Sovereigns before international courts

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1. Introduction

Sovereigns may be brought before international courts and tribunals in connection with financial claims arising under two different heads:

- debts held by other sovereign creditors and
- debts held by private creditors.

The first encompasses claims relating to bilateral loans, ie loans contracted by sovereigns with other sovereigns usually under the umbrella of official development assistance (ODA) as well as claims associated with loans originally contracted with private creditors (like bonds) which subsequently come into the hands of sovereign creditors.[1]

The second embraces not only claims held and brought by private parties, but also claims imputable to private parties but enforced by the national state acting in a diplomatic protection role: in which case the injury to the private parties merges with injury to the state and the state becomes the claimant.[2]

Against this background, we now turn to examining the many kinds of international dispute settlement mechanism directly or indirectly available to foreign holders of sovereign bonded debt.

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2. Mixed claims commissions

On certain occasions the injured parties' national states and the foreign states against which the claims are raised agree to establish an international forum for the settlement of disputes between the defaulting debtor and unsatisfied creditors.

The traditional route was the mixed claims commission: bilateral commissions established by international agreements with the purpose, among other things, of settling claims between citizens of different states (although the claim must proceed under the name of the state).[3] Claims on bonded debt under such commissions include claims brought before the mixed claims commissions between Colombia and the United States (established 1864), where umpire Sir Frederick Bruce concluded

1 This is particularly the case of US treasury bonds copiously purchased on the market by Japan and China.
2 Edwin M Borchard, *The Diplomatic Protection of Citizens Abroad* (The Banks Law Publishing Co, New York 1915), 360.
3 Rudolph Dolzer, 'Mixed Claims Commissions', in *Encyclopedia of Public International Law*, vol III (Elsevier, Amsterdam 1997), 438.

that the commission lacked jurisdiction, drawing a distinction between cases of mere unpaid bonds and acts of injustice and violence.[4] Other bond claims were referred to the mixed claims commissions between Venezuela and the United States (established 1885), which reached a different conclusion. Emphasising the inclusive meaning of the word 'claims' under Article II of the establishing treaty, Commissioner Little held that to interpret this otherwise would amount to the interpolation of a material treaty clause.[5] Similarly, Commissioner Findlay, in sanctioning a divergence from the 'Palmerston doctrine', found that the policy of non-intervention in relation to bond claims should have been departed from at the point where arbitration was resorted to as a means of dispute resolution.[6]

3. Mixed arbitration

The role of the international claims commissions has been gradually replaced by mixed arbitration, ie a type of international adjudication where nationals of one state can bring claims against another state without state involvement. A significant historical example was the treaty between Chile and France of 1892, which provided for the establishment of an arbitral body[7] before which French holders of Peruvian bonds were entitled to present their claims directly against Chile[8] in cases where funds had already been appropriated.[9]

3.1 The ICSID

Nowadays we see mixed arbitration in the work of the International Centre for the Settlement of Investment Disputes (ICSID).[10] The ICSID Convention is a general instrument intended to protect and therefore promote foreign investment, providing a mechanism for conciliation and arbitration of disputes in this field. The ICSID will have jurisdiction where three criteria are met:

- nationality of the parties
- consent to submit to arbitration, and
- an investment dispute (Article 25, ICSID Convention).

Although in terms of the first condition, the intrinsic negotiability of bonds as

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4 The Commission, drawing from the US government policy of not enforcing these claims, was unable to assume that in the absence of clear language the US government had intended to delegate to it powers which it had not exercised in the instant case: *Claims of Riggs, Oliver and Douglas*, John B Moore, *History and Digest of the International Arbitrations to which the Unites States has been a Party*, Vol IV (Government Printing Office, Washington 1898) 3612–6.

5 *Aspinwall*, in John B Moore (n 4), 3634.

6 *Aspinwall* (n 4), 3649.

7 Henri La Fontaine, *Pasicrisie Internationale: Histoire Documentaire des Arbitrages Internationaux* (1794–1900) (*Imprimerie Stampelli et CIE*, Berne 1902) 594–601.

8 In this case the national state of the creditors played the mere role of a '*curateur*', Germain Watrin, *Essai de construction d'un contentieux international des dettes publiques* (Recueil Sirey, Paris 1929), 98.

9 The arbitration was merely intended to identify who was entitled to receive these sums, William H Wynne, *State Insolvency and Foreign Bondholders*, vol II: *Selected Case Histories* (Yale University Press, New Haven 1951), 162.

10 The ICSID establishing Convention was drafted in 1965 by the International Bank for the Reconstruction and Development (IBRD) to provide international methods of settlement of disputes on foreign investment (opened for signature March 18 1965) (1965) 4 ILM 532.

11 Muthucumaraswamy Sornarajah, *The International Law of Foreign Investment* (2nd edn, CUP, Cambridge 2004) 227–8.

financial instruments can raise problems,[11] if we refer to Article 25(2) of the ICSID Convention might the position appears to be reasonably clear: natural persons must possess the nationality of any contracting state other than the state party to the dispute on the date on which the parties have consented to submit to arbitration as well as on the date on which the request was registered;[12] and juridical persons must possess the nationality of any contracting state other than the state party to the dispute on the date on which the parties have consented to submit to arbitration[13] or (if they have the nationality of the contracting state on that date) the parties have agreed to be treated as nationals of another contracting state on the grounds of foreign control.[14] However, the Additional Facility permits jurisdiction to be exerted in disputes in which solely one party is a contracting state or a national of a contracting state.

In relation to the second condition, consent to submit to the ICSID must be expressed in written form and formalised in an investment contract or a special compromis between the host state and foreign investors, or in an offer from the foreign state contained in host state legislation, or a multilateral treaty, or a bilateral investment treaty.[15]

The last condition, the nature of the investment, is by far the most controversial.

Neither the final text of the Convention nor the Report of the Executive Directors provides a definition of 'investment'.[16] This apparent vagueness has arisen because of fundamental disagreement over the issue, with two directly opposing views: on the one hand, that shared by developing countries in favour of a circumscribed jurisdiction of the ICSID over specific types of investment dispute; and on the other, that of developed countries in favour of a wider jurisdiction over every investment dispute. This would seem to indicate that it is possible to submit to the ICSID any legal dispute arising directly out of an investment (Art 25(1)).[17]

That said, some indication of what should be covered by 'investment' can be inferred from the preamble of the Convention where there is a clear reference to the need for international cooperation on economic development and to the fact that private investment plays a part in this: which would seem broad enough to capture indirect investment like bonded debt. Indeed, the arbitral tribunal in *CSBO v Slovakia* held that the notion of investment acknowledged in the Convention was sufficiently wide to include loans, as far as they 'may contribute substantially to the State's economic development'.[18] By the same token, in *Fedax v Venezuela* the arbitral

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12 The determination of nationality is primarily left to the law of the state whose nationality is claimed, subject to the relevant rules of international law, Christoph H Schreuer, *The ICSID Convention: A Commentary* (2nd edn, CUP, Cambridge 2009) 265–74.

13 In this context the nationality is determined on the basis of the test of the incorporation or the seat of the party; still, many BITs combine the traditional criteria of incorporation and seat with those of controlling interests and substantial business activity: Chittharajan F Amerasinghe, 'Jurisdiction *Ratione Personae* under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1974–5), 47 BYIL 227, 259.

14 The element of the foreign control must be appreciated independently from the agreement of nationality, although the presence of an agreement on nationality amounts to a strong presumption in favour of foreign control which can be rebutted only if unreasonable: Schreuer, *The ICSID Convention* (n 12) 299–329.

15 Schreuer, *The ICSID Convention* (n 12) 192–217.

16 See the Report of the Executive Directors (1965) 4 ILM 524, para 27.

17 Julian Davis Morterson, 'The Meaning of 'Investment': ICSID Travaux and the Domain of International Investment Law' (2010) 51 *Harv Int'l* L J 257, 280–96.

tribunal, assuming on the one hand that Venezuela had received a loan corresponding to the amount of the issued notes[19] and on the other hand that the loan was contracted for public works,[20] came to the conclusion that the purchase of these instruments could qualify as a foreign investment[21] as long as the purchaser remains a foreign national.[22] Nonetheless, a distinction must be drawn: while bonds issued with the purpose of raising money for public projects should fall squarely in the purview of the ICSID Convention,[23] bonds not related to specific projects are more problematic. Still, if the *raison d'être* of a modern state is to promote the economic development of the country,[24] bonded loans with foreign holders may presumably qualify as investment under the ICSID Convention (unless the respondent can prove the contrary).

It should be emphasised that the investment must satisfy the conditions of not only the ICSID Convention, but also the instrument encapsulating the consent of the parties (eg, investment contract, investment treaties, host state national legislation).[25] It is also necessary to further appreciate the differences between 'treaty claims' and 'contract claims':

- treaty claims being based on the violation of a BIT and
- contract claims being based on a violation of the investment contract.

In *SGS v Pakistan* the arbitral tribunal held that the presence of a domestic arbitral clause contained in investment contracts did not affect ICSID jurisdiction in connection with treaty claims,[26] while in *SGS v Philippines* the arbitral tribunal refused to exercise jurisdiction on contract claims where there was an exclusive forum selection clause in the investment contract.[27]

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18 *Cekoslovenska Obchodni Banka AS v The Slovak Republic* (decision on objections to jurisdiction, May 24 1999) (1999) 14 ICSID Rev 251, 276–7, para 76. In this case the loan was part of a series of financial transactions related to a privatisation plan, cf Peter Griffin, Ania Farren, 'How ICSID Can Protect Sovereign Bondholders' (September 2005), IFLR 21, 22.

19 *Fedax NV v The Republic of Venezuela* (decision on objection to jurisdiction, 11 July 1997) (1998) 37 ILM 1378, 1385, para 37.

20 Fedax (n 19) 1386, para 42. The arbitral tribunal further found that the transaction satisfied the basic features of investment as defined by Professor Christoph Schreuer in his work 'Commentary on the ICSID Convention' (1986) 11 ICSID Rev 316, 372: that is to say: duration, regularity of profits, assumption of risk, substantial commitment, level of development of host state: *Fedax* (n 19) 1387, para 43.

21 'Since promissory notes are evidence of a loan and a rather typical financial and credit instrument, there is nothing to prevent their purchase from qualifying as an investment under the Convention', *Fedax* (n 19), 1384, para 29.

22 'In such a situation, although the identity of the investor will change, the investment in itself will remain constant, while the issuer will enjoy a continuous credit benefit until the notes becomes due. To the extent that this credit is provided by a foreign holder of the notes, it constitutes a foreign investment which in this case is encompassed by the terms of the Convention and the [BIT]', *Fedax* (n 19), 1386, para 40.

23 Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 AJIL 711, 728.

24 Adam Smith, *An Inquiry into the Nature and the Causes of the Wealth of the Nations* (first published 1776, RH Campbell and AS Skinner, Gen eds, Liberty Fund, Indianapolis 1981), V.i.c.1.

25 Schreuer, *The ICSID Convention* (n 12) 117–25; if the investment does not qualify under the ICSID Convention, the consent may operate as a submission to another arbitral mechanism, Noah Rubins, "The Notion of 'Investment' in International Investment Arbitration", in N Horn, S Kröll (eds), *Arbitrating Foreign Investment Disputes* (Kluwer, The Hague 2004) 283, 289–90.

26 *SGS Société Générale de Surveillance SA v Islamic Republic of Pakistan* (decision on objections to jurisdiction, August 6 2003) (2003) 42 ILM 1290, 1318-1321, paras 163–74.

This issue of bond claims was fully rehearsed by the award on jurisdiction and admissibility rendered by the arbitral tribunal in *Abaclat & Others*.[28] On the question of jurisdiction, the tribunal focused its analysis on the subsumption of bonds under the notion of investment encapsulated in the Italy–Argentina BIT and in the ICSID Convention. As to the BIT, Article 1(1)(c) specifically enumerates 'obligations' among applicable types of investment, which is clearly broad enough to encompass sovereign bonds. Since the dispute concerned rights arising out of the claimants' security entitlements, the arbitral tribunal found that the relation between that kind of entitlement and bonds was sufficiently close to enable it to consider the dispute related to an investment, and that it was of no relevance that the distribution had occurred electronically without any physical transfer (para 358).[29]

Furthermore, the tribunal accepted that the funds deriving from bond issuance had been used to finance Argentina's economic development, and that it was irrelevant whether they had been used to repay previous debt or to implement specific policies (para 378).[30]

In terms of the ICSID Convention, the tribunal did not follow the criteria applied in *Fedax*,[31] on the assumption that if the bond investment did not satisfy all of those criteria, the claimants' investment contributions would have been left without procedural ICSID protection, which would plainly contradict the stated purposes of the ICSID Convention, that is, to promote foreign investment and allow parties to determine the type of investment that they wish to promote (para 364).

The tribunal concluded that the contributions made by the claimants led to the creation of the value that Argentina and Italy intended to protect through the BIT (para 365).[32] With reference to admissibility, the ICSID tribunal (dealing with collective proceedings), came to the conclusion that the Convention's silence on this

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27 *SGS Société Générale de Surveillance SA v Republic of the Philippines* (decision on objections to jurisdiction, 29 January 2004) (2004) 16(3) WTA Mat 91, 133–6, paras 130–44.

28 *Abaclat & Others (formerly known as Giovanna Beccara & Others) v The Argentine Republic*, Case No ARB/07/5 (decision on Jurisdiction and Admissibility, award August 4 2011), available at www.italaw.com.

29 "In other words, whatever the technical nuances between bonds and security entitlements may be, they are part of one and the same economic operation and they make sense together", *Abaclat & Others* (n 28) paras 359-60.

30 The question of the territorial link of the investment was resolved differently by arbitrator Abi-Saab in his dissenting opinion: on the legal test he considered applicable law, forum, currency of payment and place of payment to infer that the debt is located outside the territory of the debt (para 78–87); on the material test he contested that the mere extension of funds to Argentina would have automatically contributed to the development of the recipient country (paras 88–119).

31 As the criteria laid down in Fedax (n 19) were substantively restated in *Salini* (*Salini v Morocco*, award 23 July 2001 (2003) 42 ILM 609, 622) their application is generally known as the '*Salini* test', Rudolf Dolzer, Christoph Schreuer, *Principles of International Investment Law* (OUP, Oxford 2001) 68.

32 "The value generated by this contribution is the right attached to the security entitlements to claim reimbursement from Argentina of the principal amount and interests accrued", *Abaclat & Others* (n 28) para 366. The ICSID tribunal took a third route leading to the same result, finding that the term 'investment' under the BIT has an objective meaning irrespective of any submission to ICSID or UNCITRAL arbitration: *ibid*, para 370 (referring to *Romak SA v The Republic of Uzbekistan* (PCA, Case No AA280) award November 26 2009, paras 180 and 207, available at www.italaw.com).

33 "[I]n the light of the absence of a definition of investment in the ICSID Convention, where the BIT covers investments which are susceptible of involving a high number of investors, and where such investments require a collective relief in order to provide effective protection to such investment, it would be contrary to the purpose of the BIT, and to the spirit of ICSID, to require in addition to the consent to ICSID arbitration in general, a supplementary express consent to the form of such arbitration", *Abaclat & Others* (n 28) para 518.

matter should be treated as a gap to be filled by the arbitrators in accordance with Article 44 of the Convention and Rule 19 of the Arbitration Rules (paras 519–20).[33] The tribunal found that the claimants' rights under the BIT provisions, the events amounting to a breach of the BIT by Argentina, and the nature of the potential damage for the claimants were sufficiently similar so as to warrant collective treatment (para 543).[34] Under this scheme Argentina would avoid dealing with a multitude of proceedings (para 545) and claimants would benefit from the collective treatment of their claims (para 546).[35]

Even if investors are successful in securing a favourable award, they might encounter problems with its enforcement since it will be subject to the law of the state where execution is sought (Article 54(3)).[36] Therefore the parties should stipulate a specific waiver of immunity from execution in the investment contracts (or, better still, in prospectuses).[37] However, the fact that the immunity rules of the forum may hinder the enforcement of the award does not affect the state's obligation to comply with the award under Article 53 of the Convention.[38] Non-compliance with that treaty obligation would amount to an international wrongful act which could lead the national state of the claimants seeking to enforce the award to resort to diplomatic protection (Article 27(1))[39] or to have recourse to the International Court of Justice (Article 64).[40]

3.2 Non-ICSID arbitration

ICSID is not the sole forum available to settle the disputes between a state and a foreign investor: parties may be precluded from submitting to ICSID if neither is party to the Washington Convention, or the BITs may indicate alternative routes of arbitration.[41]

One route is for the contracting parties to agree in writing that all disputes relating to the contract should be submitted to the PCA in accordance with the Optional Rules (Optional Rules for Arbitrating Disputes between Two Parties of Which Only One is a State, adopted by the Permanent Court of Arbitration in 1993).

An alternative body of rules can be applicable for claims against states where

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34 In other words, homogeneous breach of homogeneous rights causing homogeneous damages, *Abaclat & Others* (n 28) para 541.

35 If it were otherwise, "not only would it be cost prohibitive for many claimants to file individual claims but it would also be practically impossible for ICSID to deal separately with 60,000 individual arbitrations. Thus, the rejection of the admissibility of the present claims may equal a denial of justice", *Abaclat & Others*, (n 28) para 537.

36 Article 54 cannot be construed as a derogation from the immunity rules on execution in force in any contracting state (Article 55); cf *AIG Capital Partners Inc & Another v Republic of Kazakhstan* (*National Bank of Kazakhstan Intervening*) [2005] EWHC 2239 (Comm) 33–61, per Aikens LJ.

37 Georges R Delaume, "ICSID Arbitration and the Courts" (1983) 77 AJIL 784, 800.

38 "(…) State immunity may well afford a legal defense to forcible execution, but it provides neither argument nor excuse for failing to comply with an award. (…) Non-compliance by a state constitutes a violation by that state of its international obligations and will attract its own sanctions", *MINE v Guinea* (Interim Order No 1 Guinea's Application for Stay of Enforcement of the Award, 12 August 1998) 4 ICSID Rep 111, 115, para 25.

39 Schreuer, *The ICSID Convention* (n 12) 414–27.

40 Resort to the ICJ is also feasible against a state party to the ICSID Convention that is not party to the ICSID arbitration which fails to comply with an award: Schreuer, *The ICSID Convention* (n 12) 1261.

41 Dolzer, Schreuer (n 31) 225.

commercial matters are involved: the Arbitration Rules adopted in 1998 by the International Chamber of Commerce.

Another alternative is to refer to the Arbitration Rules adopted in 1998 by the London Court of International Arbitration which can apply to every sort of dispute. Or again there is the UNCITRAL's Arbitration Rules, adopted by the UN General Assembly in 1976 which can be applied by existing arbitral institutions.

In order for these arbitrations to apply the written consent of the state must be incorporated in the terms of the loan, which will be binding on all subsequent purchasers as named in the prospectus and in the listing documents and incorporated by reference in the bonds.[42] Although in recent practice arbitral clauses have been inserted referring to these alternative arbitral routes,[43] again enforcement and recognition of the awards may be problematic.[44]

4. Diplomatic protection before international courts

National states have in some cases had recourse to diplomatic protection bringing the claims of their unpaid national bondholders before international courts. Such a decision remains fundamentally a matter of discretion for the state.

4.1 The Serbian and Brazilian loans

Both the Serbian and Brazilian loan cases concerned bonded loans: the *Serbian Loans* case concerned bonds issued in French Francs by Serbia in the period 1895 to 1913 and mainly offered for subscription to French nationals;[45] the *Brazilian Loans* case related to bonds issued in French Francs by Brazil and mainly offered to French citizens in the period 1909 to 1912.[46] International controversy arose because of failure by the sovereign issuers to comply with the gold clause contained in the terms of the loans.

In both the cases France, the national state of the majority of the bondholders, acting in diplomatic protection against the issuing countries, brought a claim before the Permanent Court of International Justice. The questions dealt with by the Court were significant on procedural and substantive points. Procedurally, although the subject matter was not technically an international controversy falling within the ambit of Article 14 of the Covenant of the League of Nations, the Court affirmed its jurisdiction by virtue of Article 36(2) of its Statute. Substantively, the Court held that, although Article 38 of its Statute clearly indicated that the Court must deliver its

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42 They are also reproduced in the trust deed/indenture or in the fiscal agency agreements, Andrew McKnight, *The Law of International Finance* (OUP, Oxford 2008) 529.

43 The Georgia 2008 bond issue applied the LCIA Arbitration Rules; El Salvador bond issue 2009 UNCITRAL Arbitration Rules; Qatar 2009, UNCITRAL Rules; Hungary 2009, UNCITRAL Arbitration Rules under the LCIA: Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (CUP, Cambridge 2011) 165–7.

44 The 1958 New York Convention on Recognition and Enforcement of Arbitral Awards permits discretion in relation to matters listed at paras 1 and 2 of Article V. Albert J Van den Berg, "Residual Discretion and Validity of the Arbitration Agreement in the Enforcement of Arbitral Awards under the New York Convention of 1958", in TK Sood (ed), *Current Legal Issues in International Commercial Litigation* (National University of Singapore, Singapore 1997) 327–36.

45 *Case Concerning the Payment of Various Serbian Loans Issued in France* (1929) PCIJ Series A No 20.

46 *Case Concerning the Payment in Gold of the Brazilian Federal Loans Issued in France* (1929) PCIJ Series A No 21.