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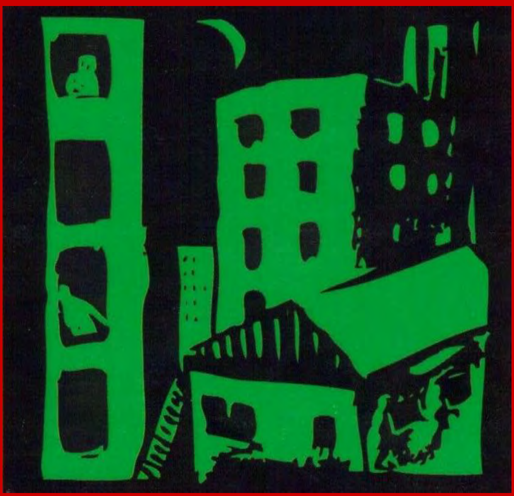

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Reconceptualising sovereign debt in international law

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ABSTRACT

Recurring debt crises and innovations in the sovereign debt landscape over the past couple of decades have rekindled interest in the nature and forms of sovereign debt. There are multiple outlets for contracting loans, all with different policies, principles and procedures. For instance, resource-backed loans have provided an additional option for resource-rich countries in Africa and Latin America to support their quest for infrastructural development. However, these and other innovations in sovereign financing may affect the dominant understanding and dynamics of sovereign debt governance. The silence of the literature on the place of development in the conceptualisation of sovereign debt is striking. Therefore, using doctrinal methodology, this article proposes a reconceptualization of sovereign debt to reflect these innovations, gaps, and *emerging trends. It is argued that sovereign financing needs a theoretical underpinning linked to the objective of development. This article proposes a distinction between development-driven and non-development-driven sovereign debt. It is argued that a development-based conception of sovereign debt would make the recurring legitimacy issues surrounding the character of the sovereign relevant and more reflective of contemporary changes in the practice of sovereign financing.*

Keywords: Sovereign debt; contract; investment; claim; international law

1 INTRODUCTION

Due to COVID-19-induced economic crises across the world, the debt profiles of countries have risen significantly.[1] Certain African countries were in debt distress even before the pandemic.[2] Unsustainable debt poses serious challenges to development. This and a host of recent cases, agreements, activities, and measures have underscored the imperative for reconceptualising sovereign debt in international law. In 2020, for instance, Angola and Chad agreed that the latter would deliver to the former 75,000 heads of cattle over a period of ten years as a complete repayment of a $100-million sovereign debt signed in 2017.[3] Chad was short of cash while drought-prone Angola needed cattle. On the face of it, this unusual debt-repayment arrangement appears to have diluted the efficacy of the currency of the original loan. The agreement also reveals changes in the creditor-debtor matrix in global sovereign financing away from the traditional developed-developing nations matrix. In fact, many so-called developing countries have now become creditor nations. An example of a creditor nation in Africa is Botswana.[4]

Importantly, the Angola-Chad "barter" arrangement illustrates the dynamism and increasing evolution of new forms of sovereign debts over the years. In the past, for instance, war indemnity was a common form of sovereign debt payable to the victor state through instalments over a certain period, through cession of territories of the defeated party, or through granting commercial concessions over an area within such territories.[5] Today, however, sovereign debt takes different forms, including

[1] Centre for Strategic and International Studies "The next wave is not a COVID-19 wave: Debt sustainability in developing countries" (2022) available at https://www.csis.org/analysis/next-wave-not-covid-19-wave-debt-sustainability-developing-countries (accessed 13 June 2022).

[2] Muchabaiwa BL "The looming debt crisis in eastern and southern Africa" (2021) at 8 available at https://www.unicef.org/esa/media/9636/file/UNICEF-ESARO-Looming-Debt-Crisis-2021.pdf (accessed 13 June 2022).

[3] Hoke Z "Chad to repay $100m debt to Angola with cattle" *Voice of America* (17/3/2020) available at https://www.voanews.com/africa/chad-repay-100m-debt-angola-cattle (accessed 26 March 2020).

[4] "Botswana offers Zimbabwe $600 million of loans" *Reuters* (26 February 2019) available at https://reut.rs/3BoZYem (accessed 26 March 2020).

[5] Prothero GW *Indemnities of war: Subsidies and loans* London: HM Stationaries Office (1920) at 1–2.

multilateral loans, sovereign bonds, export credits, sovereign credit default swaps,[6] resource-for-infrastructure (RFI), and resource-backed loans (RBLs).[7] In other words, the sovereign debt landscape has changed completely. In addition, the idea of financing for development has added crucial impetus to the relevance of debt financing.

Thus, innovative private and public sources of finance have been developed over the past couple of decades. New multilateral lenders have emerged, as have new bilateral lenders and new private lenders. Sovereign wealth funds (SWFs) have become critical players in the bond markets. For instance, a Russian SWF, in a politically questionable setting, subscribed to the Ukrainian government's bonds worth billions of dollars and later, upon default by Ukraine, sued to recover in a United Kingdom court, raising fundamental validity issues.[8]

This article argues that such a method of contracting sovereign debt does not support the global objective of development and is therefore tainted in terms of legitimacy. In this context, "development" entails channelling resources to enhance a country's economic growth, improve human welfare and build economic and social infrastructure in line with global ideals; it is widely accepted as a global objective, with the Sustainable Development Goals (SDGs) serving as evidence of its universalisation. Embedding development into the concept of sovereign debt will give practical meaning to responsible international lending and borrowing.

Interestingly, state guarantees for private debts, which increased dramatically over the past decades, have also been creating debt liability for sovereign guarantors.[9] In certain cases, state-owned enterprises (SOEs), especially natural resources companies, have been accumulating huge debts and becoming debt-procurement instruments for their governments.[10] The recent Venezuelan debt crisis is an example.[11] In addition, sovereign debt transactions could be hijacked easily by hedge funds, the so-called vulture funds that often purchase debts at a discount on secondary debt markets and then pursue full repayment through aggressive litigation. These debts are increasingly

[6] Packer F & Suthiphongchai C "Sovereign credit default swaps" (2003) December *BIS Quarterly Review* 79.

[7] Mihalyi D, Adam A & Hwang J "Resource-backed loans: Pitfalls and potentials" (2020) available at https://resourcegovernance.org/sites/default/files/documents/resource-backed-loans-pitfalls-and-potential.pdf (accessed 26 March 2020).

[8] *Ukraine v Law Debenture Trust Corp Plc* (2018) Court of Appeal at para 200 available at https://www.judiciary.uk/wp-content/uploads/2018/09/law-debenture-v-ukraine-final-judgment-14-sept-18.pdf (accessed 28 March 2020).

[9] Ellmers B "Evolving developing country debts and solutions for change" EURODAD Discussion Paper (2016) 7 available at https://eurodad.org/files/pdf/1546625-the-evolving-nature-of-developing-country-debt-and-solutions-for-change-1474374793.pdf (accessed 13 February 2019).

[10] Venezuela, for instance. See Scott RE, Choi SJ & Gulati M "Anticipating Venezuela's debt crisis: Hidden holdouts and the problem of pricing collective action clauses" (2020) 100 *Boston University Law Review* 253–300; Moatti T & Muci F "An economic framework for Venezuela's debt restructuring" Harvard Kennedy School (2019) available at https://www.hks.harvard.edu/sites/default/files/degree%20programs/MPAID/files/Moatti%2C%20Thomas%20and%20Muci%2C%20Frank%20SYPA.pdf (accessed 13 February 2020).

[11] Seelke CR "Venezuela: Political crisis and US policy" (2020) March Congressional Research Service available at https://fas.org/sgp/crs/row/IF10230.pdf (accessed 13 March 2020).

held as "investments" as creditors ingeniously expand their debt-recovery options to the investment-treaty regime. The latter has been creeping into the sovereign-debt regime, forcing certain states to reconsider the concept of "investment" in their bilateral investment treaties (BITs).[12]

All the issues above raise fundamental questions about the actual character of sovereign debt. First, what constitutes "sovereign debt"? Secondly, how have the various forms of sovereign debt evolved? Lastly, who is a "sovereign" for the purpose of sovereign-debt liability under international law? The changing composition of sovereign debts has, arguably, created conceptual confusion that adds complexity to an already complicated, problematic regime. In addition, most conceptions of sovereign debt tend to be silent on the critical element of development. Such conceptions ignore the importance of development in terms of providing moral content to sovereign financing. Development has become a global objective; debt crises have become recurring phenomena that can undermine it. In fact, the Euro Zone Debt crisis between 2010 and 2015 demonstrated the potential cross-border effects of a debt crisis in an increasingly interconnected global economic environment.[13] Thus, the frequency of the crises and their devastating effects on individual economies and global financial stability make it extremely important to examine the character of sovereign debt in the context of development.

This article seeks to answer the above questions. It examines the nature and forms of sovereign debt. The remainder of the article is structured as follows: section two defines "sovereign debt" and identifies its core features; section three examines the legal form of sovereign debt as a contract and then identifies the common classes of creditors; section four examines the "investment" element in sovereign debt; section five examines the nature of the permanent party (that is, the sovereign debtor) in sovereign debt transactions in the light of emerging practices and certain validity issues raised in some of these transactions; and section five concludes the article.

2 DEFINITIONS OF SOVEREIGN DEBT

Since the Middle Ages, borrowing and lending have been key features of international economic relations.[14] "Sovereign debt" deals with the financial undertakings of states. It is sometimes called "public debt", "national debt", "international loan", "external debt" or "foreign debt", although these terms do not necessarily mean the same thing.[15] Most scholars use "foreign or external debt" interchangeably with "sovereign debt". However, the latter is a broader term that includes the former within its purview. Arruda defines "external debt" simply as "the sum total of a country's debts resulting from loans and

[12] Examples are the EU-Canada Comprehensive Economic and Trade Agreement; United States-Uruguay BIT; North American Free Trade Agreement (NAFTA) (article 11.39); and Morocco-Nigeria BIT 2016.

[13] Laryea TW "Introductory remarks" (2011) 105 *Proceedings of the Annual Meeting of American Society of International Law* 139.

[14] Tomz M *Reputation and international cooperation: Sovereign debt across three centuries* Princeton: Princeton University Press (2007) at 1–20.

[15] International Law Association (ILA) Sovereign Insolvency Study Group *State insolvency: Options for the way forward* (2010) at 9.

financing contracted with persons resident abroad and guaranteed by its government".[16] By this definition, "external debt" consists of a state's contracted loans and government guarantees. The report of the United Nations (UN) Independent Expert on the Impacts of Foreign Debt on Human Rights states that "foreign [or external] debt is debt owed to non-residents and consists of public, publicly guaranteed, and private non-guaranteed long-term debt, short-term debt and use of IMF [International Monetary Fund] credit".[17] The residence of creditors, not their citizenship or their institutional capacity, seems to be the main emphasis here.

In the same vein, the UN Guiding Principles on Foreign Debt and Human Rights 2012 (GPFDHR) uses the term "foreign or external debt" and defines it as follows:

[A]n obligation [including a monetary obligation] created under a contractual agreement and owed by a State to a non-resident lender which may either be an international financial institution, a bilateral or multilateral lender, a private financial institution or a bondholder, or is subject to foreign law. It includes:

(i) loans, that is, advances of funds to the debtor by the lender on the basis of an undertaking that the borrower will repay the funds at some future point (including deposits, bonds, debentures, commercial loans and buyer's credits); and

(ii) suppliers' credits, that is, contracts whereby the supplier allows the customer to defer payment until sometime after the date on which the goods are delivered or the services are provided.[18]

The definitions by Arruda and the GPFDHR ignore the conflict-of-law element in "external debt". The International Law Association (ILA) avoids this pitfall by describing "external debt" from the perspective of the potential application of multiple systems of law in resolving disputes pertaining to such debt. As stated by the ILA, "[E]xternal debt is expressed in some foreign currency, typically payable abroad, governed by some external law and subject to the jurisdiction of external courts."[19] In other words, different systems of law are potentially applicable before different courts, and these may include the domestic law of the sovereign debtor, the law of the lender's country, the law of the market, the law of a neutral country or, in certain cases, "public international law (or its offshoots)".[20] This is one of the fundamental features of sovereign debt. Indeed, as observed by Wood, "much of the complexity associated with international finance results from the fact that an international loan agreement or bond issue must inevitably involve the laws of more than one country".[21] This feature gives

[16] He also defines it as "the foreign money loaned to the government or to companies over several years. It is money loaned with interest." See Arruda M *External debt: Brazil and the international financial crisis* London: Pluto Press (2000) at 6 and 140.

[17] UNHRC *Guiding Principles on Foreign Debt and Human Rights* (adopted on 5 July 2012) (2012) (GPFDHR) at para 22.

[18] See section 1(4) of GPFDHR (2012).

[19] ILA Sovereign Insolvency Study Group (2010) at 9.

[20] Wood P *Law and practice of international finance* London: Sweet & Maxwell (1980) at 1.

[21] See Wood (1980) at 3–4.

sovereign debt a global outlook, which is important in the context of development as a global concern.

However, currency variation is also important. Indeed, Tennekoon views this form of lending as the "provision of finance at a financial centre by foreign lenders to foreign borrowers largely in a currency which is not the currency of the financial centre".[22] Currency is significant in sovereign borrowing due to the concomitant foreign exchange risks and what is termed the "original sin" that followed the debt crises of the 1980s and 1990s.[23] Generally, a country's economic policies, both monetary and fiscal, tend to influence its borrowing in foreign currency.[24] Sovereign debt could also be considered from the source of the finance or in terms of the character or position of the lender. In other words, it includes debts owed to supra-national entities, governments or their agencies, banks and bondholders.[25] For this reason, liabilities arising from trade debt, judgement debt or arbitral awards also qualify as sovereign debt.[26]

Importantly, all the definitions above deliberately exclude domestic financial undertakings by either central or subnational governments and their respective agencies. This explains the use of the term "foreign or external". However, the domestic debt of national governments is also "sovereign debt", although it is usually called "national debt". The distinguishing features of a sovereign's domestic debt are that it is denominated in local currency, making it largely unsusceptible to foreign exchange risks and, more importantly, subject to the exclusive control of the domestic legal system.[27] Thus, domestic debt is not normally subject to the jurisdiction of international tribunals or international investment arbitration. It is thus outside the scope of this article. However, it is worth noting that domestic debt may be susceptible to adverse legislative measures or other actions of the government that might affect creditors' interests and consequently disincentivise future external loans.[28] It is part of the overall "public debt" obligations of a government and, if poorly managed, can negatively affect a country's financial rating and economic growth.[29]

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[22] Tennekoon RV *The law and regulation of international finance* London: Butterworth (1991) at 2.

[23] Cassard M & Folkerts-Landau DFI "Management of sovereign assets and liabilities" in Folkerts-Landau DFI & Cassard M (eds) *Sovereign Assets and liabilities management* Washington: IMF (1989) at 8–10. "Original sin" refers to a situation in which a country is unable to borrow abroad in its domestic currency. See Eichengreen B, Hausmann R & Panizza U "The pain of original sin" (2003) at 2 available at https://eml.berkeley.edu/~eichengr/research/ospainaug21-03.pdf (accessed 29 May 22).

[24] Rosenberg CB & Tirpak M *Determinants of foreign currency borrowing in the new member states of the EU* Washington: IMF (2008) at 7-9.

[25] ILA Sovereign Insolvency Study Group (2010) at 9.

[26] ILA Sovereign Insolvency Study Group (2010) at 9.

[27] ILA Sovereign Insolvency Study Group (2010) at 9.

[28] Olivier J "Debt maturity and the international financial architecture" (2009) 99(5) *The American Economic Review* 2135 at 2138.

[29] Standard & Poor's *Default, transition and recovery: 2014 annual sovereign default study and rating transactions* (2015) at 26.

3 SOVEREIGN DEBT AS A CONTRACT

Not surprisingly, all the definitions above conceive of sovereign debt as a contract. Respect for contracts is one of the bedrocks of international finance.[30] The contractual element is the core feature of sovereign debt. Thus, vitiating elements such as duress can taint an otherwise formal sovereign-debt agreement.[31] The term "debt" reflects the mutuality of minds inherent in the core philosophy of contract. It is a liability arising from loans. Black's Law Dictionary states that a debt is "a liability on a claim [...] a specific sum of money due by agreement or otherwise [...] the aggregate of all existing claims against a person, entity or state".[32] A loan is a contract structured on asymmetrical performance, that is, one party lends and the other subsequently repays over a period of time.[33] In the words of Sommers et al., "the lender performs his part of the bargain at the outset, while the performance of the debtor is stretched over a period".[34] There is always a maturity period.

A debt entitles creditors to receive interest payments before maturity. Thereafter, the legal effect of performance or non-performance – as the case may be – sets in. Thus, time is of the essence. Aguir notes that "payments are typically contingent only on time".[35] As with private debts, a sovereign-debt default could trigger an action for enforcement. For this purpose, sovereign debtors usually waive their sovereign immunity under international law at the point of contracting. Sovereign debt is a loan *sui generis*. First, it tends to have a multijurisdictional element, as observed above.[36] The League of Nations' Committee on International Loan Contracts stressed that "the essential criterion of what is an international loan is the fact of issue in a country or countries other than that of the borrower".[37] It is worth stating that the Committee was referring specifically to a "market loan" (such as bonds), which is different from bilateral loan contracts between governments or multilateral loans between governments and international organisations.

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[30] Rieffel A *Restructuring sovereign debt: The case for ad hoc machinery* Washington: Brookings Institution (2003) at 45.

[31] *Ukraine v Law Debenture Trust Corp Plc* (2018) Court of Appeal at para 200 available at https://www.judiciary.uk/wp-content/uploads/2018/09/law-debenture-v-ukraine-final-judgment-14-sept-18.pdf (accessed 28 March 2020).

[32] Garner B *Black's Law Dictionary* (1999) at 410.

[33] Buchheit LC "Law, ethics, and international finance" (2007) 70(3) *Law and Contemporary Problems* 1 at 2.

[34] Sommers D, Broches A & Delaume GR "Conflict avoidance in international loans and monetary agreements" (1956) 23(3) *Law and Contemporary Problems* 463.

[35] See Aguir M "Sovereign debt: Empirical facts" (2015) at 2–3 available at https://scholar.princeton.edu/sites/default/files/maguiar/files/lecture_1_empirics.pdf (accessed 13 January 2018).

[36] Wood (1980) at 3–4.

[37] League of Nations "Report of the Committee for the Study of International Loan Contracts" available at http://biblio-archive.unog.ch/Dateien/CouncilMSD/C-145-M-93-1939-II-A_EN.pdf (accessed on 11 June 2018).

Secondly, it largely depends upon the goodwill and creditworthiness of the debtor. In other words, it is generally not a secured loan in the sense of requiring collateral security for creditors to fall back on in the event of default.[38] The International Centre for the Settlement of Investment Disputes (ICSID) arbitration tribunal in the *Postova Banka* case pointedly notes that "creditors have much more limited legal resources if a sovereign debtor fails to make a contracted payment".[39] Chinese RBLs could be seen as an exception in this regard, as commodities or resources are often used as collateral to secure repayment. Other lenders could adopt this approach to reduce their exposure to default risks. Interestingly, RBLs usually have developmental objectives.

Thirdly, sovereign debt could have implications for a country's monetary policy. This is because it is susceptible to internal and external financial risks.[40] A sovereign debt that is poorly structured in terms of maturity, interest rate, and currency can contribute to financial instability. According to the IMF, "excessive reliance on foreign currency debt can lead to exchange rate and/or monetary pressures if investors become reluctant to refinance the government's foreign-currency debt".[41]

Finally, a sovereign loan is also peculiar in terms of "the inequality of status between the parties to the contract although this is not of the essence of the loan contract".[42] Perhaps one exception is a bilateral loan between governments in that international law presumes formal equality of status. Even here, however, there is a certain element of inequality, at least in terms of financial capacity and structural powers. Generally, loan contracts tend to bring unequal powers or persons together.[43] As many developing countries enter the club of international lenders, this structural inequality could lose its significance. However, as will be examined subsequently, the actual status and capacity of parties under international law may affect the validity of loan agreements and could incentivise repudiation.

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38 Borchard famously remarked: "He who contracts with the sovereign or the state has nothing but the state's honour and credit as a sanction … [T]he contract is … a gambling contract, depending for its performance entirely on the good faith and capacity of the debtor to pay", quoted in Kamlani DS *The four faces of power in sovereign debt restructuring: Explaining bargaining outcomes between debtor states and private creditors since 1870* (unpublished PhD thesis, London School of Economics and Political Science, 2008) at 70.

39 *Poštová Banka AS & Istrokapital SE v The Hellenic Republic* (2011) ICSID Case No ARB/13/8 at paras 318–324 (hereafter "Postova Banka case").

40 Nelson RM "Sovereign debt in advanced economies: Overview and issues for US Congress" (2013) at 2–3. Black notes that excessive and poorly managed sovereign debt could affect the entire economy through "higher borrowing costs for households, banks and corporations; lower economic growth; financial repression; credit rating downgrades; weakening of banking systems". See Black L "The changing nature of sovereign debt" (2012) available at https://www.tiaa.org/public/pdf/tcam_the_changing_nature_of_sovereign_debt_0.pdf (accessed 23 August 2018).

41 See also International Monetary Fund and the World Bank Guidelines for Public Debt Management (2001) available at https://www.imf.org/external/np/mae/pdebt/2000/eng/guide.pdf (accessed 29 May 2022).

42 See Schmitthoff M "The international government loan" (1937) 19(4) *Journal of Comparative Legislation and International Law* 179 at 180.

43 See Kamlani (2008) at 43–48.

The above definitions focus on the character of the parties. While the position or status of the debtor remains constant (that is, a sovereign borrower), there is variation in the class of creditors depending on the type and structure of the loan. This too is critical in the context of post-default measures, including debt relief packages. Of course, certain lenders are driven by the objective of development, while others are commercial-oriented lenders. However, reconceptualising sovereign debt in the context of development will require paying more attention to the loan's features and its objectives rather than only to the character of the borrower.

3.1 Official and non-official creditors

Creditors may be divided into two classes: official and non-official. It is important to examine these briefly to understand their policies or approaches to sovereign debt in the context of development.

3.1.1 Official creditors

Official creditors are either bilateral or multilateral lenders, and are usually established by laws or multilateral legal instruments. They are governed by their respective charters or articles of agreement, and answerable directly or indirectly to a government or group of governments. Their loans are often called "official loans". Prominent multilateral creditors include the IMF, World Bank (WB) and regional development banks (RDBs) such as the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB).[44] Although each of these institutions has distinct mandates and lending policies in accordance with its charter or articles of agreement, sovereign lending is one of their predominant businesses. They also provide development aid, as well as loans at both concessionary and non-concessionary rates.[45] Importantly, the IMF and WB have what is called a "preferred creditor" status, as their facilities are usually accorded priority over others in the event of distress.[46]

It is striking that the above institutions were established primarily to advance the economic-development objectives of their member states. For instance, the IMF principally provides temporary financing to its members facing balance-of-payment difficulties, including by way of lending to low-income countries (LICs) to support poverty reduction.[47] Its interest-free Poverty Reduction and Growth Fund (PRGF), designed for poor countries, covers three programmes: an extended credit facility (for LICs facing medium- to long-term balance-of-payment problems), a standby credit facility (for LICs facing short-term balance-of-payment problems), and a rapid credit

[44] Borenstein E, Yeyati EL & Panizza U (eds) *Living with debt: How to limit the risks of sovereign finance* Washington: Inter-American Development Bank (2005) at 105–107.

[45] See Borenstein, Yeyati & Panizza (2005) at 106.

[46] Rutsel-Silvestre JM *The financial obligation in international law* Oxford: Oxford University Press (2015) at 494.

[47] Emine B *Sovereign default, private sector creditors and the international financial institutions* Washington: IMF (2009) at 6.

facility (for LICs facing a short-term balance-of-payment problem).[48] It is therefore development-driven. IMF lending normally involves policy prescriptions, called "conditionalities", that enable the borrower to resolve the balance-of-payment problem and repay the loan on time.[49] This is the core feature of IMF lending. In particular, the policy prescriptions concern the borrower's structural and macro-economic fundamentals, including financial markets institutions, monetary and fiscal policies.[50]

Bilateral official lending occurs largely through national development banks or aid agencies, and government-guaranteed loans, through export credit agencies.[51] Their loans are therefore development-driven. In most cases, these agencies operate in low- and middle-income countries in need of financing for development. Prominent examples are China's policy banks: China Development Bank (CDB) and the Export-Import Bank of China. A recent study found that all Chinese overseas lending activities were official, advanced either directly by the Chinese government or through these policy banks or the central bank.[52] Between 1998 and 2018, China's direct loans to low- and middle-income countries climbed to more than $1.3 trillion, accounting for "a quarter of total bank lending to emerging markets".[53] By this measure, China has become the world's largest official lender, surpassing even the IMF and WB.[54] China's loans account for more than 40 per cent of external debt of 50 low- and middle-income economies.[55] Developed countries are also indebted to China, as the People's Bank of China continues to purchase sovereign bonds issued by these countries. In 2011, US indebtedness to China stood at $1.6 trillion, amounting to 10 per cent of US gross domestic product (GDP).[56] In 2018, China's loans to the rest of the world combined was estimated to be over $5 trillion, amounting to 6 per cent of global GDP.[57]

China's bilateral lending practices have been criticised as "opaque" and "secretive"; moreover, unlike other official creditors, which often offer concessionary loans, China lends at market rates with shorter maturities and "collateral clauses that secure repayment through commodity export proceeds".[58] The implication of this approach is that it gives Chinese policy banks a preferred-creditor status. Importantly, China's bilateral lending varies from the traditional government-to-government lending. It is

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48 IMF "IMF support for low-income countries" (2022) available at https://bit.ly/3BBLIPN (accessed 29 May 2022).

49 See Emine (2009) at 6–7.

50 Emine (2009) at 7.

51 Emine (2009) at 7.

52 Horn S, Rainhart C & Trebesch C "China's overseas lending" (2019) 2132 *Kiel Institute for the World Economy Working Paper 1*.

53 Horn, Rainhart & Trebesch (2019) at 3.

54 Horn, Rainhart & Trebesch (2019) at 3.

55 Horn, Rainhart & Trebesch (2019) at 4. See also Jin J, Ma X & Gallagher K "China's global development finance: A guidance note for global development policy center databases" (2018) available at https://www.bu.edu/gdp/files/2018/07/Coding-Manual-.pdf (accessed 25 March 2020).

56 Horn, Rainhart & Trebesch (2019) at 5.

57 Horn, Rainhart & Trebesch (2019) at 5.

58 Horn, Rainhart & Trebesch (2019) at 5–7.

more akin to "commercial" loan in that China usually uses its SOEs to extend the loan to SOEs of borrowing states.[59] Nevertheless, the funds come from the Chinese government or its policy banks.

In addition, China is not a member of the Paris Club of creditors. This makes its lending practices different from those of Paris Club's members and, by implication, these exclude the application of creditor coordination, comparability of treatment and other principles associated with debt restructuring under the Paris Club rules. Nevertheless, China's influence has been growing in the sovereign-debt regime. It seems to have a flexible restructuring model. For now, China's sovereign debtors have not been exposed to sovereign-debt profiteering activities of vulture funds and holdouts. Certain critics even acknowledge that Chinese practices have historical antecedents, as they "share many features with French, German and British 19th century foreign lending, which also tended to be market-based, partially collateralised by commodity income, and characterised by a close link of political and commercial interests".[60]

The appellation "creditor nations" is often used to describe developed countries that offer bilateral government-to-government loans or government-backed agencies' loans. They renegotiate the terms of the loan, if the need arises, through Paris Club.[61] However, apart from China, many emerging economies have become official bilateral creditors either directly or through their alter egos such as SWFs. The latter's business orientation gives them more flexibility in their investment portfolios, which extend to bonds and other fixed assets.[62] Although they are government-owned, it is not clear whether SWFs fit the description of "official creditors". The case of *Law Debenture Trust Corp v Ukraine* indicates that, at least for the purpose of sovereign debt, SWFs can be called official creditors as they function as alter egos of their governments.[63] As explained below, they are wholly owned by governments. Of course, SWFs are not all the same in terms of their purpose and investment strategies.[64] Nonetheless, they invest

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[59] Horn, Rainhart & Trebesch (2019) at 7.

[60] Horn, Rainhart & Trebesch (2019) at 5.

[61] Krasner (1999) ch 5.

[62] International Forum for SWFs (IFSWF) "Trends in SWFs asset allocation over time: A survey" (2016) available at https://www.ifswf.org/trends-sovereign-wealth-funds-asset-allocation-over-time-survey (accessed 28 March 2020).

[63] In the appeal by Ukraine against the decision in the *Law Debenture* case, the Court of Appeal held that the sole subscriber to the bonds 'was, and (the evidence showed) was always intended to be, Russia'. See *Ukraine v Law Debenture Trust Corp Plc* (2018) at para 200.

[64] There are five categories of SWFs: stabilisation funds, usually established to insulate national budgets from commodity price swings; saving funds, usually established to save windfalls for future generations; reserve investment corporations, usually established to increase return on reserve; development funds, established to facilitate investments in socio-economic projects; and contingent reserve funds. See IMF "Sovereign wealth funds: A work agenda" (29 February 2008) at 5 available at https://www.imf.org/external/np/pp/eng/2008/022908.pdf (accessed 29 May 2022).

hugely in government bonds. For obvious reasons, SWFs' preferences are, among other things, bonds issued by the governments of developed and emerging states.[65]

In essence, both multilateral and bilateral lenders have either direct or indirect governmental support. Before the emergence of these lenders, the predominant official loan was the direct government-to-government loan, which, as noted above, could even arise from defeat in war, that is, in the form of war indemnity.[66] In the past, non-payment of private creditors' claims by sovereign debtors could lead to wars or other forms of state intervention.[67] The latter included taking direct control of the revenue sources of the sovereign borrower by the creditors' state.[68] However, these measures are no longer obtainable. Instead, there has been an upsurge in the activities of multilateral and bilateral lenders. As noted earlier, new multilateral and bilateral lenders have emerged. For instance, China led more than 90 countries to form the Asian Infrastructure Investment and Development Bank (AIIDB).[69] China, Brazil, Russia, India, and South Africa (BRICS) also formed the New Development Bank in 2014.[70] These are both development-driven lenders.

3.1.2 Non-official creditors

Non-official creditors are otherwise called private lenders because they are purely business-oriented private or institutional investors and banks having little or no connection with their home government. They are, in other words, non-state actors (NSAs) in international lending. Private lending to sovereigns can be divided into two classes: bonds issue and direct-term loan agreement with a bank or banks.[71] Bonds are fixed-income securities by which a holder extends money to an entity for a defined period of time and at certain interest rates.[72]

Bonds entered the sovereign debt landscape in the 14th and 15th centuries as "forced loans" extracted by the sovereign from its wealthy citizens.[73] They later became

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65 International Forum for SWFs (IFSWF) "Trends in SWFs asset allocation over time: A survey" (2016) available at https://www.ifswf.org/trends-sovereign-wealth-funds-asset-allocation-over-time-survey (accessed 28 March 2020).

66 Mallard G "'The Gift' revisited: Marcel Mauss on war, debt, and the politics of reparations" (2011) 29(4) *Sociological Theory* 225 at 227.

67 Weidemaier WMC "Contracting for state intervention: The origins of sovereign debt arbitration" (2010) 73 *Law and Contemporary Problems* 335.

68 Krasner (1999) ch 5.

69 China controls a stake of more that 30 per cent and 26 per cent of the voting rights, while India and Russia are the second and third largest shareholders, respectively. See BBC News "China-led AIIB development bank holds signing ceremony" (29 June 2015) available at http://www.bbc.com/news (accessed 12 December 2017). South Africa is a "prospective Founding Member" of the AIIBD. See https://www.aiib.org/en/about-aiib/governance/members-of-bank/index.html.

70 See paragraphs 11 and 12 of the BRICS Fortaleza Declaration (15 July 2014) available at http://www.brics.utoronto.ca/docs/140715-leaders.html (accessed 30 May 2022).

71 See Wood (1980) at 177 and 233.

72 Andritzky R "Government bonds and their Investors: What are the facts and do they matter?" (2012) *IMF Working Paper* WP/12/158 at 2–5.

73 The Tontine Coffee House "The first sovereign bonds" (2018) available at https://thetchblog.com/2018/12/17/the-first-sovereign-bonds/ (accessed 9 April 2020).

transferable notes. Thus, bonds have remained flexible, tradeable, and transferable debt instruments through the ages. With growing internationalisation of capital markets around the world, sovereign bondholders could come from different parts of the world. This naturally adds to the complexity of sovereign debt, especially in the event of default. Nevertheless, capital markets have provided alternative borrowing outlets, and sovereigns are taking advantage of this to raise capital.[74] As will be seen, emerging creditor nations' SWFs and other agencies have been subscribing to sovereign bonds issued by developed and emerging economies. The case of *Law Debenture Trust v Ukraine* illustrates the point.

The other form of private lending to sovereigns is the international loan contract. Before the Mexican debt crisis of the 1980s, the most preferred form of sovereign financing was an international loan constituted by agreement between the sovereign borrower and the lending commercial bank or banks through syndication.[75] The latter normally occurs where the loan is so large that a single bank cannot, or does not wish to, provide the entire sum; hence a group of banks form a syndicate – with a lead manager and an agent bank – to provide it. In such a situation, "each bank commits to contribute a proportion of the loan under the terms of a single loan agreement between the lending syndicate and the borrower".[76] Syndicated loans have also increased over the years.[77]

Apart from the official character of the loan and the creditors, there are other notable differences between official and non-official creditors. The priority accorded to certain multilateral creditors as "preferred creditors" is one. Secondly, while private creditors are driven principally by profit, the objectives of the official creditors are often dictated by wider, sometimes political, considerations, as may be provided by their constitutive documents.[78] With respect to multilateral creditors, Emine notes that their objectives include "promoting development and social welfare", although this "may lead them to lend more in support of development projects, to lend in riskier environments, and to lend more in hard times relative to private lenders".[79] Thirdly, non-official creditors have no "conditionalities" attached to loan contracts in terms of policy prescriptions. These are common features of modern official (especially multilateral) policy-lending, which could constrain the sovereign autonomy of the borrower.

It is also worth pointing out that, apart from their non-official status and common objective of profit-making, non-official creditors have little in common. For instance, the

[74] Tanaka M "Bank loans versus bond finance: implications for sovereign debtors" (2006) 116 (510) *The Economic Journal Conference Papers* 149.

[75] Rieffel (2003) at 188–219.

[76] Wood (1980) at 256.

[77] Gong D, Jiang T & Wu W "A foreign currency effect in the syndicated loan market of emerging economies" (2018) 52 *Journal of International Financial Markets, Institutions and Money* 211 at 211–212.

[78] The Agreement Establishing the European Bank for Reconstruction and Development 1990 (as amended in 2013) (AEEBRD), for instance, stipulates that members should "be committed to the fundamental principles of multiparty democracy, rule of law, respect for human rights and market economies". See article 1 of AEEBRD.

[79] Emine (2009) at 109.

nature of sovereign bonds generated controversy in the *Abaclat* and *Postova Banka* cases where, it was argued, bonds purchased on the secondary market cannot be said to have contributed to the economic development of the sovereign issuer to form the basis for any debt-recovery claim.[80] Unlike official and syndicated bank loans, bondholders have exit options, that is, they can sell the bonds on the secondary markets. The issuer usually has a direct relationship with the initial subscribers. Therefore, purchase of sovereign bonds on the secondary markets illustrates the flexibility of bonds as financial instruments. This flexibility, however, allows investors, including vulture funds, to acquire sovereign bonds. It was partly on this ground that a privity objection was raised against bondholder claims in *Abaclat*. The negative activities of vulture funds have given moral credence to this objection, as such funds usually fight off debt-restructuring proposals through fierce litigation.[81] They purchase debts at a discount, frustrate restructuring, and litigate to recover the full value of the debt plus interest. It is estimated that on average eight cases are filed against sovereign debtors annually by vulture funds and that 25 judgements from certain of these cases have yielded almost USD 1 billion.[82]

However, since bonds are inherently transferable, bondholders can be said to have legitimate expectations and rights against the sovereign issuer. This means that "a holder in due course acquires the property in the instrument and all rights under it free of any defects in title of a prior holder or defences available to the issuer against a prior holder".[83] Hence, it is difficult to argue that there is no privity between the parties. As noted above, bondholders are mostly institutional investors from different countries. They are entitled to a return on their investments in the form of interest.[84]

4 SOVEREIGN DEBT AS INVESTMENT

It seems a creditor, whether official or non-official, would consider lending as an investment. However, in adjudication before arbitral tribunals this is not as straightforward as it seems, especially with respect to sovereign bonds. This is because, as regards investment arbitration, only sovereign debt instruments that qualify as "investment" under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention)[85] and relevant bilateral investment treaties (BITs) can clothe ICSID tribunals with the necessary jurisdiction to

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[80] *Abaclat & Others v The Argentine Republic* [2013] 52 ILM 667.

[81] Fisch JE & Gentile CM "Vultures or vanguards: The role of litigation in sovereign debt restructuring" (2004) 53 *Emory Law Journal* 1043 at 1052–1053.

[82] AfDB Africa Legal Support Facility "Vulture funds in the sovereign debt context" at https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context (accessed 2 July 2022).

[83] Wood (1980) at 183. See also *McKenty v Van Horenback* (1911) 21 Mn R 360.

[84] For instance, *Abaclat & Others v The Argentine Republic* [2013] 52 ILM 667 Decision on Jurisdiction and Admissibility, Dissenting Opinion of Professor Georges Abi-Saab at para 269 (hereafter "Abaclat Dissenting Opinion") and *Poštová Banka Case* at paras 336–342.

[85] ICSID *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States* (March 18 1965) (hereafter "ICSID Convention 1965") at 25.

adjudicate. In other words, a sovereign debt which is the subject of adjudication must not only provide a prior contractual cause of action, but must also be capable of standing as a treaty obligation to enable invocation of ICSID jurisdiction in claims against the sovereign debtor.[86]

In *Postova Banka*'s case, the ICSID tribunal held that "loans and bonds are distinct financial products".[87] Similarly, in his dissenting view in the *Abaclat Jurisdiction Award*, Abi Saab argues thus:

Affirming the jurisdiction of ICSID Tribunals over such instruments, would extend it over a vast new field. It would cover virtually all capital market transactions, ranging from standardised financial instruments, such as shares and bonds to structured and derivative products, such as hedges and credit default swaps.[88]

The issue in contention arose from the interpretation of article 25 of the ICSID Convention, which provides that

the jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State … and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.

The term "investment" was deliberately left undefined.[89] In practice, however, ICSID tribunals adopt a "double-barrel" approach, that is, they first refer to definitions of "investment" in the relevant BIT or investment chapters of Free Trade Agreements for guidance, and then, secondly, they examine "investment" under the provision of article 25 of the ICSID Convention.[90] The popular *Salini* case states that an economic activity must meet the following criteria to qualify as an "investment" under article 25: (a) it must amount to a substantial contribution of the investor; (b) it must be for a certain duration; (c) the investment activity must involve an operational risk; (d) there must be a certain regularity of profit; and (e) there must be a contribution to the economic development of the host state.[91]

Therefore, it is debatable whether sovereign debt is, for this purpose, an "investment".[92] There are two schools of thought on the issue. The first argues that debt instruments are not typical investments as defined in the *Salini* case, in that most of the substantive investment protection guarantees cannot address the creditors' desire for

[86] *Abaclat & Others v The Argentine Republic* [2013] 52 ILM 667.

[87] Tennekoon (1991) at 147.

[88] See *Abaclat* Dissenting Opinion at paras 268–69.

[89] ICSID *History of the ICSID Convention: Documents concerning the origin and the formulation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States vol II–1* (2009) at 22.

[90] *Abaclat* (2013) at paras 344 and 387; *Ambiente Ufficio SpA and others v Argentine Republic* IIC 689 (2015) ICSID Case No ARB/08/9 at paras 212–235, 356 and 438.

[91] *Salini v Morocco* (2001) 41 ILM 609 at para 52.

[92] Pahis S "BITs and Bonds: The international law and economics of sovereign debt" (2021) 115(2) *AJIL* 242.

enforcement.[93] In addition, on policy grounds, ICSID arbitration on sovereign-debt claims might encourage holdout, thwart sovereign-debt restructuring, and the tribunal may not be able to determine debtor's payment capacity in the event of an award.[94]

The second school considers sovereign debt an "investment" subject to ICSID jurisdiction.[95] This school looks at the developmental objectives of sovereign debt, arguing that ICSID arbitration offers a depoliticised, binding, impartial, effective adjudication forum away from the shortcomings of domestic tribunals.[96] While rejecting the *Salini* test, the majority in *Abaclat* held that "with regard to investments of a purely financial nature, the relevant criteria should be where and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred".[97] Thus, it concludes, portfolio investments and sovereign bonds may qualify as "investments".[98] Similarly, in the *Alemanni* case, the tribunal held that "as a fact of international economic life, sovereign bond issues were plainly within the normal field of contemplation of the Contracting Parties".[99]

However, it seems unarguable that, taken outside the investment-arbitration controversy, "sovereign debt", as a financing tool, is meant, ideally, to be an investment for the purpose of economic development of the sovereign debtor and its citizens. For the purpose of investment arbitration, however, the BIT definition is usually the determining factor. Indeed, modern BITs often explicitly exclude sovereign debt from the definitional scope of "investment", suggesting that the old-generation BITs were concerned not with sovereign debt but foreign direct investment.[100] This approach is a plausible response to the activities of vulture funds and other creditors who habitually frustrate debt restructuring initiatives. It also aligns with the debtor's developmental drive, as debt restructuring tends to restore the country to debt sustainability and economic stability.

[93] Waibel M "Opening Pandora's box: Sovereign bonds in international arbitration" (2007) 101 *American Journal of International Law* 711.

[94] See Waibel (2007) at 750–759. See also Waibel M *Sovereign defaults before international courts and tribunals* Cambridge: Cambridge University Press (2011) at 209–251.

[95] Norton E "International investment arbitration and the European debt crisis" (2012) 13 *Chicago Journal of International Law* 291. See also Youngjin J & Sangwook HD "Sovereign debt restructuring under the investor-state dispute regime" (2014) 31(1) *Journal of International Arbitration* 75.

[96] See Norton (2012) at 302.

[97] *Abaclat* (2013) at paras 346–374.

[98] *Abaclat* (2013) at paras 376–387.

[99] See *Alemanni v Argentine Republic* 2014 IIC 666 (ICSID) at para 320 available at https://www.italaw.com/sites/default/files/case-documents/italaw4061.pdf (accessed 17 November 2021).

[100] See EU-Canada Comprehensive Economic and Trade Agreement at annex X. See also United States-Uruguay BIT and NAFTA at a11.39; article 1 of Morocco-Nigeria BIT 2016 clearly excludes sovereign debt instruments.

5 THE "SOVEREIGN", DEBT AND DEVELOPMENT

The entry of emerging economies into the club of creditors has opened more financing outlets and development opportunities for LICs. In this section, the article examines a few of these new lending institutions and how they fit into the reconceptualisation of sovereign debt to align with the objectives of development. It is argued that some of the legitimacy issues that surround sovereign-debt governance can be linked to development as a global objective.

5.1 Emerging markets creditors

Many governments of emerging markets economies have been providing financing to LICs and developing countries through development banks or funds, SOEs, sovereign wealth funds and subnational governments. These financing vehicles, as wholly owned government entities, possess elements of "sovereignty". In the same vein, states provide sovereign guarantees for their subnational governments and SOEs. However, these lending institutions vary in terms of structure, form, investment strategies, and development objectives.

State-owned bondholders such as SWFs represent a new phenomenon in the evolution of sovereign debt. They are wholly owned by states. Many SWFs, for instance, invest in, among other kinds of assets, sovereign bonds issued by both developed and developing countries. In fact, certain SWFs function as development funds. Sharma has observed that "sovereign development funds have been used as a tool for certain countries to support development".[101] These funds have combined financial-performance objectives with development objectives.[102] Many SWFs have investment strategies that lead to broader global development-policy objectives. Unlike foreign-exchange reserves managed by central banks, SWFs tend to have medium- to long-term investment strategies. As SOEs, they are unlikely, by their behaviour, to frustrate debt restructuring proposals as vulture funds often do. Their investment behaviours are guided by Generally Accepted Principles and Practices for SWF (Santiago Principles).[103]

However, as the case of *Law Debenture* illustrates, SWFs can be used to undermine a sovereign issuer's economic interests. In this case, Russia was the sole subscriber of Ukraine's USD 3 billion bonds. Ukraine refused to make payment when the principal fell due, on the ground, among others, that its finance minister lacked the authority to enter into the transaction under Ukrainian law and that the notes were void because of alleged duress arising from unlawful use of force, economic pressure and unlawful trade measures imposed on Ukraine by Russia.[104] The court of first instance held that "a

[101] Sharma R "Sovereign wealth funds investments in sustainable development sectors" (2017) 1 available at https://www.un.org/esa/ffd/wp-content/uploads/sites/4/2017/11/Background-Paper_Sovereign-Wealth-Funds_16-Nov.pdf (accessed 2 July 2022).

[102] See Sharma (2017) at 18.

[103] International Working Group of SWFs *Generally accepted principles and practices* (2008) available at https://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf (accessed 13 June 2022).

[104] *Ukraine v Law Debenture Trust Corp Plc* (2018).

state's capacity to borrow rests in its sovereignty", and granted a summary judgement against Ukraine.[105] On appeal, it was held, among others, that illegitimate pressure could render sovereign bonds unenforceable.[106] Relying on article 2(4) of the Charter of the United Nations, the Court of Appeal held that "use of force by one state against another and also the threat of use of force by one state against another are in violation of a general norm of international law with the status of *ius cogens*".[107]

By invoking the UN Charter as a potential legal ground for vitiating a sovereign bond, this decision brings to fore the moral significance of creditors' behaviour in contracting sovereign debt. Although the matter is on appeal at the Supreme Court at the time of this writing, it can be argued that sovereign bonds issued under duress would be illegal and illegitimate and would hardly qualify as a development-driven debt.

As discussed above, it is unclear whether SWFs as bondholders would qualify as official creditors. It seems that, on the basis of ownership, they fit the description of official creditors. This position is reinforced by the OECD's definition of "official financing" as "transactions undertaken by the official sector [i.e. Government] at their own risk and responsibility, regardless of the source of funds [taxation of or borrowing from the private sector]. Official agencies include federal, state and local departments and agencies."[108] SWFs are public investment vehicles through which governments seek to achieve explicit national objectives.[109] On this ground, they qualify as "official creditors".

Secondly, emerging markets' development banks or funds have become active participants in sovereign financing. As noted above, Chinese banks have been highly active in this regard. Development banks from oil-rich Middle Eastern states as well as India have also provided loans to several LICs. Prominent among these are the Kuwait Fund and the Saudi Fund for Development. The latter, for instance, provides loans at concessionary rates of 1 per cent, with repayment terms of up to 50 years.[110] It finances development projects mainly in LICs. The significance of this changing landscape can be seen in the membership of the Paris Club (where most of the 22 permanent members are OECD countries).[111] "New" creditor nations who are not members of Paris Club are not bound by the Paris Club's principles on bilateral debt restructuring. UNCTAD has observed thus:

105 *Ukraine v Law Debenture Trust Corp Plc* (2018) at paras 129, 168 and 175

106 *Ukraine v Law Debenture Trust Corp Plc* (2018) at para 159.

107 *Ukraine v Law Debenture Trust Corp Plc* (2018) at para 165.

108 See OECD Factsheet at https://www.sheffield.ac.uk/polopoly_fs/1.659262!/file/Is_it_ODA.pdf (accessed 13 June 2022).

109 Capape J & Guerrero T "More layers than an onion: Looking for a definition of sovereign wealth funds" (2013) available at https://sites.tufts.edu/sovereignet/files/2017/09/More-Layers-than-an-Onion-Looking-for-a-Definition-of-Sovereign-Wealth-Funds.pdf (accessed 13 June 2022).

110 Saudi Fund for Development available at https://www.devex.com/organizations/saudi-fund-for-development-sfd-44289 (accessed 13 June 2022).

111 Paris Club "Who are the members of the Paris Club?" available at https://clubdeparis.org/en/communications/page/who-are-the-members-of-the-paris-club (accessed 13 June 2022).

[N]ew sovereign creditors with considerable weight include China, Brazil, Venezuela, and Taiwan, Province of China, along with several oil-rich states from the Middle East. The Paris Club has invited some of these new lenders to become members of the Club, but they have not joined. The Paris Club has attempted to establish its restructurings as a standard for other bilateral creditors through the 'comparability of treatment' clause ... [which] obliges the debtor state to seek restructurings from other creditors on terms that are comparable to the concessions of the Paris Club. However, non-members of the Paris Club are reluctant to follow the terms set by the Paris Club. Some of these creditors have so far cancelled significant amounts of debt bilaterally at their own pace.[112]

The emergence of new creditors has clearly challenged the relevance of the Paris Club. This could have a broader implications for debt relief for LICs. In Africa, for instance, China holds more debt than the next ten creditors combined.[113] Non-Paris Club debts are therefore on the rise globally.

5.2 "The sovereign"

A recurring issue in sovereign-debt governance is the sovereignty-compromising effect of debt and the powerlessness of borrowing states to resist it.[114] The changing composition of sovereign debt, with a multitude of "semi-publics" acting on behalf of states, raises further theoretical issues, some of which were considered in the *Law Debenture* case.[115] In the context of Africa, substantial debts were accumulated to finance the extravagant lifestyles of corrupt leaders.[116] Although the doctrine of odious debt was developed to address this and other concerns, African states ended up repaying some of these debts. Such a concept has, in functional terms, not been helpful. It is therefore important for sovereign debt to be managed through responsible lending and borrowing in a manner that facilitates Africa's development. This is one of the reasons why a development-driven conception is important – it could have implications for sovereign-debt contracting.

For this reason, it is important to explore the question raised by Lineau: "Who, really, is the 'sovereign' in sovereign debt?"[117] This is not just an abstract question; it is central to the changing character of sovereign debt, given that state-affiliated semi-publics are

[112] UNCTAD *Sovereign debt workout: Going forward, roadmap and guide* (2015) at 32–34.

[113] Heitzig C, Ordu AU & Senbet L "Sub-Saharan Africa's debt problem: Mapping the pandemic's effects and the way forward" (2021) 3 available at https://www.brookings.edu/wp-content/uploads/2021/10/COVID-and-debt.pdf (accessed 13 June 2022).

[114] See Krasner (1999) at chapter 5. See also Taylor CR "A modest proposal: Statehood and sovereignty in a global age" (1997) 18 *University of Pennsylvania Journal of International Economic Law* 745 at 777.

[115] Appeal pending at the UK Supreme Court at the time of writing. *Ukraine v Law Debenture Trust Corp Plc* [2019] QB 1121 available at http://www.bailii.org/ew/cases/EWCA/Civ/2018/2026.html (accessed 13 June 2022).

[116] Boyce J & Ndikuman L *Africa's odious debts: How foreign loans and capital flight bled a continent* Zed Books (2011).

[117] Lienau O "Who is 'sovereign' in sovereign debt: Reinterpreting a rule-of-law framework from the early twentieth century" (2008) 33 *The Yale Journal of International Law* 63.

becoming active in the debt market. As the *Law Debenture* case illustrates, the validity of sovereign debt may sometimes be affected by the purpose, legitimacy and moral orientation of the parties.[118] Unfortunately, apart from the odious debt doctrine, discussions of sovereign debt tend to ignore the surrounding legitimacy concerns and, as Lineau observes, this puts the sovereign-debt regime in the uncomfortable situation of functioning without a clear theory of what it means by "sovereign".[119] The concept of odious debt can hardly cover the situation in the *Law Debenture* case. In *Chrystalex v PDVS*, for instance, a US court held that PDVS, the indebted state-owned company, was merely an alter ego of the state of Venezuela.[120] In the context of the latter's debt crises, creditors went after the state-owned oil company and refinery.[121] In the same vein, the debt crisis in Venezuela is relevant for determining the sovereign in sovereign debt. The opposition leader, recognised by more than 50 countries in the world, attempted vainly to resolve his country's debt crisis with creditors as the US government gave him control of all Venezuelan assets in the US.[122]

As noted above, controversy over so-called "odious debt" (illegitimate, illegal, non-consensual, war or reprehensible debts mostly incurred by despotic regimes) has been rekindled recently.[123] However, this concept might not suit the Russia-Ukraine debt debacle in the *Law Debenture case*. It can explain the Venezuelan debt crisis and the Democratic Republic of Congo's case for the purpose of sovereign-debt liabilities.[124] First, *sovereignty* and all that it entails are vested in the *sovereign.* However, defining

[118] Lienau O "The challenge of legitimacy in sovereign debt restructuring" (2016) 57(1) *Harvard International Law Journal* 151; Raffer K "Odious, illegitimate, illegal, or legal debts: What difference does it make for International Chapter 9 Debt Arbitration?" (2007) 70(4) *Law and Contemporary Problems* 221.

[119] See Lienau (2008) at 64.

[120] *Crystallex Intl Corp v Bolivarian Republic of Venezuela & Petróleos de Venezuela SA (PDVSA)* 3rd Circ 2019 at para 10.

[121] Moatti T & Muci F "An economic framework for Venezuela"s debt restructuring" Harvard Kennedy School (2019) available at https://www.hks.harvard.edu/sites/default/files/degree%20programs/MPAID/files/Moatti%2C%20Thomas%20and%20Muci%2C%20Frank%20SYPA.pdf (accessed 13 February 2020).

[122] Smith C & Wigglesworth R "Venezuela's opposition sets out debt restructuring plans" *Financial Times* (3 July 2019) available at https://www.ft.com/content/f8c70f3a-9d18-11e9-9c06-a4640c9feebb (accessed 8 April 2020).

[123] Hanlon J "'Illegitimate' loans: Lenders, not borrowers, are responsible" (2006) 27(2) *Third World Quarterly* 211.

[124] This arose when vulture funds sued the DRC over sovereign debt in UK and US courts to seize assets belonging to a state-owned company. In *FG Hemisphere Associates v Republique du Congo* 455 f 3d 575 (5th Circuit 2006) the Privy Council held that the government's mining company was not responsible for the government's debt. See Neate R "Privy council blocks 'vulture fund' from collecting $100m DRC debt" *The Guardian* (18 July 2012) available at https://www.theguardian.com/business/2012/jul/18/privy-council-vulture-fund-drc (accessed 13 July 2018). In the US, the following suits were also filed and similar issues were raised: *Af-Cap Inc v Republic of Congo* 383 f 3d 361 (5th Circuit 2004); *FG Hemisphere Associates v Republique du Congo* 455 f 3d 575 (5th Circuit 2006); and *Kessington International Ltd v Republic of Congo and Ors* (2007) EWCA Civ 1128 (7 November 2007).

and identifying the *sovereign* is a theoretically charged endeavour.[125] Scholars have developed several theories to explain and rationalise the concept of sovereignty.[126]

The focus here is on *juridical sovereignty*, that is, the legal capacity, status and formal standing of a *sovereign* in international financial relations.[127] Broadly, Kurtulus defines juridical sovereignty as "a condition in which an agent – a state or a similar entity – according to law is supreme within a certain territory and independent of agents outside of it."[128] Qureshi and Ziegler define economic sovereignty as "the totality of the economic powers of a State, as well as its equal status in international economic relations."[129] These definitions are by no means adequate. In particular, they fail to disaggregate the constitutive elements of the juridical sovereign and proceed upon the assumption that "the state" is simply the sovereign.[130] Therefore, further contextualisation is important. For this purpose, we will approach the notion of the "sovereign" from two perspectives: internal and external.[131] These perspectives are not mutually exclusive but mutually reinforcing as incidents and manifestations of sovereign powers within and outside a country.[132] A *sovereign* in the external sense is relatively straightforward – that is, a juridical state is widely considered as the "sovereign" in international law.[133]

Narrowed down to the sovereign-debt regime, external sovereignty is a juridical state's international economic status and its capacity to engage in international financial transactions and operate externally.[134] In this sense, a *sovereign* possesses certain legal features, namely sovereign equality,[135] sovereign immunity,[136] and independence.[137] Notwithstanding the elements of sovereign equality and non-interference, today the new vision of external sovereignty is that of cooperation and interdependence among nations and between states and NSAs, especially in the areas of investment and

[125] Kurtulus EN *State sovereignty: Concept, phenomenon and ramifications* (2005) at 67.

[126] Loughlin M "The erosion of sovereignty" (2016) 45 *Netherlands Journal of Legal Philosophy* 57; Eleftheriadis P "Hart on Sovereignty" (2013) 85 *Oxford University Legal Research Paper Series* 2–14; MacCormick N "Beyond the Sovereign State" (1993) 56 *Modern Law Review* 1.

[127] Convention on the Rights and Duties of States (CRDS) 1933, article 1.

[128] Kurtulus (2005) at 84.

[129] Qureshi & Zeigler (2011) at 48–49.

[130] Sarooshi D "The essentially contested nature of the concept of sovereignty: Implications for the exercise by international organisations of delegated powers of government" (2004) 25 *Michigan Journal of International Law* 1109; Loughlin (2016) at 59.

[131] Rodrigues (1953) at 19; Kurtulus (2005) at 81 (calling this division "a spatial division of authority").

[132] Kurtulus (2005) at 62–63.

[133] See, for example, Taylor (1997) at 750 and Krasner (2001) at 18.

[134] Qureshi & Ziegler (2011) at 64.

[135] Kingsbury (1998) at 603–605.

[136] Rule of *par in parem non habet imperium* ("one equal entity does not have sovereign authority over another such entity"): *Compania Naviera Vascongado v SS Cristina* (1938) AC at 490; *Trendtex Trading Corp Ltd v Central Bank of Nigeria* (1977) 1 QB 552-553; *Kuwait Airways Corp v Iraqi Airways Co* (2001) 3 WLR 117.

[137] UN Charter 1945, article 2(1); *Case Concerning Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua v United States of America*) (1986) ICJ Reports 14 (hereafter "Nicaragua case").

finance.[138] States are driven into partnerships largely for investment, economic development, and cooperation, mainly through BITs.[139] Their external sovereignty conditions their participation in international economic relations. Their financial commitments are part of these activities.

Finally, the important point with respect to external sovereignty, for the present purpose, is that the state, as sovereign, is subject to the rules of international law. The state has the capacity to sue and be brought before an international tribunal over actionable claims. In particular, its contractual and treaty commitments impose financial obligations on it. For sovereignty in the internal sense, the debt crisis in Venezuela – where two parallel heads of governments, each recognised by some states, have been dealing with the state's debts – is a case in point.[140]

From this perspective, sovereignty could be described as the supreme authority vested in an institution, person or body (sovereign) covering the powers to make, unmake, enforce and alter pre-existing laws in a state and to govern generally within its territorial compass.[141] Qureshi and Ziegler consider the following as the major incidents of internal economic sovereignty of a state: permanent sovereignty over its natural resources; sovereignty over its non-natural resources, including financial services and human resources; economic self-determination and governance; and non-interference in its economic affairs.[142] They observe that internal sovereignty is increasingly impacted upon by norms emanating from international economic organisations such as the IMF and WB.[143]

There are three main schools of thought on this issue: the rule-of-law, the popular, and the statist schools. The latter is concerned with the original source of authority as well as the effective control of a government without much consideration given to its legitimacy and moral orientation.[144] The *Tinoco* case seems to favour this approach.[145] The statists' conception fits into the legal positivists' theoretical premise.[146] For instance, in positivist international law, sovereignty has no moral undertones.[147] It is strictly about de facto control of the state and of persons within the state, as recognised by other states. The propriety or moral content of the process of assuming such control

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138 Mattli W "Sovereignty bargains in regional integration" (2000) 2(2) *International Studies Review* 149.

139 UNCTAD "Recent trends in international investments agreements and investor-state dispute settlement" (2015) UNCTAD IIA Issue Note 2015 at 2 available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf (accessed 21 December 2017).

140 Smith C & Wigglesworth R "Venezuela's opposition sets out debt restructuring plans" *Financial Times* (3 July 2019) available at https://www.ft.com/content/f8c70f3a-9d18-11e9-9c06-a4640c9feebb (accessed 8 April 2020).

141 Martin EA *Oxford Dictionary of Law* (2003) at 469.

142 Qureshi & Ziegler (2011) at 56.

143 Qureshi & Ziegler (2011) at 63.

144 Merriam (2000) at 44.

145 Lienau (2008) at 78.

146 Payandeh P "The concept of international law in the jurisprudence of HLA Hart" (2010) 21(4) *European Journal of International Law* 967.

147 Brownlie I *Principles of public international law* 4th ed (1990) at 288.

is immaterial. Hence, by this logic, it can be argued that the opposition leader in Venezuela, recognised by more than 50 states but lacking control over the state's instruments of coercion, has no sovereign authority to deal with Venezuelan debts. This is because, by the statist position, the legitimacy or moral propriety of a constitutional order and its internal structures or processes is immaterial in constituting and determining the internal sovereign and its powers, contractual obligations, and capacity for external relations and commitments. International creditors would prefer this conception of sovereignty because it ensures sovereign continuity, predictability and relative certainty in their relationship with the state regardless of who the sovereign is.[148]

Unlike the statists, the popular school adopts a pragmatic approach and conceives of sovereignty in the context of the will or consent of the people, "a 'sovereign people', whose consent provides legitimacy to government and authority for its decisions".[149] As Savigny aptly argues, "the State originally, and according to nature, arises in a people, through a people, and for a people".[150] In the context of sovereign debt, this seems plausible because it is the people who pay for such debt.[151] They are the taxpayers. Therefore, their consent is important for the legitimacy of the debt. However, the people are not the sovereigns in traditional international law as they cannot conduct international transactions or even borrow in their capacity as such on behalf of, or in the name of, their state.[152] They are the beneficiaries – or the presumed beneficiaries – of sovereign debts. Viewed from a development perspective, loans are contracted, and debts are forgiven, mainly to facilitate development. The people are at the heart of development.

Thus, a fictional "social contract" (the constitution) provides the basis for agency between the state and its citizens in the realm of international relations, including loan contracts with other states or legal actors. It is this arrangement which enables the state to contract legitimately on behalf of its citizens and assume financial obligations as such. This conception of the sovereign might not be favoured by international creditors, as it could create uncertainty in the event of a transition in government or succession of state.[153] As noted, regardless of the legal basis, legitimacy or moral orientation of the government, creditors prefer sovereign continuity, as this serves as a guarantee that loans will be repaid.

Finally, Lineau champions the "rule-of-law" school.[154] In interpreting the *Tinoco* case, Lineau advances a new rule-of-law framework on sovereignty for the purpose of

[148] Tideman N & Lockwood S "The legitimate repudiation of a nation's debts" (1993) 19(3) *Eastern Economic Journal* 251.

[149] Lienau (2008) at 76.

[150] Quoted in Merriam (2000) at 51.

[151] Arruda M *External debt: Brazil and the international financial crisis* (2000) at 8–9.

[152] Vienna Convention on the Law of Treaties (UN 1969), articles 6 and 26; Loughlin (2016) at 59.

[153] Wood (1980) at 14; Sornarajah M *The international law on foreign investment* (2007) at 83.

[154] Lienau (2008) at 78.

sovereign debt.[155] She argues that regardless of the constitutional order, its legitimacy and internal structures or processes,

a sovereign government's international action is valid and binding on successor governments only if it has followed its own internal legal requirements for competence or ratification … [A]n international contract signed in contravention of a government's own internal laws … risk[s] repudiation by a subsequent regime.[156]

This aligns with the reasoning in the *Law Debenture* case. Lineau argues that an additional requirement identified in the *Tinoco* case is that "a sovereign debt contract may not be internationally enforceable unless it intends to serve a legitimate governmental purpose".[157]

This, however, raises questions about what exactly "legitimate governmental purpose" entails. The GPFDHR recognises this perspective.[158] Lienau suggests that the government, regardless of its character, shape or democratic credentials, is the sovereign so long as it is a government "both constituted and constrained by law".[159] The Venezuelan case does not support this proposition, as the government came to power through a questionable election, yet it contracted loans in the name of the state.[160] In the context of this article, therefore, the *sovereign* is the juridical borrower against whom performance is expected. Conversely, it can make claims or counterclaims against creditors. However, such action is not a claim by or against a federating unit or any state-owned entity, governmental agency or institution within the juridical state. Thus, debt qualifies as "sovereign debt" where the borrower is a sovereign recognised under international law and its government exercises power in the interests of the development and welfare of its people, who, for this purpose, qualify as the government's principal.

This idea of sovereignty has been recognised by the UN's Basic Principles on Sovereign Debt Restructuring which provides for a debtor's "right" to debt restructuring.[161] The decision to restructure debts belongs exclusively to the sovereign debtor but, once such a decision has been made, there must be a transparent, impartial and good-faith negotiation (that is, excluding self-help) between the debtor and its creditors to ensure a return to debt sustainability.[162] This is in the spirit of the principle of sovereignty.[163]

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[155] Lienau (2008) at 78.

[156] Lienau (2008) at 78. See *Tinoco Arbitration Case (Britain v Costa Rica)* (1924) 18 *American Journal of International Law* at 150–151 (hereafter "Tinoco case").

[157] Lienau (2008) at 82 (noting Judge Taft's statement that the loan was for personal rather than legitimate government purposes).

[158] GPFDHR (2012), section 45.

[159] Lienau (2008) at 78.

[160] Seelke CR "Venezuela: Political crisis and US Policy" (2020) March *Congressional Research Service* available at https://fas.org/sgp/crs/row/IF10230.pdf (accessed 13 March 2020).

[161] Principles 1–4 UN Basic Principles on Sovereign Debt Restructuring.

[162] Principles 1–4 UN Basic Principles on Sovereign Debt Restructuring.

[163] Paliouras V "The right to restructure sovereign debt" (2017) 20 *Journal of International Economic Law* 115 at 121.

5.3 Development

From the above discussion, the idea of development as recognised in numerous UN instruments can give practical meaning to the notion of responsible lending and borrowing. Conceptions of sovereign debt should align with this idea. Unlike the concept of odious debt, a development-driven conception of sovereign debt combines legal and moral elements reflective of emerging contemporary practices and trends. It addresses situations uncontemplated by the former, as seen in the *Law Debenture* case. It must be admitted that not all commercial loans can serve development objectives. In rejecting the presumption that the sovereign bonds in contention "served to finance Argentina's economic development", Abi-Saab argues as follows:

Not all funds made available to governments are necessarily used as "investment" in projects or activities contributing to the expansion of the productive capacities of the country… [as such] funds can be used to finance wars, even wars of aggression, or oppressive measures against restive populations, or even be diverted through corruption to private ends.[164]

6 CONCLUSION

This article proposes a reconceptualisation of sovereign debt to reflect emerging trends and practices in international financial law. The forms of contracting sovereign debts have evolved. This raises a fundamental theoretical concern regarding the character of these new forms of loans and their implications for the global objective of development. Hence the need to identify certain elements that are constant: the loan capital tied to the underlying objective of development, and the status of the debtor as a sovereign and its express, voluntary agreement with the lender.

A debt incurred by subnational or state-owned entities without compliance with the domestic legal framework may not qualify as sovereign debt. However, in a situation where an SOE is used as a front for the national government to secure loans, then the government cannot deny liability. There is usually a domestic legal framework that defines the circumstances under which these loans may be imputed to the national government. Conversely, a loan offered to a sovereign by another sovereign or its SOE or subnational is a sovereign debt. The key is the status of the borrower, not the lender. Sovereignty is a central concept that shapes the changing nature of sovereign debt especially with respect to the validity issues that often confront claimants at the point of adjudication. Although sovereign debts are widely considered to be unsecured, history and recent practices suggest that commodities can be collateralised to secure the transaction. Despite reservations about the secrecy of certain Chinese loans, it would be unwise for states not to take advantage of these loans to finance their development. States have a duty to explore multiple debt-financing outlets for sustainable development. Care must be taken to ensure the loan obligations do not compromise the fulfilment of a state's other obligations. Furthermore, debt-profiteering behaviour should be outlawed – both internationally and domestically – so that the development

[164] See a dissenting opinion in *Abaclat* (2013) at paras 113–159.

objective of sovereign debt can be preserved. Thus, questionable behaviours of governments in sovereign-debt contracting would render the loan Illegitimate and possibly unenforceable.

AUTHORS' CONTRIBUTIONS

Bello did the literature study and resultant research report, to which both authors contributed. Snyman-Van Deventer developed the draft article based on the LLD thesis of Bello and oversaw the revision process, to which both of the authors contributed.

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