaluation of Exceptional ACCESS Under the 2010 Stand-by Arrangement*, IMF Country Report No. 13/156, at 2, 17, 21, 22, 26 (May 20, 2013) (acknowledging its projections regarding Greece's economy and capacity to pay were overly optimistic in hindsight).

[212] *But see* Waibel, *supra* note 17, at 758, 759 (arguing that while tribunal's ability to determine states' capacity to pay is "tenuous" tribunals could adjudicate such disputes).

[213] *See* Puig & Shaffer, *supra* note 85, at 407.

[214] In return for regular premium payments, investors can purchase credit defaults swaps (CDS) that pay out in the event of a default. The CDS market for sovereign debt grown to such an extent that the concern has shifted away from creditor exposure to the "empty creditor" problem, in which creditors, fully insured against default, face less incentive to agree to restructuring. Das, Papaioannou & Trebesch, *supra* note 3, at 59; *see also* IMF, *Sovereign Debt Restructuring*, *supra* note 21, at 32.

[215] *See* Puig & Shaffer, *supra* note 85, at 362.

Kingdom . . . will meet fierce resistance."[216] In taking this approach, national courts have sometimes played a destructive role in sovereign default cases.[217]

At the same time, by establishing clear rules that recognize sovereign debt instruments as enforceable contracts, national courts have slowly but surely encouraged creditors and states to agree to private solutions to sovereign debt problems. As discussed above, more and more sovereign debt contracts now contain collective action clauses that can avoid the worst consequences of the rigid enforcement of sovereign debt contracts. While these changes have been painstakingly slow, and have yet to catch up with some problematic provisions, including the *pari passu* clause,[218] the steady application of contract law by national courts has given states and creditors clear rules to negotiate around.

Why should international investment tribunals not do the same? As an initial matter, unlike national contract law, the Vienna Convention on the Law of Treaties requires that BITs be interpreted in their "context and in the light of [their] object and purpose."[219] The object and purpose of investment treaties—investment promotion—compels consideration of the real world effects that BIT interpretations create, which in turn requires considering how those interpretations will interact with other factors and institutions. Ignoring the context in which investment treaties are applied and the effects of that application is incompatible with the law on treaty interpretation.

Just as importantly, the putatively mandatory nature of investment law, the breadth of its application, and its substance and procedure all favor flexibility over stability. The weight of arbitral precedent has treated investment treaties as creating a set of mandatory rules that cannot be contracted out of.[220] The mandatory nature of international investment law neutralizes one of the principle benefits to clear and stable rules, namely that they facilitate party autonomy and efficiency by providing a clear basis for negotiations.[221] Instead, mandatory rules, particularly inflexible ones, threaten to constrain party autonomy rather than facilitate it, and to undermine rather than advance efficiency.[222] This is particularly so because investment treaties establish substantive and procedural rights that in any other context would amount to important price terms subject to negotiation.[223]

The BITs and bonds dilemma is an extreme illustration of the inefficiencies that mandatory rules can create. But mandatory rules can also create inefficiencies in more subtle ways, including by forcing substantive and procedural protections onto states and investors that

[216] Buchheit, Gulati & Tirado, *supra* note 48, at 6–7. As Weidemaier and McCarl observe, "judges cannot simply declare sovereign loans unenforceable; their role and training require them to issue a recognizably 'legal' opinion that recognizes sovereign loans as binding legal obligation." W. Mark C. Weidemaier & Ryan McCarl, *Creditors' Remedies*, *in* SOVEREIGN DEBT MANAGEMENT 139, 150 (Rosa M. Lastra & Lee Buchheit eds., 2014). Moreover, they have an interest in preserving their respective forums' reputations as "jurisdiction[s] where contract rights are protected." GULATI & SCOTT, *supra* note 24, at 176.

[217] *See, e.g.*, Panizza, Sturzenegger & Zettelmeyer, *supra* note 71, at 657–59 (describing recent evolutions in national law that have exacerbated the holdout problem).

[218] *See* GULATI & SCOTT, *supra* note 24, at 29.

[219] *See* Vienna Convention on the Law of Treaties, Art. 31(1), May 23, 1969, 1155 UNTS 331 [hereinafter VCLT]. According to Article 31(2), "[t]he context for the purpose of the interpretation of a treaty shall comprise, [inter alia] the text, including its preamble and annexes."

[220] *See* Arato, *supra* note 184, at 360.

[221] *See* COOTER & ULEN, *supra* note 92, at 178.

[222] *See* Arato, *supra* note 184, at 360.

[223] *Id.* at 372.

they may otherwise have chosen to forgo. For example, investment treaties create an additional enforcement mechanism that insulates investors from the risk of sovereign acts. But that mechanism comes at a cost to states that we would expect to be priced into contracts *ex ante*.[224] Where investors do not desire or are not willing to pay that cost, investment treaties may actually impede rather than promote investment.[225]

The potential for such inefficiencies is particularly significant in light of investment law's expansive reach. Most BITs purport to impose a single set of rules over nearly every aspect of the economy, including "all assets" or "every kind of asset"—from real property to concession contracts, equity shares, debt, and claims to performance and money.[226] This extraordinary breadth increases the risk that any one mandatory rule will be inefficient with respect to at least some transactions. As Arato has observed, applying the same set of rules designed for "Blackstonian property" to contracts, debt, and equity has distorting effects.[227] Imposing mandatory one-size-fits-all procedural rules can likewise cause inefficiencies.[228]

In this context, the substantive and procedural flexibility of investment law makes sense. BIT standards are notoriously vague and capacious. Fair and equitable treatment,[229] national treatment, and even expropriation[230] standards leave ample room for a multitude of interpretations that can vary depending on the circumstances and the transaction at issue. The enforcement mechanism for BIT obligations is likewise optimized for flexibility. The ad hoc nature of investor-state arbitration, the lack of any meaningful appeals mechanism, and the lack of binding precedent allow tribunals the flexibility to tailor their interpretations to the transaction before them without constraining other tribunals with respect to future transactions.

This flexibility makes further sense in light of the genesis of BITs. BITs are negotiated and established among states, leaving no opportunity for negotiation with investor beneficiaries. Moreover, because their standards are meant to cover a wide range of investments, they are not tailored to any particular one. In that sense, BITs can be conceived as incomplete contracts whose interpretation and application calls for considering what optimizes the particular transaction at issue.

Flexibility, of course, has its own costs. Particularly where it leads to inconsistencies with respect to the same transactions and the same factual circumstances, the flexibility of investment law substance and procedure can create uncertainty that impedes states and investors from pricing treaty rules into their transactions *ex ante*. Ideally, these costs would lead to a

[224] Horn & Norback, *supra* note 89, at 5–6.

[225] *See* Arato, *supra* note 184, at 405. In effect, investment treaties force investors to purchase insurance whether they want to or not.

[226] *See* Pahis, *supra* note 15, at 140.

[227] *See* Julian Arato, *A Private Law Critique of International Investment Law*, 113 AJIL 1, 3 (2019).

[228] *See, e.g.*, Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 856–60 (2006) (party autonomy with respect to procedure can lead to efficiencies); Kevin E. Davis & Helen Herschkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507 (2011) (acknowledging the efficiency case against mandatory procedural rules but arguing that the privatization of procedure has other negative effects).

[229] *See, e.g.*, CAMPBELL MCLACHLAN, LAWRENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 226–47 (2d. ed. 2017) (noting the various applications of the FET standard).

[230] *See e.g.*, SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY INTERPRETATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION 231–91 (2009) (observing the divergences in the interpretation of what constitutes an indirect expropriation are so great as to create a sense of "disarray").

reexamination of the mandatory nature of international investment law, at least with respect to state contracts in which investors are in a position to bargain—and pay—for the protections that they desire. In addition, or alternatively, states could specify more precise standards of treatment for different transactions, as some states are beginning to do with respect to sovereign debt.

Yet as long as the vast majority of investment agreements impose a set of mandatory rules that cover an extraordinarily wide range of assets and transactions without distinction, flexibility as opposed to stability may be the next best option. That is certainly the case with respect to sovereign debt.

## V. Conclusion

Sovereign debt poses a dilemma to international investment tribunals. While most investment treaties cover sovereign debt, that coverage threatens to undermine the core purpose of those treaties. Instead of encouraging investment by correcting inefficiencies and thus reducing the cost of capital, applying investment treaties to sovereign debt threatens to do the opposite. Investment treaties threaten to worsen the holdout problem, make states even more reluctant to restructure unsustainable sovereign debt, and to increase litigation and uncertainty costs. All of these effects increase the cost of lending for creditors and the cost of borrowing for states, leaving both groups worse off than they otherwise would be in investment law's absence.

This Article identifies that dilemma and proposes a solution to it. It demonstrates how guaranteeing the equal treatment of like creditors, but going no further, can resolve all of the inefficiencies that investment treaties would otherwise create. It further demonstrates how guaranteeing the equal treatment of like creditors would allow treaties to play a positive role in the sovereign debt regime by preventing states from unjustifiably discriminating between creditors. Finally, it shows how current investment treaties can be reasonably interpreted to achieve that outcome.

Ultimately, however, what makes this proposal possible may also undercut its efficacy. That is because the flexibility of investment treaty norms that allows for an interpretive solution to the BITs and bonds dilemma also makes it less likely that tribunals will adopt it in a uniform manner on which states can rely. It is for this reason that states should take steps to limit the costs that investor-state arbitration may impose on sovereign debtors and creditors.

Some states have already been moving in this direction. A few newly negotiated investment treaties, such as the recently adopted (but not yet in force) Argentina-Japan BIT, exclude sovereign debt all together.[231] Other agreements, like the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), take a more elaborate approach that only allows for discrimination claims in the event of a negotiated restructuring, but permits other claims in the absence of one.[232] The analysis in this Article reveals the strengths and weaknesses of each of these approaches.

On the one hand, the Argentina-Japan approach of excluding sovereign debt entirely solves the BITs and bonds dilemma by preventing BITs from increasing deadweight losses and

[231] *See* Argentina-Japan BIT, *supra* note 78, Art. 1.

[232] *See* CPTPP, *supra* note 78, ch. (Investment), Annex 9-G.

encouraging inefficient state behavior. However, like arbitral decisions that reject jurisdiction, it deprives investment law of the opportunity to ensure the nondiscriminatory treatment of creditors.

On the other hand, the CPTPP, which allows for national treatment and most favored nation treatment claims in the event of a negotiated restructuring,[233] maintains a positive supportive role for international investment law. However, it does not resolve all of the inefficiencies of subjecting bonds to the strictures of that law. That is because the CPTPP defines "negotiated restructuring" as a restructuring agreed pursuant to the collective action clause of a particular instrument, or agreed by holders of at least 75 percent of the aggregate principal of that instrument.[234] Like other such clauses, therefore, the CPTPP allows holdout creditors to gain a blocking position in a particular debt series and bring claims for full payment[235] (in the case of the CPTPP, by way of an expropriation claim[236]).

If one were more concerned about opportunistic defaults than about inefficient over-compliance, then the CPTPP approach could make sense. Relative to no differentiation of sovereign debt at all, it balances some progress against the holdout problem with an increase in creditor leverage that could act as a check on opportunistic defaults. Alternatively, if one were concerned about inefficient over-compliance but not about creditor discrimination, then the Argentina-Japan approach of excluding sovereign debt would make sense. But if one accepts the consensus of empirical studies that states are too reluctant, not too willing, to restructure their debts *and* one recognizes that state agents may nevertheless have an incentive to unjustifiably discriminate among creditors, the better approach is to restrict tribunals' jurisdiction over sovereign bonds to claims for discrimination, even in the absence of a negotiated restructuring.

In addition to future treaty reforms, states should also consider more immediate steps. They might, for example, issue interpretive statements that support the interpretations described in this Article. While tribunals have accorded differing weight to such statements, at least some have accepted them as binding or at least persuasive.[237] States and creditors could also attempt to limit the scope of international investment arbitration through modifying sovereign debt instruments, notwithstanding investment law's putatively mandatory nature. Such attempts are unlikely to be successful, although at least some tribunals have

[233] *Id.*, paras. 2–3.

[234] CPTPP, *supra* note 78, ch. 9 (Investment), Art. 9.1 ("*negotiated restructuring* means the restructuring or rescheduling of a debt instrument that has been effected through (a) a modification or amendment of that debt instrument, as provided for under its terms, or (b) a comprehensive debt exchange or other similar process in which the holders of no less than 75 per cent of the aggregate principal amount of the outstanding debt under that debt instrument have consented to the debt exchange or other process") (emphasis in original).

[235] While an aggregate collective action clause could address this problem, imposing one via treaty would present obvious complications, such as requiring that all creditors—including creditors not covered by the treaty—participate in an aggregate vote that conflicts with or has no basis in their contracts.

[236] CPTPP, *supra* note 78, ch. 9 (Investment), Annex 9-G, para. 1. The CPTPP attempts to discourage such claims by imposing a 270-day waiting period, but it allows them nonetheless. *Id.* at 3.

[237] *See* Anthea Roberts, *State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority*, 55 HARV. INT'L L.J. 1, 53 (2014) ("disagreement exists over whether an 'authentic' interpretation by the treaty parties is binding or simply highly persuasive"); Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AJIL 45, 59 (2013) (noting that tribunals have given different weight to such statements depending on whether they operated under a private or public international law paradigm).

signaled that they would give effect to explicit contractual terms that purport to impose such limits.[238]

All of these proposals—treaty amendments, interpretive statements, and revisions of bond covenants—face their own obstacles, however. In addition to the transaction costs of their negotiation and the time they will take to come into force, each may also face a coordination problem. Even though applying international investment law to sovereign debt may be costly for creditors and states in the aggregate, like holdout litigation more generally, it could still produce benefits for those creditors that employ it. And because other creditors of other states may be able to obtain such advantages through other BITs or through other debt instruments, creditors and creditor states may resist unilaterally disclaiming them.[239] Sovereign bonds, therefore, may pose a different version of the coordination problem that commentators have typically ascribed to investment treaties, in which capital importing states sign on to BITs because they are stuck in a prisoners' dilemma.[240] With respect to sovereign debt, capital *exporting* states and their creditors may face such a dilemma instead.

All of these obstacles, including the coordination problem, are surmountable. But they do make it more difficult for states to implement a social-welfare maximizing solution to the BITs and bonds dilemma on their own, particularly in time to address the next wave of sovereign defaults. Which makes it all the more important that tribunals do so instead.

[238] *See* Crystallex Int'l Corp. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/11/2, Award, paras. 481–82 (Apr. 4, 2016) (holding that a waiver of investment arbitration would have to be explicit to be effective, and that an exclusive forum selection clause that merely omits reference to investment arbitration does not waive an investor's rights under the applicable treaty).

[239] The new Argentina-Japan BIT both evidences this coordination problem and provides a potential solution to it. While that agreement excludes sovereign debt from its coverage, it calls for revisiting that exclusion in the event Argentina signs a new BIT that covers sovereign debt. *See* Argentina-Japan BIT, *supra* note 78, Art. 31(a). That solution, however, is only partial as it allows for the possibility that old BITs may continue to provide coverage even after the new Japan-Argentina BIT applies.

[240] *See* Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998).