WOULD THE INVOLVEMENT OF ICSID INCREASE THE MOMENTUM OF SOVEREIGN DEBT RESTRUCTURING?

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I. Sovereign Debt Restructuring

While there is no universally accepted definition, a sovereign debt restructuring can be defined as an exchange of outstanding sovereign debt instrument such as loans or bonds, for new debt instrument or cash through formal process. Sovereign debt here refers to debt issued or guaranteed by the government of a sovereign state. One can generally distinguish two main elements in a debt restructuring: debt rescheduling, defined as a lengthening of maturities of the old debt, possibly involving lower interest rate; and debt reduction, defined as a reduction in the face (nominal) value of the old instrument. Both types of debt operation involve a "haircut," that is, a loss in the present value of creditor claim.

Rating agencies such as Standard & Poor's (2006), typically define distressed debt exchange as restructuring at terms less favorable than the original bond or loan terms. However, it is important to distinguish distress debt exchanges from routine liability management operations (LMDs) aimed at improving the profile of public debt, such as debt swaps, which could occur in normal times.

Default events and debt restructuring are closely related but not identical. A default is the failure of a government to make a principal or interest payment on time (beyond the grace period). Default can be partial (i.e. when only parts of country's debt are not being serviced) or complete (involving a halt of all debt payments to creditors.) in most cases, restructurings occur after a default, and are known as post-default restructurings. However, recently years have also seen a number of pre-emptive debt restructuring, where outstanding debt instruments are exchanged before the government misses any payments.

Relatedly, the concept of a "credit event" has gained increasing attention in the recent years and is mostly used in context of credit default swaps (CDS), which have grown in importance in recent years. Importantly, not all sovereign debt restructuring automatically trigger a credit event. Debt exchanges that are not forced upon creditors or debt exchange in normal times may not constitute a credit event. More specifically, the International Swaps and Derivatives Association (ISDA) consider a restructuring a credit event only if: (i) it occurs as a result of deterioration in the creditworthiness or financial condition of the sovereign; and (ii) it is "binding on all holders" (i.e. applies in mandatory form to all bondholders of a series). These criteria apply irrespective of whether the debt restructuring is pre or post default.

Sovereign Debt Restructuring by Types of Creditor					
Creditor	**Commercial Banks**	**Bondholders**	**Bilateral (Governments)**	**Multilateral (World Bank, IMF)**	**Suppliers, Trade Creditors**
Restructuring Vehicle	**London Club (Creditor Committees)**	**Exchanges Offers**	**Paris Club**	**Preferential Treatment, Debt relief only for poorest countries**	**Ad hoc**

Table 1: Overview of Debt Restructuring Vehicles by Types of Creditor[1]

A. Problems faced in SDR

1. Data Sources

As debts owed either directly by a country's national government, or owed indirectly by virtue of that government guarantee to private sector creditors, like banks and bondholders. Such defaults seem very difficult. The most widely comprehensive and widely used source of data on the dates of defaults on sovereign debt owed to private sector creditors, as well as the dated of settlement of these default, is published by the

1 Mar L. J. Wright, Sovereign Debt Restructuring: Problems and Prospects, Harvard Law Business Review, available at http://www.hblr.org/wp-content/uploads/2012/07/HLB206.pdf. (Visited on September 22, 2013).

ratings agency Standard and Poor's (S&P). The agency uses World Bank's estimates of debt reduction interest and principal forgiven, and debt buy-packs, as published in Global Development Finance (GDF) in order to obtain the largest sample possible and to ensure consistency of treatment across default episodes[2]. This has two drawbacks. First, it does not capture the effects of any extensions of maturities on creditor losses. Second, the World Bank data do not make any distinction between forgiveness of debts by private creditors and forgiveness of debt by private creditors and forgiveness by official creditors. Therefore, it is necessary to scale the amount of forgiveness using estimate of the total amount of debt renegotiated and the proportion owed to private creditors from both GDF and Institute for International Finance[3].

2. *Delay in Reaching Agreement*

Looking across all defaults, delays in restructuring average 7.4 years with the median default taking around six years to be resolved. These figures for delay are slightly less than the average 8.8 year average length of default recorded in a census of defaults over the past two centuries by Pitchford and Wright.[4]

There is considerable variation in the amount of delay observed across groups of countries. Wright reports data on differences in delays across countries at different levels of development and across different regions as classified by the World Bank[5]. He finds that the average low-income country experienced delays in excess of nine years, while the average upper-middle-income country was able to restructure its debts in just over 5.5 years. Driven by the concentration of low –income countries in Su-Saharan Africa, there is a tendency for delays to be longer in Sub-

2 David Benjamin & Mark L. J. Wright, Recovery Before Redemption: A Theory of Delays in Sovereign Debt Ren gotiations 3, 68–72 (UCLA Working Paper, 2009), available at www.econ.ucla.edu/mlwright/research/workingpapers/RBR_040809.pdf (Visited on September 18, 2013).

3 Id.

4 Rohan Pitchford& Mark L. J. Wright, Restructuring the Sovereign Debt Restructuring Mechanism 5 (UCLA Working Paper, June 5, 2007), available at http://www.econ.ucla.edu/mlwright/research/workingpapers/RSDRM.pdf. (Visited on September 20, 2013).

5 Mark L. J. Wright, Restructuring sovereign debts with private sector creditors: theory and practice, in sovereign debt and the financial crisis: will this time be different? 295, 295–304.

Saharan Africa, at 8.5 years, than in Latin America and the Caribbean, at about 7.5, and Europe and Central Asia, at 4.5 years.[6]

3. Creditor Losses

Using the same samples of debt restructuring episodes as in this Article, Benjamin and Wright found that average creditor losses, weighted by the level of outstanding debt, were 38%; equivalently, the average recovery rate for the creditors was 62%. The median haircut was slightly higher at 42%. Like delays in restructuring, there was also considerable variation in the size of haircut cross countries, with some groups of creditors not losing as much as 90% of the value of their claims.[7]

Wright reports on the variation in creditor losses by income level and by region. He finds that there is a tendency for haircuts to decline with the income level of a country.[8] Haircuts were largest in low-income countries, where they exceeded 50% on average, and were lowest in the upper-middle-income countries at around 38%. When the data are disaggregated by region, the largest haircuts were found in Sub-Saharan Africa, where they averaged just below 50%, while the largest haircuts across the European and Central Asian, Latin America and Caribbean, and Middle East and North African regions were all roughly 30%[9].

4. Costs of Restructuring

The available evidence suggests that many sovereign debt restructuring operations are quite costly in terms of the expenses required to administer the restructuring. Pitchford and Wright present evidences that the costs of restructuring vary from as little as 0.5% of the value of the debt being restructured, for relatively straightforward restructurings, to up to more than 3% of the value of the debt for complicated restructuring operations in which the sovereign's debts are numerous private creditors within the country.

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6 Id. at 298.
7 Supra note 1, at 40.
8 Supra note 4, at 298.
9 Supra note 4, at 70-71.

Only a small share of these costs, including legal fees and printing expenses, are easy to verify and share between creditors. This is important because to the extent that costs cannot be verified, they are difficult to reimburse. And given the size of these costs, this creates an incentive for some creditors to free rides on the efforts of other creditors.

Therefore, the evidence indicates that the process of restructuring sovereign debts or at least those debts owed to private sector creditors is time consuming, expensive, and largely ineffective at preserving the value of creditor claims or reducing the long term indebtedness of the sovereign debtor. These outcomes also tend to be worse for the poorer countries of Sub-Saharan Africa, although this conclusion must be tempered by the fact that lending from private sector creditors is far less important for these countries as compared to official lending.

II. International Centre For Settlement Of Investment Disputes (Icsid)

The ICSID is an autonomous international institution established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID or the Washington Convention) with over one hundred and forty member States. The Convention sets forth ICSID's mandate, organization and core functions. The primary purpose of ICSID is to provide facilities for conciliation and arbitration of international investment disputes.[10]

A. Formation:

The ICSID Convention was a multilateral treaty formulated by the Executive Directors of the International Bank for Reconstruction and Development (later renamed The World Bank). It was opened for signature on March 18, 1965 and entered into force on October 14, 1966.

10 Available at https://icsid.worldbank.org/ (Visited on September 12, 2013).

B. Objectives:

The Convention sought to remove major impediments to the free international flows of private investment posed by non-commercial risks and the absence of specialized international methods for investment dispute settlement. ICSID was created by the Convention as an impartial international forum providing facilities for the resolution of legal disputes between eligible parties, through conciliation or arbitration procedures. Recourse to the ICSID facilities is always subject to the parties' consent.[11]

C. Setting of disputes:

The ICSID does not conciliate or arbitrate disputes; it provides the institutional and procedural framework for independent conciliation commissions and arbitral tribunals constituted in each case to resolve the dispute.

D. Features:

The ICSID Convention provides the basic procedural framework for conciliation and arbitration of investment disputes arising between member countries and investors that qualify as nationals of other member countries. This framework is supplemented by detailed Regulations and Rules adopted by the ICSID Administrative Council pursuant to the Convention.

A principal feature of conciliation and arbitration under the ICSID Convention is that they are based on a treaty establishing an autonomous and self-contained system for the institution, conduct and conclusion of such proceedings.

Arbitration and conciliation under the Convention are entirely voluntary, but once the parties have given their consent, neither may unilaterally withdraw it. A further distinctive feature is that an arbitral award rendered pursuant to the Convention may not be set aside by the courts

11 Available at https://icsid.worldbank.org/ICSID/ (Visited on September 21, 2013).

of any Contracting State, and is only subject to the post-award remedies provided for in the Convention. The Convention also requires that all Contracting States, whether or not parties to the dispute, recognize and enforce ICSID Convention arbitral awards.

Now further question is that, how is SDR and ICSID concern with the international investment law? This issue dealt in the further part of this paper.

III. The Relationship Of Sdr And Icsid With International Investment Law

As it is already mentioned that, ICSID is an autonomous international institution established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

As evidenced by its large membership, considerable caseload, and by the numerous references to its arbitration facilities in investment treaties and laws, ICSID plays an important role in the field of international investment and economic development. Today, ICSID is considered to be the leading international arbitration institution devoted to investor-State dispute settlement and forms a very integral part of international investment law[12].

Sovereign debt restructuring disputes form an integral part of the international investment law as majority of the decisions delivered in the above disputes involving sovereign states and entities of different nationalities are settled in the ICSID.

Jurisdiction for the said matters arises from Article 25 of the ICSID Convention which states as follows:

12 International Centre for Settlement of Investment Disputes, available at https://icsid.worldbank.org/ICSID/Index jsp (Visited on September 11, 2013).

Article 25

"(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally. (2) "National of another Contracting State" means: (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

(4) Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1[13])."

13 Available at https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partA-chap02.htm (Visited on August 30, 2013).

Thus as per the established principles of international law Sovereign Debt Restructuring falls within the scope and jurisdiction of the ICSID and ICSID being a body constituted by a convention and ratified by more than 140 states establishes itself as an indispensable body in the development of international investment law.

IV. Gaps Existing In The Present Sdr (Sovereign Debt Restructuring) Mechanism: Way Forward And Solutions

The scope of this part of paper is to explore the pros and cons of the sovereign debt restructuring in the event of a financial crisis. As it is already mentioned that, the concept of the borrowing has been a vital component of the world economy growth since the establishment of the nation states. However, increasing cases of debt crises is one of the vital phenomena for today's concern when government defaulted to pay its debts.

Although, the sovereign debt restructuring has been a constant component of the global economy, but the fact is that, there is no uniform rules and regulation to regulate the concept of sovereign debt restructuring, it is one of the great flaws in the international financial regime. Further, allowing the concept of debt restructuring can affect the recovery of the debt, which would discourage the investment of the creditors. Moreover, it would lead the dispute in case of the default.

On the other side, it is noticeable that many of the treaties have restricted the concept of the debt restructuring in wake of the financial crises. Therefore, in that case sovereign debt restructuring could be deemed illegal under such treaties.

For instance in many IIAs are not adequate enough to provide cover for nations to restructure their debt. For most cases the only possible safeguard are "essential security" provisions. A handful of the United States' treaties have an annex that discusses sovereign debt restructuring that is very limited. Language like Article 18 United States Model BIT is found in many treaties:

… to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests (USTR, 2004). The article does not mention economic crises per se[14].

Therefore such kind of treaties may restrict the ability of the nation to restructure debt in the wake of a financial crisis. This would lead to undermine the ability of nations to recover from financial crises

Now other mooting point is that, whether there is need of separate settlement dispute mechanism for the purpose of settlement of the dispute arises due to fault in paying debts or not?

V. Sdr Come Under The Jurisdiction Of Icsid?

On August 4, 2011, an arbitral tribunal at the International Centre for Settlement of Investment Disputes ("the ICSID") set new precedent for the arbitration world. In Abaclat (and others) v. The Argentine Republic[15], the Tribunal held that it had jurisdiction to hear claims brought by some 60,000 Italian nationals against the Republic of Argentina following Argentina's default and later partial restructuring of its sovereign debt. This decision is unprecedented in at least two respects. It is the first decision to hold that an arbitral tribunal has the legal authority to hear claims that a sovereign's default and debt restructuring may have breached a bilateral investment treaty ("BIT"). Second, Abaclat is the first arbitral decision to hold that 60,000 Claimants may join in one mass claims arbitration under the institutional rules of the ICSID.

The ICSID rules[16]do not expressly address the question of mass proceedings. Thus, the Tribunal was required to interpret this silence:

14 Kelvin P. Gallagher, the New Vulture Culture: Sovereign debt restructuring and trade and investment treaties, The idea of working paper series, Paper no. 02/2011

15 ICSID Case No.ARB/07/5.

16 Available at http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp. (Visited on September 22, 2013).

was it a "qualified silence," indicating that mass claims were not allowed, or was this an unintended "gap," which the Tribunal has the power to fill?[17] In answering this question, the Tribunal made a series of inferences based on its findings regarding the purpose and scope of the Argentina-Italy BIT. It found 1) the relevant BIT covered investments that are likely to involve a large number of Claimants if violated; 2) such investments were likely to require collective relief to provide effective protection of investments; 3) BITs are intended to protect investments they cover in their definition of "investment"; 4) the ICSID is intended to promote and protect investments such as those made pursuant to BITs; 5) it would be contrary to the spirit of ICSID to interpret the silence as qualified silence and thus the treaty's silence on mass claims is a gap, giving the Tribunal the power to step in.[18]

According to the Tribunal, Article 44 of the ICSID Convention and Rule[19] of the ICSID Arbitration Rules provide the Tribunal with the authority to make procedural modifications necessary to hear mass claims. Article 44 provides: "If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question."19 In addition, Rule 19 ICSID Arbitration Rules states: "The Tribunal shall make the orders required for the conduct of the proceeding."[20] Since the Tribunal found that the necessary modifications to hear mass claims concerned only the method of examination and the manner of presentation rather than the substance or the object of the claim, the Tribunal concluded that it had the power to diverge from the usual ICSID procedures.[21] Although the Tribunal recognized that the procedural adaptations would make it difficult for Argentina to respond to each individual claim, and that each Claimant would likely be unable to present a full case, these limits on the rights of both parties were justified in the interest of overall fairness. Neither party would be put at an unfair disadvantage given that all parties' procedural rights would be curtailed slightly and given that the alternative of conducting 60,000 separate proceedings would be a much bigger challenge.[22]

17 Supra note 9, at 517.
18 Id. at 518-19.
19 Id. at 509.
20 Id. at 510.
21 Id. at 534-535.
22 Id. at 536, 545.

Finally, the Tribunal emphasized that mass proceedings were only acceptable where the claims raised by a high number of claimants were identical or "at least sufficiently homogenous."[23]In Abaclat, each Claimant's individual claim arose from the same basic type of financial instrument and found the same fault with Argentina's post-default behaviour. Thus, the Tribunal found that the claims here were sufficiently homogenous.[24]

Additionally, the decision is noteworthy for its refusal to apply the otherwise widely accepted Salini criteria for determining whether a particular financial transaction constitutes an "investment."[25] In rejecting the Salini factors, the Tribunal adopted a broader approach that may expand the types of claims that can be brought under ICSID jurisdiction. Now, claims may be based on purely financial instruments bought by far removed investors so long as the claims relate to a sovereign's actions. As a result of this broader definition of "investment" and the determination that claims resulting from sovereign debt restructuring may fall within ICSID jurisdiction, it is likely that more of these claims will be resolved in arbitration rather than in court.

This outcome is made more likely because judgments of international arbitral tribunals are generally easier to enforce than judicial decisions of foreign courts. As noted in Part 1, holdout creditors who rejected Argentina's initial exchange offering in 2005 have since brought numerous suits in courts in New York, Germany, Italy, and elsewhere,[26]and some of these claims have resulted in multibillion-dollar judgments against Argentina.[27]However, sovereign immunity rules make

23 Id. at 540.

24 Id. at 544.

25 Matthew Gearing et al., Abaclat and others V the Argentine Republic, Allen Overy (Dec. 2011), Available at http://www.allenovery.com/AOWEB/AreasOfExpertise/Editorial.aspx? (Visited on September 15, 2013).

26 Karen Halverson Cross, Investment Arbitration Panel Upholds Jurisdiction to Hear Mass Bondholder Claims against Argentina, Am. Soc'y Int'l L. Insights, Vol. 15, Iss. 30, p. 1, Nov. 21, 2011 [hereinafter ASIL], available at http://www.asil.org/pdfs/insights/insight111121.pdf . (Visited on August 30, 2013).

27 Hilary Burke, World Bank court to hear case on Argentina default, Thomson Reuters News & Insights, Aug. 10, 2011, available at http://newsandinsight.thomsonreuters.com/Securities/News/2011/08 (Visited on September 18, 2013).

it "nearly impossible"[28] for Claimants to enforce their awards because foreign sovereigns' assets are largely protected from seizure. Under the Foreign Sovereign Immunities Act, though, it is easier to attach a foreign country's assets to enforce an arbitral award than to enforce a foreign judgment.[29]Additionally, arbitration has more favorable rules for enforcing arbitral awards than regular court procedures in countries that are signatories to the New York or ICSID Conventions. Together with the Tribunal's apparent expansion of the definition of "investment," the relative ease of enforcing arbitral judgments suggests that foreign investors will choose to bring suit in arbitral proceedings as opposed to foreign courts.

Finally, the Ablacat decision held for the first time that mass claims are admissible under the rules of the ICSID. If the decision stands, it means that individual bondholders will be able to join their claims and bring mass arbitrations in cases that previously would have fallen by the wayside due to the costs of arbitrating each individual claim. [30] This development may increase the number of mass claims in arbitral proceedings and eventually lead arbitral institutions to address the question of mass claims expressly in their procedural rules. . If the Abaclat decision is followed in the future, it will likely have significant impact on sovereign debt restructuring, the drafting of arbitration clauses, and the scope of ICSID jurisdiction over mass claims arbitrations.

28 See SICE Foreign Trade Information System, (2012), available at http://www.sice.oas.org/ctyindex/ARG/ARGBITs_e.asp. (Visited on September 22, 2013).

29 Supra note 20, at 2.

30 Jessica Beess and Chrostin, Soveriegn Debt Restructuring and Mass Claims Arbitration before the ICSID, Th AbaclatCase,Harvard International Law Journal, Vol. 53, Number 2, Summer 2012, available at http://www.harvardilj.org/wp-content/uploads/2010/05/HLI206.pdf. (Visited on September 11, 2013).

As it is already mentioned in Abaclat (and others) v. The Argentine Republic case that International Centre for Settlement of Investment Disputes ("the ICSID") had a jurisdiction to hear claims brought by some 60,000 Italian nationals against the Republic of Argentina following Argentina's default and later partial restructuring of its sovereign debt.

But center issue is that, would it be proper forum for settlement of disputes arising out of sovereign debt? Moreover, the further question is that, what are parameters ICSID will adopt to ensure the neutrality without undermining the equally important goal of sovereign debt restructuring? What is the guarantee that, creditors will be treated equitably and fairly?

Hence, the idea of separate settlement dispute mechanism is appealing more rather than giving the jurisdiction to ICSID to decide these cases, which are dealing with specific issues. Therefore, special treatment is necessary to deals such kind of matters.

VI. Way Forward And Solutions

Taking into the consideration of the pros and cons , the most appropriate solution to the sovereign debt restructuring problems appears to be to learn from the private law model governing commercial and individual; insolvency and introduce a full-fledged proceeding. The huge advantage of this approach is that it has the potential to guarantee both transparency and predictability and can lead to an all encompassing solution through its obligatory inclusion of all (or at least most) creditors. [31] Therefore, in the light of above discussions following suggestions have been worked out for reform in present sovereign debt restructuring mechanism.

1. There is need of comprehensive and uniform legal regime for regulation of the sovereign debt restructuring.

31 Carlos A. primo Braga and Gallina A. Vincelette, Sovereign debt and the Financial Crises,, will this time be di ferent?, The World Bank Washington DC

2. Clarify that the essential security exceptions cover financial crises and that sovereign debt restructuring taken by host nations is 'self-judging' and of 'necessity[32]

3. It is required to establish common settlement dispute mechanism for the expeditious disposal of cases. Even though some previous attempt has been done to create a common tribunal, for instance, League of Nations Loans Tribunals and IMF Sovereign Debt Rescheduling Mechanism (SDRM), but these tribunal never came into existence.

4. There is need to enact public international insolvency law and uniform rules on sovereign debt treatment to avoid discrimination.

Therefore, a comprehensive and predictable sovereign debt restructuring process would help reduce this uncertainty in this regard. Hence, it would lead to better solution for reducing the chances of financial crises.

32 Kelvin P. Gallagher, the New Vulture Culture: Sovereign debt restructuring and trade and investment treaties, The idea of working paper series, Paper no. 02/2011