AIR CANADA, VENEZUELA, AND FINANCIAL INSTABILITY: HOW FREE TRANSFER PROVISIONS PREVENT BITS FROM SERVING THEIR PURPOSE

NICHOLAS UTTER*

ABSTRACT

International commerce has always had a conflict of interest with sovereign politics. During the past 150 years, international businesses and sovereigns have worked to resolve this tension with political rhetoric that emphasizes the material benefits that come with pursuing free trade. This rhetoric, such as "a rising tide lifts all boats," logically extends to designing international laws that facilitate a business environment with as little unpredictable political friction as possible. Many of these laws restrain state sovereignty—a foundational principle of international law—because markets function more smoothly if the rules of the game are generally beyond the scope of sovereign discretion. This Note considers the power of these laws to limit a state's monetary sovereignty—a state's relative autonomy to control its money—in ways that can harm the international business environment.

Free transfer requirements are standard provisions in many international investment agreements and typically mandate that states exchange investors' state-denominated-currency "without delay" unless an exception applies. A recent arbitration ruling based on a dispute between Air Canada and Venezuela over a free transfer requirement in the Canada-Venezuela BIT demonstrates how tribunals can limit sovereigns' monetary autonomy under the auspices of customary international law standards. This ruling also shows how BIT free transfer requirements practically eliminate a sovereign's authority to enact exchange controls. This Note argues that free transfer

* J.D., Boston University School of Law, 2024. Thank you to Professor Perry Mehrling for teaching me about money and for providing thoughtful comments. Thank you to Professor Rachel Thrasher for teaching me about international law and for providing thoughtful comments. Thank you to Mom and Dad for encouraging me, whether I am a maple syrup farmer or a law student. Thank you to Jaden for always being excited to spend time with me, even when that means talking about law and financial crises during our evenings.

requirements in BITs should contain exception provisions that allow states to confidently enact exchange controls in times of financial distress. This would provide states with an important legal tool to autonomously stabilize their economies and avoid financial crises that might otherwise spread internationally. To this point, the Air Canada v. Venezuela ruling illustrates how BIT free transfer requirements can discipline sovereigns in ways contrary to BITs' purpose of promoting both a stable business environment and economic development.

This Note proposes changes to BIT free transfer requirements to address this discrepancy between BITs' legal purposes and their economic effects. These proposals—via a legal design that would adjust the balance of power in investor-sovereign relationships—would disincentivize economic free-riding by foreign investors and would create policy space for host states to exercise their monetary sovereignty in pursuit of financial stability and economic development.

CONTENTS

I. INTRODUCTION 413
II. BACKGROUND 415
A. *A Sovereign's Autonomy Over its Future* 417
B. *A Sovereign's Ability to Restrict Free Transfers* 421
III. INTERNATIONAL LAW AND EXCHANGE CONTROLS 423
A. *The IMF* 424
B. *Trade and Investment Agreements* 426
C. *Standards of Review* 429
D. *Air Canada v. Venezuela* 431
1. Air Canada's Demand for Repatriation of its Venezuelan Earnings 432
2. Venezuela's Exchange Restrictions and the Canada-Venezuela BIT 433
IV. THE TRIBUNAL'S RULING 435
A. *Holding: Venezuela Treated Air Canada Inequitably and Discriminatorily* 435
B. *Dicta: The Prudential Regulation Exception Would Not Apply Anyways* 438
C. *Venezuela's Insufficient Foreign Exchange Defense* 441
D. *Overview* 443
E. *Distributional Consequences* 444
V. BIT ADJUSTMENTS TO PROMOTE STABILITY AND ECONOMIC DEVELOPMENT 446
A. *Legal Proposals* 446
B. *Economic Effects* 449
VI. CONCLUSION 452

I. INTRODUCTION

International Investment Agreements (IIAs) generally have the dual purpose of protecting foreign investments and promoting economic development.[1] The underlying economic rationale is that every country will be better off if it can use its comparative advantage in trade and thus trade barriers should be removed and trade incentives should be created.[2] To this point, Bilateral Investment Treaties (BITs) are agreements designed to promote international trade by legally protecting foreign investments.[3] BITs and other IIAs protect investments because they allow foreign investors, such as multinational corporations (MNCs), to file claims in international court against sovereign states ("host states") where they have investments.[4]

Under BITs, states contract away part of their sovereign immunity—a principle rooted in customary international law under which foreign investors are normally limited to filing claims against a state via that state's domestic court system[5]—based on a bet that the wealth and developmental benefits from incentivizing foreign investment will outweigh the costs of lost sovereign immunity and the risk of MNC control over parts of their economy.[6] BITs typically also include exception provisions, as a hedge against this lost sovereignty, that allow a state to pursue domestic policies

---

[1] *See, e.g.*, Agreement for the Protection and Promotion of Investments, Can.-Ven., July 1, 1996, 2221 U.N.T.S. 8 [hereinafter Canada-Venezuela BIT] ("[r]ecognizing that the promotion and protection of investments of the investors . . . will be conducive to stimulation of business initiative and to the development of economic cooperation"); *see also* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS] (emphasizing that members desire "the early achievement of progressively higher levels of liberalization of trade in services . . . while giving due respect to national policy objectives.").

[2] *See* DAVID RICARDO, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION 142 (3rd ed. 1817) ("It would undoubtedly be advantageous to the capitalists of England, and to the consumers in both countries, that under such circumstances, the wine and the cloth should both be made in Portugal, and therefore that the capital and labour of England employed in making cloth, should be removed to Portugal for that purpose.").

[3] *See Bilateral Investment Treaties*, OFF. OF THE U.S. TRADE REPRESENTATIVE, https://ustr.gov/trade-agreements/bilateral-investment-treaties (last visited May 2, 2024) ("The U.S. bilateral investment treaty (BIT) program helps to protect private investment, to develop market-oriented policies in partner countries, and to promote U.S. exports.").

[4] *See id.*

[5] *Sovereign Immunity: Past, Present, and Future*, BROOKINGS (May 11, 2022), https://www.brookings.edu/research/sovereign-immunity-past-present-and-future/ (a summary of the Congressional Study Group on Foreign Relations and National Security).

[6] *See* MICHAEL TREBILCOCK ET AL., THE REGULATION OF INTERNATIONAL TRADE 591 (4th ed. 2012) (noting the relationship between BITs and foreign direct investment is positively correlated in countries with stronger rule of law and negatively correlated in countries with less rule of law).

that would otherwise violate the BIT.[7] This Note considers BIT "free transfer" exception provisions in the context of the modern international monetary system to better understand how a tribunal's interpretation of whether an exception provision applies might alleviate or exacerbate a state's financial instability.[8]

In a 2021 case between Air Canada and the Government of the Republic of Venezuela (*Air Canada v. Venezuela*),[9] the International Center for Settlement of Investment Disputes (ICSID) Arbitration Tribunal ruled on whether Venezuela's foreign exchange restrictions were legitimate under the free transfer exception provision in the Canada-Venezuela BIT.[10] Broadly, this Note argues that the *Air Canada v. Venezuela* ruling highlights how BITs can limit a contracting state's sovereignty over its future because—contrary to BITs' general purpose and goal of promoting stable business environments and economic development—free transfer provisions can incentivize economic free-riding and destabilizing capital outflows.[11] More narrowly, this Note argues that the *Air Canada v. Venezuela* ruling demonstrates that BITs would better serve their purpose if free transfer requirements included exception provisions that sovereigns facing potential currency crises could confidently rely on to protect them from future adverse arbitration awards.

Underlying this Note's argument is the concern that while international law is selling utopia—a world where IIAs actively facilitate developing countries' capacity to exercise their sovereign autonomy to pursue their development goals—it is instead enforcing a status quo where IIAs perpetuate asymmetric economic relationships and stymy developing countries' ability to pursue economic growth.[12]

This Note is structured in the following way. Part II provides background historical, legal, and economic context to the Note's argument. Part III lays out an overview of international laws relevant to exchange controls including the International Monetary Fund (IMF), international trade and investment

---

[7] Robert Brew, *Exception Clauses in International Investment Agreements as a Tool for Appropriately Balancing the Right to Regulate with Investment Protection*, 25 CANTERBURY L. REV. 205, 217 (2019).

[8] *See*, *e.g.*, Canada-Venezuela BIT, *supra* note 1, at art. 8(6).

[9] Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 188 (Sept. 13, 2021).

[10] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8(6).

[11] *See, e.g.*, Quinn Slobodian, *What Really Controls Our Global Economy*, N.Y. TIMES (Mar. 12, 2023), https://www.nytimes.com/2023/03/12/opinion/economic-zones-global-economy (noting the economic risks of "bargaining away slivers of sovereignty.").

[12] *See* MARTTI KOSKENNIEMI, APOLOGY TO UTOPIA: THE STRUCTURE OF INTERNATIONAL LEGAL ARGUMENT 17 (2005); *see also* QUINN SLOBODIAN, GLOBALISTS: THE END OF EMPIRE AND THE BIRTH OF NEOLIBERALISM 16 (2018) ("The normative neoliberal world is not a borderless market without states, but a doubled world kept safe from mass demands for social justice and redistributive equality by the guardians of the economic constitution.").

agreements, standards of review, and how the *Air Canada v. Venezuela* dispute relates to Venezuela's domestic exchange control laws. Part IV analyzes the Tribunal's ruling, including both the holding and dicta. Part V proposes legal adjustments to BIT free transfer exception provisions and considers the economic effects of the proposals. Finally, Part VI concludes.

II. BACKGROUND

International traders have always had a strong incentive to lobby for trade policies that reduce their risk of accepting money as payment that is worth less than the original contract value of the goods or services they sold abroad. For example, in 1363 the King of England enacted laws to protect English merchants from the risk of accepting potentially debased foreign coins as payment.[13] This medieval policy framework aligns with modern foreign exchange conversion requirements in BITs because the medieval traders, like modern foreign investors, did not want to take on the currency risk associated with accepting manipulatable foreign state money at settlement.[14] Requiring payment in the international unit of account—both historically and in the modern day—disciplines state monetary policy because trading partners want the stable "intrinsic price" to settle payments deficits rather than a sovereign's manipulatable "nominal price."[15] This prevents sovereigns from "making the money printer go brrr"[16] because such policies would potentially ruin the store of value of their money and thus reduce the willingness of international counterparties to conduct business in the domestic unit of account.[17]

Capital controls are a legal tool that can counteract the monetary discipline states are subject to because of the international nature of trade. Capital control laws—and, specifically, laws that limit the outflow of foreign exchange—can be traced at least to medieval England where, in 1340,

---

[13] *See* JOHN H. MUNRO, WOOL, CLOTH, AND GOLD: THE STRUGGLE FOR BULLION IN ANGLO-BURGUNDIAN TRADE 1340–1478, at 39-40 (1973) (in May 1363 King Edward decreed that only money coined at his new mint in Calais was valid as a means of payment in an effort to prevent the importation of debased Flemish coins "which [English] merchants maintained were defrauding them by as much as one third.").

[14] *Id.*

[15] *See* HJALMAR HORACE GREELEY SCHACHT, CONFESSIONS OF THE OLD WIZARD: THE AUTOBIOGRAPHY OF HJALMAR HORACE GREELEY SCHACHT 333 (Diana Pyke trans., 1955) [hereinafter SCHACHT] (emphasizing that "there is no organization or measure of control sufficiently powerful to check the devastating effects on currency of a policy of unrestricted spending.").

[16] *Id.*; *see also* James Mackintosh, *Gold Will Need More Bad News to Keep Prospering,* WALL ST. J. (Aug. 15, 2020), https://www.wsj.com/articles/gold-will-need-more-bad-news-to-keep-prospering-11597492800 (noting that the "money printer go brrr" internet meme is a reference to the potential for unrestrained use of counter-cyclical monetary or fiscal stimulus).

[17] *See* SCHACHT, *supra* note 15, at 333.

Parliament enacted a law that required export merchants to provide silver to the royal mint for every sack of wool they shipped abroad.[18] English Parliament pursued this policy to prevent silver from going abroad in order to improve the country's financial stability by maintaining its purchasing power and reducing its risk of being unable to settle future deficits denominated in silver as they came due.[19] In the modern era, international laws and norms prioritizing the free flow of capital typically supersede sovereigns' authority to enact capital controls and thus limit sovereigns' discretionary power to spend money and pursue development goals.[20]

Just so, the Canada-Venezuela BIT free transfer provision requires the contracting parties to freely exchange foreign investors' *state-currency-denominated deposits* at the current market rate of exchange with the currency used to make the initial investment—typically the United States dollar (USD or "US dollar").[21] Foreign investors can undertake business investments on foreign territory—utilizing public infrastructure including the host state's currency to conduct business—and can request on-demand conversion of their state-currency-denominated deposit accounts.[22] The ubiquity of free transfer provisions like this one across international trade and investment agreements illustrates how modern international businesses use the law to insure against the inherent currency risk in their foreign investment decisions.[23]

---

[18] *See* MUNRO *supra* note 13, at 36 (noting that "[t]his first bullionist export regulation failed . . . as did virtually all its successors, because of combined Flemish and domestic resistance" which led to a reduction in international trade). It is beyond the scope of this Note to fully unearth the history of exchange control laws, and instead the goal is merely to emphasize that they are not a modern phenomenon and very likely existed in various forms long before even this medieval law was enacted.

[19] *Id.* at 39-40.

[20] Under international law, sovereigns (unlike corporations) cannot be compelled to sell their assets to pay debts, however the pressure to maintain access to international capital markets and the pressure to meet obligations to foreign investors can easily force them to forgo governmental expenditures and investment projects. *See, e.g.*, Perry Mehrling, *A Money View of Credit and Debt*, CTR. FOR INT'L GOVERNANCE INNOVATION 1, 5-6 (Nov. 4, 2012), https://www.cigionline.org/sites/default/files/inet2012mehrling_amoneyviewofcreditanddebt.pdf (emphasizing the "survival constraint"—the moment in time when past obligations come due and an entity must have liquidity to fund those obligations—as a crucial lens for analyzing how entities operate within an economy); Murtaza Syed, *Between Debt and the Deep Blue Sea*, THE NEWS INT'L (Feb. 8, 2023), https://www.thenews.com.pk/print/1038583-between-debt-and-the-deep-blue-sea (emphasizing that Pakistan agreeing to a new debt restructuring agreement with the IMF will lead to "unbearable austerity on an antagonised population already laid low by a major cost of living crisis and political dysfunction").

[21] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8(6) (emphasis added).

[22] *See id*. at art. 8(1) (foreign investors can demand exchange transfers for reasons that include needing the money to pay for business expenses or for general funding needs).

[23] *See, e.g.*, U.S. MODEL BILATERAL INVESTMENT TREATY art. 7 (2012) [hereinafter US

To this point, the Canada-Venezuela BIT requires conversion of foreign exchange "without delay" to protect foreign investors like Air Canada from the currency risk associated with holding stocks of Venezuelan bolivars.[24] This provision protects foreign investors from sovereign decisions that might devalue the domestic currency such as issuing too much debt or enacting policies that lead to capital flight. The potential for these unpredictable domestic policies is considered "political risk,"[25] whereas "currency risk" encompasses exposure to currency devaluation more generally.[26] It is important to distinguish the two concepts because, while domestic political risk can lead to currency devaluation, states must also manage currency risk that arises beyond the scope of their political influence.

The next sections outline the legal and economic context within which sovereigns make monetary policy decisions and how BIT free transfer provisions—depending on whether an exception applies—can harm a sovereign's capacity to enact countercyclical measures to pursue financial stability and economic development.

A. A Sovereign's Autonomy Over its Future

Sovereignty is an international legal principle under which a state has supreme authority within its territory.[27] Correspondingly, sovereign equality between states is the international legal principle under which the sovereignty of one state cannot infringe on the sovereignty of another.[28] "Monetary sovereignty" is a related principle of international law under which states have: (1) the right to issue currency; (2) the right to determine and change the value of that currency; and (3) the right to regulate the use of that currency,

---

MODEL BIT]; *see also* Michael Waibel, *BIT by BIT – The Silent Liberalisation of the Capital Account*, *in* INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY – ESSAYS IN HONOUR OF CHRISTOPH SCHREUER 497, 506 (Christina Binder et al. eds., 2009) (noting that "withdrawal privileges appear to be simply an extension of the long-standing principle in international law that the property of foreign nationals is entitled to minimum protections against arbitrary deprivations . . . [o]ver time, their scope broadened to include guaranteed transferability of funds.").

[24] Canada-Venezuela BIT, *supra* note 1, at art. 8.

[25] *See* TREBILCOCK, ET AL., *supra* note 6, at 591; Carolina Moehlecke & Rachel Wellhausen, *Political Risk and International Investment Law*, 25 ANN. REV. POL. SCI. 485, 486 (2022) ("The legally binding commitments in IIAs overwhelmingly prioritize political risk mitigation.").

[26] *See* James Chen, *Currency Risk: Definition, Examples, and Ways to Manage*, INVESTOPEDIA (May 25, 2022), https://www.investopedia.com/terms/c/currencyrisk.asp (defining currency risk as risk associated with changes in price of one currency in relation to another).

[27] *See, e.g.*, Daniel Philpott, *Sovereignty: An Introduction and Brief History*, 48 J. INT'L AFFS. 353, 357 (1995).

[28] *See* U.N. Charter art. 2, ¶¶ 1, 2.

or any other currency, within its territory.[29] Monetary sovereignty is in tension with the principle of sovereign equality between states because of the interrelated balance sheets of households, businesses, and states in an international financial system dominated by the USD.[30] For example, if the United States exercises its monetary sovereignty to increase the value of the USD by raising interest rates, this infringes on the ability of sovereigns that owe debts in USD to exercise their supreme authority within their territory. This is because they will have relatively less spending capacity due to more expensive USD liabilities.

Just so, a sovereign's ability to fund investments and import purchases is crucial to its stable economic development.[31] Inevitably there is some level of a funding gap, such as if there is a trade deficit or a lag between government spending commitments and when tax receipts allocated to pay for those commitments come due, which a country must pay for by issuing debt. Relatively few sovereigns have the legal and economic infrastructure—i.e. deep and liquid capital markets with predictable legal backstops and strong export production—required to successfully issue debt payable in their own currency.[32] Therefore, most countries issue "external debt" denominated in USD, the modern international settlement currency.[33] Every sovereign unable to issue debt in its own currency has an inherent currency risk in its capital structure because many of its cash inflows—such as tax receipts and fees—will be denominated in its state-currency-denominated unit of account despite owing cash outflow payments denominated in USD.[34] This currency mismatch between inflows and outflows means that a country's ability to pay its USD debt obligations depends on maintaining a stable currency relative

---

[29] F.A. MANN, THE LEGAL ASPECT OF MONEY: WITH SPECIAL REFERENCE TO COMPARATIVE PRIVATE AND PUBLIC INTERNATIONAL LAW 460-67 (5th ed. 1992); *see also* Claus D. Zimmerman, *A Contemporary Concept of Monetary Sovereignty*, 24 EUR. J. INT'L L. 797, 797-98 (2013) (arguing that monetary sovereignty is "more than a mere rhetorical framework for debates on specific rights and duties of states . . . [and] is still relevant today as a legal concept for evaluating the contemporary exercise of sovereign powers in the realm of money and for improving our understanding of the driving forces behind the evolution of the law.").

[30] *See, e.g.*, Syed, *supra* note 20.

[31] *Id*.

[32] *See* Barry Eichengreen & Ricardo Hausman, *Exchange Rates and Financial Fragility* 12 (Nat'l Bureau of Econ. Rsch., Working Paper No. 7418, 1999) (describing the "original sin" issue where "[i]f a country was able to borrow abroad in its own currency, it would stand to benefit by depreciating that currency and thus eroding the real value of its external debts. In anticipation of this, foreigners are unwilling to lend in a denomination that the borrower can manipulate unless they are compensated to an extent that only those borrowers planning to devalue are prepared to pay."); *see also* MUNRO, *supra* note 13, at 40.

[33] *See, e.g.*, Syed, *supra* note 20.

[34] *See* MICHAEL PETTIS, THE VOLATILITY MACHINE 99 (2001).

to the USD.

More broadly, a sovereign's ability to autonomously control its economic development depends on its ability to secure and maintain funding for its debt. This requires counterparties that are willing to (1) fund debt issuances and debt roll-overs,[35] and (2) hold that funding on their balance sheets over time.[36] Securing and maintaining funding requires a stable domestic currency because creditors demand predictable positive returns over time which, as noted above, is less likely if a sovereign's domestic-currency-denominated cash inflows lose value.[37] Creditors will sell if they are faced with losses or potential losses, which can quickly lead to a currency crisis and, correspondingly, a sovereign being unable to fund its future development goals.[38] Therefore, without exception, sovereigns must maintain relatively stable domestic currencies in reference to the USD—oftentimes at the costly price of austerity in their spending budgets—to maintain the funding necessary for relative control of their economic development.[39]

Because of USD dominance, every country with an open capital account must follow suit, ex-ante or ex-post, when the Federal Reserve Bank of the United States ("Federal Reserve") hikes interest rates or they will face capital flight and corresponding weakening terms of trade, weakening access to capital market funding, increasing balance of payments problems, and general currency crisis risk.[40] Economist Hélène Rey's study of international capital flows shows how USD dominance creates a dilemma where—because of the powerful effects of international capital flows—countries are limited to either having an open capital account or having an autonomous monetary

---

[35] *See* Carol Bertaut, Valentina Bruno & Hyun Song Shin, *Original Sin Redux: Role of Duration Risk* 15 (Bank for Int'l Settlements, Working Paper No. 1109, 2023) (noting that, while some emerging market economies have made progress on overcoming original sin and are now able to borrow from global investors in domestic currency, there has been a decreasing trend in local currency holdings by global investors since 2012 with local investors being forced to step in as buyers when foreign investors decide to sell securities).

[36] *See id.* at 4 (noting that, for example, "mutual funds substantially reduce their holdings of local currency bonds following dollar appreciation, and do so much more than other sectors especially for longer maturities bonds"); Comm. on the Glob. Fin. Sys., *US Dollar Funding: An International Perspective* 39-40 (Bank for Int'l Settlements, Working Paper No. 65, 2020) [hereinafter *US Dollar Funding*].

[37] *See* PETTIS, *supra* note 34, at 99-100.

[38] *Id.*

[39] *See* Eichengreen & Hausman, *supra* note 32; Syed, *supra* note 20.

[40] *See* PETTIS, *supra* note 34, at 99-100; Slobodian, *supra* note 11, at 270-71 ("In the neoliberal vision of world order, the world economy exercises discipline on individual nations through the perpetual threat of crisis, the flight of investment that punishes expansion in social policy, and speculative attacks on currencies in reaction to increases in government spending.").

policy.[41] The study provides strong contemporary empirical evidence that non-US sovereigns must manage a baseline currency risk outside of their control and that their only practical means of enacting autonomous monetary policy is to place restrictions on capital flows.[42]

Rey's work aligns with economist John Maynard Keynes' emphasis on the difficulty of maintaining monetary sovereignty in the face of international capital flows. Keynes argues that if monetary policy operates on the premise that *any* barrier to free trade will harm both trading partners' economies, then policymakers must raise interest rates during times of capital outflow to protect their balances of foreign exchange, which will have the effect of reducing domestic investment and employment.[43] Keynes notes that this policy framework "sacrifice[s] [domestic monetary policy] to the operation of blind forces"[44] and emphasizes that "[i]t is the policy of an autonomous rate of interest, unimpeded by international preoccupations . . . which is capable of restoring economic health and strength internationally."[45] BIT free transfer requirements fall under the same laissez-faire framework that Keynes criticizes because they codify practical concerns about the stability of a country's balance of payments as, at most, secondary issues compared to the primary goal of incentivizing commerce by guaranteeing convertibility.

In the modern international monetary system, some non-US countries have an advantage in their ability to maintain their desired interest rate in the face of potentially destabilizing capital outflows, which might otherwise lead to currency devaluation and financial crisis.[46] This is because they can meet

---

[41] Hélène Rey, *Dilemma Not Trilemma: The Global Financial Cycle and Monetary Policy Independence* 21 (Nat'l Bureau of Econ. Rsch., Working Paper No. 21162, 2018) (emphasizing that "[f]luctuating exchange rates cannot insulate economies from the global financial cycle, when capital is mobile.").

[42] *Id.* For example, there are contexts where a particular country's economy might be undergoing a period of dynamic growth with plenty of slack in its labor market, but if the Federal Reserve raises rates, then that country will be forced to slow its economy and put many of its workers out of a job by also raising rates to avoid the destabilizing effects of capital flight.

[43] JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 293-94 (Wordsworth ed. 2017) (1936) (highlighting the continued relevance and wisdom of mercantilist policies, "which the unrealistic abstractions of Ricardo first forgot and then obliterated." Overreliance on laissez-faire economic theory led London statesmen in the early 1800s to "devis[e] the most dangerous technique for the maintenance of equilibrium . . . the technique of bank rate coupled with a rigid parity of the foreign exchanges.").

[44] *Id.* at 293 (a commitment to allowing the free flow of international capital pressures domestic policymakers to raise interest rates "to protect the foreign balance . . . which [is] likely to cause unemployment at home.").

[45] *Id.* at 302.

[46] Perry Mehrling, "*Where's My Swap Line?": A Money View of International Lender of Last Resort* 2 (Glob. Econ. Governance Initiative, Working Paper No. 053, 2021).

payment obligations in times of financial distress by utilizing lines of credit, at the current exchange rate for their currency, via central bank swap lines with the Federal Reserve.[47] In stark contrast, developing countries such as Venezuela face heightened currency risk because they *do not have access* to these central bank swap lines with the Federal Reserve, and thus are more exposed to currency price volatility than countries with access to these politically-determined lines of credit.[48]

Overall, these interrelated economic, political, and legal forces create an unequal, unstable, and hierarchical global monetary system[49] that eliminates much of non-US states' monetary sovereignty because they limit states' right to issue currency, their right to determine and change the value of that currency, and their right to regulate the use of that currency.[50] At a general level, their monetary sovereignty is impaired because of the overhanging and disciplining risk that creditors might choose to stop funding their debt if they enact monetary policy that increases creditors' risk of losing money. Exchange restrictions are one of the few legal tools available to sovereigns to claw back some of this lost monetary sovereignty and to mitigate the economic risks stemming from their vulnerable and unequal place in the international monetary system.[51]

B. A Sovereign's Ability to Restrict Free Transfers

Free transfer exception provisions are carve-outs in IIAs that allow sovereigns some discretion to enact laws limiting non-residents' ability to

---

[47] *See id.* ([T]he world has seen the emergence of a rather different system of international lender of last resort, organized as a network of central bank liquidity swap lines largely limited to the core countries of the Global North. In this system, central banks swap their own currency for dollars, which they then on-lend to their own banking systems as needed.).

[48] *See id.*; *see also* Joel Michaels*, Capital Regulation as Climate Policy* 59 IDAHO L. REV. 127, 161 (2023), (emphasizing that bank capital requirement "risk weights" for holding sovereign debt include political considerations rather than strictly credit risk considerations. Under the 1988 Basel I accord "all sovereign debt and central bank obligations issued by the negotiating states and OECD countries was given a 0% risk-weight, while non-OECD countries' sovereign debt was assessed at a 100% risk-weight . . . [t]he Basel Committee chose these risk-weights because of political and diplomatic considerations.").

[49] *See* PERRY MEHRLING, MONEY AND EMPIRE: CHARLES P. KINDLEBERGER AND THE DOLLAR SYSTEM 151-52 (2022) ("Whatever the origin of the hierarchy, the fact that the dollar sat on top was a problem. The global role of the dollar placed the United States in a position of responsibility and authority that US and non-US sovereigns both came to resent, for different reasons.").

[50] *See* MANN, *supra* note 29, at 461-62.

[51] *See* ATISH R. GHOSH ET AL., TAMING THE TIDE OF CAPITAL FLOWS: A POLICY GUIDE 18 (2017) (noting that exchange controls are a legal tool that derive from sovereigns' right to regulate the use of their currency).

freely convert stocks of state-currency-denominated money into an international settlement currency such as the USD.[52] In connection with the economic issues sketched above, limitations on free conversions of state currency are legal mechanisms to force counterparties (such as foreign investors) to continue to fund the sovereign's debt.[53] This is an important legal tool because currency crises can occur due to factors outside of a sovereign's control—i.e. unrelated to the sovereign's political risk—which lead to capital flight and a corresponding inability to meet USD-denominated settlement obligations as domestic currency values plummet.[54] Domestic instability can spread when it leads to disruptive exchange rate movements, which can cause instability in the broader international financial system.[55]

Countries can improve their domestic financial stability by building up a stock of USD, such as by forcing their exporters to sell USD denominated money inflows to the state central bank.[56] This is a hedge against future

---

[52] *See e.g.*, Canada-Venezuela BIT, *supra* note 1, at art. 8(6); Rachel D. Thrasher, Sarah Sklar & Kevin P. Gallagher, *Policy Space for Capital Flow Management: An Empirical Investigation,* 24 J. INT'L ECON. L. 779, 796 (2021) (noting that 98% of investment treaties contain a free transfers commitment because of some combination of investors' demand for reassurance and host states' desire to signal that they are open for business and friendly to foreign investors).

[53] "Funding" refers to economic entities' willingness, voluntary or otherwise, to hold a stock of currency originally issued as a short-term liability flow by a bank or other financial institution. This language choice helps clarify the important connection between debt and currency. Capital flight occurs because economic parties are less willing to fund debt denominated in a particular currency, for various predictable and unpredictable reasons. Conversely, "hot money" capital inflows occur because economic players increase their desire to fund debt denominated in a particular currency. *See US Dollar Funding*, *supra* note 36, at 39-40.

[54] *See* PETTIS, *supra* note 34, at 99; Rey, *supra* note 41, at 21; Hyman P. Minsky, *The Financial-Instability Hypothesis: Capitalist Processes and the Behavior of the Economy*, *in* FINANCIAL CRISES: THEORY, HISTORY, AND POLICY 26 (Charles P. Kindleberger & Jean-Pierre Laffargue eds., 1982) (noting that "the stability of a financial system depends on the weight of hedge finance in the total private financial structure."). Permitting a sovereign to restrict conversions increases the weight of hedge finance in a sovereign's financial structure, and thus its relative financial stability, because such restrictions are a hedge against capital outflow risk and thus improve a sovereign's capacity to meet its payment obligations.

[55] *See* PETTIS, *supra* note 34, at 99; Legal & Strategy, Pol'y & Rev. Dep'ts, *Modernizing the Legal Framework for Surveillance,* IMF 1, 7 (June 26, 2012), https://www.imf.org/external/np/pp/eng/2012/062612.pdf ("For instance, contagion or swings in market sentiments in reaction to policy announcements can transmit shocks across borders through asset prices without affecting balance of payments flows. To recognize this point, the bilateral surveillance section of ISD clarifies that systemic stability is most effectively achieved when a member promotes not only its own balance of payment stability, but also its own domestic stability.").

[56] *See* J. Scott Davis et al., *Russia Counters Sanctions' Impact with Currency Controls, Averts Crisis (For Now)*, FED. RSRV. BANK OF DALL. (May 31, 2022), https://www.dallasfed.org/research/economics/2022/0531 (noting that central bank foreign

capital flight because, in the event of potentially destabilizing selling pressure on its currency, the central bank can stabilize the price of its currency by selling its stock of USD and purchasing its domestic currency in the open market.[57] Importantly, this strategy comes with the corresponding lost economic opportunity to reinvest the USD revenues back into the economy.[58] Exchange controls are a legal tool sovereigns can use to mitigate their currency risk and create policy space for economic development by distributing the currency risk to domestic firms and foreign investors rather than bearing all of the risk themselves.[59]

This Note examines whether sovereigns have sufficient policy space under BIT free transfer exception provisions to confidently rely on exchange controls to improve their ability to meet settlement obligations—and mitigate the associated risk of disruptive exchange rate movements that cause international financial instability—during times of financial distress. This has important consequences from an international public policy perspective because sovereigns that can confidently rely on exchange controls can more easily choose to pursue economic development rather than stockpiling foreign exchange to hedge against the risk of currency devaluation.[60] Next, Part III analyzes the relevant legal architecture surrounding BIT free transfer exception provisions.

III. INTERNATIONAL LAW AND EXCHANGE CONTROLS

There is no supranational organization with complete jurisdiction and enforcement powers over sovereigns' use of capital controls or, more specifically, foreign exchange controls. Generally, international law—in both its binding and exhortatory forms—aims to minimize the likelihood that a sovereign will restrict foreign investors' on-demand access to USD because it interprets restrictions as impediments to free trade.[61] Below is a brief

exchange interventions are equivalent to capital controls); MUNRO *supra* note 13, at 36.

[57] *See* MATTHEW C. KLEIN & MICHAEL PETTIS, TRADE WARS ARE CLASS WARS: HOW RISING INEQUALITY DISTORTS THE GLOBAL ECONOMY AND THREATENS INTERNATIONAL PEACE 112 (2020) (emphasizing that mercantilist exchange control policies by foreign trade surplus countries like Russia and China subsidize their export price competitiveness but repress domestic consumption); Mona Ali, *Reforming the IMF: Global Monetary Hierarchy and Steps Towards Change*, PHENOMENAL WORLD (May 13, 2023), https://www.phenomenalworld.org/analysis/reforming-the-imf/ (Given the inherent asymmetry in the international monetary system, hard currency war chests empower countries lower in the monetary hierarchy to cope with financial shocks. Over the course of the 2021–2022 dollar appreciation, countries that had larger ex ante reserves—especially in Latin America, the Middle East and North Africa, and sub-Saharan Africa—experienced lower ex post depreciations against the dollar.").

[58] *See* KLEIN & PETTIS, *supra* note 57, at 112.

[59] *See* GHOSH ET AL., *supra* note 51, at 12.

[60] *See supra* Part I.A; *see also* KEYNES, *supra* note 43, at 302.

[61] *See* Francois Gianviti, *Current Legal Aspects of Monetary Sovereignty*, *in* CURRENT

outline of the international legal landscape relevant to a sovereign's capacity to restrict conversions of money denominated in their unit of account.

A. The IMF

In the aftermath of World War II (WWII), at Bretton Woods in 1944, the major international powers created the IMF.[62] The IMF Articles of Agreement ("IMF Articles") include provisions outlining member countries' legal authority to enact capital controls.[63] During this post-WWII era, the international monetary system transitioned away from a politics-based system and towards a more market-based system with the USD at the top of the international monetary hierarchy.[64] Capital controls were an important part of countries' legal toolkit to develop functioning economies and capital markets during this transition.[65]

In tension with promoting sovereigns' capacity to autonomously control their economy with capital controls, the IMF Articles generally disallow restrictions on current account convertibility because of the IMF's emphasis on the primacy of promoting international commerce.[66] To this point, Article VI(3) recognizes the right of members to:

> [E]xercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will *unduly delay transfers of funds in settlement of commitments*, except as provided in . . . Article XIV, Section 2.[67]

DEVELOPMENTS IN MONETARY AND FINANCIAL LAW 3, 10-11 (2005).

[62] Sandra Kollen Ghizoni, *Creation of the Bretton Woods System,* FED. RSRV. HIST., https://www.federalreservehistory.org/essays/bretton-woods-created (last visited Jan. 18, 2024).

[63] Articles of Agreement of the IMF, art. 6, § 3, 60 Stat. 1401, 2 U.N.T.S. 39 [hereinafter IMF Articles]; *see also* THOMAS A. BERNES ET AL., CHINA'S ENGAGEMENT WITH AN EVOLVING INTERNATIONAL MONETARY SYSTEM: A PAYMENTS PERSPECTIVE 8 (2014), https://www.cigionline.org/static/documents/china_engagement_cigi-inet_special_report_web_0.pdf [hereinafter CIGI REPORT ON CHINA] (noting that despite Keynes' advocacy, "the dollar, not the bancor, would be the international money, de jure as well as de facto.").

[64] *See* MEHRLING, *supra* note 49, at 151.

[65] *See* GHOSH ET AL., *supra* note 51, at 43-44.

[66] *See* IMF Articles, *supra* note 63, at art. 1; *see also What is the Current Account in the Balance of Payments Statistics (BOPS)?*, IMF, https://datahelp.imf.org/knowledgebase/articles/484331-what-is-the-current-account-in-the-balance-of-paym# (last visited May 2, 2024) (defining the current account as "flows of goods, services, primary income, and secondary income between residents and nonresidents.").

[67] *See* IMF Articles, *supra* note 63, at art. 6 (emphasis added); *see also id.* at art. 8, § 4(a) (distinguishing the current account—which tracks net flows from trade in goods and services, net earnings on cross-border investments, and net transfer payments over a period of time such

Under Article XIV(2), IMF members that have not yet adopted all of the IMF provisions have more leeway to restrict convertibility, and such members "shall withdraw restrictions maintained under this Section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the general resources of the Fund."[68]

In contrast to its inflexible "Washington Consensus" era before the Great Financial Crisis, modern IMF policy guidelines recognize and support the right of countries to pursue their financial goals with the use of capital control regimes.[69] However, while this rhetorical "soft law" policy shift advocates for capital controls on the capital account, it *does not* extend to endorsing capital controls on the current account.[70] To this point, IMF Article VIII(4)(a) provides almost no policy space for host states to restrict on-demand foreign exchange convertibility because it requires that:

> Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents: (i) that the balances to be bought have been recently acquired as a result of current transactions; or (ii) that their conversion is needed for making payments for current transactions.[71]

Overall, the IMF disallows foreign exchange conversion restrictions for members unless they have not yet adopted all IMF provisions and are using the restrictions to manage balance of payments problems.[72] The IMF's authority does not include enforcement mechanisms to procedurally *stop* member countries from pursuing foreign exchange controls, though it can limit member country access to IMF resources and implement procedures that can force a member country to withdraw from the fund.[73] IMF laws

---

as a year—from the capital account which represent stocks of assets denominated in a particular currency).

[68] *Id.* at art. 14, § 2 (emphasis added).

[69] *See* Luma Ramos et al., *Evaluating the Implementation of the IMF's Institutional View on Capital Flows* 2 (Glob. Econ. Governance Initiative, Working Paper No. 54, 2022) (emphasizing that the IMF's internal policy on capital controls is not entirely clear since its official 2012 "departure from viewing a fully open capital account as an optimal policy" because recent internal IMF reports do "not address the issue of when, for what countries and under what circumstances are CFMs discussed, and if the consistency extends to discussing capital flows for all members that experience capital account volatility.").

[70] *See* IMF Articles, *supra* note 63, at art. 6.

[71] *Id*. at art. 8, § 4.

[72] *See id.* at art. 14, § 2.

[73] *See id*. at art. 15, § 2; *see also* Deborah E. Siegel, *The Compatibility between FTAs-BITs and Regulating Capital Flows*, *in* CAPITAL ACCOUNT REGULATIONS AND THE TRADING SYSTEM: A COMPATIBILITY REVIEW 67, 70 (2013) (noting that because "capital account liberalization is not one of the IMF's purposes and the Articles recognize the right of members

limiting a sovereign's ability to restrict foreign exchange conversion are "soft laws" that influence international laws and norms to varying degrees depending on a country's membership status, reliance on IMF funding, and political-economic context.[74]

B. Trade and Investment Agreements

Most countries have signed and ratified many binding bilateral and multilateral trade and investment agreements with clauses that prohibit the adoption of exchange restrictions except in certain circumstances.[75] Some of these agreements permit foreign investors to bring legal action against sovereigns in arbitration fora like the ICSID, which reduces the scope of states' sovereign immunity.[76] Most of the binding legal framework related to exchange controls is based on this decentralized and overlapping network of bilateral, regional, and multilateral agreements because there is no supranational organization with legal authority over capital controls.[77]

Some major international trade agreements—such as the General Agreement on Tariffs and Trade 1994 (GATT) and the General Agreement on Trade in Services (GATS)—anchor their exchange control restriction rules to IMF standards by requiring members to enact restrictions in line with their responsibilities under the IMF Articles.[78] The GATS does not allow

---

to restrict capital movements, the IMF may not establish conditionality which would require members receiving financial assistance to remove particular capital account restrictions" though potential consequences for IMF members include "not receiv[ing] scheduled financing or [being] declared ineligible to use IMF resources.") (emphasis added).

[74] *See* HAROLD JAMES, INTERNATIONAL MONETARY COOPERATION SINCE BRETTON WOODS 273 (1996) (interpreting the IMF as a norm-promoting institution—rather than as a rules-based system—where the obligations under Article IV are "more of a pious code filled with a hope of liberalization than a serious attempt to change countries' policies by specific intervention on the part of the Fund.").

[75] *See* Thrasher, Sklar & Gallagher, *supra* note 52, at 796; Eric Helleiner, *Freeing Money: Why Have States Been More Willing to Liberalize Capital Controls than Trade Barriers?,* 27 POL'Y SCIS. 299, 311 (1994).

[76] *See* TREBILCOCK ET AL., *supra* note 6, at 591-92.

[77] *See id.* at 593 (emphasizing how trade and investment agreements have a multilateralization effect where, because most of them include Most Favored Nation treatment provisions, a new agreement with a trade or investment partner requires treating that new partner with the same preferential standard as other Most Favored Nation partners).

[78] The GATS is more relevant for this Note than the GATT because the underlying dispute between Air Canada and Venezuela relates to trade in (airline carrier) services rather than trade in goods. *See* General Agreement on Tariffs and Trade 1994 art. 15, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994]; GATS, *supra* note 1, at art. 11 (providing that "[n]othing in this Agreement shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the use of exchange actions which conform with the Articles of Agreement, provided

"restrictions on international transfers and payments for current transactions"[79] except that:

> In the event of serious balance-of-payments and external financial difficulties or [the] threat thereof a Member may adopt or maintain restrictions on trade . . . including on payments or transfers for transactions related to such commitments.[80]

Article XII of the GATS—qualifying the applicability of exchange restrictions—states that though restrictions cannot be discriminatory, "[i]n determining the incidence of such restrictions, Members *may give priority* to the supply of services which are more essential to their economic or development programmes."[81] Under both the GATT and GATS, balance-of-payments-based measures must "be temporary, preferably price-based, administered in a transparent manner, and apply to the general level of imports (i.e. avoid sectoral specificity)."[82]

United States and Canadian free trade agreements (FTAs) and BITs align with the IMF, GATT, and GATS because they generally disallow free transfer restrictions unless an exception applies.[83] BITs can contain various types of exceptions that allow for restrictions on free transfer provisions, which are typically qualified by the host state's obligation to restrict transfers in a "non-discriminatory and equitable fashion."[84] Legal scholars Rudolf Dolzer and Christoph Schreuer distinguish two types of BIT exceptions that can provide monetary policy space for sovereigns in times of financial distress: (1) balance-of-payment safeguard clauses ("BOP safeguards"), and (2) preserving the integrity and soundness of financial institutions clauses ("prudential regulations").[85] BOP safeguard and prudential regulation exceptions are relatively rare in BITs despite the ubiquity of free transfer

that a member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions, except under article XII or at the request of the Fund."). The parties to the WTO treaties (GATT and GATS here) do not have any recourse to ICSID or investor-state disputes more generally.

[79] GATS, *supra* note 1, at art. 11.

[80] *Id*. at art. 12.

[81] *Id.*

[82] *Technical Information on Balance of Payments*, WTO, https://www.wto.org/english/tratop_e/bop_e/bop_info_e.htm (last visited May 2, 2024).

[83] Philip J. MacFarlane, *The IMF's Reassessment of Capital Controls After the 2008 Financial Crisis: Heresy or Orthodoxy?,* 19 UCLA J. INT'L L. & FOREIGN AFFS. 167, 195 (2015). Importantly, US and Canadian FTAs typically will have investor-state dispute settlement in contrast to the arbitration fora under BITs.

[84] RUDOLPH DOLZER & CHRISTOPHER SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 193-94 (3d. ed. 2008).

[85] *See id*. at 195; *see also* Waibel, *supra* note 23, at 513.

requirement provisions.[86] While ninety-five percent of BITs have free transfer requirements that permit foreign investor recourse to Investor State Dispute Settlement, only forty percent have a BOP safeguard exception (and only four percent have a prudential regulation exception) that a host state could potentially rely on to enact exchange controls on foreign investor owned money.[87]

A major legal issue is defining the scope of what constitutes an economic situation that sufficiently justifies applying a BOP safeguard or prudential regulation exception. BOP safeguards apply depending on whether there is a sufficiently serious "BOP disequilibrium."[88] A BOP disequilibrium can lead to a financial crisis because it increases the risk that a country cannot fund its settlement commitments and thus there is an increased risk of default and currency devaluation.[89] The IMF acknowledges the difficulty of creating a universally applicable standard for what constitutes sufficiently serious BOP problems.[90] For example, IMF emergency funding decisions based on a BOP disequilibrium standard "inevitably requir[e] judgment because country circumstances (e.g. BOP problems . . .) vary significantly."[91] Further, a BOP disequilibrium standard is difficult to apply to IIAs—especially given that arbitration judges generally lack the IMF's financial and economic expertise—because of confounding external factors such as if an interest rate increase in the United States might push a sovereign's capital structure from solvency into insolvency.[92]

Prudential regulation exceptions allow a sovereign to restrict foreign investors' "freedom to provide financial services during extraordinary periods" in order to preserve the safety and soundness of financial

---

[86] *See* Thrasher, Sklar & Gallagher, *supra* note 52, at 787, 796.

[87] *Id.* at 787; *see also* U.S. MODEL BIT, *supra* note 23, at art. 20.

[88] *See* FRENCH MODEL BILATERAL INVESTMENT TREATY art. 8 (2006) (noting that the BOP safeguard applies to transfers when "capital movements . . . cause or threaten to cause a *serious disequilibrium to its balance of payments*") (emphasis added); IMF Articles, *supra* note 63, at art. 18(1)(b) (noting that "the decision to allocate special drawing rights shall take into account . . . the attainment of a *better balance of payments equilibrium*") (emphasis added); *see also* Tejvan Pettinger, *Balance of Payments Disequilibrium*, ECON. HELP (July 10, 2017), https://www.economicshelp.org/blog/185/economics/balance-of-payments-disequilibrium/ (noting that a *significant deficit on the current account*—where a country's imports cost more than it receives in payment for its exports—is typically referred to as disequilibrium) (emphasis added).

[89] *See* PETTIS, *supra* note 34, at 136.

[90] IMF, *2018 Review of Program Design and Conditionality,* Policy Paper 47 (May 2019), https://www.elibrary.imf.org/view/journals/007/2019/012/article-A001-en.xml [hereinafter IMF 2018 Policy Paper].

[91] *Id.*

[92] *See supra* Part I.A.

institutions.[93] To this point, former General Counsel of the IMF Sean Hagan emphasizes that the North American Free Trade Agreement (NAFTA) has a lower standard for allowing exchange restrictions on financial services industries because their ability to easily sell foreign currency creates more risk of currency price volatility.[94] Prudential regulation exceptions allow sovereigns to manage BOP disequilibrium problems, but only to the extent that the BOP disequilibrium can be addressed by preventing foreign financial services providers from freely converting their money.[95] Importantly, preserving the safety and soundness of financial institutions is also part of the de facto rationale for BOP safeguard exceptions because serious BOP disequilibrium inevitably harms the safety and soundness of financial institutions.[96]

Overall, BITs with a free transfer prudential regulation exception contain *less* potential policy space—because they only apply to foreign investors providing financial services rather than any foreign investor with domestic money holdings—for sovereigns to manage serious BOP disequilibrium than BITs with BOP safeguard exceptions. However, the language in prudential regulation exceptions that specifically allows restrictions on financial services providers potentially gives tribunals better guidance to find that the exception applies compared to BOP safeguard exceptions which have a less well-defined standard. BOP disequilibrium is an ambiguous legal standard that has high stakes political and economic consequences. Even agreements that permit BOP safeguard exceptions, like the GATS and the IMF in certain contexts, do not necessarily contain sufficient clarity for sovereigns to know when they can rely on a BOP safeguard exception to enact exchange restrictions.[97]

C. Standards of Review

Whether an exception to an exchange control rule might operate as a

---

[93] DOLZER, *supra* note 84, at 193-94, 215; *see also* US Model BIT, *supra* note 23, at art. 20 (noting that sufficient prudential reasons to restrict transfers include "the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services provider, *or* to ensure the integrity and stability of the financial system.") (emphasis added).

[94] Sean Hagan, U.N. Conference on Trade and Development, *Transfer of Funds*, 37, U.N. Doc. UNCTAD/ITE/IIT/20 (2000).

[95] *See id*.

[96] Chuku Chuku et al., *Are We Heading for Another Debt Crisis in Low-Income Countries? Debt Vulnerabilities: Today vs the Pre-HIPC Era* 6 (IMF, Working Paper No. 23/79, 2023) (highlighting that "a 'systemic' debt crisis can be defined . . . in the sense of threatening the solvency of large and possibly interconnected private creditors, and hence the global financial system.").

[97] *See* IMF 2018 Policy Paper, *supra* note 90, at 47.

successful defense for breach of a BIT depends on the standard of review that the governing body applies.[98] Legal scholars Abba Kolo and Thomas Wälde argue that tribunals should "review the measures adopted by the host state so as to ascertain whether the chosen means sufficiently take into account the interests of the foreign investor."[99] This investor-centric standard of review implies that tribunals should only consider the rationale behind a host state's actions so far as it helps clarify whether the investor was forced to take on risks or losses "result[ing] in insufficient protection . . . in emergency situations . . . allow[ing] states broadly to avoid their international obligations."[100] This standard of review prioritizes BITs' role as instruments of investor protection and downplays their role as instruments of host state economic development because it does not consider the exchange restriction from the perspective of the host state's domestic policy goals.

Just so, Kolo and Wälde posit that a host state that enacts policy under a prudential regulation exception can "invok[e] the doctrine of necessity or emergency under customary international law as a basis to derogate from its transfer obligations under such investment treaties."[101] Under this standard of review, "international tribunals would defer to the host state authorities to the extent that the measures are legitimate, transparent, non-discriminatory and *least restrictive of investment* in achieving the legitimate public purpose."[102] Interpreting prudential regulation exceptions under these customary international law standards demands a high threshold standard of review because the default interpretation is for the investor to take on as little burden-sharing of risk as possible.[103]

Contrastingly, legal scholar Michael Waibel argues that this standard of review based in customary international law is too restrictive of host state policy goals because BIT free transfer requirements can have a chilling effect that prevents countries from enacting necessary monetary policy.[104] Waibel proposes a degree of scrutiny for exchange restriction exceptions in line with the United States Supreme Court framework which "generally accords rational basis review to economic policy measures" under which "a policy measure is constitutional if it is rationally related to a legitimate governmental interest."[105] He emphasizes that "[a] similar approach holds promise for ICSID tribunals with respect to exchange restrictions" because

---

[98] *See* DOLZER & SCHREUER, *supra* note 84, at 124.

[99] Abba Kolo & Thomas Wälde, *Economic Crises, Capital Transfer Restrictions and Investor Protection Under Modern Investment Treaties*, 3 CAP. MKTS. L.J. 154, 167 (2008).

[100] *Id*.

[101] *Id*. at 164

[102] *Id*. at 168 (emphasis added).

[103] *See* Waibel, *supra* note 23, at 516.

[104] *See id*.

[105] *Id*.

"it leaves policy-makers substantial leeway, while still subjecting them to scrutiny at a general level."[106]

The *Air Canada v. Venezuela* ruling is important because it helps clarify the standard of review that an ICSID tribunal will likely apply in its analysis of whether a BIT free transfer exception provision should apply.[107] The outcome of this case, in turn, helps inform potential policy proposals that aim to better achieve BITs' dual purpose of investment protection and economic development. Air Canada brought its case against Venezuela in 2016; nine years after Venezuela left the IMF in order to recapture some of its lost monetary sovereignty.[108] This ruling is especially relevant because there had not been prior international arbitration cases specifically ruling on the bounds of a country's legal ability to restrict foreign exchange where there was not also a finding of expropriation.[109]

D. Air Canada v. Venezuela

Exchange restrictions on outflows are often implemented in the context of currency crises and thus foreign investors and host states will both argue for legal interpretations that limit their exposure to currency–devaluation-related losses.[110] The remainder of this Note analyzes the recent dispute ruled on at the ICSID at the World Bank between Air Canada and Venezuela related to exchange restrictions Venezuela placed on Air Canada's money during a currency crisis.[111] Predictably, both parties make legal arguments aimed at minimizing their losses related to the bolivar's massive devaluation during Venezuela's currency crisis.

---

[106] *Id.*

[107] Daniel Powell & Leigh Crestohl, *Air Canada Lands Victory Against Venezuela: What This Means for Future International Arbitration Proceedings*, ZAIWALLA & CO (Nov. 10, 2021), https://www.zaiwalla.co.uk/index.php/news/article/daniel-powell-and-leigh-crestohl-explore-what-the-air-canada-victory-against-venezuela-means-for-future-international-arbitration-proceedings.

[108] Mark Tran, *Venezuela Quits IMF and World Bank*, THE GUARDIAN (May 1, 2007), https://www.theguardian.com/business/2007/may/01/venezuela.imf.

[109] *See, e.g.*, Rusoro Mining v. Venezuela, ICSID Case No. ARB(AF)/12/5, Award, ¶¶ 274-75 (Aug. 22, 2016) (highlighting the interrelationship between Venezuela expropriating Canadian-owned mining interests in connection with limiting mining company foreign exchange transfers); *see also* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 326 (Sep. 13, 2021) (the arbitration tribunal expressly did not use the Most Favored Nation provision in the BIT for determining whether there was discriminatory action taken by Venezuela against Air Canada).

[110] *See* TREBILCOCK ET AL., *supra* note 6, at 581; Tim McLaughlin & Svea Herbst Bayliss, *Venezuela's Currency Woes an Increasing Threat to U.S. Corporate Profits*, REUTERS (Jan. 24, 2015), https://www.reuters.com/article/cbusiness-us-venezuela-currency-results-idCAKBN0KX0FC20150124.

[111] *See generally* Air Can., ICSID Case No. ARB(AF)/17/1.

1. Air Canada's Demand for Repatriation of its Venezuelan Earnings

In 2016, Air Canada commenced arbitration against Venezuela alleging that Venezuela breached the Canada-Venezuela BIT, which was signed on July 1, 1996, and in force since January 28, 1998.[112] Air Canada faced significant losses on its bolivar holdings despite having full legal access to the money in its deposit account at its bank, Banco Mercantil, in Venezuela.[113] This is because Venezuela was undergoing a currency crisis with rampant inflation and it refused to exchange Air Canada's bolivars for USDs at the favorable rate that it had previously made the exchanges under, and thus Air Canada faced significant losses because its bolivars were losing value.[114] In an attempt to recoup its losses, Air Canada alleged that Venezuela violated the Canada-Venezuela BIT—which guarantees free transfers "without delay"[115]—because Venezuela never processed fifteen of Air Canada's 2013 Authorization for Currency Acquisition (AAD) requests for bolivar-US dollar conversions.[116] These AAD requests amounted to roughly $50 million USD based on the subsidized conversion rates available to foreign carriers at the time.[117]

Venezuela did not argue that its failure to process the requests within five years of submission was somehow "without delay," it instead argued that the Canada-Venezuela BIT free transfer exception provision permitted Venezuela to utilize its "sovereign prerogatives under international law in order to safeguard its national economy and [it was] therefore entitled to regulate its own currency."[118] In opposition, Air Canada argued that the exception should not apply,[119] and therefore, the ICSID Arbitration Tribunal should order Venezuela to pay damages to put it in the same position it would have been in had its bolivars been exchanged for dollars at the subsidized 2013 rate.[120] The Tribunal's ruling in favor of Air Canada helps clarify the

---

[112] *See id*. at ¶ 130 (noting that the dispute was also based on the ICSID Additional Facility ("AF") Rules). It is outside the scope of this Note to analyze the relevance of the AF Rules.

[113] *See id*. at ¶ 337.

[114] *Id.*

[115] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8(2).

[116] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 356 (Sep. 13, 2021) (describing the administrative process for obtaining foreign exchange transfers where foreign carriers made Application for an Authorization of Foreign Currency Acquisition requests to the Venezuelan government).

[117] *See id.* at ¶ 21; *see also* Ewan Robertson, *Venezuelan Authorities to Combat Foreign Currency Scam with Fingerprint Devices*, VENEZUELANALYSIS (Oct. 7, 2013), https://venezuelanalysis.com/news/10077.

[118] *See* Air Can., ICSID Case No. ARB(AF)/17/1, ¶ 389.

[119] *Id*. at ¶¶ 320, 324.

[120] *Id*. at ¶ 640.

contours of how much monetary sovereignty a country has to enact policies in pursuit of financial stability under BIT free transfer requirements.[121]

2. Venezuela's Exchange Restrictions and the Canada-Venezuela BIT

Article VIII of the Canada-Venezuela BIT guarantees investors "unrestricted transfer of investments and returns . . . without delay in the convertible currency in which the capital was originally invested . . . [u]nless otherwise agreed by the investor . . . at the rate of exchange applicable on the date of the transfer."[122] A sovereign can restrict foreign exchange convertibility under the Article VIII(6) exception provision, which states that "a Contracting party may prevent or limit transfers by a financial institution . . . through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions."[123] This free transfer provision exception is a prudential regulation exception that plausibly provided Venezuela with domestic policy space to pursue financial stability.[124] Whether Venezuela had permissibly restricted bolivar conversions under the Canada-Venezuela BIT depended on whether the Tribunal decided Venezuela's abdication from processing Air Canada's foreign exchange requests was sufficiently defensible under the Article VIII(6) prudential regulation exception.[125]

Under Providencia No. 23, an administrative order by CADIVI, Venezuela's foreign exchange administrative body, Venezuela offered a heavily subsidized 6.3 bolivar to 1 US dollar rate for foreign carriers like Air Canada, so long as they followed an application procedure demonstrating they earned the bolivars legitimately.[126] This application for foreign

---

[121] *See* US Model BIT, *supra* note 23, at art. 7, §§ 1, 4 (mandating that "[e]ach Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory" with no BOP or prudential regulation exceptions).

[122] Canada-Venezuela BIT, *supra* note 1, at art. 8, §§ 1-2.

[123] *Id*. § 6.

[124] *See* DOLZER & SCHREUER, *supra* note 84, at 193-94 ("Three approaches can be found in recent treaty practice to allow such restrictions . . . [a] third approach . . . concerns specifically the right to restrict the freedom to provide financial services during extraordinary periods, preserving the right of the host and the home state to maintain 'the safety, soundness, integrity or financial responsibility of financial institutions.'").

[125] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 188 (Sep. 13, 2021).

[126] *See id*. at ¶ 19. "On April 8, 2003, CADIVI issued Providencia No. 23, an administrative order that regulated the [AADs] by foreign air carriers in Venezuela and which were processed at an exchange rate of 6.3 bolivars to 1 U.S. dollar." *Id.* This was based on Exchange Agreement No. 2 (February 9, 2003) between the Venezuelan Minister of Finance and the Central Bank "which established the official exchange rates for the purchase and sale of U.S. dollars." *Id*.

exchange regularly took up to four months to process and Air Canada agreed to the delayed process that would otherwise violate the "without delay" requirement under Article VIII(6).[127] Importantly, Providencia No. 23 stated that "[t]he authorizations by international air transportation companies to acquire foreign currency will be subject to currency availability as established by the Central Bank of Venezuela and the directives issued by the National Executive in the corresponding norm."[128] Therefore, Venezuela also made the related argument that it was legally protected under the Article VIII(6) exception because Providencia No. 23—the exchange regime Air Canada agreed to—permitted it to place limits on currency transfers in cases of insufficient foreign exchange at the Central Bank of Venezuela.[129]

Providencia No. 23 forced the Venezuelan central bank to take on losses when it processed AAD requests because it offered a fixed exchange rate to investors during a period of high inflation, which created significant losses as the bolivar continued to lose value.[130] Venezuela could procedurally delay settlement obligations by processing AAD requests slowly, and even halt conversions altogether if there was insufficient foreign exchange on hand.[131] On its face, this Venezuelan law provided its central bank with discretionary space to allocate its limited stock of USD reserves to mitigate capital flight because the law reduced the risk of the central bank not having sufficient USD on hand to settle USD liabilities.[132] Unfortunately, in 2013 and 2014, Venezuela suffered a debilitating currency crisis because it did not have sufficient USD reserves and was otherwise unable to maintain sufficient demand for bolivars.[133]

It is beyond the scope of this Note to argue that a more lenient free transfer exception provision in the Canada-Venezuela BIT would have materially improved Venezuela's currency crisis or that the exception should have permitted Venezuela to ignore a $50 million conversion obligation. However, this does not diminish the fact that a $50 million conversion—the amount of

---

[127] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8, §§ 1-2 (guaranteeing unrestricted transfers without delay unless otherwise agreed by the investor).

[128] Air Can., ICSID Case No. ARB(AF)/17/1, at 125 n.612 (quoting Exh. C-9 / Exh. R-11, CADIVI Providencia Administrativa No. 23, published in Official Gazette No. 37.667 (Apr. 8, 2003) (Venez.)).

[129] *See id.* at ¶ 381.

[130] *See* PETTIS, *supra* note 34, at 136.

[131] *See* Air Can., ICSID Case No. ARB(AF)/17/1, at 125 n.612 (citing Exh. C-9 / Exh. R-11, CADIVI Providencia Administrativa No. 23, published in Official Gazette No. 37.667 (Apr. 8, 2003) (Venez.)); *see also id.* ¶ 261 (noting that in 2013 CADIVI further delayed AAD processing by increasing the amount of paperwork).

[132] *See* PETTIS, *supra* note 34, at 136.

[133] Nathan Jaccard, *Hacking Through Venezuela's Thick Foreign Exchange Jungle*, ORGANIZED CRIME & CORRUPTION REPORTING PROJECT (Jan. 18, 2019), https://www.occrp.org/en/chavezman/hacking-through-venezuelas-thick-foreign-exchange-jungle/.

foreign exchange Air Canada was requesting—could reasonably push a sovereign into a full-blown currency crisis.[134] Venezuela's refusal to process Air Canada's AAD requests was a means of exercising its monetary sovereignty to maintain domestic financial stability because it reduced selling pressure on the free-falling bolivar.[135] To this point, despite acknowledging "that a sovereign prerogative [to pursue financial stability] exists in this context,"[136] the Tribunal ruled that Venezuela's interminable delay of Air Canada's AAD requests was not valid under the Article VIII(6) exception provision of the Canada-Venezuela BIT.[137]

Part IV analyzes the Tribunal's ruling and how it informs future domestic policy choices for sovereigns managing currency crisis risks under the constraints of BIT free transfer provisions.

IV. THE TRIBUNAL'S RULING

The ICSID Tribunal found that Venezuela was liable for breaching the Canada-Venezuela BIT unless the exception could apply as an affirmative defense because, even under the broadest construction of what could constitute "without delay" under the free transfer requirement provision, Venezuela failed to process Air Canada's AAD requests for *five years* and thus clearly violated the BIT.[138] Importantly, the Tribunal also commented on issues outside of the direct scope of its holding, which helps clarify some of the contours of the relationship between exchange restrictions and BIT free transfer requirement exceptions.

A. Holding: Venezuela Treated Air Canada Inequitably and Discriminatorily

On March 17, 2014, Air Canada suspended its active business with Venezuela when it stopped conducting its Toronto-Caracas route in response to political uncertainty in Venezuela and because its AAD requests were not being processed.[139] In connection with this, the Tribunal ruled that an Article VIII(6) defense could not apply because:

[134] *See* PETTIS, *supra* note 34, at 142 (emphasizing how inverted capital structures (i.e., where a sovereign funds itself with short-term foreign-currency-denominated debts) can induce a currency crisis in one country rather than another despite the countries having similar underlying economies).

[135] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 389 (Sep. 13, 2021).

[136] *See id*. at ¶ 390.

[137] *See id*. at ¶¶ 391-93.

[138] *Id*. at ¶¶ 378-79 (emphasis added) (noting that Venezuela categorized the AAD requests as "under analysis" for five years without further administrative processing).

[139] *See id*. at ¶ 367.

> the provision itself requires that any measures taken be "equitable, nondiscriminatory and [in] good faith." [And] in the instant case, [Venezuela] settled other carriers' AAD requests immediately after [Air Canada] announced its decision to suspend its operations and during the time [Air Canada] was still contacting [Venezuela] to reevaluate the situation.[140]

The Tribunal states that the BIT eliminates Venezuela's "sovereign prerogative" to enact monetary policy via exchange restrictions unless the restrictions are "actually applied via the relevant regime and without discrimination."[141] This language shows that the Tribunal interpreted the applicability of the exception provision under customary international law "fair and equitable" treatment standards, which require "at a minimum non-discriminatory and nonarbitrary treatment of the investment."[142] Therefore, the Article VIII(6) exception could only apply if Venezuela's measures were applied to similar entities in a non-discriminatory and nonarbitrary manner.[143] The Tribunal's ruling implies that they considered Air Canada a sufficiently similar foreign investor when compared to the other foreign air carriers and thus Venezuela's measures needed to be non-discriminatory and nonarbitrary as applied to all of the foreign carriers.[144] This is despite the fact that Air Canada no longer provided airline services in Venezuela at the time of this disparate treatment.[145]

Venezuela would have received much less of a short-term economic benefit from exchanging $50 million—at a massive loss because of bolivar hyperinflation—for an airline no longer operating in its country compared to settling with the other bolivar-deposit-owning carriers.[146] To this point, Venezuela settled "all" of the other foreign carriers that *still serviced* Venezuela.[147] Therefore, the ruling demonstrates that transfer restrictions are discriminatory if foreign investors in the same industry receive different treatment even if the foreign investor receiving worse treatment is no longer conducting business with the sovereign.[148] Venezuela was facing extreme

---

140 *Id*. at ¶ 392 (emphasis omitted).

141 *Id*. at ¶ 390 (emphasis omitted).

142 TREBILCOCK ET AL., *supra* note 6, at 592.

143 *See id.;* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 390 (Sep. 13, 2021); *see also* Kolo & Wälde, *supra* note 99.

144 *See* Air Can., ICSID Case No. ARB(AF)/17/1, ¶ 392.

145 *Id*. ¶ 451.

146 *See id*.

147 *See id*.

148 *See* TREBILCOCK ET AL., *supra* note 6, at 586, 592; *see also* Methanex Corp. v. U.S., Final Award, 44 I.L.M. 1345, ¶¶ 29, 38 (UNCITRAL 2005) (ruling that discriminatory national treatment standards for international investment agreements should have a narrower scope than for trade agreements and should compare differential treatment to *other existing*

difficulties in balancing payments—and a corresponding currency crisis—while trying to maintain other aspects of its political and economic stability, such as ensuring the availability of airplane services.[149] In that context, there was plausibly a rational basis for Venezuela to "settl[e] other carriers' AAD requests immediately after [Air Canada] announced its decision to suspend its operations."[150] This is because Venezuela needed to make difficult decisions about foreign exchange allocation while also making sure airlines continued to operate in Venezuela.[151]

The ruling shows that the "least restrictive" standard for permitting exchange restrictions drastically reduces the potential scope of sovereign monetary autonomy during a currency crisis.[152] It is unclear if Venezuela could have applied foreign exchange restrictions *equally* among all foreign airline carriers under the BIT. This is because a tribunal could reasonably interpret restrictions on foreign airlines as not the "least restrictive" policy to manage a currency crisis or could find ways that the treatment was otherwise discriminatory under customary international law standards.[153]

Creating non-discriminatory policies during a currency crisis is a difficult task because there is limited time for deliberation and different foreign investors—even amongst a specific subset such as foreign airline carriers—could have very different methods of managing their foreign currency, which could lead to some investors receiving worse treatment than others despite facially non-discriminatory policies.[154] The Tribunal did not provide specific

domestic investments in the same situation).

[149] *See* Amelia Cheatham et al., *Venezuela: The Rise and Fall of a Petrostate*, COUNCIL ON FOREIGN RELS., https://www.cfr.org/backgrounder/venezuela-crisis (Mar. 10, 2023).

[150] Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 392 (Sep. 13, 2021); *see also* Waibel, *supra* note 23, at 516.

[151] Venezuela argued that:

> When Claimant decided to 'jump ship' and abandon the route it had been operating without undue interference from the Republic for almost a decade, other companies understood the social and public interest dimension of the service they were providing and continued to operate. In circumstances in which it was becoming increasingly difficult for CADIVI to administer the ebbing available currency, the government established clear priorities. In this context it was only reasonable and proportionate for the Republic to give preference to those airlines who were still operating, thus ensuring the public service of air transportation of passengers.

Air Can., ICSID Case No. ARB(AF)/17/1, ¶ 466.

[152] *See* Waibel, *supra* note 23, at 515.

[153] *See* Kolo & Wälde, *supra* note 99, at 168; TREBILCOCK ET AL., *supra* note 6, at 593.

[154] For example, if one foreign airline purchased its jet fuel from Venezuela in bolivars and a second foreign airline purchased its jet fuel from the United States in dollars, then an equally applied foreign exchange restriction would affect the airlines disparately—with the second airline receiving worse treatment—because the restriction would harm the second airline's ability to fund jet fuel purchases compared to the first airline. *See* TREBILCOCK ET AL.,

guidance on what non-discriminatory or equitable policies might look like, other than to say that Venezuela's restrictions did not qualify under Article VIII(6).[155]

Unlike the GATS free transfer exception, which permits members to "give priority to the supply of services which are more essential to their economic or development [programs],"[156] the Canada-Venezuela BIT contains no language that might reconcile strict constructions of non-discriminatory or equitable requirements with the complicated economic reality of a financial crisis.[157] Overall, the Tribunal's holding demonstrates how sovereign policies that restrict foreign exchange conversion must survive a high threshold for an exception to apply. Arbitration tribunals will interpret findings of fact related to sovereign decisions made during crisis-inducing BOP disequilibrium in the context of customary international law norms, which prioritize a BIT's goal and purpose of investor protection ahead of the host state's monetary sovereignty.[158]

B. Dicta: The Prudential Regulation Exception Would Not Apply Anyways

In dicta, the Tribunal states that because Air Canada "is neither a financial institution, nor an affiliate of such institution, nor an associated person of such institution" it cannot be subject to exchange restrictions under the Article VIII(6) exception.[159] Further, the Tribunal notes that Banco Mercantil's involvement as the financial intermediary between Air Canada and the Central Bank of Venezuela "does not make [Article VIII(6)] relevant."[160] Though both of these points are dicta, the language points to the high level of scrutiny an exchange control policy must survive for a prudential regulation exception to apply.

The dicta aligns with Dolzer and Schreuer's definition of a prudential

---

supra note 6, at 594.

[155] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 392 (Sep. 13, 2021).

[156] GATS, *supra* note 78, at art. 12, ¶ 3.

[157] *See generally* Canada-Venezuela BIT, *supra* note 1, at art. 8, §§ 4, 6.

[158] *See* Air Can., ICSID Case No. ARB(AF)/17/1, ¶ 390; Daniel Powell & Leigh Crestohl, *Air Canada Lands Victory Against Venezuela: What This Means for Future International Arbitration Proceedings*, ZAIWALLA & CO (Nov. 10, 2021), https://www.zaiwalla.co.uk/index.php/news/article/daniel-powell-and-leigh-crestohl-explore-what-the-air-canada-victory-against-venezuela-means-for-future-international-arbitration-proceedings (emphasizing that "international law requires this Tribunal to interpret the concept of fair and equitable treatment in a manner consistent with the context of investor-State arbitration and the purpose of the [BIT] itself: namely investment protection. In this regard, the more liberal approach, which focuses on the broadly consistent elements of 'fair and equitable', is appropriate.").

[159] Air Can., ICSID Case No. ARB(AF)/17/1, ¶ 391.

[160] *Id.*

regulation exception because it limits Article VIII(6) applicability to foreign investors that provide financial services, such as financial institutions.[161] However, the Tribunal does not explain why Air Canada—despite having a depository account with an important financial institution, Banco Mercantil, and agreeing to Venezuela's CADIVI foreign exchange regime—is clearly not "a person related to [a Venezuelan] financial institution."[162] Further, this interpretation arguably goes against the plain meaning[163] of the Article VIII(6) exception, which allows restrictions for "maintenance of the safety, soundness, integrity or financial responsibility of financial institutions,"[164] because it distinguishes non-financial-service-providing foreign investors' "claims to returns" as irrelevant to maintaining the safety and soundness of financial institutions.[165] From an economic perspective, deposit holders such as Air Canada can instigate capital flight, cause serious BOP disequilibrium, and harm the safety and soundness of financial institutions regardless of whether they are financial services providers.[166]

The Tribunal's interpretation of the BIT's prudential regulation exception

---

[161] *See* DOLZER & SCHREUER, *supra* note 84, at 193-94; Hagan, *supra* note 94, at 37.

[162] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8, ¶ 6.

[163] Financial stability depends on banks being able to secure funding for settlement obligations. Thus, the plain meaning interpretation of exception provisions for maintaining the safety and soundness of financial institutions is arguably that policies that help banks meet their settlement obligations—when banks are struggling to do so otherwise—are in pursuit of the safety and soundness of financial institutions. *See, e.g.,* Federal Reserve Act, 12 U.S.C.A. § 343(3)(A) (West)

> In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System . . . may authorize any Federal reserve bank . . . to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange . . . [p]rovided, [t]hat before discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility *is unable to secure adequate credit accommodations from other banking institutions*.

(emphasis added).

[164] *See* Canada-Venezuela BIT, *supra* note 1, at art. 8, ¶ 6.

[165] *Id*.

[166] In March 2023, the Federal Reserve provided liquidity to regional banks under § 343(3)(A) to maintain the safety and soundness of the financial system after a subset of behaviorally correlated depositors—who were not a group of foreign investor financial services providers—disproportionately withdrew their money from Silicon Valley Bank. *See, e.g.*, Matt Levine, *SVB Couldn't Ignore Its Losses, But the Fed Can*, BLOOMBERG (Mar. 13, 2023), https://www.bloomberg.com/opinion/articles/2023-03-13/svb-couldn-t-ignore-its-losses-but-the-fed-can; *see also* Ken Klippenstein & Daniel Boguslaw, *Pentagon Tries to Cast Bank Runs as National Security Threat*, THE INTERCEPT (Apr. 3, 2023), https://theintercept.com/2023/04/03/silicon-valley-bank-bailout-pentagon/ (explaining how bank runs—analogous to capital flight—can be a threat to a domestic financial system to the point that there is a meaningful national security threat).

drastically limits states' monetary sovereignty to enact exchange restrictions because, under Article VIII(6), "relatedness" cannot exist for foreign investors that do not provide financial services.[167] Further, the safeguard provisions in Providencia No. 23, which allow for restrictions on transfers if the central bank is running low on foreign exchange,[168] are not legally viable under Article VIII(6) because Air Canada is not sufficiently related to a Venezuelan financial institution.[169] This demonstrates how prudential regulation exceptions limit a sovereign's ability to create flexible domestic laws to address their currency risk exposure to foreign investor deposit holdings.

Rather than analyzing the risk of investor-induced financial instability by looking at a host state's unique composition of foreign direct investment, tribunals can instead rule on the prudential regulation exception's applicability based on a binary distinction between financial services providers and other foreign investors. This shows how the Canada-Venezuela BIT effectively requires free transfers of domestic currency holdings for foreign investors that are not financial services providers. The BIT does not require a tribunal to analyze whether a particular mix of foreign investors might bring heightened currency risk despite not being financial services providers.[170]

In further dicta, the ICSID Tribunal notes that, regardless of whether Air Canada was sufficiently related to a financial institution, Article VIII(6) cannot operate as a defense because "restrictions . . . would have to be for the purpose of maintaining the 'safety, soundness, integrity or financial responsibility of financial institutions' which was not the case with respect to the measures taken by [Venezuela] to safeguard its national economy."[171] The Tribunal provides no further explanation for its conclusion suggesting Venezuela's failure to process Air Canada's AAD requests was not to safeguard its national economy.[172] To this point, the Tribunal does not consider how the underlying exchange control regime of *delaying conversions* was one of the specific tactics Venezuela was using to maintain the "safety, soundness, integrity or financial responsibility of [its] financial institutions."[173]

Overall, the dicta shows how a prudential regulation exception reduces a

[167] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 389 (Sep. 13, 2021).

[168] *See id.* at 125 n.612 (citing Exh. C-9 / Exh. R-11, CADIVI Providencia Administrativa No. 23, published in Official Gazette No. 37.667 (Apr. 8, 2003) (Venez.)).

[169] *See id.* at ¶¶ 389, 391.

[170] *See id*. at ¶ 391.

[171] *Id*.

[172] *Id*. at ¶¶ 391-92.

[173] *Id*. at ¶ 391.

sovereign's monetary autonomy more than a BOP safeguard exception because prudential regulation exceptions allow tribunals to find free transfer restrictions inapplicable without even attempting to analyze a sovereign's relative BOP disequilibrium.[174] In 2013, the Central Bank of Venezuela was close to insolvent—there was significant inflation and corresponding capital flight with hyperinflation on the horizon[175]—and yet, even with the benefit of this hindsight, the Tribunal does not acknowledge that Venezuela's efforts to delay conversions of bolivar-denominated deposit liabilities might have been in the interest of its financial stability.[176]

C. Venezuela's Insufficient Foreign Exchange Defense

Venezuela's second potential defense under the Article VIII(6) exception was that it had insufficient foreign exchange on hand to process Air Canada's AAD requests and thus was protected under safeguard provisions in its Providencia No. 23 foreign exchange regulation.[177] Analogous to its cursory acknowledgment of the legal existence of Venezuela's "sovereign prerogative," the Tribunal did "not question the fact that [Venezuela's exchange control] regime set forth the possibility to reject AAD requests" because of a lack of available foreign exchange.[178] The Tribunal then looked to the facts to determine whether the "alleged lack of U.S. dollar currency justified [Venezuela's] inaction in relation to [Air Canada's] 15 AAD requests."[179]

Venezuela submitted a document it produced in 2018 detailing its central bank's balance sheet from the relevant period, which illustrated how the bank was dealing with a sharp reduction of foreign exchange from nearly $34 billion in 2013 to $27 billion in 2014.[180] Looking at the facts, "[t]he Tribunal [gave] no weight to a document produced in 2018 - either in favor or against [Venezuela]" because it was not sufficiently "contemporaneous."[181] The

---

174 *See* DOLZER & SCHREUR, *supra* note 84, at 193-94.

175 *See* Cheatham et al., *supra* note 149.

176 *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 391 (Sep. 13, 2021).

177 *See id.* at 125 n.612 (citing Exh. C-9 / Exh. R-11, CADIVI Providencia Administrativa No. 23, published in Official Gazette No. 37.667 (Apr. 8, 2003) (Venez.)).

178 *See id.* at ¶¶ 382, 390.

179 *Id*. at ¶ 382

180 *Id*. at ¶ 381; *see also* Bolivarian Republic of Venez., Annual Report Exhibit D (Form 18-K) (Dec. 21, 2017), https://www.sec.gov/Archives/edgar/data/103198/00011931251737 6486/d505622dex99d.htm (corroborating the accuracy of Venezuela's evidence because it shows sharply reduced foreign exchange totals from $32 billion in 2013 to $27 billion in 2014, to *under $4 billion in 2015*) [hereinafter Venez. Annual Report].

181 *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 382 (Sep. 13, 2021).

Tribunal noted that Venezuela had not "met its burden of proving with contemporaneous documents that there was a shortage of U.S. dollar reserves at the relevant time such that [Air Canada's] requests could not be processed" because of the *procedural* irrelevance of the evidence of the central bank letter.[182] In further dicta, the Tribunal opines that "[t]his being said, the Tribunal cannot ignore the fact that at the same time U.S. dollar amounts equivalent to other airlines' AADs were paid to those airlines between May and October 2014."[183]

The Tribunal's commentary does not specifically clarify the legal standard for when sovereigns can limit foreign exchange conversions under prudential regulation exceptions because of "insufficient funds" carve-outs in domestic exchange control laws. The dicta indicates the Tribunal would likely look to evidence of contemporaneous foreign exchange payments and would interpret any payments to foreign investors in the same sector as dispositive proof of inequitable or discriminatory treatment.[184] This is in line with the customary international law standard the Tribunal applied in its holding, based on the fact that Venezuela processed all of the foreign carriers' AAD requests except for Air Canada's.[185] The dicta highlights the power of BIT free transfer requirements to override domestic laws like Providencia No. 23—even at the procedural level of arbitration—that seek to carve out safeguard provisions that might limit convertibility.

Sovereigns like Venezuela face a high threshold to successfully defend exchange restrictions based on insufficient funds safeguards in their domestic laws.[186] This is because the Tribunal relies on a procedural rule and declines to accept evidence of Venezuela's dwindling foreign exchange despite the common knowledge that the bolivar was free-falling during the time in question.[187] Of further concern, the Tribunal paradoxically acknowledges, in dicta, it "has no reason to doubt Respondent's submission that there was a decline in available foreign currency and that it had to prioritize in this regard," and yet—when opining on potentially relevant substantive evidence—it interprets evidence that Venezuela prioritized its foreign exchange outflows during a time of crisis as somehow indicating that Venezuela had *sufficient* foreign exchange at the time in question.[188]

---

182 *Id*.

183 *Id*.

184 *Id*.

185 *See supra* Section III.B.

186 *Compare* Kolo & Wälde, *supra* note 99, at 168, *with* Waibel, *supra* note 23, at 516.

187 *See*, *e.g.*, Venez. Annual Report, *supra* note 180.

188 *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶¶ 382, 407 (Sep. 13, 2021) (emphasizing that Venezuela also violated Article II of the BIT because it treated Air Canada unfairly and inequitably because Venezuela "has not produced any contemporaneous documents evidencing a shortage of hard currency to satisfy

This paradox demonstrates the power of BIT free transfer provisions to compel tribunals that see clear evidence of economic crisis to still choose to force sovereigns to take on losses that can further increase financial instability.[189] This is in tension with the legal purpose of BITs to create and maintain a more stable environment for international trade.[190]

D. Overview

The Tribunal's ruling shows that ICSID arbitration tribunals will use a high level of scrutiny to determine whether a restriction on the free transfer of funds—otherwise guaranteed by a BIT—is defensible under a prudential regulation exception. Just so, Venezuela's indefinite failure to convert Air Canada's bolivars did not qualify under the Article VIII(6) exception.[191] Correspondingly, Venezuela's "insufficient funds" argument based on safeguard protections in its Providencia No. 23 law was also ineffective as an exception defense under Article VIII(6).[192]

Generally, the Tribunal's ruling aligns with Kolo and Wälde's application of customary international law to free transfer provisions, where "international tribunal[s] would defer to the host state authorities to the extent that the measures are legitimate, transparent, non-discriminatory and least restrictive of investment in achieving the legitimate public purpose."[193] Venezuela treated Air Canada discriminatorily under the customary international law "fair and equitable treatment" standard when it settled with the other foreign airline carriers and not with Air Canada.[194]

The Tribunal avoids making findings of fact based on economic factors such as whether Venezuela's exchange restrictions were plausibly in pursuit of financial stability or about the relative seriousness of Venezuela's BOP disequilibrium.[195] This highlights how foreign investors can rely on BIT enforcement mechanisms that use international law to abstract from the underlying economic conditions BITs are theoretically designed to promote and protect.[196] To this point, a prudential regulation exception limited Venezuela's potential monetary sovereignty because—even in the case of

---

Claimant's requests. The evidence instead shows that it did have sufficient hard currency available.").

[189] *See* SCHACHT, *supra* note 15, at 161-62; Minsky, *supra* note 54, at 26.

[190] *See* TREBILCOCK ET AL., *supra* note 6, at 594.

[191] *See* Air Can., ICSID Case No. ARB(AF)/17/1, ¶¶ 391-93.

[192] *Id*. at ¶¶ 382-83.

[193] *See* Kolo & Wälde, *supra* note 99, at 168.

[194] *See* Powell & Crestohl, *supra* note 158.

[195] *See supra* Section III.C. There is also the question of whether arbitration tribunals have the necessary expertise to make accurate rulings on the complex issue of what qualifies as a sufficiently "serious" BOP disequilibrium.

[196] *See supra* Section III.B.

serious BOP disequilibrium—it narrowed the range of permissible exchange restrictions to restrictions on foreign financial services providers.[197] Overall, the Tribunal's application of a high threshold standard of review—combined with the difficulty of implementing equitable and non-discriminatory exchange restrictions during a currency crisis—implies that sovereigns rather than foreign investors will typically bear the losses allocated from disputes over the legitimacy of exchange restrictions under BIT free transfer exception provisions.

E. Distributional Consequences

At its core, the international public policy issue of when sovereign monetary policy ought to supersede BIT investor protections requires identifying which political and economic contexts justify a sovereign forcing an investor to take on currency risk rather than the sovereign taking on all of the currency risk itself.[198] The Tribunal's ruling to award Air Canada more than $20 million in damages[199]—despite Venezuela's plausibly rational basis to limit conversions for foreign investors during a period of rapid inflation and economic catastrophe[200]—shows how BIT free transfer provisions force sovereigns to take on the full burden of losses related to foreign investor deposit holdings during a currency devaluation.[201] This is because currency crises will force sovereigns to make difficult distributional choices necessary for maintaining financial stability, which will inevitably violate free transfer exception provisions in BITs. As this ruling shows, these decisions can easily be characterized as inequitable or discriminatory because tribunals will default to using customary international law standards that prioritize investor interests over host state domestic policy needs.

This high threshold standard of review effectively eliminates a state's monetary sovereignty to regulate its currency via exchange controls on foreign investor deposit holdings during times of economic distress. BIT free transfer requirements can force sovereigns like Venezuela to immediately settle large foreign exchange liabilities, which can intensify financial

---

[197] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 391 (Sep. 13, 2021)

[198] *See supra* Sections I.A-B.

[199] *See* Air Can., ICSID Case No. ARB(AF)/17/1, ¶¶ 639-46 (ruling that the 2014 exchange rate of 10.9 bolivar/USD should be used to calculate damages rather than the especially subsidized 6.3 bolivar/USD rate available to foreign airlines in 2014 when Venezuela stopped making AAD payments to Air Canada).

[200] *See* Waibel, *supra* note 23, at 515; *see also* Venez. Annual Report, *supra* note 180.

[201] *See* Kevin P. Gallagher, *Reforming United States Trade and Investment Treaties for Financial Stability: The Case of Capital Controls*, INT'L INST. FOR SUSTAINABLE DEV. (Apr. 5, 2011), https://www.iisd.org/itn/en/2011/04/05/reforming-united-states-trade-and-investment-treaties-for-financial-stability-the-case-of-capital-controls/.

instability and contribute to repressed economic conditions after the crisis is over.[202] The Tribunal's ruling also plausibly incentivizes sovereigns to hold off on financial reform because free transfer requirement exceptions do not provide policy space to proactively allocate currency risk to foreign investors. This chilling effect on reform can exacerbate a sovereign's financial losses which harms both its economy and its foreign investors' future revenue streams (which are what the investment agreements were implemented to protect in the first place!).[203] Further, the high threshold standard of review can have a chilling effect on domestic policy because it incentivizes more conservative development efforts.[204] This is because sovereigns know they are on the hook for all of the losses associated with future currency crises and thus will err towards stockpiling foreign exchange rather than investing in their economies.[205]

This Note argues that—in their current legal form—BIT free transfer provisions go against public policy because they amplify risks of international financial instability and disincentivize vulnerable countries from pursuing development goals. Under BITs, states should not be forced to contract away their sovereign right to regulate their currency via exchange control laws. This issue is especially relevant for countries that are already managing reduced levels of monetary sovereignty because they do not have access to currency-risk-mitigating tools such as central bank swap lines or the ability to issue debt funded in their own currency.[206]

Next, Part V proposes changes to BIT free transfer provisions that would better achieve BITs' dual purpose of promoting a stable business environment and economic development.

---

[202] *See* SCHACHT, *supra* note 15, at 161-62 (emphasizing the inherent "Transfer Problem" where German payment of reparations in foreign exchange, as required by the Treaty of Versailles, was impossible because it required export production beyond what the world market could physically absorb).

[203] *See* Rachel D. Thrasher & Kevin P. Gallagher, *Mission Creep: The Emerging Role of International Investment Agreements in Sovereign Debt Restructuring*, 6 J. GLOBALIZATION & DEV. 257, 263 (2015); Magalie Masamba, *What Role Do Previous Proposals Play in the Quest for a Global Rule of Law for Sovereign Debt Restructuring? An Analysis of the Changing Restructure Architecture*, 41 B.U. INT'L L.J. 121, 125 (2023).

[204] *See supra* Parts I-II.

[205] *See supra* Parts I-II; *see also* Barry Eichengreen et al., *Yet it Endures: The Persistence of Original Sin*, 34 OPEN ECON. REV. 1, 31 (2023) (illustrating that stockpiling reserves is not only an issue for the most vulnerable countries but is also crucial for middle income countries working to develop a bond market denominated in their local currency).

[206] *See supra* text accompanying notes 31, 45.

V. BIT ADJUSTMENTS TO PROMOTE STABILITY AND ECONOMIC DEVELOPMENT

It is beyond the scope of this Note to analyze many of the logistical and political issues—such as the global coordination required to amend more than 3,000 BITs or the political issues related to appeasing MNCs that have a vested interest in maintaining the investor-friendly status quo—relevant to these proposed BIT adjustments. That said, this Note argues that making legal adjustments to BIT free transfer provisions would promote BITs' goals of investor protection and economic stability while also increasing host state monetary sovereignty and autonomy to pursue economic development.

The Tribunal's ruling shows how the burden is on the sovereign to ensure that its exchange control measures are applied in strict accordance with customary international law standards for an exception to apply. This aligns with the general international economic law principle that IIAs should limit sovereign discretion, which might otherwise create an unpredictable business environment.[207] In contrast, this Note argues that states should have the policy discretion to enact exchange controls to mitigate domestic currency crises and pursue stable economic development, especially given their limited degree of monetary sovereignty within the USD-dominated international monetary system. This Note proposes two potential options to change the current BIT free transfer provision regime and then analyzes relevant economic issues stemming from these proposed changes.

A. Legal Proposals

Both proposed adjustments would force tribunals to construe the applicability of BIT free transfer exceptions more broadly and thus would limit investor-centric interpretations based on default customary international law standards. Importantly, each proposed option requires that BIT free transfer provisions contain BOP safeguard exceptions that trigger when a country (such as Venezuela in 2013) suffers from serious BOP disequilibrium. There would need to be an exception provision added to free transfer requirements in the majority of BITs because most BITs do not even contain a free transfer requirement safeguard.[208] Further, adding BOP safeguard exceptions rather than prudential regulation exceptions would help avoid dispositive rulings based on findings of fact—such as whether a foreign investor is a financial services provider or not—that are potentially unrelated to the underlying economic problem.[209] However, there is still the issue that "serious BOP disequilibrium" is a complicated economic and legal standard that varies depending on a sovereign's unique political and economic context

---

[207] *See supra* Part I.

[208] *See* Thrasher, Sklar & Gallagher, *supra* note 52, at 787.

[209] *See supra* Section III.B.

at a given point in time.[210] These proposed legal changes address this issue by reducing tribunals' discretion to make rulings on this complex standard that they do not necessarily have expertise in.

The first proposed option is to codify the standard of review for free transfer provisions' BOP safeguard exceptions as a "rational basis" standard under which a policy measure satisfies the threshold requirement if it is "rationally related to a legitimate governmental interest."[211] Under this option, BIT free transfer provisions should not contain customary international law language like "fair and equitable treatment" and "non-discriminatory" in reference to investor rights. Instead, treatment requirements should relate to an investor's access to "fair administrative treatment."[212] This legal design helps to narrow potential judicial discretion to issues relating to due process and fair treatment within the court system.[213] Overall, this proposal would create a presumption that an exchange restriction is valid so long as it plausibly relates to a governmental interest (such as trying to prevent a financial crisis).

The second proposed BIT adjustment option mirrors the Southern African Development Community (SADC) Model BIT under which safeguard provisions are self-executing and thus "once the State taking the safeguard measure declares it to be necessary, that is the end of the matter . . . the decision cannot be challenged under the arbitration process."[214] This irrebuttable presumption would provide sovereigns with the discretion to enact exchange restrictions without fear of adverse arbitration rulings but would leave more room for potentially unchecked abuses of investor rights in the name of monetary sovereignty.

Under both BIT adjustment options, this Note proposes reining in sovereigns' inherent discretionary power via a soft law requirement that sovereigns provide advance notice to foreign investors whose free transfers they might restrict.[215] The notice requirement would mitigate the risk of leaving foreign investors like Air Canada in the dark about why the sovereign was unable to convert their deposits, which was a major part of the reason Air Canada suspended its services to Caracas and instigated the ICSID

---

[210] *See supra* Section II.B.

[211] *See* Waibel, *supra* note 23, at 516; US Model BIT, *supra* note 23, at art. 7 ¶ 4.

[212] *See* SOUTHERN AFRICAN DEVELOPMENT COMMUNITY MODEL BILATERAL INVESTMENT TREATY TEMPLATE 24. (2012) [hereinafter SADC Model BIT].

[213] *Id*.

[214] *See id*. at 29 (To "ensure a certain level of discipline, the State Party taking such measures is compelled to consult with the other State Party after taking such measures, or prior to their renewal if needed. This does not give a right of veto to the other State Party, but does impose a measure of accountability in the process.").

[215] *Id.* at 21-22 (emphasizing the importance of clearly defining what constitutes investments in "like circumstances.").

action.[216]

A related issue is whether exceptions to exchange transfer provisions should be reviewed under *different* treatment standards than the other articles in an investment agreement. Waibel notes that "the rare [BOP] safeguard in a BIT is an exception to the transfer of funds provision *only*." [217] Importantly, this specific textual placement suggests that exceptions to free transfer requirement provisions "do not carve out an exception to all of the BIT's treatment standards."[218] This interpretation drastically limits the potential effectiveness of more broadly construed exception provisions. For example, Venezuela might still be liable for violating the BIT even if the Tribunal ruled it was justified in restricting Air Canada's transfers under the Article VIII(6) prudential regulation exception. This is because the Tribunal also held that Venezuela would be liable for the same actions under Article II of the BIT which mandates the host country "accord investments or returns . . . fair and equitable treatment."[219]

Because of this contradiction, Waibel argues that "[a] better approach would be for BIT drafters to formulate BOP safeguards as a general exception to *all* of the BIT's treatment obligations."[220] This approach exists in multilateral treaties such as the GATT under which free transfer provision exceptions can plausibly achieve their full purpose as "a general escape clause" because "no further examination for violation of the fair and equitable or the expropriation treatment standard" is required.[221] Therefore, the BOP safeguard exceptions should also include "a general escape clause" to prevent these double-jeopardy type issues from arising if a sovereign enacts an exchange restriction.[222]

Overall, this Note proposes that BITs contain liberally construed BOP safeguard exception provisions under free transfer requirements. The safeguard provisions should have either a "rational basis" standard of review or an irrebuttable self-executing judgment standard of review to guide

---

[216] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 451 (Sep. 13, 2021).

[217] *See* Waibel, *supra* note 23, at 516.

> A better approach would be for BIT drafters to formulate BOP safeguards as a general exception to all of the BIT's treatment obligations. Thus, if a government imposed exchange restrictions consistent with the BIT's BOP safeguard, no further examination for violation of the fair and equitable or the expropriation treatment standard would lie. This approach is taken in important multilateral treaties such as the GATT, where BOP safeguards are typically a general escape clause.

[218] *Id.*

[219] *See* Canada-Venezuela BIT, *supra* note 1, at art. 2, ¶ 2.

[220] *See* Waibel, *supra* note 23, at 516 (emphasis added).

[221] *Id.*

[222] *Id.*

tribunals ruling on the legitimacy of host state exchange restrictions. This legal design aligns with the original IMF policy framework after WWII under which capital controls were a vital part of countries' legal toolkit to develop functioning economies and capital markets.[223] Further, these proposals align with current IMF policy on free transfer requirements because they emphasize the importance of BOP disequilibrium as the core economic and legal standard relevant to whether exchange controls should be imposed.[224] There is still drastic inequality among states—including their relative monetary sovereignty within the international monetary system—and this Note argues that these proposed changes to BITs would help BITs better fulfill their purpose of improving states' capacity to develop their economies. The next section considers the economic effects of these proposed adjustments to BIT free transfer provisions.

B. Economic Effects

Broadly, the economic goal of these proposed legal changes is to improve sovereigns' capacity to meet payment obligations during times of financial distress. Each of the proposals would allow for more host state autonomy over their monetary policy under an international monetary system where interest rates and the effects of capital flows are otherwise generally beyond most states' control.[225] This increased degree of monetary sovereignty would enable countries to legally restrict foreign exchange conversions, which would be a hedge against the potentially destabilizing effects of foreign investor deposit outflows.[226] The economic question then turns to whether these proposed changes to BITs would give too much discretion to sovereigns to manipulate the rule of law via ad hoc exchange restrictions, which could plausibly have a chilling effect on international trade and foreign investment.[227]

Such an outcome would thwart this Note's policy goals because improvements in the public capacity to spend money due to the availability of exchange restrictions would be negated by reductions in the private sector's inducement to invest and willingness to trade.[228] Importantly, this Note does *not* argue that exchange restrictions are long-term economic solutions for trade and investment policy. Instead, this Note argues that

---

[223] *See supra* Section II.A.

[224] *See supra* Section II.A.

[225] *See* Rey, *supra* note 41, at 21; KEYNES, *supra* note 43, at 293-94.

[226] *See* Minsky, *supra* note 54, at 26.

[227] *See*, *e.g.*, TREBILCOCK ET AL., *supra* note 6, at 11. *But see* Moehlecke & Wellhausen, *supra* note 25, at 496 (emphasizing that IIAs can have a chilling effect on sovereigns enacting domestic regulation including environmental regulation).

[228] *See* KEYNES, *supra* note 43, at 301 ("The weakness of the inducement to invest has been at all times the key to the economic problem.").

exchange restrictions are a tool—that can facilitate greater autonomy to mitigate financial instability and promote economic development—that should be legally available to vulnerable countries during difficult times. Legally allowing delays of foreign exchange conversion during crises is a small concession in the power balance of investor-sovereign relationships because host state monetary policy would still be subject to substantial discipline from the forces of international trade and investment.[229]

These BIT adjustments would create better balance in the investor-sovereign relationship because foreign investors would knowingly take on more of the sovereign's currency risk than they currently do when they decide to make an investment. Importantly, it would still be in the sovereign's interest to curate a predictable business environment to ensure continued access to the benefits—such as air carrier services—that foreign investors provide because those investors always have the option to walk away from their investment.[230] Further, this Note argues that the investor-host state relationship is more complex than a zero-sum economic power balance game, and thus these policy proposals should also be considered in terms of their potential to create more dynamic and sustainable economic relations.

It can be a good thing for markets to legally permit sovereigns to conduct more self-interested monetary policy because the current investor-centric status quo incentivizes sovereigns to delay economic reform because of their exposure to currency risk.[231] A better allocation of currency risk liability amongst foreign investors and host states could encourage economic stabilization rather than destabilization. This is because—in addition to the host state having more discretion to stabilize its economy when it has less currency risk liability—foreign investors who are *not* insured against all currency risk will plausibly change their behavior in ways that mitigate their exposure to currency risk.

To mitigate currency risk under these proposed BIT changes, a foreign investor would take steps to reduce large foreign-currency-denominated deposit balances which—because of an increased risk of foreign exchange restrictions—–might otherwise lead to losses. This encourages the investor to spend down their deposit account balances in the foreign country where

---

[229] *See* MUNRO, *supra* note 13, at 39; *see, e.g.*, Kyla Tienhaara, *Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement*, 7 TRANSNAT'L ENV'T L. 229, 250 (2017) (highlighting how the investor-sovereign relationship is asymmetric and that IIAs have a chilling effect on sovereigns' capacity to implement domestic policy to deal with climate change).

[230] *See* Air Can. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/17/1, Award, ¶ 466 (Sep. 13, 2021); TREBILCOCK ET AL., *supra* note 6, at 11.

[231] *See* Masamba, *supra* note 203, at 125 (emphasizing that economic crises will be larger and recovery more painful if sovereigns are incentivized to put off economic adjustments because they are faced with the prospect of unsustainable debt payments).

they earned the money rather than leaving deposit balances idle and exposed. Therefore, these proposed changes would encourage firms to find ways to substitute spending they had been making under an international unit of account (such as the USD or Euro) with spending under the local currency unit of account. This would be stabilizing for an economy under pressure from capital flight because these new credit arrangements would not require settlement payments and—rather than requiring a stock of foreign exchange on hand—would merely require adjustments to the domestic-currency-denominated bank ledgers of the investor and its vendors.[232] Further, a sovereign that knows it is protected by a BOP safeguard exception provision, in the face of an impending financial crisis, will be more likely to take proactive action to mitigate economic losses—which has a stabilizing effect on the interrelated global financial system—rather than delaying and exacerbating inevitable losses because of legal considerations.[233]

More broadly, incentivizing this change in spending behavior could reasonably have a stabilizing effect on a sovereign's currency because more money would be turned over "in country" rather than flowing out of the country in large deposit conversions, which otherwise puts downward pressure on the currency.[234] This increased foreign investor spending would promote domestic stability and correspondingly promote international financial stability because it would create a more stable business environment by increasing business activity and reducing the risk of capital flight.[235] With less risk of being unable to settle foreign exchange obligations, sovereigns would have more policy space to pursue economic development which would further improve foreign investors' business prospects because of factors such as infrastructure improvements, supply chain capacity increases, and increased host state consumer demand.[236] Further, these proposed adjustments would have economically stabilizing value because they would encourage norms like collaboration and mutual support between foreign investors and sovereigns due to more closely aligned financial interests.[237]

---

[232] *See* SCHACHT, *supra* note 15, at 289 (noting that German policy limiting foreign exchange conversion—in addition to the policy of creating discounts for non-resident expenditures of Deutsch Marks—"gave the creditor countries an interest in buying as many goods as possible from Germany" and mitigated foreign creditor losses).

[233] *See* Masamba, *supra* note 203, at 125.

[234] *See* SCHACHT, *supra* note 15, at 290 (commenting on the "Mefo bill" system which encouraged businesses to settle accounts via credit arrangements rather than with cash as a way to increase business activity without creating inflationary pressure in a low foreign exchange environment).

[235] *Id*. at 289.

[236] *Id*. at 290; *see also* Syed, *supra* note 20 (emphasizing that Pakistan's external debt "is most difficult for us to service since it requires foreign exchange, [Pakistan] could create much more fiscal space by including domestic debt in the restructuring effort.").

[237] *See* SCHACHT, *supra* note 15, at 289.

Firms could also choose to hedge their increased currency risk by purchasing and selling options. This solution highlights that firms have the choice of paying for insurance rather than free-riding on the coattails of binding investment agreements. If insured firms faced currency losses related to their foreign investments then the sovereign would not have to take the losses inherent in exchange conversions–as they must under current BIT free transfer provisions–and neither would the firm.[238] Analogous to the stabilizing effects of deposit insurance reducing the risk of a bank run, insuring against currency risk would reduce foreign investors' tendency to demand conversion of foreign-currency-denominated deposits in times of heightened risk because they would not face currency losses.[239]

Overall, these proposed changes to BIT free transfer exception provisions would better align sovereign and foreign investor interests by forcing firms to proactively manage their exposure to currency risk as opposed to the free-riding status quo. This alignment of interests would promote domestic and international financial stability by limiting capital flight and encouraging foreign investors to spend more of their foreign-currency-denominated deposit accounts in the country where they invested rather than selling the deposits and putting downward price pressure on the foreign currency. Importantly, these proposed adjustments would mitigate asymmetric aspects of the sovereign-foreign investor relationship and could better achieve BITs' goal of promoting host state economic development. This Note argues that creating the legal space for countries to utilize exchange controls under BITs would reduce the risk of financial instability and incentivize a more risk-aligned and collaborative relationship between foreign investors and sovereigns.

VI. CONCLUSION

The *Air Canada v. Venezuela* arbitration ruling demonstrates how BITs impose constraints on state monetary sovereignty in ways that limit states' ability to take action in the face of financial crises. The Tribunal's holding and dicta analyzing the (in)applicability of the free transfer exception provision in the Canada-Venezuela BIT show how BITs effectively insure foreign investors against the currency risk inherent in their investments. This Note argues that free transfer requirements in BITs should contain exception provisions that allow states to retain sufficient monetary sovereignty to

---

[238] It is important to note that there is not a liquid foreign exchange market in every currency, especially developing country currencies. *See* Annina Kaltenbrunner et al., *A Structural Analysis of Foreign Exchange Markets in Sub-Saharan Africa* 31 (Eur. Inv. Bank, Working Paper No. 2022/11, 2022), https://www.eib.org/attachments/lucalli/economics_working_paper_2022_11_en.pdf.

[239] Anella Munro & Philip Wooldridge, *Motivations for Swap-Covered Foreign Currency Borrowing*, 3-4 (Bank for Int'l Settlements, Working Paper No. 52, 2009).

confidently enact exchange controls to stabilize their economies during times of financial distress.

The *Air Canada v. Venezuela* ruling demonstrates that even the minority of BITs that contain free transfer requirement exceptions are unlikely to help vulnerable countries like Venezuela avoid bearing all of the currency risk inherent in their foreign investors' deposit holdings. This case highlights how difficult it is for sovereigns to make distributional decisions during a financial crisis that a tribunal could ever interpret as non-discriminatory and equitable—and thus valid under a BOP safeguard or prudential regulation exception—under customary international law standards.

This Note argues that, in their current form, BIT free transfer requirements run counter to the policy goal of BITs to promote stable business environments because they distribute the burden of foreign investment currency risk entirely on the host state, which can plausibly *increase* international financial instability. Further, sovereigns without the ability to enact exchange controls will pursue less ambitious development policies because they know they are on the hook for unpredictable future foreign exchange liabilities. This chilling effect goes against the other primary purpose of BITs, which is to promote host state economic development.

This Note proposes two options for legal design changes to BIT free transfer requirements—both of which include BOP safeguard exceptions that tribunals must construe broadly—that would allow sovereigns sufficient policy space to enact exchange controls during times of financial distress. The legal proposals would help avoid rulings in line with the dicta in *Air Canada v. Venezuela*, under which a tribunal can paradoxically make a finding of fact that there is not a sufficiently serious BOP disequilibrium for an exception provision to apply despite the facts constituting clear evidence of a currency crisis. These proposals promote financial stability because they would provide sovereigns unambiguous discretion to compel foreign investors to fund debt denominated in the local currency.

Importantly, BIT free transfer exceptions should not encourage policies like Venezuela's decision to interminably delay $50 million of foreign exchange transfers and shut off communication with a foreign investor. Instead, this Note argues that sovereigns should be able to rely on BOP safeguard exceptions to temporarily restrict free transfers to stabilize their economies in times of crisis. This helps address the economic reality—which current BIT free transfer requirement provisions do not address—that developing countries must manage higher levels of currency risk because of their vulnerable position in the international monetary system.

Creating policy space for host states to enact exchange controls under BIT free transfer requirements would increase developing countries' monetary sovereignty and reduce international law's capacity to perpetuate unequal economic relations. This Note argues that this power shift would be a good thing because it would encourage more balanced and financially aligned

foreign investor-host state relationships and would create policy space for states to pursue financial stability and economic development.