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# ***Sovereign Defaults Before International Courts and Tribunals***

*Michael Waibel*

(Cambridge: Cambridge University Press, 2011)

428 pp.

C\$135.95

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In the wake of the Great Recession, sovereign debt has enjoyed a resurgence of academic attention. In addition to (in)famous defaults such as Argentina's, the looming possibility of sovereign debt non-payment lurks behind many post-recession political crises, as is the case with the controversial cross-default clauses in Russia's loans to the Ukraine.<sup>1</sup> Public debt more broadly has become more perilous in municipal markets as well. For example, Detroit's bankruptcy has served as a stark reminder of how unsafe purportedly "safe" government investments can prove to be – and how the default of public debt implicates services to the polity. Inspired by these vivid news events, the recent explosion of scholarship on sovereign debt has brought no shortage of new policy proposals.<sup>2</sup> To this fray, Michael Waibel offers an important insight: we have been here before. Indeed, Waibel's painstaking historical analysis in *Sovereign Defaults Before International Courts and Tribunals* offers a careful study that should be read by all who want to join this debate. Only through such analysis can we see how the various modalities of public debt restructuring in the past have worked – and failed – and thus have an informed discussion of how to move forward.

Waibel begins in the mid-nineteenth century, when "half of all US state debt was in default, and 10 per cent was repudiated outright."<sup>3</sup> He proceeds to recount two centuries of sovereign debt disputes all around the world. From the Dominican Republic's former receivership<sup>4</sup> to the Ottoman public debt commission<sup>5</sup> to modern-

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<sup>1</sup> Anna Gelpern, "Ukraine's Russian Bonds – A Gazprom Clause?" (27 April 2014) online: <<http://www.creditslips.org/creditslips/sovereign-debt/>>.

<sup>2</sup> See, e.g., Symposium, *The Nation State and Its Bank: The International Regulation of Financial Institutions, Financial Products, and Sovereign Debt* (2014) 49 Tex Int'l LJ 149.

<sup>3</sup> Michael Waibel, *Sovereign Defaults Before International Courts and Tribunals* at 3.

<sup>4</sup> *Ibid.* at 47.

day Argentina,<sup>6</sup> Waibel's work spans the lengthy and surprisingly diverse history of international attempts to grapple with the ability of the modern nation-state to incur debts beyond its capacity (or willingness) to pay. He provides an exhaustive account of a variety of techniques used to address defaults, from military force<sup>7</sup> to quasi-receivership<sup>8</sup> to arbitration clauses<sup>9</sup> to mixed-claims commissions,<sup>10</sup> generally tracing an arc from political diplomacy to more adjudicative frameworks, such as claims tribunals and, yes, domestic courts.<sup>11</sup> He also shows how "host" governments were actively involved, both in designing proposals for restructurings and stymieing the atomistic collection attempts of their citizen-creditors.<sup>12</sup> Throughout his book, Waibel does not shy away from addressing factors, such as state succession and odious debt, that can make already complicated foreign default cases even more contentious.<sup>13</sup>

For the legal historian, or quite frankly, just general nerd, the book is delight. For the scholar or policymaker seeking more normative punch, the book is more disappointing. But Waibel is unapologetic about his mission. The primary purpose of *Sovereign Defaults* is not to persuade readers of the merits of a single coherent theory of sovereign default but rather to analyze "a wide range of cases" in order to find "organizing principles relevant to the future adjudication of sovereign defaults."<sup>14</sup> While Waibel does tantalize with some tentative arguments built on his exhaustive analysis towards the end of *Sovereign Defaults* (such as, e.g., the impropriety of using International Centre for Settlement of Investment Disputes (ICSID) panels to restructure public debt),<sup>15</sup> the book's insights stick primarily to its stated scope.

It is difficult to overstate the depth of Waibel's detailed analysis of the jurisprudence of sovereign debt disputes. Throughout his work, Waibel scatters fascinating and perhaps-forgotten historical anecdotes, such as the travails of investors in the "sovereign" bonds of Poyais. The bonds for the "newly independent" state had a beautiful prospectus but, unfortunately, the country itself was entirely

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<sup>5</sup> *Ibid.* at 129.

<sup>6</sup> *Ibid.* at 289.

<sup>7</sup> *Ibid.* at 29-38.

<sup>8</sup> *Ibid.* at 42-57.

<sup>9</sup> *Ibid.* at *passim*.

<sup>10</sup> *Ibid.* at 171-182.

<sup>11</sup> *Ibid.* at 121.

<sup>12</sup> *Ibid.* at 23 (discussing how creditor countries traditionally enjoyed "complete functional control over claims arising from sovereign debt" and intervened "only after determining that internationalizing the claim to a higher level was consistent with the government's broader economic and political objectives.").

<sup>13</sup> *Ibid.* at 129-143.

<sup>14</sup> *Ibid.* at 19.

<sup>15</sup> *Ibid.* at 316.

fictional.<sup>16</sup> And he notes with quiet understatement how even investors in real countries can find themselves in similarly absurd situations. Following the Soviet repudiation of Czarist debts, for example, investors in Russian sovereign debt had to wait until the 1980s or even later to have their claims resolved.<sup>17</sup> But that is how it should be, Waibel implies, in the loose world of debt restructuring. Creditors are beggars in this world, in contrast to their chooser status in most municipal insolvency systems.

Indeed, of particular interest to bankruptcy scholars will be the comparisons drawn between the ad hoc and quasi-formalized systems of sovereign default resolution and the more familiar bankruptcy systems under municipal laws, especially their cross-border subfields. The big difference is that dissident-binding voting powers are generally absent in the sovereign debt realm. As Waibel notes following *Itoh v People's Republic of the Congo*, "This award demonstrates the inability of countries in current international law to bind all creditors to a restructuring agreement, even if such agreement is reached in the Paris Club."<sup>18</sup> [Although, to be fair, Waibel also notes their manufacture *ex contract* through collective action clauses (CACs).] Similarities between sovereign debt and domestic insolvency systems include such familiar friends as fights about choice of law and the (in)ability to pay and, of course, the ever-present battle over priority.<sup>19</sup>

Perhaps the most interesting historical lesson for comparison to municipal insolvency law is the sovereign debt field's persistent resistance to explicit haircuts. Payments of debt may be postponed or placed on more favorable terms, but there is great concern, probably animated by moral hazard worries, over outright concessions. For example, during the 1920's the U.S. government held approximately \$24 million in Austrian bonds.<sup>20</sup> Congress found that "the economic structure of Austria is approaching collapse and great numbers of the people of Austria are, in consequence, in imminent danger of starvation and threatened by disease growing out of extreme privation and starvation."<sup>21</sup> However, the solution proposed by Congress, and the United Nations, was not to take an explicit haircut but rather to extend the maturity by twenty years.<sup>22</sup> While a municipal insolvency lawyer might be surprised by this trend, its longevity may be in question post-Argentina, and certainly post-Detroit. But the comparativist to municipal law should also take heed of the normative resistance to the private debt model. Several

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<sup>16</sup> *Ibid.* at 10.

<sup>17</sup> *Ibid.* at 39

<sup>18</sup> *Ibid.* at 153.

<sup>19</sup> *Ibid.* at 63, 86.

<sup>20</sup> *Ibid.* at 114

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.* at 114-15. The historical bent of the analysis necessarily underemphasizes the rise of deeply indebted developing nations who are accorded debt relief but who find themselves more in dialogue with the IMF and World Bank than the public markets anyway.

cases Waibel explores raise questions about the desirability of moving towards an international insolvency system at all. In the Venezuelan Preferential Case, for instance, Britain argued that parallels to municipal bankruptcy law were wholly inapposite, and indeed “any such procedure must necessarily be incompatible with the continued existence of the insolvent state as an independent sovereign state.”<sup>23</sup>

As mentioned, Waibel generally shies away from argument, but in Part II of his book, he gradually turns from history towards a more normative perspective. For example, he rejects the rise (fad?) of ICSID tribunals, grimly concluding that “ICSID tribunals – in addition to lacking jurisdiction – are unable to effectively deal with sovereign debt crises.”<sup>24</sup> Part of Waibel’s objection is merely doctrinal: ICSID lacks jurisdiction, he contends, because sovereign debt instruments fail to satisfy the “objective core meaning of ‘investment’” in the Convention on the Settlement of Investment Disputes between Disputes and Nationals of Other States (“the Convention”).<sup>25</sup> In reaching this conclusion, he builds on Schreuer’s work in elaborating a five-element test regarding the typical characteristics of an “investment” under the Convention.<sup>26</sup> According to Waibel, sovereign bonds clearly lack a relation to some of his elements, such as association with a commercial undertaking and the sharing of commercial risk, and have only a tenuous connection to another, the territorial link with the host country.<sup>27</sup> But he goes beyond this doctrinal critique. As a normative matter, finally showing his argument colours, Waibel contends that it is right that there is no jurisdiction:

If sovereign debt were to qualify as an investment, then the jurisdictional reach of ICSID becomes extremely broad. . . . The likely effect would be to convert ICSID tribunals into commercial courts of general jurisdiction, in lieu of domestic courts called on to adjudicate such disputes by virtue of contractual dispute resolution clauses.<sup>28</sup>

This additional enforcement prospect would be undesirable (perhaps iniquitous) because it would undermine global “economic policy flexibility” during crises by causing creditor governments to “lose their traditional role as diplomatic gatekeeper” to the scope of recovery, if any, afforded bondholders.<sup>29</sup> Moreover, it would strip debtor governments of their immunity trumps to demur payment and thus “derail efforts by the international community to resolve debt crises in an

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<sup>23</sup> *Ibid.* at 33.

<sup>24</sup> *Ibid.* at 316.

<sup>25</sup> *Ibid.* at 230.

<sup>26</sup> *Ibid.* at 230-244.

<sup>27</sup> Two additional elements, the existence of a positive impact on development and the long-term transfer of financial resources, would vary on a case by case basis.

*Ibid.*

<sup>28</sup> *Ibid.* at 251.

<sup>29</sup> *Ibid.* at 316.

orderly manner.”<sup>30</sup> In other words, if pushy creditors can actually force governments to cough up and pay by getting adjudicative access, such as through these tribunals, then we face an outcome fraught with policy problems. There is a need to counterbalance creditor repayment with the attendant loss of public services to the incumbent residents of the debtor nation, which may have difficulty in paying anything close to the full notional amount, and this balancing may be better suited for political actors than investment tribunals.<sup>31</sup>

The main problem with Waibel’s arguments are that they are underdeveloped. Other than flagging the issue and naively resting on an unstated premise that debtor countries need protection from rapacious lenders, Waibel does not engage the counterargument of debtor recalcitrance, a topic highly salient given Argentina’s trip to the U.S. Supreme Court.<sup>32</sup> And there is something potentially unsettling about blaming ICSID arbitration, as the venue for the vindication of the legal rights of creditors, for the problem of the holdout without discussion of the incidence of holding out.<sup>33</sup> Still, it seems churlish to fault an author who by design is trying to avoid normative debate, and so it is perhaps more fair simply to observe that the critical discussion leaves the reader hungering for more.

Where Waibel gets most creative is in exploring the future. Capitalizing on the rise of arbitration of cross-border disputes, Waibel suggests institutions might be constructed that could effectively arbitrate sovereign debt. He argues that this will only be possible if certain preconditions are met, however, including “dedicated and durable institutions, the progressive development of the international law on public debt, and protection for the country’s essential public services in financial distress.”<sup>34</sup> The fact that arbitration may be useful is all the more interesting given the past historical examples Waibel unearths showing its prior use – before it got crowded out by a more capacious assertion of municipal court jurisdiction.<sup>35</sup>

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<sup>30</sup> *Ibid.* at 317.

<sup>31</sup> *Ibid.* at 318. Indeed, Waibel’s collection of cases – including private arbitrations – where “ability to pay” is legally adjudicated is fascinating in showing that sometimes this question can, and does, get resolved legally. *Ibid.* at 88-98. Noteworthy too are the defensive doctrines sometimes used to shoehorn in an ability-to-pay test, such as, e.g., unexpected devaluation. *Ibid.* at 86-87. Other commentators, including one of us, fret that ability-to-pay analysis may be too politically sensitive today for binding resolution. John AE Pottow, “Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign-Debt Restructurings” (2014) 49 *Tex Int’l LJ* 219 at 239.

<sup>32</sup> See e.g. *Republic of Argentina v NML Capital, Ltd.*, \_\_ U.S. \_\_, 2014 U.S. LEXIS 4167 (2014).

<sup>33</sup> See *Id.* at 320 (discussing increased incentives to hold out if ICSID’s jurisdiction is increased). In fairness, one of us makes the same empirical assumption elsewhere. See Pottow, *supra* note 31.

<sup>34</sup> Waibel, *supra* note 3 at 323.

<sup>35</sup> *Ibid.* at 157.

*Sovereign Defaults* is comprehensible enough to be read by students yet comprehensive enough to provide new insights into public debt restructuring for even experienced scholars. Lawyers and historians alike will find something new in its pages. Even in a world of CACs, the subject matter remains topical and, linked with the rise of arbitration, important. Poor Weibel's publication date means he missed out on Argentina,<sup>36</sup> Greece, and the revision of UNCITRAL's arbitration rules, showing just how fast-moving this field is. But that is no matter: Weibel's study is careful, useful, and helps inform the debate in this increasingly vital policy arena.

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<sup>36</sup> See *NML Capital, Ltd.*, \_\_ U.S. \_\_, 2014 U.S. LEXIS 4167.