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Sovereign Debt Restructuring: Locating Indian Law and Jurisprudence in the Contemporary International Legal Order

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ABSTRACT

Distressed sovereign debt ceases to be a rarity. Majority of the Asian countries grappled with financial crisis during the 1990s. Often sovereign debt crisis grows into a perpetual nightmare for nations as the process of sovereign debt restructuring is relegated to ad- hoc mechanisms of resolution. In absence of a comprehensive international regime, majority of the complications arising from sovereign default are frequently left to the uncertain market forces. Despite a long history of financial crisis, there is lack of adequate safeguards and international policy framework to ensure timely and equitable restructuring of sovereign debt. Nevertheless, sovereign debt restructuring has met with varied response from multilateral and domestic initiatives in the last few decades. Majority of these initiatives are voluntary in nature, with no legal entity or statutory rules of procedure. Although geared towards debt relief, the process continues to be case based and ad- hoc; often left to the discretion of the creditors. Taking advantage of this inadequacy in the legal framework, several creditors have resorted to litigations. Such litigations undermine sovereignty and often impede development and realization of human rights. Prevention and management of unsustainable sovereign debt and subsequent litigations continue to baffle the international institutions. Nations have acknowledged that nothing short of legislation is required to establish uniformity and certainty. Hence, a set of nations have proactively augmented the customary international law by national legislations e.g. the US Foreign Sovereign Immunities Act 1976 (FSIA) and the State Immunity Act 1978 of the UK. For reasons unknown, several States have forgone the opportunity to pass national legislation and continue to rely on international customary law in determining the scope of immunity (Finke, 2010: 857). India belongs to this category of nations. As India is emerging as an attractive destination for Foreign Direct Investment (FDI), Indian government needs to set out

appropriate rules and regulations that explicitly define the degree, scope and extent of state immunity.

KEYWORDS

Sovereign debt restructuring, state immunity.

1- INTRODUCTION

Distressed sovereign debt ceases to be a rarity. Majority of the Asian countries grappled with financial crisis during the 1990s, followed by other countries across the globe. Starting with Thailand in 1997 the debt crisis spread to Indonesia, South Korea, Philippines, Malaysia and Singapore. The crisis soon spread to Russia (1998) and Latin America (1980s). Brazil defaulted in 1980 followed by Mexico in 1982[1]; several Latin American countries followed the suit in a decade long debt crisis. Argentina's default during 2001 is considered the largest in history amounting to more than USD 100 billion in private debt. Other countries that faced similar problems include Brazil, Cote d'Ivoire, Ecuador, Panama, Peru, Poland, Democratic Republic of Congo, Turkey and Vietnam; Greece being the latest to join the list. Moreover, several countries in Europe are in the early stages of a sovereign debt crisis (Wright, 2012: 154). Since 1975, the amount of sovereign debt in default peaked in 1990 at an estimated more than $335 billion issued by 55 countries (Hatchondo et al., 2007: 169).

Often sovereign debt crisis grows into a perpetual nightmare for nations as the process of sovereign debt restructuring is relegated to ad- hoc mechanisms of resolution. In absence of a comprehensive international regime, majority of the complications arising from sovereign default are frequently left to the uncertain market forces. Despite a long history of financial crisis, there is lack of adequate safeguards and international policy framework to ensure timely and equitable restructuring of sovereign debt. Nevertheless, sovereign debt restructuring has met with varied response from multilateral and domestic initiatives in the last few decades. Majority of these initiatives are voluntary in nature, with no legal entity or statutory rules of procedure. Although geared towards debt relief, the process continues to be case based and ad- hoc; often

[1] Mexico defaulted again in 1995.

left to the discretion of the creditors. Taking advantage of this inadequacy in the legal framework, several creditors have resorted to litigations. Such litigations undermine sovereignty and often impede development and realization of human rights. Prevention and management of unsustainable sovereign debt and subsequent litigations continue to baffle the international institutions. Nations have acknowledged that nothing short of legislation is required to establish uniformity and certainty. Hence, a set of nations have proactively augmented the customary international law by national legislations e.g. the US Foreign Sovereign Immunities Act 1976 (FSIA) and the State Immunity Act 1978 of the UK. For reasons unknown, several States have forgone the opportunity to pass national legislation and continue to rely on international customary law in determining the scope of immunity (Finke, 2010: 857). India belongs to this category of nations. As India is emerging as an attractive destination for Foreign Direct Investment (FDI), Indian government needs to set out appropriate rules and regulations that explicitly define the degree, scope and extent of state immunity.

1.1- Sovereign Debt

Sovereign debt[2] is the "money that a country's government has borrowed, typically issued as bonds denominated in a reserve currency".[3] It is the debt guaranteed by a particular government[4] representing the debt of the central government, rather than that of a person or organization. It can also be defined as the money a government owes to the holders of its government bonds. Since the bonds issued are in a reserve currency and are sold to foreign investors it is called

[2] Legally, debt is a contract in which the borrower accepts an amount of money and concurrently agrees to pay it back. In case the borrower fails to repay the creditor acquires certain rights and powers vis-a-vis the borrower's assets (Schleifer, 2003: 2).

[3] Oxford Dictionary

[4] External Debt (2016, April 7). Retrieved from: http://data.worldbank.org/topic/external-debt

external debt.[5] In recent times majority of the sovereign debt has primarily taken the form of loans borrowed from private commercial banks and multilateral financial institutions (Eaton and Fernandez, 1995: 2032). Sovereign external debt is a subset of the Gross external debt as it precludes the debts owned by the citizenry of a country. In essence then, sovereign debt includes bonds issued in reserve currency and loans from multilateral creditors. Sovereign debt can be classified into major categories such as public debt; publicly guaranteed debt; private non-guaranteed credits; and loans from International Financial Institutions (IFIs). Public debt is the debt of central government. Provincial or sub- national debt does not constitute public debt. Publicly guaranteed debt is an external obligation of a private debtor which is guaranteed by public entity whereas. Private non- guaranteed credits are not guaranteed by public entity. Principally sovereign debt includes public debt and loans due to IFIs.[6]

1.2- Sovereign Debt Crisis

Increasing external debt can lead to a debt crisis if the debt burden becomes unsustainable. Sovereign debt crisis is a situation when a country's foreign exchange reserves are insufficient to meet its foreign exchange payment obligations over an extended period of time (Buchheit, 1988). Detragiache and Spilimbergo (2001) state that a country is in debt crisis if it has a rescheduling or restructuring agreement with commercial creditors; or a country may be in debt crisis if it

[5] Gross external debt is defined as "the outstanding amount of those current, and not contingent liabilities owed to non-residents by residents of an economy that require payment(s) either of principal and/or interest by the debtor at some point(s) in the future." External Debt Statistics: Guide for Compilers and Users (Draft), IMF, Washington DC, March 2000, Appendix III, Glossary of Terms.

[6] Sovereign bonds have been the predominant form of debt affected in the major waves of default in the post 2008 period. It is only during the defaults of the 1980s were bank loans more important than bonds (Sturzenegger and Zettelmeyer 2006).

receives a large non- concessional IMF loan (Manasse and Roubini, 2005: 4) or when a country faces significant difficulties in repaying its debts as a result of difficult access to capital markets (Stichelmans, 2015: 7). Further, a sovereign default is when a scheduled debt service is not paid beyond a grace period specified in the debt contract or when a sovereign makes a restructuring offer that contains terms less favorable than the original debt[7] (Hatchondo et al., 2007: 164). According to credit ratings agency Standard and Poor's a default has begun when the sovereign "tenders an exchange offer of new debt with less favorable terms than the original issue" when a payment is not made within the grace period specified in the contract.[8] As can be inferred, there can be no a priori definition of sovereign debt crisis as it can be caused by varying factors or a combination thereof. The varying definitions are probably innocuous for the purpose of our study, and we shall concentrate on national-level debts and debts guaranteed at the national level and not upon provincial or municipal debt.

Variable factors that can lead to a debt crisis are weak macroeconomic policies, worsening terms of trade, adverse environmental conditions, political and institutional factors (Das et al., 2013:6) and other external factors which are often combined with protracted armed conflicts[9] and

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[7] Credit-rating agencies consider a "technical" default an episode in which a sovereign makes a restructuring offer that contains terms less favorable than the original debt (Hatchondo et al., 2007: 164).

[8] John Chambers, Sovereign Defaults and Rating Transition Data 2010 Update, STANDARD & POOR'S (Feb.23, 2011) Retrieved from: http://www.standardandpoors.com/ratings/articles/en/us/? assetID=1245302231824.

[9] African Countries have a prolonged history of armed conflicts.

sometimes misguided borrowing and lending decisions.[10] Another important reason for debt crisis can be odious and illegitimate debt. There have been several instances when debt has been "illegally" issued by past governments.[11] Tainted by corruption and lacking transparency, often these debts have been proved to be in violation of domestic laws and international treaties. There is a general consensus internationally- for a debt to be odious it is sufficient that the debt be incurred without the consent of the people as is the case of dictatorship (Wright, 2012: 190). In such a circumstance, the debt seldom accrues any benefit to the people and these facts are known to the creditors lending at that time. The most prominent example of such illegitimate debt is that of Argentina. During Argentina's default at the end of 2001, the Argentine Federal Court held that a substantial portion of Argentina's foreign debt was fraudulent and illegitimate, having been amassed when the country was under military rule.[12]

Sovereign debt crisis is accompanied by economic dislocation, political upheaval and long-term loss of access to capital markets (Krueger, 2002: 2). Explicit or clandestine trade sanctions have been experienced by countries in default. Martinez and Sandleris have shown empirical evidence that countries in default experience a significant decline in foreign trade, which may indicate the imposition of trade sanctions, or the loss of access to trade credit facilities (Martinez and

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[10] Debt Relief for Poverty Reduction: The Role of the Enhanced HIPC Initiative. (2001, August 2). Retrieved from http://www.imf.org/external/pubs/ft/exrp/debt/eng/

[11] Arturo C. Porzecanski, When Bad Things Happen to Sovereign Debt Contracts: The Case of Ecuador, 73 DUKE J.L. CONTEMP. PROBS. 251, 267–69 (2010); Adam Feibelman, Ecuador's Sovereign Default: A Pyrrhic Victory for Odious Debt?, 25 J. Int'l Banking L. & Reg. 357, 360–62 (2010).

[12] A Case of Illegitimate Debt in Argentine, African Forum and Network On Debt And Development (2007). (2016. July 9). Retrieved from: http://www.afrodad.org/downloads/Argentina%20FTA% 20Final.pdf.

Sandleris, 2011: 909). Debt crisis can reduce the amount of foreign credit available to private domestic firms via a decline in supply because lender's perceptions of country risk worsen (Drudi and Giordano, 2000). Further, the domestic costs associated with default include damages to domestic financial system by inducing a domestic banking crisis and fall in domestic output (Wright, 2012: 159).

Unable to pay back its debt; in order to free up public resources, a country is forced to choose between two options- (1) default on payment and subsequent debt restructuring or (2) receive IMF-funded bailout and the conditionalities that are attached to bailout loans.[13] Most often than not, there is a reluctance on debtor country's side to default on payment and they choose the latter option and accept IMF's conditionalities. Nonetheless history of sovereigns is replete with numerous incidences of debt defaults. Developing countries have been facing the hazard of sovereign debt crisis for a long time now. Since 1950, most debt crisis occurred in developing or emerging market economies. Distressed sovereign debt in an advanced economy is a comparatively recent phenomenon (Reddy et al., 2014: 282).

As discussed earlier, a country facing debt crisis has limited options; either to default on payment and then request debt restructuring or consent to the conditionalities that come along with IMF-funded bailout. The conditionalities or austerity policies are economically more disruptive, and are more costly for all parties involved (Stichelmans, 2015: 7). The debt crisis lasts longer as the objective is to reduce public debt by cutting down public expenses and raising taxes. This has a negative impact on economic recovery as the reduction of public expenses and tax increases

[13] Eurodad (2014) Conditionality yours, An analysis of the policy conditions attached to IMF loans (2016, July 7). Retrieved from: http://www. eurodad.org/files/pdf/53466a66139aa.pdf

reduce the economic output and therefore lower tax revenues and increase spending on benefits (*ibid*). This can induce recession which affects the level of employment. Increased unemployment in turn creates new conditions of poverty. A good example of slowed economic growth due to economic reforms is Greek crisis. Greek economy lost around 29% of its GDP between 2008 and 2014 due to debt crisis and the resultant unemployment reached 25% by 2014.[14] There is a detailed assessment of how foreign debt and the subsequent IMF-supported adjustment programs implemented in the mid-1980s through the early 1990s have caused or aggravated human rights violations among the affected nations (Ozden, 2007). An alternative to IMF bailout; a relatively costless sovereign debt restructuring process is in the best interests of the sovereign in default (Bai, 2012: 160).

1.3- Sovereign Debt Restructuring

While there is no universally accepted definition; sovereign debt restructuring is an exchange of outstanding sovereign debt instruments, such as loans or bonds, for new debt instruments or cash through a legal process (Das et al., 2013: 4). It may involve debt rescheduling with or without a reduction in the face value of old debt instruments (Reddy et al., 2014: 282). Arguably a restructuring in which creditors voluntarily exchange their debts for new debt instrument with different payments should not constitute a restructuring credit event.[15] Sovereign debt

[14] Oxfam Research Report (2011) Owning Development, Taxation to fight poverty (2016, July 7) Retrieved from:
https://www.oxfam.org/ sites/www.oxfam.org/files/rr-owning-developmentdomestic-resources-tax-260911-en.pdf

[15] Christopher Whittall, Greek CDS Uncertainty Fuels Dumping, INT'L FINANCING REV. (June 3, 2011), Retrieved from:
http://www.ifre.com/greek-cds-uncertainty-fuels-dumping/637561.article.

restructurings are aimed at mitigating some of the problems caused by debt crisis such as economic dislocation and long-term loss of access to capital markets (Krueger, 2002: 2). In recent past, sovereign debt restructuring episodes have been quite frequent. In the last 60 years there have been around 600 cases of debt restructurings in 95 countries. Of these; 186 were debt restructurings with private creditors and 450 were with Paris Club (Das et al., 2013: 5). Of the 186 debt restructurings with the private creditors; 109 were post default restructurings whereas 77 were preemptive (*ibid*). It is pertinent to note here that 'debt relief' is different from 'debt restructuring'. Debt relief is a subset of debt restructuring. When a sovereign debt restructuring involves reduction in the value of outstanding debt obligations, it is called debt relief (Reddy et al., 2014: 281).

Quintessentially, sovereign debt restructuring seems to be distinct rectilinear process. In reality though, the process of sovereign debt restructuring is seldom so straight forward. Each step involves considerable negotiations and is time consuming. Several conflicting interests interplay and the process is politically charged. To provide some relief to distressed sovereign, several international initiatives have been undertaken. The next section captures the responses of the governments and multilateral institutions towards some of the problems of sovereign debt and its restructuring.

2- INTERNATIONAL INITIATIVES

Sovereign debt restructuring has been met with varied response from individual states as well as from the multilateral initiative throughout the last few decades. Though mostly creditor/lender initiated, these international initiatives have led to considerable increase in sovereign debt relief (Sukoon, 2010: 93). Several bilateral creditors have extended debt relief which has restrained the sale of claims to private litigants in secondary markets which in turn has reduced the number of lawsuits. Several debt relief initiatives have curtailed the crippling debt of countries in the past three decades. Although the past decades have seen marked and significant improvement in the provision of debt relief to distressed sovereigns; the picture is not equally good when it comes to sovereign debt restructuring processes. The minimal support towards establishing a fair and equitable debt restructuring process is partly due to the interconnection between debt problems and political, economic and social factors of both the creditor and debtor countries. Legislative efforts have been undertaken by few national governments like Belgium and UK but they have been less successful than expected in motivating other governments to adopt similar legislations.

The efforts by multilateral institutions and government include the Highly Indebted Poor Countries (HIPC) debt relief initiatives (1996), Multilateral Debt Relief Initiative- MDRI (2005) and Debt Reduction Facility (DRF), initiatives by Norway (1998), G8 (2005), initiatives by China (2007), and the Paris Club Initiatives (2007).

2.1- The Paris Club Initiative (1956, 2007)

The Paris club[16] is an informal and voluntary group (not a legal entity and sans statutory rules of procedure) comprised of several creditor countries which aim to make coordinated efforts towards helping sovereign debtor countries with debt obligations difficulties (Sukoon, 2010: 96) or are nearing default. It was initially founded in 1956, when Argentina had difficulty in repayment and an official meeting was hosted by the French Treasury (Calitz, 2012: 339).

[16] Presently the permanent members of the Paris Club are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, Russia Federation, Spain, Sweden, Switzerland, UK, and USA.

Fulfillment of IMF conditionality is a prerequisite to receiving HIPC debt relief. Its operations address purely bilateral and regional obligations falling outside of the largely multilateral debts governed by the IMF or World Bank as they allow the HIPC to service its payment towards multilateral creditors (Bai, 2013: 718). The design of Paris club is not tailor made to suit the needs of specific debtors and relies heavily on the conditionalities of an IMF programme. The club has well accepted rules and no creditor is treated differentially. However, practically it becomes more difficult to establish comparable treatment of creditors if the debtors have to negotiate with them separately (Stichelmans, 2015: 9). This facilitates the behavior of holdouts; the result was that many commercial debtors could buy debt from Paris club bilateral creditors in secondary market at cheap prices and litigate against the sovereign. Estimated, 46 lawsuits have been filed against 12 HIPC by 2006 (Sukoon, 2010: 97).

2.2- HIPC Debt Relief Initiatives (1996)

In 1990s, the external debt of many countries reached unsustainable levels. The IMF and the World Bank introduced the HIPC initiative in 1996. The initiative was designed as a debt reduction package. The aim was to ensure that no poor country faced a debt burden that it cannot manage. Hence, the multilateral organizations and governments worked together to reduce the external debt burdens of the most heavily indebted poor countries to sustainable levels. [17] The HIPC initiative was a two- step process: (1) Decision Point and (2) Completion Point. To qualify for assistance under HIPC initiative, a country was expected to fulfill certain obligations namely adjustment and reform programmes. Some 40 countries received debt write offs conditional on the implementing the reforms. Once it reaches the decision point a country immediately qualifies

[17] Factsheet Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative 2016, April 8). Retrieved from: https://www.imf.org/external/np/exr/facts/hipc.htm

to receive interim debt relief. On conclusion of the second step of completion point, a country received full and irrevocable debt relief. The HIPC initiative was envisaged to free up the scarce resources which would then be used for boosting social spending and improving public debt management.

It was expected that once the international financial institutions like IMF and World Bank considered a country eligible for debt relief, other commercial and bilateral creditors would join in and write off debts voluntarily (Sukoon, 2010: 93). However, this did not happen and there were numerous instances of HIPC's sovereign debt being traded in secondary markets and subsequent litigations. It remains a challenge to involve all the creditors to write off their debts. The African Development Bank (ADB), the Inter- American Development Bank (IaDB) and several members of the Paris club have completely written off their debts. Some countries of Paris club have gone even beyond but unfortunately non- Paris club bilateral creditors and other commercial creditors have not delivered full debt relief.[18]

2.3- Multilateral Debt Relief Initiative- MDRI (2005) and World Bank Debt Reduction Facility (DRF)

The HIPC initiative was supplemented by MDRI in 2005 with the aim of facilitating the realization of Millennium Development Goals. Under the aegis of MDRI, three multilateral institutions- IMF, World Bank and the ADB allowed for 100% percent debt relief for eligible HIPC. Further, the IaDB provided additional "beyond HIPC" debt relief to the five HIPCs in the

[18] Recently an idea of having a Heavily Indebted Middle Income Country Initiative, specifically for the Caribbean countries, has been put forward (Ramcharan, 2015).

Western Hemisphere in 2007.[19] Under the DRF, funding was made available to eligible HIPC governments to buy back debts owed to external commercial creditors. DRF turned out to be the most efficient agency in deterring original creditors from selling their debt in secondary market (Sukoon, 2010: 94).[20]

2.4- Initiative by Norway (1998)

In 1998 Norway was the first OECD country to present a comprehensive Plan of Action on debt relief for developing countries. [21] Norway has been a consistent support of the HIPC Initiative launched in 1996, improving it in 1999 and then refining it in 2004. In collaboration with the ADB and IaDB, Norway initiated debt- for- development swaps with Pakistan, Vietnam and Ecuador (Sukoon, 2010: 95). As a part of HIPC initiative, Norway extended absolute debt relief to Benin, Senegal, Cote d'Ivoire, Sierra Leone, Guinea, DR Congo. An important peculiarity of the Norway initiative is that it is specifically designed to benefit only the indebted countries and not other creditors. This helped in avoiding lawsuits.

2.5- G8 (2005)

In 2005, the Group Eight (G8) countries (UK, USA, Canada, France, Germany, Italy, Russia, and Japan) in its Gleneagles Communique, agreed to increase aid to Africa and offered debt cancellation of US $40 billion (Sukoon, 2010: 96). The G8 also decided upon 100 % debt relief to the eligible countries of the HIPC initiative. The aim of G8 was to write off debt to reduce the

[19] Factsheet Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative (2016, April 8). Retrieved from: https://www.imf.org/external/np/exr/facts/hipc.htm

[20] DRF is known to have successfully stopped litigations in Nicaragua, Mozambique and Liberia.

[21] Towards the Year 2000 and Beyond R: The Norwegian Debt Relief Strategy (2016, July 6) Retrieved from:
http://www.norway.az/ARKIV/policy/humanitarian/debtreliefplan/#.V3yXYPl97IU

purchase of sovereign debt in secondary market which eventually will lead to a decrease in the number of lawsuits filed against sovereigns by commercial creditors. It should be noted here that similar to Norway's initiative, the G8 initiative also depended upon fulfilling the prerequisites of the decision point of HIPC initiative.

2.6- Initiatives by China (2007)

The initiatives undertaken by China are peculiar as China is not a member of the Paris Club. Its debt relief programme differs substantially from the ones that are endorsed by the multilateral institutions and the Paris Club. China has not bound its beneficiaries to the conditions of the HIPC initiatives but still extends 100% debt relief to African countries. In 2007, China agreed to write off all interest – free government loans to HIPC countries that were overdue at the end of 2004 (Sukoon, 2010: 97).

As is evident from the above discussion, international initiatives have met with some success as far as debt relief is concerned. These multilateral and individual efforts of states have helped to reduce the indebtedness of countries and bring them back on the path of development. However, it is to be noted here that majority of the international initiatives are voluntary in nature, with no legal entity or statutory rules of procedure. In other words, the entire process is ad- hoc and left to the discretion of the creditors. More importantly, the debt relief initiatives have largely targeted poorer countries. For the other developing economies that have distressed debt situation, there have not been enough measures. Also, when the amount is considerably large to waive off or when there is involvement of bilateral private lenders, the debt relief would substantially reduce. Moreover, debt write-off may not be the right step towards for prudent financial management. There is a precise lack of a comprehensive approach towards sovereign debt restructuring that is based on an internationally accepted national or international framework. A piece- meal approach does not suffice and fails to deal with the various problems of sovereign debt restructuring. It is imperative to cure the root cause of the problem, of why nations become indebted in an unsustainable manner.

The impetus on developing an international legal framework for sovereign debt restructuring is not a recent phenomenon. The Paris Club initiative was undertaken in 1956 because the international community realized that sovereigns are facing distressed debt situation. One of the first well-crafted proposals was made in 1979. The Group of 77 developing countries proposed the first policy initiative for sovereign debt restructuring to create an "International Debt Commission" (Rogoff and Zettelmeyer, 2002: 472). It never materialized because of resistance from the creditor countries. The Group of 77 effectively championed the resolution at the United Nations General Assembly (UNGA) which recognized that a state's efforts to restructure debt should not be impeded by hedge funds that seek to profit from distressed debt. It remains an uphill battle to actually realize it as the US, Germany and the UK which are key countries in global finance are amongst those which objected (Khor, 2015: 3); and in any event it would not have had powers other than making recommendations (Rogoff and Zettelmeyer, 2002: 472).

In 2002, a similar recommendation from the IMF for an improved sovereign debt restructuring mechanism (SDRM) was made. However, it focused more on preserving asset values in case of default and protects creditors' rights. Immediately thereafter the US Treasury Department proposed a framework for sovereign debt restructuring on the lines of US bankruptcy code for corporates. In 2012, the intergovernmental Group of Twenty- Four on International Monetary Affairs and Development Communiqué highlighted the need for further research on sovereign debt restructuring mechanisms[22] (Reddy et al., 2014: 275). In 2012, under the aegis of Centre for International Governance and Innovation (CIGI) and Institute for New Economic Thinking (INET), a five point agenda for global arrangements for resolving sovereign debt crisis has been proposed (Schadler, 2012). With the emergence of sovereign debt crises in developing and developed countries, United Nations Conference on Trade and Development (UNCTAD) made a proposal to improve the coherence, fairness and efficiency of sovereign debt workouts. It established an ad hoc Working Group on a Debt Workout Mechanism in 2013 composed of stakeholders and independent experts.[23] Most recently *The South Summit of the G77* in Bolivia in June 2014 called for a proper global debt restructuring mechanism (Khor, 2015: 2). In September, 2015 the UNGA passed a binding resolution on the "Basic Principles on Sovereign Debt Restructuring Processes." (A/69/L.84). It laid down the basic guidelines for sovereign debt restructuring guided by customary law and basic international principles of law. The binding resolution is adopted in response to the exponentially growing concerns about sovereign debt crises and debt sustainability particularly in the backdrop of transnational economic fragility.

Several proposals for an international legal framework for sovereign debt restructuring have been made but it still remains an unfinished task. There is a greater diversity of creditor claims and interests that need to be taken care of while restructuring sovereign debt. Additionally, as nations increasingly issue debt in a range of legal jurisdiction it is a herculean task to ensure creditor coordination in event of default and restructuring. Difficulty in securing collective action and the

[22]Intergovernmental Group of Twenty-Four on International Monetary Affairs And Development Communiqué. (2012, April 19). Retrieved from:
http://www.imf.org/external/np/cm/2012/041912.htm

[23] Sovereign Debt Workouts: Going Forward Roadmap and Guide (2013). (2016, July 17). Retrieved from: http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf

dilution of sovereign immunity are two of the major factors that have made sovereigns extremely reluctant to restructure their debt (Krueger, 2002: 2). It should be borne in mind that there are other problems associated with restructuring sovereign debt like long term access to capital, economic dislocation and political upheaval. However, the scope of the present paper is limited to analyzing the doctrine of sovereign immunity.

3- DILUTION OF SOVEREIGN IMMUNITY

Historically, states enjoyed absolute immunity. Sovereignty refers to the internationally accepted principle of non-intervention and mutual recognition that create the boundaries between independent states (Guder, 2008: 261). Sovereign immunity is a concept that is ingrained in the customary international law concept of sovereign equality of states; it protects every state against possible encroachments by the exercise of jurisdiction by foreign national courts (Cosnard and Stern, 1996) and provides sovereigns immunity from lawsuits and other legal actions without their consent. Ingrained in the most customary international law; sovereign immunity has two components: *immunity from jurisdiction* and *immunity from execution.* Both these immunities are based on well accepted international principles.

3.1 Immunity from Jurisdiction

Immunity from jurisdiction involves treating sovereigns with equality and dignity; a sovereign state cannot be sued in foreign courts without its consent (Panniza et al., 2009: 653), this is a part of general principles of international law. This principle is derived from the doctrine of equality of sovereign nations under international law which prescribes that legal persons of equal standing cannot have their disputes settled in the courts of one of them (Brownlie, 2003: 324). An individual or a company can be hauled into court but a sovereign cannot be treated in a similar fashion unless it has waived off its immunity explicitly. The involvement of State in commercial activity is an exception when such immunity gets annulled automatically. Only to the extent that a foreign state's property has been used for the benefit of the government's sovereign activities, the commercial activity exception holds inapplicable. A specific example of this is the case of *Donegal International Ltd v Republic of Zambia & Anor.* In this case, in the original debt contract between Romania and Zambia; mutual sovereign immunity was respected. However, Romania sold its debt bonds to Donegal International Ltd. Donegal made Zambia sign a supplementary agreement under which Zambia was made to waive off its immunity. Hence, instead of accepting all the previous terms and conditions as assigned to the primary lender, Zambia waived off its sovereign immunity. Had Zambia negotiated properly with Donegal, Donegal would be forced to respect the original agreement.

3.2 Immunity from Execution

Immunity from execution is a check against indiscriminate attachment of foreign state's property which can have adverse socio-political corollaries. This perhaps is a weaker defense as compared to the immunity against jurisdiction. This rule is pertaining to the attachment of foreign state's property, after a judgment has been obtained against a foreign state. Overtime, it has become prevalent that the immunity right must only be recognized where governments act in the exercise of their public authority and must be denied where governments act as any private person might (Kupelian and Rivas, 2014: 15). A classic example of this is when a firm NML Capital detained Argentine Naval Vessel on a port of Ghana. Argentina approached the International Tribunal for the law of the sea, which held that Ghana should release the ship as a UN convention gives warships immunity from civil claims in foreign ports. The tribunal added that holding the ship was "a source of conflict that may endanger friendly relations among states".[24]

Ascending from this theoretical underpinning of sovereignty is the qualification and validation for differential treatment of sovereign debt, sovereign debt crisis and subsequent debt restructuring. Sovereign has a special legal status arising from the doctrine of sovereign immunity which precludes a lawsuit against a sovereign without that of sovereign’s consent or waiver (Wright, 2012: 156). During the nineteenth century, under the prevailing doctrine of absolute immunity a state enjoyed immunity while involving in commercial activity and so holdout litigation was limited to national courts (Waibel, 2007: 714). A creditor did not have a right to sue a nation state; she had to persuade her own nation to pressurize the debtor country to pay. Hence, private commercial interests did not get in the way of diplomatic and political relations (Panniza et al., 2009: 653).

A restrictive interpretation of sovereign immunity started post World War II when the US courts did not allow sovereign immunity to the Soviet Union corporates operating in US. Allegedly the U.S. government encouraged a more restrictive theory of sovereign immunity under which foreign sovereigns were denied immunity for commercial activities carried on inside, or with direct effect inside, the US. This paved the way for allowing private parties to sue a foreign government in U.S. courts if the complaint relates to commercial activity and this restrictive view was embodied in the Foreign Sovereign Immunities Act (FSIA) of 1976 (*ibid*).

[24] Seized Argentinian sailing ship leaves Ghana (2016, July 10). Retrieved from: https://www.theguardian.com/world/2012/dec/20/argentina-sailing-ship-ghana-release

Post 1970s, the deregulation of the financial market in the US and the UK led to a rise in the use of negotiable instruments which could be traded in the international market. A demand for such instruments was created by design to accommodate the change in international trade. With the growth of negotiable instruments it became impossible to classify the acts of State into strict categories of *iure imperii* (public acts) and *iure gestionis* (commercial acts). This overlap in State functions happened deliberately and not by chance. The parallel events in the financial and economic world impact the legal system of a country and also internationally. These are not isolated arenas and work in tandem, each one influencing the other. The supplementary legal framework further weakened the sovereign as compared to the private interests. The emergent pattern of international trade deliberately ripped the sovereign off the benefits of immunity and made it more vulnerable to litigations. Increasing incidences of litigations have perplexed the IFIs and nation states alike.

Creditors who are dissatisfied as to the terms of restructuring often resort to litigations to realize their contractual claims against a defaulting sovereign. This is of particular concern in sovereign debt restructurings as in holdout litigation a minority of creditors chooses to sue for full repayment whilst the majority of creditors have accepted the terms of debt restructuring (Waibel, 2007: 713). The resort to market forces for sovereign debt restructuring has led to this phenomenal increase in litigations targeting assets of defaulting sovereign nations, not only within the state, but internationally across jurisdictions. Aggressive litigations haunt the distressed nations in dire need of restructuring. As the private litigants that aggressively haunt the distress nations, often upsetting the restructuring process, are generally called as 'vulture funds'.

3.3- Commercial Activity Exception

Ostensibly both the immunities - immunity from suit and immunity against execution - should be a sufficient safeguard against litigations. However a single exception quashes both the provisions: involvement of State in commercial activities. It is noteworthy that in case of sovereign debt market, countries act much like private borrowers (Waibel, 2007: 712). Post the Latin American Crisis of the 1980s, the sovereign-immunity defense from suit has often been unavailable to the sovereign defendants, mostly due to the application of the "commercial activity" exception (Balckman and Mukhi, 2010: 52). Moreover, foreign state's property has been executed as and when it is being used for "commercial activity". In most incidences of litigations, the sovereign has waived off such immunity either explicitly or implicitly in the contract. It has been held time and again in several judgments that a party cannot waive a right if considerations of public policy or morals are involved (Kupelian and Rivas, 2014: 30) but still there have been numerous episodes when sovereign has waived off immunity. This brings us to a loophole in the current legal framework pertaining to waiver of sovereign immunity. An exception has become a major deciding factor of the scope of the principle of sovereign immunity in increasing number of litigations against a sovereign.

3.4- Restrictive Doctrine of Sovereign Immunity

Overtime the strength of sovereign immunity protection has decreased considerably. The resolute decline in absolute sovereign immunity is partly due to a transition in the nature of international trade and partly due to the absence of an international forum for sovereign debt resolution. The requisite legal machinery to buffer nations against economic and political shocks impairing their payment capacity is largely absent (Waibel, 2007: 759). Over the years, States are either compelled to waive their immunity or consent to be sued, specifically when they enter in to commercial contracts. It is now universally accepted that the doctrine of sovereign immunity is not applicable when a sovereign participates in commercial activity and behaves like a private player. A more restrictive doctrine of sovereign immunity has emerged in response to increased government participation in commercial activities (Wright, 2012: 156). There have been several instances when the sovereign has waived of its immunity in commercial contracts. The decline in the strength of the protection over time, both through statutory changes and through case laws has opened a window for legal enforcement of contractual claims against sovereign states (Panizza et al., 2009: 653). Unfortunately, recent times have witnessed a phenomenal increase in litigations targeting assets of defaulting sovereign nations, not only within the state, but across jurisdictions. With the sovereign space eroding overtime, the sovereign acts and assets which do not fall within the strict definition of "sovereign" sphere have fallen prey to such litigation. It is pertinent to note here that although the involvement of State in commercial activity leads to quashing of the privilege of sovereign immunity; there still remains a stark difference between a sovereign doing business and a corporate. The two cannot be compared and hence cannot be treated in the same manner. As discussed, several lacunas in the international sovereign debt restructuring framework have led to avenues for litigations against sovereign. As reported by the World Bank and IMF (2007), there have been forty-seven court cases against a total of eleven highly indebted poor countries (Pitchford and Wright, 2011: 5). A special mention here is Argentina which faced over one hundred lawsuits following its 2001 default (Gelpern, 2005). Litigations decrease welfare for countries and their populations; they threaten regional and at times global political and financial stability (Waibel, 2007: 712). Theoretically litigations against a sovereign may be *legal*; it is to be noted that lawsuits are invigorated by the unsustainable debt positions of sovereign countries. A country's debt position is determined by not only the financial and economic but also political issues and these factors play an important role in determining whether a lender will become dissatisfied and have recourse to litigation (Sukoon, 2010: 63). Such creditors specialize in bringing suit against a country in default and enjoy greater bargaining power because of their experience in litigation. They may incur greater bargaining costs because they maintain a large legal staff but the relative gain from delay is greater due to greater bargaining power and is unaffected by bargaining costs (Pitchford and Wright, 2011: 27).

4- FOREIGN STATE IMMUNITY: INDIA

India is emerging as an attractive destination for Foreign Direct Investment (FDI). Several policy initiatives for promoting deregulation and liberalization have been undertaken to facilitate the FDI inflows. However, in cases where the investors are foreign- state[25] controlled investors; there is a growing concern as to the appropriate legislation in case of disputes as the foreign states enjoy sovereign immunity which provides them an advantage over private persons. Frequently disputes arise from non- sovereign activity and commercial transactions entered into by a state (Foakes et al., 2005: 1). The rules of state immunity vary considerably from one country to another and so should be properly known and deliberated as it can affect business and nations alike. With the ongoing lawsuits against several nations, Indian government needs to set out appropriate rules and regulations that explicitly define the degree, scope and extent of state immunity. Sovereign immunity being one of the most potent defenses available to a sovereign state, it can help distressed debtors to avoid litigations while restructuring sovereign debt. Growth in government participation in business ought to be coupled with corresponding evolution of legislation governing the issue. While India subscribes to the internationally

[25] A *foreign state* is defined as any state outside India that is recognized by the Central Government- Section 87A of CPC.

accepted maxim of sovereign immunity, "*par in parem non habet imperium*"[26] meaning "an equal has no power over an equal"; there is absence of any distinct domestic legislation for the same. Having a domestic legislation is important as it may be the international law that determines the general rules of whether or not a state should be accorded immunity, but it is national law that interprets and applies those rules (Foakes et al., 2005:2). India, unlike its American, British and other Common law counterparts, does not have a comprehensive Immunity Act (Choudhary, 2010: 11). Compared to other countries the arrival of the doctrine of Sovereign Immunity is relatively recent in India as it came with the British. It was believed that that the King of England ruled by divine right and thus could do no wrong, consequently the courts would not allow a lawsuit against the king. This English concept of sovereign immunity was transported to the Indian colonies and it became ingrained in our law as well (Krishna, 2012: 1). However, it has been evolving ever since as the international perception of immunity has been rapidly changing with changing forms of public administration. In India it has been subject to the contrasting times and ideas pre and post- independence theoretically. But practically in absence of an exclusive code as to the extent of sovereign immunity, it still depends upon the decisions of court as to what is the appropriate extent of State immunity in a particular case. Precedents serve as the primary source of understanding of the applicability of sovereign immunity and hence judiciary predominantly employs cases as a means of narrowing the scope of sovereign immunity (Krishna, 2012: 16).

Post-independence efforts were made to codify India's legal position on the doctrine of sovereign immunity. The first report by the Law Commission recommended that the doctrine of

[26] This maxim translates to "one sovereign state is not subject to jurisdiction of another state". See Y. V. Chandrachud, The Law Lexicon 21 (1st ed., Wadhwa and Company 1997).

absolute sovereign immunity be abolished from Indian legal system.[27] Even though the first report found the doctrine to be outdated, for numerous reasons the draft bill for the abolition of absolute sovereign immunity doctrine never passed. Thus, it was left to the discretion of courts to decide on the extent and degree of immunity as well as its compatibility in accordance with the Constitution of India (Garje, 2009: 1). In a later period, the Government (Liability in Tort) Bill, 1965 was passed. However, this too could not be enacted into law. Subsequently a new bill was reintroduced in 1967, which too met the same fate. This led to the default employment of the Courts as the final arbiters in the matter concerning the doctrine of sovereign immunity. This raises the question as to why the law has not been rationalized to take account of the changed situation of public administration (Garje, 2009: 4). Post-independence the doctrine of absolute sovereign immunity became unsuitable to a republican welfare nation. Nevertheless, the Government of India in its Memorandum on State Immunity[28], in its "Final Report on Immunity of States in respect of Commercial and other Transactions of a Private Character" has taken the position that immunity shall not be extended to commercial activities undertaken by a foreign State or its trading organizations. The memorandum explicitly stated that no distinction shall be made between commercial activities undertaken directly by a foreign government from those undertaken through trading organizations. The status of juristic personality of such trading organizations would be immaterial (Choudhary, 2010: 16). Additionally, India has signed the

[27] First Report of the Law Commission of India, Liability of the State in Tort- 1950.

[28] Submitted to the Asian-African Legal Consultative Committee (AALCC), 1960.

UN Convention on Jurisdictional Immunities of States and their Property[29]. However, India has not ratified nor accepted, approved or acceded to the said treaty (Sharan, 2016).[30]

4.1- SECTION 86- CODE OF CIVIL PROCEDURE

In India Section 86 of the Code of Civil Procedure (CPC) proscribes any legislation against sovereigns and also against execution of any decree against the property of a foreign state. It also deals with the exception when a person may sue a foreign sovereign in a court of law with the consent of the central government. The conditions under which such permission may be granted are deliberated upon in the same section. Section 86 of the CPC lays down following conditions under which a suit can be initiated against a sovereign:

a- If the foreign state has instituted a suit in the court against the applicant.

b- If the foreign state, by itself or another, trades within the local limits of the Indian court.

c- If the foreign state's immovable property, in respect of which the applicant want to sue is situated in India.

d- If the foreign state has waived privilege of Section 86.

CPC is a procedural law that comprises the rule by which a court hears and determines what happens in civil lawsuits, criminal or administrative proceedings (Choudhary, 2010: 16). The

[29] India signed the UN convention in 2007.

[30] Sharan, S. (2016) India: Suing A Foreign State In India: Piercing The Veil Of Sovereign Immunity, 14 June 2016, Retrieved from: http://www.mondaq.com/india/x/500590/trials+appeals+compensation/Suing+A+Foreign+State+In+India+Piercing+The+Veil+Of+Sovereign+Immunity

rules are designed to ensure a fair and consistent application of fundamental justice to all cases that come before a court (Cardozo, 1998). The code is exhaustive on matters specifically dealt by it but unfortunately it does not have a comprehensive Sovereign Immunity Act. The section does contain a sub- section entitled "Suits by Aliens and by or against Foreign Rulers, Ambassadors and Envoys" which deals with suit against a foreign State in India inter alia. A substantive law on the topic does not exist.

As technically a person can sue a foreign sovereign in a court of law with the consent of the central government, the permission from central government is quintessential. In the prominent case of *Mirza Ali Akbar Kashani v. United Arab Republic and Anr*.[31], the Supreme Court of India has held that the permission from central government has to be taken at the earliest instance possible. In the case *Royal Nepal Airline Corporation v. Monorama*[32], the suit was instituted without the consent of the Government of India. The Government of Nepal through its Ministry of Transport and Communication; owned the Royal Nepal Airline Corporation. Chief Justice of Calcutta High Court- Bose C. J. held that the Corporation was a Department of Government of Nepal prima facie from the proofs submitted and hence was entitled to jurisdictional immunity.[33] However, the determination of whether a claim for immunity may be granted or not should not be discussed while the proceedings of the court has started as it is not the judiciary’s prerogative. If sovereign immunity is to be granted it has to be granted at the very onset. The permission to entertain a suit cannot be deterred until the disposal of the suit but has to be sought ex ante.

[31] (1966) 1 SCR 319- A case was filed against the United Arab Republic and the Republic of Egypt- Ministry of Economy, Supplies, Importation Department

[32] A.I.R. 1966 Cal. 319

[33] Bidhusbhusan Prasad v. Royal Nepal Film Corporation, A.I.R. 1983 NOC 75 (Cal.)

Although administrative in nature, the consent order under section 86 ought to follow the principles of natural justice as it decides the rights of the concerned parties.[34]

On a close examination of section 86, it can be noted that the central Government can grant the permission to sue and waive off immunity subject to the provisions made in clause 2 of the same section. Of the four subsequent paragraphs from 2(a) to 2(d), it is only in in subsection 2(b) and 2(c) that the central government is required to decide. In the other two sections, it is left to the foreign sovereign to decide whether to submit to the jurisdiction of the courts or not. An important aspect that is not deliberated upon in this section is “contracts of employment”. Neither of the two subparagraphs 2(b) and 2(c) mention of “contracts of employment” as an exception to foreign state immunity, let alone its scope and applicability (Choudhary, 2010: 18). It is completely left to the discretion of the executive to determine whether to treat this as an exception to foreign state immunity or not. Hence, only sub- section 2(b) and 2(c) empower the government to decide whether a suit is permissible or the nature of the activity, whether it is sovereign function or not.

Several pre- independence[35] and post- independence[36] case judgments have deliberated upon the distinction between sovereign and non-sovereign functions of state. Taxation, police functions, eminent domain, maintenance of law and order, legislative functions, administration of law, grant of pardon are considered as the sovereign functions of the State. Sovereign functions

[34] Shanti Prasad Agarwalla & Others vs. Union of India and Others AIR 1991 SC 814.

[35] P. & O. Steam Navigation Co. v. Secretary of State.

[36] State of Rajasthan v. Mst. Vidyawati, (AIR 1962 SC 933); Kasturi Lal Ralia Ram v. State of UP, (AIR1965SC1039); Satyawati v. Union of India, (AIR1957Delhi98); Union of India v. Smt. Jasso, (AIR 1962 Punj 315 FB); Union of India v. Sugrabai , (AIR 1969 Bom 13).

essentially are those functions, the execution of which cannot be delegated to any private agency or person. The Supreme Court has unambiguously stated that, "Act done in the course of employment but not in connection with sovereign powers of the State, State like any other employer is vicariously liable."[37] However, while executing sovereign functions the State enjoys immunity. This clearly indicates departure from the feudalistic notion of justice and sovereign immunity. With the rising trend of public private partnerships (PPP) and neo- liberal public administration, it becomes ambiguous as to what tests distinguishes sovereign function from non- sovereign. Post 1970s, there has been a move towards restrictive interpretation of what constitutes sovereign function. In cases- *Mrs. Pushpa v. State of Jammu & Kashmir*, 1977 ACJ 375; *Fatima Begum v. State of Jammu & Kashmir*, 1976ACJ 194; *Union of India v. Miss Savita Sharma*, 1979 ACJ; it was held that drivers driving army/ government vehicles do not always constitute an act in exercise of sovereign power. Further, sovereign immunity is not applicable- in cases under Motor Vehicles Act 1988; where right to life as guaranteed under Article 21 is in question[38]; and in cases in public domain under Article 32 and Article 226.[39]

From the above discussion it is clear that there are three prominent problems with section 86: Firstly, the permission to sue a foreign State is left entirely to the discretion of the Central Government. Such permission is not based on rule of law but political and diplomatic considerations which make it ambiguous. There is absence of any precise directive as to what all reasons factor in while granting a permission to sue. It has been observed in several cases that neither the CPC nor any other legal instrument stipulates procedure to be followed by the Central

[37] P. & O. Steam Navigation Co. v. Secretary of State.

[38] Challa Ramkonda Reddy v. State of AP, (AIR 1989 AP 235).

[39] State of A.P. Vs. Chella Ramakrishna Reddy (AIR 2000 SC 2083).

Government while granting (or refusing) the requisite sanction.[40] The very basis of suing a foreign State becomes political in nature rather than rule based system. Second, the process followed in India may turn contrary to international law as when the Central Government gives such consent, the foreign State cannot rely upon rules of international law pertaining to jurisdictional immunity of states (Choudhary, 2010: 12). Thus, it is alleged that Section 86 exclusively empowers the Central Government to determine competency of suits against a foreign State in India.[41] Also, it sub- plants the pertinent principles of international law governing sovereign immunity (*ibid*). Third, the scope of immunity remains indeterminate as Section 86 does not enlist which entities or instrumentalities of a foreign State may claim immunity in India. Presently, India endorses a more restrictive theory of sovereign immunity and accords immunity to a foreign sovereign and also to its instrumentalities which constitute a part of the sovereign's acts *jure imperii*. However, Section 86 fails to state the extent and degree of immunity of an organ/ agency/ instrumentality of a foreign State.

5- CONCLUSION

To conclude, it may be said that the rise in FDI has to be coupled with a corresponding evolution of legislature and jurisprudence balancing the rights of citizens and foreign sovereign. Drawing from the jurisprudence, it is amply clear that the doctrine of sovereign immunity based on archaic colonial jurisprudence do not befit modern Indian jurisprudence. Not only in India but in a majority of developing countries it is being gradually realized that the concept of sovereign immunity is an anachronistic. It is an outdated justification in a republican nation which guarantees life and liberty as well as rule of law (Garje, 2009: 7). Despite the contemporary

[40] B. Sen, A Diplomat's Handbook of International Law and Practice, pg- 115.

[41] Ali Akbar v. United Arab Republic, A.I.R. 1966 S.C. 230.

developments in trade, legislation and jurisprudence, Indian position on foreign state immunity remains unsettled. As is clear from the above discussion, neither section 86 nor any other rules or practice establish legal clarity on the determination of degree, scope and extent of state immunity or the difference between acts *jure imperii* and acts *jure gestionis*. A need is felt to ordain an Indian Foreign State Immunity Act which reflects Indian legal position on state immunity at national and international levels (Choudhary, 2010: 22). An India specific comprehensive immunity code is long overdue. Time and again, several scholars and judges have expressed a desperate need for a legislative act exclusively dealing with the concept of sovereign immunity in order to avoid misuse of this doctrine (Krishna, 2012: 16). As the ancient conception of unrestricted sovereign immunity has no room in the international trade relations of the modern world (Schmitthoff and Wooldridge, 1972: 216), the requisite domestic code on sovereign immunity should be such that it is coherent with the UN Convention and at the same time does not freeze the useful development of law and international trade. The growing concerns oblige that each state must tailor a statute to its unique legal setting (Davis, 1970: 386).

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