Ahead of the Next International Financial Crisis: Contextualizing Sovereign Default and Proposing an Improvement to the Restructuring Process

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INTRODUCTION

Imagine living in a country where the economy is booming, capital is flowing in, and families are happy.[1] Now imagine waking up in the same place one year later and finding that, due to sovereign default, basic groceries cost five times the minimum wage, 93 percent of the country's population cannot afford food, over 90 people have been killed during demonstrations demanding international food aid, and hyperinflation has risen to 720 percent.[2] Unfortunately, this scenario is not only the story of Venezuela's suffering economy in 2017, but is the all too common, very dismal picture of many countries that have experienced default.[3] Worse yet is the fact that it can take fifteen

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1. *See* Rocio Cara Labrador, *Venezuela: The Rise and Fall of a Petrostate*, COUNCIL ON FOREIGN REL., https://www.cfr.org/backgrounder/venezuela-crisis (last updated Jan. 24, 2019).

2. Mercy Benzaquen, *How Food in Venezuela Went from Subsidized to Scarce*, N.Y. TIMES (July 16, 2017), https://www.nytimes.com/interactive/2017/07/16/world/americas/venezuela-shortages.html.

3. *See, e.g.*, Niki Kitsantonis, *Greece, 10 Years into Economic Crisis, Counts the Cost to Mental Health*, N.Y. TIMES (Feb. 3, 2019), https://www.nytimes.com/2019/02/03/world/europe/greece-economy-mental-health.html; Elizabeth Melimopoulos, *Argentina's Crisis: What Went Wrong and What Is Next*, AL JAZEERA (Sept. 16, 2018), https://www.aljazeera.com/news/2018/09/argentina-crisis-wrong-180914154523757.html; Laura Sullivan, *How Puerto Rico's Debt Created a Perfect Storm Before The Storm*, NPR (May 2, 2018, 7:10AM ET), https://www.npr.org/2018/05/02/607032585/how-puerto-ricos-debt-created-a-perfect-storm-before-the-storm.

years, if not more, for a country to resolve its default crisis and begin its path to recovery.[4]

In modern times, most sovereign lending is in the form of international and domestic unsecured bonds.[5] This means that the bonds are not backed or guaranteed by an asset, only by the full faith and credit of the issuer.[6] The current amount of outstanding international sovereign bonds is about $900 billion in U.S. dollars.[7] Between 1990 and 2016, the average amount of sovereign debt in default was approximately $280 billion, ranging from $140 to $490 billion in U.S. dollars in any given year.[8] Between 6 percent and 18 percent of all sovereigns were in default during this same period.[9] Despite the prevalence of sovereign borrowing and, naturally then, sovereign default, the process that follows a sovereign default is often unpredictably chaotic, time-consuming, and economically and politically damaging to the defaulting state.[10]

One of the main indicators of whether a system works well is to look at its success rate. In the default and restructuring context, the best indicator of success is that the participant only participates one time, and never revisits the system again.[11]

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4. *Argentina's Economic Crisis*, CONG. RESEARCH SERV. (Oct. 2, 2018), https://fas.org/sgp/crs/row/IF10991.pdf (discussing how the resolution of the 15-year long dispute with bondholders allowed Argentina to regain access to international capital markets).

5. Matthias Goldmann, U.N. Conference on Trade and Development, *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions*, 40 (Feb. 2012), https://unctad.org/en/PublicationsLibrary/gdsddf2012misc3_en.pdf.

6. *Unsecured Debt*, BLACK'S LAW DICTIONARY (Free Online Legal Dictionary 2d ed.).

7. U.N. Conference on Trade and Development, *Sovereign Debt Restructurings: Lessons Learned from Legislative Steps Taken by Certain Countries and Other Appropriate Action to Reduce the Vulnerability of Sovereigns to Holdout Creditors* (Oct. 26, 2016) [hereinafter *Sovereign Debt Restructurings*] (Side-Event of the Second Committee of the UNGA organized by UNCTAD).

8. DAVID BEERS & JAMSHID MAVALWALLA, BANK OF CAN., DATABASE OF SOVEREIGN DEFAULTS, 2017, TECHNICAL REPORT NO. 101, at 15.

9. *Id.* at 12 (This is calculated as the number of governments in default as a percent of all governments. In 2016 the total number of sovereigns globally was 214.).

10. *See, e.g.*, U.N. Conference on Trade and Development, *Sovereign Debt Workouts: Going Forward Roadmap and Guide*, at 12–14 (Apr. 2015) [hereinafter *Sovereign Debt Workouts*].

11. *See Process - Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics (last accessed Apr. 12, 2019) ("A fundamental goal of the federal bankruptcy

When applying this standard to the sovereign default restructuring and workout system, there are few success stories to speak of, as evidenced by the high number of countries that have defaulted repeatedly.[12] In the last twenty years, a substantial number of prominent sovereigns have defaulted, including most notably the countries involved in the Eurozone crisis, including Greece, Portugal, Ireland, the United Kingdom, Iceland, Spain, and Cyprus between 2008 and 2015[13], Argentina in 2001 and 2014[14], and Venezuela[15] and Puerto Rico[16] in 2017. In fact, over the last fifty years, more than half of all sovereign default restructurings were followed by another default by the same country within five years' time.[17] Now, it's 2020, and Argentina is teetering on default once again.[18]

Unfortunately, repeat defaults aren't unique to Argentina. Ecuador, Jamaica, Belize, and Greece[19] are all countries that have defaulted at least twice in the last twenty years.[20] Many of the issues mentioned above lead to cyclic patterns of default as the current sovereign default restructuring and workout process does not allow sovereigns to achieve sustainable economic stability, the main goal of bankruptcy and restructuring processes.[21] As we look ahead and prepare for the next inevitable

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laws enacted by Congress is to give debtors a financial 'fresh start' from burdensome debts.").

12. *See generally* BEERS & MAVALWALLA, *supra* note 8.

13. IRA W. LIEBERMAN, IN GOOD TIMES PREPARE FOR CRISIS 411 (2018).

14. Katy Watson, *Argentina Defaults for Second Time*, BBC NEWS (July 31, 2014), https://www.bbc.com/news/business-28578179.

15. *Venezuela in Selective Default, Says Credit Ratings Agency*, BBC NEWS (Nov. 14, 2017), https://www.bbc.com/news/world-latin-america-41982069.

16. Sullivan, *supra* note 3.

17. Martin Guzman & Joseph Stiglitz, *A Soft Law Mechanism for Sovereign Debt Restructuring*, DEVELOPING ECON. (Oct. 13, 2017), https://developingeconomics.org/2017/10/13/a-soft-law-mechanism-for-sovereign-debt-restructuring/.

18. Sam Meredith, *As 'Do-or-Die' IMF Talks Draw to a Close, Argentina Faces Prospect of Another Default*, CNBC (Feb. 18, 2020, 3:45 AM), https://www.cnbc.com/2020/02/18/argentina-on-the-brink-of-default-as-do-or-die-imf-talks-near-end.html ("Argentina is on the cusp of registering another devastating default, analysts have told CNBC, as international investors anxiously await the outcome of "do-or-die" debt restructuring talks.").

19. *See generally* BEERS & MAVALWALLA, *supra* note 8.

20. Rick Noack, *MAP: Greece Isn't the First Nation to Default on a Sovereign Debt*, WASH. POST (July 1, 2015, 10:53 AM), https://www.washingtonpost.com/news/worldviews/wp/2015/07/01/map-greece-isnt-the-first-nation-to-default-on-a-sovereign-debt/?noredirect=on&utm_term=.f5127daeff04.

21. *Process - Bankruptcy Basics*, *supra* note 11 ("A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial 'fresh

global financial crisis,[22] the international community needs to address why nations who default once are likely to default again and prevent this occurrence through the adoption of a sovereign default workout mechanism.[23]

This Note seeks to explore the issues with the current sovereign default and restructuring process. Part I briefly outlines the current sovereign default and restructuring process covering both important contract clauses and litigation. Part II compares the current array of contractual solutions including *pari passu* clauses, collective action clauses, engagement clauses, and trust structures. This Note concludes that none of these solutions will sufficiently fix the current sovereign default and restructuring process. Instead, more consideration should be given to the elimination of *pari passu* clauses, the uniform development of and submission to a model sovereign debt restructuring process, and the formation of one central neutral forum for debt renegotiation under the United Nations ("U.N.") that will adjudicate the default and restructuring workout process in a neutral, uniform, and orderly manner.

I. BACKGROUND: CURRENT ATTEMPTS AT CURING THE SOVEREIGN DEBT SYSTEM

A. GENERAL OVERVIEW AND IMPORTANT PARTIES

Sovereign debt is the term commonly used to refer to debt issued by national governments and fiscally autonomous territories.[24] Sovereign debt is a contractual obligation like other kinds of private debt, and default occurs whenever the sovereign does not honor the original terms of the debt contract.[25] When

start' from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision: [I]t gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

22. *See* Phillip Inman, *World Economy at Risk of Another Financial Crash, Says IMF*, GUARDIAN (Oct. 3, 2018 10:00 AM), https://www.theguardian.com/business/2018/oct/03/world-economy-at-risk-of-another-financial-crash-says-imf.

23. *See generally* Edward Kelly, Note, *Replacing Havoc: Creating Rules for Sovereign Default*, 64 CLEV. ST. L. REV. 1049 (2016).

24. BEERS & MAVALWALLA, *supra* note 8, at 1.

25. Eduardo Borensztein & Ugo Panizza, *The Costs of Sovereign Default* 1–2 (Int'l Monetary Fund Working Paper No. WP/08/238), https://www.imf.org/external/pubs/ft/wp/2008/wp08238.pdf.

sovereign default occurs, most commonly the creditors agree to extend the maturity on the debt, giving the sovereign more time to pay, or in more extreme circumstances, reduce the interest rate or outstanding principal.[26] A default results in harm to the sovereign's credit rating and credibility as well as lost revenue for the creditors, likely causing future borrowing costs for the sovereign to rise. When an agreement cannot be reached, creditors turn to litigation to enforce the debt instruments.[27] Because of the complexities involved in the differing venues, legal principles, jurisdictions, and debt contracts involved, the litigation process is often lengthy. A country that has defaulted often faces devaluation of its currency, exclusion from world markets in the form of new debt issuance restrictions, trade embargoes, high unemployment rates, and high inflation—all of which render the country both unable to pay off its creditors and unable to obtain any new sources of financing.[28] In addition, the defaulting government is often unable to continue funding many of its social programs to its citizens.[29] Overall, whether or not litigation occurs, sovereign default results in a very ad-hoc, unpredictable, and damaging restructuring process for the sovereign and its citizens, its creditors, and international financial markets.[30] The costs of default to a sovereign are so great that a country's first default often proves to be the start of a vicious cycle, driving the country back into default over and over again.[31]

One reason for this cycle of default is that the restructuring process is very disorderly and drawn-out, doing major damage to

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26. *See* Maximiliano Dvorkin et al., *Sovereign Debt Restructurings*, ECON. DYNAMICS (June 25, 2018), https://economicdynamics.org/meetpapers/2018/paper_1273.pdf ("Sovereign debt crises generally involve debt restructurings characterized by a mix of face-value haircuts and debt maturity extensions.").

27. Julian Schumacher et al., *Sovereign Defaults in Court* 27 (Eur. Cent. Bank, Working Paper Series No. 2135 Feb. 2018) ("In recent years, 50 percent of debt crises involved litigation, compared to less than 10percent in the 1980s and early 1990s. The claims under dispute have grown notably, from close to zero in the 1980s to an average of 3 percent of restructured debt, or 1.5 percent of debtor country GDP in the 2000s. Compared to corporate debt markets, these are large numbers. Indeed, we are not aware of many fields of law in which such a high share of disputed claims end up in court.").

28. Borensztein & Panizza, *supra* note 25, at 2.

29. Schumacher et al., *supra* note 27, at 24 (stating that litigating creditors regularly use legal strategies to block sovereigns from issuing or repaying debt through London or New York, thus undermining their access to credit markets).

30. Borensztein & Panizza, *supra* note 25, at 3.

31. *See* Kelly, *supra* note 23, at 1050.

the sovereign's reputation and resources in the meantime.[32] In the case of sovereign default, creditors cannot take control of the sovereign's assets or use them to pay off the outstanding debt.[33] Thus, creditors really only have two remedies: renegotiate the terms of the debt or litigate to get a better agreement that results in more money to the creditors than what was contemplated in negotiations.[34] When a sovereign defaults, there are no international treaties that govern the next steps, no court with explicit jurisdiction or expertise to oversee the restructuring process, and so far, no universal contractual solution.[35] As a result, there are significant issues with the sovereign debt restructuring process, including varying interpretations by courts of the contract provisions commonly contained in sovereign debt contracts, exclusion from international financial markets, expensive and time consuming litigation, inability to properly restructure the debt and regain stability in their economy, and holdout creditors—creditors that purchase enough of the outstanding sovereign debt to give them large enough voting power to stall negotiations until they get paid in full—delaying negotiations.[36]

The International Monetary Fund (the "IMF")[37] and the U.N.[38] are the most prominent global organizations with a role in the sovereign default system. The IMF is arguably the most impactful and recognized international powerhouse within the sovereign default landscape.[39] The IMF has 189 member-

32. *Id.* at 1050–51.

33. Umakanth Varottil, *Sovereign Debt Documentation: Unraveling the Pari Passu Mystery*, 7 DEPAUL BUS. & COM. L. J. 119, 121 (2008) ("Sovereigns rarely have assets situated outside their jurisdiction, making it cumbersome for creditors to recover meaningful judgments.").

34. Ronald J. Silverman & Mark W. Deveno, *Distressed Sovereign Debt: A Creditor's Perspective*, 11 AM. BANKR. INT'L L. REV. 179, 179 (2003).

35. *See generally* Mark C. Weidemarier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 51 (2013) (discussing some of the contractual solutions proposed).

36. Mark Koba, *Sovereign Debt: CNBC Explains*, CNBC (Oct. 14, 2011, 10:05 AM), https://www.cnbc.com/id/44771099.

37. *See generally IMF Lending*, INT'L MONETARY FUND (Feb. 25, 2019), https://www.imf.org/en/About/Factsheets/IMF-Lending [hereinafter *IMF Lending*]; *List of Members*, INT'L MONETARY FUND, https://www.imf.org/external/np/sec/memdir/memdate.htm (last updated Mar. 7, 2017) [hereinafter *List of Members*].

38. G.A. Draft Res. 15/12959, U.N. Doc. A/69/L.84, at ¶ 2 (July 29, 2015) [hereinafter *U.N. Sovereign Debt Principles*]; *Sovereign Debt Workouts*, *supra* note 10; *see generally Sovereign Debt Restructurings*, *supra* note 7.

39. *Sovereign Debt Workouts*, *supra* note 10.

countries to whom it lends money at the members' requests, typically in hopes of avoiding default and stabilizing the members' economies.[40] To become a member, countries must: (1) agree to the code of conduct found in the IMF Articles of Agreement; (2) pay a quota subscription; (3) refrain from restrictions on exchange of foreign currency; and (4) strive for openness in economic policies affecting other countries.[41] Many of the members have also agreed to certain, or all, of the articles in the IMF Articles of Agreement.[42] The IMF receives its funds from member countries through their payments of quotas.[43] Currently, the IMF has about 1 trillion U.S. dollars available for lending to its members.[44] Quotas are assigned to each member of the IMF based largely on its position in the world economy.[45] The IMF typically requires the member sovereign to agree to a program of economic policies before the IMF provides lending to ensure the best chance of avoiding default and achieving economic sustainability and stabilization.[46] The IMF does this through "policy conditionality" which sets forth the policy arrangement with the sovereign to the Fund's Executive Board

40. *IMF Lending*, *supra* note 37; *List of Members*, *supra* note 37; *see also* Christian Walter, *Debt Crisis*, MAX PLANCK ENCYCLOPEDIA OF PUB. INT'L L., § (C)(1)(a)(28) https://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1516?rskey=jfHI6Z&result=1&prd=MPIL ("Today, the most important function of the IMF is to provide loans to its members in order to help them overcome balance of payment problems.").

41. *Obligations and Benefits of IMF Membership*, INT'L MONETARY FUND, https://www.imf.org/external/np/exr/center/mm/eng/mm_bnfts.htm (last visited Feb. 28, 2020).

42. *See generally List of Members*, *supra* note 37 (listing the states that have signed the Articles of Agreement).

43. *Where the IMF Gets Its Money*, INT'L MONETARY FUND (Mar. 8, 2019), https://www.imf.org/en/About/Factsheets/Where-the-IMF-Gets-Its-Money.

44. *Id.*

45. *Id.*

46. *IMF Lending*, *supra* note 37 ("The IMF's various lending instruments are tailored to different types of balance of payments need as well as the specific circumstances of its diverse membership (see table). Low-income countries may borrow on concessional terms through facilities available under the Poverty Reduction and Growth Trust, currently at zero interest rates. Historically, for emerging and advanced market economies in crises, the bulk of IMF assistance has been provided through Stand-By Arrangements (SBAs) to address short-term or potential balance of payments problems. The Standby Credit Facility (SCF) serves a similar purpose for low-income countries. The Extended Fund Facility (EFF) and the corresponding Extended Credit Facility (ECF) for low-income countries are the Fund's main tools for medium-term support to countries facing protracted balance of payments problems. Their use has increased substantially in since the global financial crisis, reflecting the structural nature of some members' balance of payments problems.").

in a Letter of Intent and Memorandum of Understanding for approval by the IMF's Executive Board prior to giving the loan.[47] Given its understanding of, and influence over, its member countries during times of financial crisis, the IMF will be crucial to the adoption and implementation of any international sovereign default workout procedures, treaties, or laws.[48]

The U.N.'s Conference on Trade and Development ("UNCTAD")—a permanent intergovernmental body established by the United Nations General Assembly that supports the citizens of the 194 countries that make up the organization—assists developing countries with accessing the benefits of a globalized economy more effectively and focuses partially on aiding its member countries in limiting their exposure to financial volatility and debt.[49] Given its role within the U.N., the UNCTAD is another international body which has dedicated significant resources to recommending sovereign debt workout principles, and a sovereign debt workouts roadmap and guide in which the U.N. argues for a more orderly sovereign debt restructuring process, explored in more detail in the next sub-section.[50] Because of its research and publications on sovereign default, its influence regarding international matters, and the emphasis it has placed on creating a better workout mechanism since 2002, the U.N. will also be crucial to the development and implementation of an international sovereign default workout procedure. [51]

The G7, G8, and G20 meetings are also especially relevant in dealing specifically with financial crises, which often includes numerous sovereign defaults.[52] Given the member

47. *Id.*

48. Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L. REV. 977, 994 (2007).

49. *About UNCTAD*, U.N. CONFERENCE ON TRADE AND DEV., https://unctad.org/en/Pages/aboutus.aspx (last visited Feb. 28, 2020).

50. *See generally U.N. Sovereign Debt Principles*, *supra* note 38; *Sovereign Debt Restructurings*, *supra* note 7; *Sovereign Debt Workouts*, *supra* note 10.

51. Bodo Ellmers, *UN Committee Passes First Ever Set of UN Debt Restructuring Principles*, EURODAD (Aug. 12, 2015), https://eurodad.org/Entries/view/1546468/2015/08/12/UN-Committee-passes-first-ever-set-of-UN-debt-restructuring-principles.

52. Walter, *supra* note 40, §(C)(2); *see also Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts*, INT'L MONETARY FUND (Dec. 15, 2017), https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/15/pp113017third-progress-report-on-cacs [hereinafter *Third Progress Report*] (stating that the G20 was instrumental in the nearly universal adoption of CACs since October 2014).

industrialized democracies[53] and their influence within the IMF and the World Bank[54], the G7, G8, and G20 meetings provide an especially intriguing opportunity for the negotiation of and submission to a sovereign debt restructuring mechanism among the members and these two highly impactive financial institutions.[55]

B. SPECIFICS OF SOVEREIGN DEBT INSTRUMENTS

The *pari passu* clause is a boilerplate provision that is a part of nearly all sovereign debt instruments.[56] *Pari passu* is a Latin phrase which literally means "in equal step" or "equally."[57] The purpose of *pari passu* clauses has historically been to ensure creditors of the same class are treated equally, most notably with regards to payments made on the debt instruments.[58] While the meaning of these clauses in the corporate bond context is well-established as ensuring equal treatment of creditors in liquidation, its relevance and interpretation in the sovereign

53. Jaden Urbi, *The Difference Between G-7, G-8, and G-20 – and Why They Matter*, CNBC (June 8, 2018, 12:10 PM), https://www.cnbc.com/2018/06/08/difference-between-g7-g8-g20-world-economy.html (stating that Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States compose the G7 members, the addition of Russia composed the G8 members from 1998 until 2014, at which point Russia was kicked out after its annexation of Crimea, the addition of Argentina, Australia, Brazil, China, the European Union, France, Germany, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, and Turkey compose the G20 members).

54. *Third Progress Report*, *supra* note 52 (stating that The G20 called for the endorsement of CACs prior to October 2014 and were instrumental in the IMF's endorsement and influence).

55. Walter, *supra* note 40, § (C)(2) ("Although the results of all of these meetings are not legally binding, the G7/G8/G20 meetings are highly relevant in dealing with financial crises . . . . In fact, the Structural Adjustment Programs, which the IMF set up following the Asian crisis, were first discussed at the level of the G7.").

56. Zachary B. Kedgley-Foot, *Sovereign Debt Restructurings: More Options to Address Holdout Creditors*, 13 N.Y.U. J. L. & BUS. 885, 889 (2017) ("The pari passu clause is a boilerplate provision that appears in the back-end of most cross-border debt documents, repeated in deal after deal in many cases, probably by junior legal associates in the early hours of the morning without any particular attention being given to its intended or understood meaning."); *see also* William W. Braton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY 823, 824 (2004) ("[T]he obligations of the Guarantor hereunder do rank and will rank at least *pari passu* in priority of payment with all other External Indebtedness of the Guarantor, and interest thereon.").

57. Varottil, *supra* note 33, at 120.

58. *Id.*

bond context is still evolving.[59] *Pari passu* clauses in sovereign debt instruments were historically intended to place all debt issued or guaranteed by the sovereign debtor on the same level footing, without payment preference or priority among themselves.[60] In addition, *pari passu* clauses restricted the sovereign debtor from issuing debt that would be legally superior to the debt that contained the *pari passu* clause.[61] Because sovereigns rarely, if ever, took any action to change the ranking of their debt obligations after issuance, *pari passu* clauses were viewed as virtually meaningless boilerplate.[62]

More recently, however, *pari passu* clauses have unexpectedly evolved into very powerful clauses relieving creditors from difficulty in enforcing judgments against sovereign debtors.[63] This happened gradually, first in the case between Elliot Associates and Peru in the early 2000s. In this instance, the *pari passu* clause was interpreted to mean "a debtor, including a sovereign, must pay all creditors ratably when it makes a payment to any of the creditors."[64] This effectively prevented the sovereign from paying some creditors, like those who had agreed to the restructuring agreement, and not paying those that had refused to participate in the restructuring agreement—the holdout creditors. This chipped away at any incentive for creditors to accept a restructuring agreement. Then, in 2012 in New York, in the dispute between Argentina and NML Capital—the fund of holdout creditors who refused to accept the new Argentine bonds issued in place of the original bonds in default—Judge Griesa broadened this definition of *pari passu* clauses further, much to the surprise of the international finance community.[65] Judge Griesa enjoined Argentina from making payments to creditors on the new bonds issued in place of the old bonds as a result of its 2005 and 2010

59. Schumacher et al., *supra* note 27, at 8.

60. Natalie Wong, *NML Capital, Ltd. v. Republic of Argentina and the Changing Roles of the Pari Passu and Collective Action Clauses in Sovereign Debt Agreements*, 53 COLUM J. TRANSNAT'L L. 396, 400 (2015).

61. *Id.*

62. *The Pari Passu Clause and the Argentine Case*, ALLEN & OVERY (Dec. 27, 2012), https://www.allenovery.com/en-gb/global/news-and-insights/publications/sovereign-debt-and-eurozone-developments.

63. *See generally* Wong, *supra* note 60, at 396.

64. Varottil, *supra* note 33, at 121.

65. Alexandra Stevenson, *How Argentina Settled a Billion-Dollar Debt Dispute with Hedge Funds*, N.Y. TIMES (Apr. 25, 2016), https://www.nytimes.com/2016/04/25/business/dealbook/how-argentina-settled-a-billion-dollar-debt-dispute-with-hedge-funds.html.

restructurings, without making ratable payments to NML Capital on the original bonds that NML Capital still held as a result of holding out and refusing to participate in the restructuring negotiations.[66] This effectively did away with the widely accepted definition of *pari passu* clauses: that the *pari passu* clause is only breached if the sovereign takes legal measures to subordinate the outstanding debt containing the *pari passu* clause.[67] Now, after Argentina, *pari passu* clauses under New York law are breached if a sovereign makes any payment on any of its debts without a ratable payment of all the other debts containing a *pari passu* clause.[68] It is uncertain exactly how inventive judges will be in interpreting *pari passu* clauses in future cases, but so far the ever-expanding interpretations of *pari passu* clauses has resulted in exploitation[69] by holdout creditors and vulture funds—funds who "buy up defaulted debts at very low prices when a country is in economic distress and aggressively litigate to recoup the debt's full value."[70] As a result, the international community is increasingly fearful of the exploitation yet to come.[71]

Collective Action Clauses ("CACs") are one purported solution to the sovereign default system, most notably to the holdout creditor problem.[72] They were first widely adopted in New York-law bonds after Mexico adopted them in February 2003, with CACs appearing in nearly every bond issuance of New York-law bonds after 2003.[73] CACs allow for collectively

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66. Wong, *supra* note 60, at 398.

67. Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, BIS 121, 123–25, https://www.bis.org/publ/bppdf/bispap72u.pdf.

68. ALLEN & OVERY, *supra* note 62.

69. *See generally* Varottil, *supra* note 33, at 120 (stating that Pari passu clause was at issue in the historic dispute between Elliot Associates and Banco de la Nacion and the Republic of Peru in the early 2000s).

70. *Sovereign Debt Restructurings*, *supra* note 7.

71. *See id.* at 21 ("Concerns about holdout litigation have acquired urgency as a result of the proliferation and success of vulture funds and the growing recognition that vulture practices undermine countries' development efforts.").

72. Weidemaier & Gulati, *supra* note 35, at 54 ("As we write, some reformers even propose CACs as a solution to the woes of the U.S. municipal bond market.").

73. *Id.* at 57–65. (citing Prospectus Supplement, Federative Republic of Brazil 10.25percent Global BRL Bonds, p. S-27 (May 10, 2007) ("A modern clause reads something like this: If an event of default . . . occurs and is continuing, the holders of at least 25percent of the aggregate principal amount of the outstanding global bonds may . . . declare all the global bonds to be due and payable immediately . . . . The holders of 66 2/3percent or more of the

binding restructuring decisions.[74]

There are two types of CACs: Modification and Acceleration.[75] Modification CACs allow a defined percentage of bondholders to accept a restructuring proposal that would bind all bondholders.[76] Acceleration CACs prevent individual bondholders from being able to demand full payment after a default and instead require the affirmative vote of a stated percentage of the bondholders, typically a minority percentage, to prevent individual holdout creditors.[77] It is common for both types of CACs to appear in bond contracts together;[78] therefore, "CAC" for the rest of this Note refers to both types of CACs taken together. CACs were born out of the recognition that New York-law sovereign bonds gave each bondholder the contractual right to opt-out of restructuring, which opened the doors for holdout creditors to exploit this right and delay a restructuring that would benefit the bondholders as a whole.[79] CACs were also intended to lead to higher willingness by investors to accept a restructuring by relieving them of worry about holdout creditors getting a better deal.[80]

A large majority of the international community endorsed the idea of uniform adoption of CACs in sovereign debt instruments.[81] So far, CACs have been a key piece of the Eurozone's response to its crisis, as Eurozone leaders have mandated the use of a standardized CAC in all Eurozone bonds issued after 2012 with a maturity of more than one year.[82] There

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aggregate principal amount of the outstanding global bonds may rescind a declaration of acceleration if the event or events of default giving rise to the declaration have been cured or waived.").

74. *Id.* at 53; *see also* Jörn Kämmerer, *State Bankruptcy*, MAX PLANCK ENCYCLOPEDIA OF PUB. INT'L L. ¶ 20 (2009) https://opil-ouplaw-com.ezp1.lib.umn.edu/view/10.1093/law:epil/9780199231690/law-9780199231690-e1105?rskey=TrGrTr&result=1&prd=MPIL ("The most significant feature of CACs is that they allow a majority of bondholders to determine and amend the specific terms of payment or at least to prevent the minority from unilateral enforcement.").

75. Weidemaier & Gulati, *supra* note 35, at 53.

76. *Id.*

77. *Id.*

78. *See id.* at 54.

79. *Id.* at 53.

80. *Id.* at 54.

81. *See generally* Walter, *supra* note 40, at ¶ 47; s*ee also* Kedgley-Foot, *supra* note 56, at 886 ("Collective action clauses have been widely adopted by the market and have the official endorsement of the [IMF] and the International Capital Market Association.").

82. Weidemaier & Gulati, *supra* note 35, at 54–62.

have been mixed responses as to how effective CACs will be in the long run at reforming the sovereign default system.[83] In theory, CACs should lead to higher rates of restructuring agreements over litigation, less time to reach a restructuring agreement which means less time the sovereign is cutoff from international markets, and less expense.

Thus far, however, CACs have largely been used politically as a peacemaker rather than as a meaningful legal solution to the sovereign restructuring issue.[84] One of the most consistently cited issues with CACs is that they are only helpful in the restructuring of public debt which includes CACs, and CACs are not binding on bonds or other debt instruments issued without CACs included; in other words, they cannot be applied retroactively to bonds.[85] In addition, CACs operate only on an issue-by-issue basis, which may allow creditors to obtain a position within a certain series of bonds and prevent the operation of the CAC on that particular series of bonds.[86] One potential solution to this issue is to implement aggregated CACs which provide that approved restructuring proposals will be aggregated across multiple series of bond issuances in order to make it more difficult for a holdout to achieve a blocking position.[87] However, this is still only available if the aggregated CAC is present in the debt instrument of all the bonds in order to make it binding on them. As a result, it still does not provide for complete unanimity among bond issuances that do not include the aggregated CACs.

Creditor engagement clauses—also known as creditor committee engagement clauses—are clauses that allow a stated percentage of the creditors to elect a creditor committee to represent the interests of the creditors in the restructuring negotiations in an effort to facilitate a more orderly process.[88] These alternative contract provisions offer benefits to both sovereign issuers and creditors, and may significantly improve the sovereign debt restructuring process by imposing "a symmetrical obligation on both creditors and the debtor to negotiate in good faith, and to disclose relevant information;

83. Kämmerer, *supra* note 74, ¶ 20.

84. *See* Weidemaier & Gulati, *supra* note 35, at 81.

85. Walter, *supra* note 40, at ¶ 47.

86. *Id.*

87. Kedgley-Foot, *supra* note 56, at 892.

88. *See* Michael Waibel, *To Formalize or Not to Formalize: Creditor-Debtor Engagement in Sovereign Debt Restructurings*, 13 CAP. MKT. L. J. 454 (2018).

robust conflict of interest rules; and payment of [creditor committee] expenses by the sovereign only if the restructuring succeeds, and third-party adjudication."[89] These contract clauses were most common in the 1980s and early 1990s when it was common for sovereign debt to be held largely by commercial banks.[90] This meant that creditors were consolidated and easy to identify, and the idea of a bank advisory committee to represent the interests of the small number of commercial banks was more intuitive and manageable.[91] At that time, nearly all sovereign debt restructurings were achieved through meetings between the sovereigns and the bank advisory committees.[92] In the modern era, however, sovereign debt is largely in the form of bonds. These are traded internationally among many different types of bondholders, making the process of identifying and negotiating with all creditors after default a much larger challenge. Now, with the rise of both the frequency of litigation and the surprising breadth of power being given to creditors, the idea of creditor committees has presented itself as an attractive option once again for the successful restructuring of sovereign debt.[93]

As with CACs, the idea of creditor engagement clauses as a potential improvement to the sovereign default workout process has received widespread international support from the International Capital Markets Association ("ICMA"), the IMF, the U.N., and the Institute of International Finance.[94] However, despite the widespread recognition of their value, creditor engagement clauses have so far appeared in very few sovereign bond issuances.[95]

Another proposed solution to the sovereign restructuring issue, specifically the issue of holdout creditors, is the use of

89. *Id.* at 453.

90. Kedgley-Foot, *supra* note 56, at 905–06.

91. *Id.*

92. *Id.* at 906.

93. Waibel, *supra* note 88, at 453.

94. Kedgley-Foot, *supra* note 56, at 906–07 (citing PRINCIPLES CONSULTATIVE GRP., PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING (2013), https://www.iif.com/Publications/ID/3482/2013-PCG-Report-on-Implementation-of-the-Principles; *U.N. Sovereign Debt Principles, supra* note 38; DEBORAH ZANDSTRA ET AL., CREDITOR ENGAGEMENT IN SOVEREIGN DEBT RESTRUCTURING, at 3–5 (2016), https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2016/04/creditor-engagement-in-sovereign-debt-restructuring.pdf).

95. Kedgley-Foot, *supra* note 56, at 907 (citing ZANDSTRA, *supra* note 94, 3–5).

trust structures. Nearly all New York-law and English-law bonds are issued under a fiscal agency structure which provides that the administrative obligations of the issuer—distributing interest and principal payments to holders and relaying information to the bondholders—are entrusted to a fiscal agent who is an agent of the sovereign and owes no duties to the bondholders.[96] Bonds issued under a trust structure[97] differ by appointing a trustee to represent the bondholders, who (in general) owes fiduciary duties to the bondholders.[98] In this way, trustees are typically entrusted with the exclusive right to litigate against the sovereign debtor for breaches of the debt instrument, and the debt instrument will typically provide for the proceeds of the litigation to be shared equally among the bondholders, accomplishing in effect the same result as a modern interpretation of a *pari passu* clause.[99] This precludes creditors from holding out during the restructuring process by impeding their ability to litigate against the sovereign except for in specific circumstances.[100] In addition, this speeds up the restructuring process by centralizing the powers of the bondholders in one trustee and aggregating the voting process.[101]

It has been recognized, however, that creditors can still holdout if a trust structure is used in the absence of a CAC.[102] This is because holdout creditors can simply "holdout" until the restructuring is over, and then direct the trustee to litigate on their behalf because they will now hold the majority of the voting power.[103] Therefore, to effectively combat holdout creditors, trust structures must be used in conjunction with CACs to bind all creditors to the negotiated or litigated restructuring agreement. If used in the absence of CACs, trust structures would be ineffective at speeding up the restructuring process because bondholders would be hesitant to accept any restructuring agreement for fear that the holdout creditor will receive a much larger payout simply by holding out and

96. *Id.* at 893–94.

97. *Id.* at 894 (bonds issued under New York-law would be under a trust indenture and bonds issued under English-law would be under a trust deed, but they generally function the same way).

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 896.

103. *Id.* at 897.

instructing the trustee to litigate further on their own behalf.[104] However, when used with CACs, and especially aggregated CACs, bondholders will more likely accept the restructuring because it is binding on all bondholders, provided the required percentage of bondholders approve it.[105]

Despite the abundance of options aimed at minimizing litigation and, more specifically, holdout creditors, the number of sovereign defaults involving litigation is over 50 percent in recent years, compared to just 10 percent between 1980 and the early 1990s.[106] The amount of disputed claims has also grown from nearly 0 percent in the 1980s to an average of 1.5 percent of the sovereign's GDP in that same time.[107] This trend is largely due to the rise in holdout creditors and vulture funds, and the failure of the international market to properly address this issue.[108] In fact, since 2000, vulture funds have been the plaintiff in at least 75 percent of sovereign default litigation.[109] Because litigating creditors frequently take action to block sovereigns from issuing or repaying debt through London or New York, sovereigns' access to international financial markets is being cutoff at increasing rates.[110] The all-too-real consequences of creditor litigation is clearly recognized as both government officials and rating agencies now regularly factor in holdout risks as well as the threat and cost of litigation when considering their political and grading policy choices.[111]

C. CURRENT LAW AND PROPOSED STATUTORY FRAMEWORKS AND SOLUTIONS

Most sovereign debt is governed by New York or English law.[112] Much of the litigation that occurs as a result of sovereign

104. *Id.* at 894.

105. *Id.*

106. Schumacher et al., *supra* note 27, at 5.

107. *Id.* ("Compared to corporate debt markets, these are large numbers. Indeed, we are not aware of many fields of law in which such a high share of disputed claims end up in court.").

108. *Id.*

109. *New Solutions Needed to Tackle Mounting Sovereign Debt Crisis*, UN NEWS CENTRE (Oct. 26, 2016), https://news.un.org/en/story/2016/10/543852-new-solutions-needed-tackle-mounting-sovereign-debt-crisis-un-trade-and.

110. Schumacher et al., *supra* note 27, at 24.

111. *Id.* at 44–53.

112. Das et al., *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 41 (Int'l Monetary Fund, Working Paper No.

defaults takes place in New York.[113] However, unlike other types of bankruptcies in the United States which are governed by the U.S. Bankruptcy code,[114] there is not a single international treaty or international bankruptcy procedure to oversee the sovereign default and restructuring or workout process[115], though several have been proposed.[116] In addition, "[u]nder current practice, there is no comprehensive forum in which all sovereign debts may be restructured."[117] As a result, there is no universal international solution to sovereign default: one of the most frequently cited criticisms to the sovereign debt restructuring process.[118]

Sovereign debt is often compared to other types of public debt, most commonly corporate debt.[119] Like corporate debt, sovereign debt is typically made up of many different classes of bonds and debt instruments, all in default at once, making the task of identifying creditors and negotiating a restructuring agreement cumbersome.[120] Because of its similarities to corporate debt, the IMF,[121] the U.N., and much academic literature have recognized the value of modeling a sovereign

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WP/12/203, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf.

113. *Id.*

114. 11 U.S.C. chs. 7, 9, 11.

115. Kämmerer, *supra* note 74, at ¶ 6 ("Current international law is far from providing a comprehensive answer to State bankruptcy. No universally applicable treaty provision is specifically designed for it. Neither does universal public international law give the State debtor a tool for discharging its debts, nor is there a specific procedure to be followed (Dolzer [1989] 540). Even the European Union, whose national economies are more closely connected to each other than anywhere else on the globe, is, in principle, hostile to bailout obligations of its Member States or the Union.").

116. *See generally Sovereign Debt Workouts*, *supra* note 10.

117. *Id.* at 32.

118. Kämmerer, *supra* note 73, at ¶ 6 ("Current international law is far from providing a comprehensive answer to State bankruptcy. No universally applicable treaty provision is specifically designed for it . . . . Even the European Union, whose national economies are more closely connected to each other than anywhere else on the globe, is, in principle, hostile to bailout obligations of its Member States or the Union.").

119. *See* Susan Block-Lieb, *Austerity, Debt Overhang, and the Design of International Standards on Sovereign, Corporate and Consumer Debt Restructuring*, 22 IND. J. GLOB. LEGAL STUD. 487 (2015).

120. *See generally IMF Survey: IMF Supports Reforms for More Orderly Sovereign Debt Restructurings*, INT'L MONETARY FUND (Oct. 6, 2014), https://www.imf.org/en/News/Articles/2015/09/28/04/53/sonew100614a [hereinafter *IMF Survey*].

121. Anne O. Krueger, *A New Approach to Sovereign Debt Restructuring*, INT'L MONETARY FUND (Apr. 2002), https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf.

debt restructuring solution after Chapters 7 and 11 of the U.S. Bankruptcy Code to provide a single forum and set of rules governing the workout process, regardless of who issued the bonds or where they were issued, and regardless of who the bondholders are.[122]

The main criticism of drawing on corporate reorganization provisions when proposing solutions in the sovereign default context is that corporate reorganization provisions operate on the assumption that the alternative to any restructuring proposal is the liquidation of the corporate debtor, which is inapplicable to sovereigns.[123] This difference in risk is reflected in the difference in yields on sovereign bonds versus the yields on corporate bonds. The risk on all bonds is that the issuer will be unable to repay the bondholder. However, corporate bond risk comes from both market risk overall—the risk that market interest rates will increase, making the bonds outstanding at lower interest rates less attractive; this risk depends heavily on inflation rates and overall health of the economy—as well as corporation specific risk—the risk that the corporation will run into financial trouble and not be able to pay off its debts, which can include a consideration of the corporation's default history.[124] In the sovereign bond context, the yields reflect risks unique to the sovereign such as exchange rate risk, economic uncertainties, and political risks that could all lead to unforeseen default on the bonds.[125] Unlike corporations, sovereigns don't really go "bankrupt"[126] in that creditors typically do not just take control of and then sell the assets of the sovereign to hedge their losses.[127] In addition, creditors and courts in corporate bankruptcy enjoy specific powers over the

122. *Id.*; *see generally* U.N. Conference on Trade and Development, Sovereign Debt Workouts: Going Forward Roadmap and Guide (Apr. 2015), https://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf.

123. Krueger, *supra* note 121, at 11.

124. *See* Justin Kuepper, *What You Should Know About Sovereign Bonds*, THE BALANCE (last updated Oct. 8, 2019), https://www.thebalance.com/what-are-sovereign-bonds-1979114.

125. *See* Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1487 (2004) ("If a company fails to repay its debts, the business can be dismantled by the unpaid creditors. However, no parallel mechanism exists to force repayment by sovereign nations since no creditor has the ability to dismantle or liquidate a country.").

126. *See id.*

127. *But see* Maria Abi-Habib, *How China Got Sri Lanka to Cough Up a Port*, N.Y. TIMES (June 25, 2018), https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html.

corporate debtors that would be largely inapplicable in the sovereign context, such as the ability to restrict the activities of the debtor to safeguard creditor interests.[128] Sovereigns enjoy significant political and governmental powers that the courts cannot interfere with.[129] In this way, some have argued that sovereign debt is more reminiscent of United States municipalities and should be governed by a statutory solution like Chapter 9 of the U.S. Bankruptcy Code.[130] It has been argued that a solution based upon Chapter 9 may be the most applicable model because under Chapter 9 only the municipality, not the creditors, may commence proceedings and propose a reorganization plan, the bankruptcy court may not interfere with the municipality's assets or political or governmental powers, and a Chapter 9 proceeding cannot be turned into a liquidation proceeding.[131] However, unlike a sovereign, United States municipalities do not enjoy complete independence and control as they are subject to the powers of the U.S. federal government and the state within which they reside.[132]

Recognizing the above analyses, the IMF proposed the Sovereign Debt Restructuring Mechanism ("SDRM") in 2001,[133] incorporating some attractive features of Chapter 9 of the U.S. Bankruptcy Code.[134] The SDRM's main objective was to provide "a framework for the orderly, predictable, and rapid restructuring of debt problems in a manner that preserves value for the benefit of both the debtor and its creditors."[135] The Mechanism had the following four main principles: 1) majority restructuring—the ability for the affirmative vote for the

128. Krueger, *supra* note 121, at 11–12; s*ee also* United States Courts, *Chapter 9 - Bankruptcy Basics*, UNITED STATES COURTS (last accessed Apr. 12, 2019), https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics (emphasizing that the court is more active in managing corporate reorganizations under chapter 11 bankruptcies than in chapter 9, municipal bankruptcies, due to the sovereignty of the debtor in the chapter 9 context).

129. Krueger, *supra* note 121, at 13.

130. *Id.* at 12–13 ("In many respects, Chapter 9 of the United States Bankruptcy Code, which applies to municipalities, is of greater relevance in the sovereign context because it applies to an entity that carries out governmental functions.").

131. *Id.* at 13.

132. *Id.* at 14.

133. Anne Krueger, First Deputy Managing Director, IMF, *Address on A New Approach to Sovereign Debt Restructuring* (Nov. 26, 2001), https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp112601.

134. Krueger, *supra* note 121, at 12–13.

135. *Id.* at 14.

majority of creditors to bind a dissenting minority, 2) a stay on creditor enforcement, 3) protecting creditor interests, and 4) priority financing—providing for private creditors to finance the sovereign during the default workout process, similar to the idea of debtor-in-possession financing in a United States Chapter 11 Bankruptcy proceeding.[136] These principles serve to preserve the economic value of the debtor and thereby maximize the value of creditor claims[137] by facilitating "the orderly, predictable, and rapid restructuring of unsustainable sovereign debt, while protecting asset values and creditors' rights."[138]

The SDRM was proposed as an optional solution that the sovereign debtor could choose to invoke, and the creditors could not impose the mechanism if the debtor did not want it, allowing a restructuring agreement to be reached without it.[139] The idea was that it would act as a safety net in the very limited circumstances of when a sovereign's debt burden was unsustainable and financial viability could not be restored without significantly reducing the net present value of outstanding debt.[140] The SDRM attempted to incentivize countries with unsustainable debt burdens to address its borrowing issue promptly, while simultaneously disincentivizing default or misuse of the mechanism.[141] The SDRM recognizes both the IMF's role in providing financial support to sovereigns throughout the default process as well as the IMF's influence on the relevant parties.[142]

The SDRM argued that the most effective legal basis for the mechanism would be statutory rather than contractual due to the shortcomings of contractual solutions, most notably the fact that they are absent from, and therefore inapplicable to, already outstanding debt that will be part of all future defaults for the foreseeable future, as well as the fact that a contractual approach would require the parties to agree to the inclusion of it in all debt issuances.[143] In addition, it is unclear how this SDRM would function much differently, if at all, than collective action

136. *Id.*
137. *Id.* at 11.
138. *Id.* at 4.
139. *Id.*
140. *Id.*
141. *Id.* at 5.
142. *Id.*
143. *Id.* at 29–30.

clauses.[144] Finally, contractual solutions are often very short-term and unsustainable because of the demonstrated innovate nature of financial markets.[145] The IMF proposed that a statutory based solution could be implemented in one of two ways: 1) through adoption by legislation in each individual jurisdiction or 2) through a universal international treaty.[146] The IMF argued that an international treaty would be the best option because it would ensure uniformity of text and interpretation, prevent creditors from avoiding jurisdictions that have adopted the legislation, prevent hesitation of adoption out of fear that others would not adopt, facilitate the establishment of a single international judicial entity with exclusive jurisdiction over disputes among the debtor and its creditors, and oversee the restructuring and voting processes.[147] The IMF proposed establishing the treaty through an amendment to IMF's Articles which could be made binding upon all members of the IMF only if accepted by three-fifths of the members, having 85 percent of the total voting power.[148]

The SDRM was highly unsuccessful with roughly one-third of the votes against it, with both emerging markets and industrialized nations rejecting it alike,[149] though it continues to be debated in nearly all major discussions surrounding sovereign default workouts. Its main critics included the United States, many large banks and institutional investors, the Institute of International Finance, the Emerging Markets Traders Association, and many financial associations who not only severely opposed the proposal, but also actually threatened to sue their governments if the SDRM was adopted for fear it would violate existing contracts.[150] While there was a lot of opposition, some influential institutions such as the Economic Commission for Latin America and the Caribbean ("ECLAC"), UNCTAD, and NGOs working on international debt issues did support the proposal.[151] The SDRM's main criticisms were that it failed to address the asymmetric relations of power and was essentially

144. *Id.* at 30–31.
145. *Id.* at 33.
146. *Id.* at 33–34.
147. *Id.*
148. *Id.*
149. Aram Ziai, *The Rise and Fall of the SDRM Proposal in the IMF*, 6 HAMBURG REV. SOC. SCI., no. 3, 2012, at 1, 9 (noting that the SDRM was rejected by the Executive Board of the IMF in April 2003).
150. *Id.* at 8.
151. *Id.*

no more than a statutory, rather than a contractual, form of collective action clauses. One major issue with the SDRM, or any proposal that hopes to use an amendment to the IMF's Articles as its method of implementation, is that the U.S. holds 16.52 percent of the voting power,[152] and the U.S. has so far been a major opponent of a statutory solution to sovereign default workouts because proposals typically contain provisions that would violate existing bond contracts if adopted.[153]

Fourteen years later, with the same goal in mind—to create a more streamlined, effective sovereign default workout process—the U.N. approved the Basic Principles on Sovereign Debt Restructuring Processes (the "Basic Principles" or "Principles") in September of 2015.[154] In summary, this publication contained the following nine principles for debt restructuring processes: 1) The sovereign's right and sole discretion to design its macroeconomic policy, including restructuring its sovereign debt; 2) Good faith engagement in the restructuring process by debtor and creditor; 3) Promotion of transparency of the process and related data to enhance accountability of the parties; 4) Independence, elimination of corruption or conflicts of interest, and restraint from exercising any undue influence on the process or other actors on the part of of all institutions and actors involved; 5) Equitable treatment of creditors by the sovereign; 6) Sovereign immunity before foreign domestic courts regarding sovereign debt restructurings; 7) Legitimacy of the institutions and operations related to sovereign debt restructuring workouts; 8) Sustainability: timely and efficient workouts that respect human rights and lead to a stable debt situation, preservation of creditor rights, and sustainable growth and development; and 9) Majority restructurings: promotion of the use of collective action clauses and minority creditors that respect decisions approved by the qualified majority of creditors.[155] The goal of these Basic Principles was to begin a dialogue regarding further reform and

152. *IMF Members' Quotas and Voting Power, and IMF Board of Governors*, INT'L MONETARY FUND (last updated Mar. 20, 2020), https://www.imf.org/external/np/sec/memdir/members.aspx.

153. *See U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, HARV. INT'L L. J. BLOG (Sept. 20, 2015), http://www.harvardilj.org/2015/09/u-n-general-assembly-adopts-basic-principles-on-sovereign-debt-restructuring/ (noting the United States also voted against the U.N.'s proposal, favoring the idea of a contractual solution instead).

154. *See generally* G.A. Res. 69/319 (Sept. 10, 2015).

155. *Id.*

improvement of the sovereign debt restructuring process by causing these Principles to become generally known, supported, promoted, and adopted by member and observer states, international organizations, and all other relevant stakeholders.[156]

The Basic Principles, though not legally binding, were approved by 136 of the 193 total voting Members, with forty-two abstaining and six —the United States, Canada, Germany, Israel, Japan, and the United Kingdom—voting against the adoption of the Principles.[157] The high approval of the Principles suggests a near unanimous global recognition of the urgent need for sustainable solutions to the sovereign debt restructuring process.[158] While the near-consensus suggests that the global arena may be ready to finally adopt a universal solution, the countries that voted against the measure are countries representing main financial powers, which presents a major roadblock, or rather six major roadblocks, to the implementation of any solution in the near term.[159] The voting results illustrated a deep divide between developed and developing counties.[160] The objections suggest that the opposing countries fear the Principles will undermine the enforcement of contractual terms, infringe on preferred creditor status of international financial institutions, and favor the IMF—as opposed to the U.N.—as the future host of any discussions on this matter.[161] While countries can, and the U.N. argues should, incorporate these Principles in their legal systems, at the end of the day, the Principles are recognized even by those in favor of them as just ideals with no real power and that do little more than start a dialogue among Member nations.[162]

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156. *See generally id.*

157. G.A. Res. 69/319, *supra* note 154 (vote records available at https://digitallibrary.un.org/record/820120).

158. *See generally* G.A. Res. 69/319, *supra* note 154.

159. *See* Julieta Rossi, *Sovereign Debt Restructuring, National Development and Human Rights*, 23 SUR - INT'L J. ON HUM. RTS. 185, 191 (2016).

160. *U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, *supra* note 153.

161. *See id.* ("The United States, which voted 'no,' stated its objection to a 'right' to restructure sovereign debt and highlighted its concern that the principles may undermine the enforcement of contractual terms. The EU common position expressed reservations that the resolution did not adequately support the preferred creditor status of international financial institutions or the decisions of competent courts. It also noted that the IMF is the 'appropriate institution' to host such discussions.").

162. *See id.* (highlighting that South Africa, while speaking on behalf of the

Major obstacles to international treaty or statutory based solutions include the apparent: which institution would oversee the disputes, in what manner would it obtain jurisdiction over the sovereigns and the creditors, and how would the decisions be enforced. One institution that has been proposed is the U.N. in a model like the International Court of Justice (the "ICJ").[163] The ICJ is the main judicial organ of the U.N. and is located at The Hague in the Netherlands.[164] The ICJ was established in 1945 through the adoption of the U.N. Charter and Statute of the ICJ and has two official languages: English and French.[165] One of the ICJ's responsibilities is to give advisory opinions on legal questions from U.N. bodies and agencies, often servicing to promote norms to influence nonconsenting states, including the United States.[166] Its other responsibility is to, in accordance with international law, decide contentious cases—legal disputes between voluntarily participating countries.[167]

Only States Members of the United Nations and other States which have become parties to the Statute of the Court or which have accepted its jurisdiction may be parties to the contentious cases.[168] States can accept the ICJ's jurisdiction by one of the following: 1) entering into a special agreement to submit the dispute to the Court; 2) by virtue of a jurisdictional clause, i.e., typically, when they are parties to a treaty whereby one of them may bring the dispute to the Court; or 3) by statute, whereby each state has accepted the jurisdiction of the Court in the event there was a dispute with another State having made a similar assertion.[169]

States may institute proceedings in the ICJ either through the notification of a special agreement which can be done by either party and must indicate both the subject of the dispute and the parties thereto or by means of an application submitted

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Group of 77 developing countries and China "stated that the resolution serves as a good basis for future discussions").

163. *International Court of Justice*, MODEL UNITED NATIONS (last visited Mar. 10, 2019), https://outreach.un.org/mun/content/international-court-justice.

164. *Id.*

165. *Id.*; *e.g.*, *How the Court Works*, INT'L COURT OF JUSTICE (last visited Mar. 10, 2019), https://www.icj-cij.org/en/how-the-court-works.

166. *The Role of the World Court*, COLUM. L. SCH. (Sept. 17, 2013), https://www.law.columbia.edu/media_inquiries/news_events/2013/september2013/donoghue-world-court.

167. *See How the Court Works*, *supra* note 165.

168. *Id.*

169. *Id.*

by the applicant state against the respondent state and must contain, in addition to the names of the parties and subject of the dispute, the basis for ICJ jurisdiction over the matter. [170] The contentious cases include both a written and an oral phase, consisting of public hearings, before which the written pleadings are not made available to the press or the public.[171] The court deliberates after the oral proceedings and then issues its binding, unappealable judgment at a public sitting.[172] In the alternative, a case may be settled between the parties at any stage of the proceedings or be discontinued by one or both of the parties.[173] The idea of the ICJ, or a similar U.N. court, as the overseeing institution of sovereign default workouts is explored in more detail in Section II of this Note.

Despite the international attention paid to the shortcomings of the current sovereign default practice, very few new ideas or solutions have changed or improved sovereign default restructurings since the last financial crisis.[174] However, prominent financial and political international organizations have drawn attention to and proposed the above potential solutions to the current sovereign default problems. The remainder of this Note will explain why these proposed solutions are not adequate and will propose an improved solution.

II. ANALYSIS

A. WHY THE CURRENT COMBINATION OF OPTIONS IS UNSATISFACTORY

As mentioned above, the current combination of options to address holdout creditors largely consisting of *pari passu* clauses, CACs, trust structures, and engagement clauses is unsatisfactory to address the issues presented by sovereign default workouts. In fact, given that there is no structure, procedure, clause, or treaty which could force private debtholders to participate in or accept a debt restructuring agreement, holdout strategies are not only possible, they are encouraged, especially when a considerable amount of money is

170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *Sovereign Debt Workouts: Going Forward*, *supra* note 10, at 3.

at stake.[175]

After Peru and Argentina and the ever-expanding interpretation of *pari passu* clauses, holdout creditors are even further incentivized and empowered to holdout in expectation of full repayment of their bonds.[176] Even if *pari passu* clauses were to be eliminated or modified in all future bond issuances, they are still present in nearly all outstanding bonds, meaning they will continue to be an issue for sovereign debtors for a very long time, especially if courts continue to expand the clauses' meaning.[177]

Even the widespread adoption of CACs is not enough because the clauses cannot be applied retroactively to outstanding bonds without CACs. Even though CACs operate on an issue-by-issue basis, which allows creditors to easily obtain blocking positions within certain series of bonds, they still cannot provide for coordinated restructuring schemes involving all creditors.[178] Additionally, because CACs are contractual clauses, they are open to the same issues as *pari passu* clauses—the unpredictable and widely fluctuating interpretations of judges.[179] In fact, nearly all contractual solutions presented suffer from the same two main issues. First, any new adoptions will not apply retroactively to the current stock of approximately 900 billion dollars of outstanding international sovereign bonds.[180] Second, New York law governs more than half of international bonds and past decisions by New York judges have been more than favorable to holdouts.[181]

While the widespread adoption of engagement clauses is a good idea in theory, it does not guarantee a smoother restructuring negotiation process or the participation of all creditors. Holdout creditors could still opt to not participate or accept the restructuring, incentivizing none of the creditors to accept the restructuring.[182] Further, the adoption of engagement clauses suffer from many of the same criticisms as CACs, mainly that they will not apply retroactively. Also, the idea of creditor engagement clauses has been around for a very long time, and

175. Walter, *supra* note 40, ¶ 45.
176. Allen & Ovary, *supra* note 62, at 12.
177. Kedgley-Foot, *supra* note 56, at 889.
178. Weidamaier & Gulati, *supra* note 35, ¶ 50.
179. Walter, *supra* note 40, ¶ 47.
180. *Sovereign Debt Restructurings*, *supra* note 7.
181. *Id.*
182. Kedgley-Foot, *supra* note 56, at 892.

convincing creditors and sovereigns to include these in all sovereign bond issuances going forward could prove to be too daunting of a task given that it is uncertain whether they would impact sovereign debt restructurings in any significant way.[183] In addition, each sovereign default typically involves many creditors, all with different interests. It would be incredibly hard to establish, and efficiently utilize, a creditor committee for negotiations.[184] Overall, engagement clauses function more like an idealistic proposal that will do little more than foster similar negotiations as are occurring now between willing creditors and sovereigns, rather than the effective solution international financial markets need.

Finally, trust structures, used in conjunction with CACs to mandate the participation of all creditors and prevent holdouts, may present a viable solution that addresses the current litigation and holdout creditor issues with the sovereign default restructuring process. However, the use of trust structures would again only be applicable on a go-forward basis and would not apply to currently outstanding debt.[185] In addition, trust structures do not provide for a uniform sovereign default workout procedure, so would likely still result in a fractured, unpredictable workout process.[186] Further, trust structures do nothing to promote civility or good faith between creditors and sovereigns. When used with CACs, they effectively eliminate creditors' rights.[187] It is unlikely that the United States or other nations will support the use of trust structures as a solution given that they contribute to the lessening of creditors' rights, in a system that already greatly favors sovereigns.[188] In fact, trust structures, while utilizing a trustee who owes fiduciary duties to the bondholders, may worsen the negotiation and restructuring process for creditors because the sovereigns will face less threat of litigation, making the sovereign more likely to default earlier and less likely to offer a fair restructuring to creditors.[189] In effect, this makes the rate of recovery for the creditors even lower than may be optimal.[190] The hostility between creditors

183. *See id.* at 910.
184. *Id.* at 892.
185. *Id.* at 888.
186. *See id.* at 890.
187. *See id.* at 892.
188. *Id.* at 896.
189. *Id.* at 896–97.
190. *Id.* at 896.

and sovereigns that may be fostered by trust structures could spell disaster for the sovereigns by leading to even longer stretches of exclusion from international markets, higher interest rates, and a higher likelihood of defaulting again in the near-term. Overall, it is doubtful that trust structures, even if used with CACs, are an ideal solution.

There is no shortage of proposed solutions and ideas aimed at fixing the current sovereign default workout process. However, all the most widely adopted and supported ideas are aimed at solving one issue: holdout creditors.[191] This is not surprising given that the most discussed and best-understood issues with sovereign default workouts are both litigation and the inability to reach a restructuring agreement quickly and at a low cost. These are both magnified by the increasing frequency of both holdout creditors and vulture funds. However, nearly all the solutions attempt to, in various ways, take away any incentive to hold out and force any minority would-be holdouts into accepting a restructuring agreement that is best for most creditors.[192] These solutions are all incomplete. They all have flaws that, in one way or another, allow holdout creditors to either delay restructurings or create a new roadblock in the sovereign default workout process. An additional issue with these solutions is that even if they temporarily reduce the instances of holdout creditors, holdout creditors will likely find a way to creatively argue any number of the clauses contained in the debt instruments to continue to be successful.[193] The potential profit to be made as a holdout creditor is a large enough incentive for holdouts to continue to find ways to delay the restructuring process.

The proposed and implemented solutions to sovereign default restructurings have not changed since the last string of sovereign defaults.[194] Ahead of the next global financial crisis, the international community should be panicking given the lack of successful solutions to sovereign default restructurings and

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191. *Id.* at 885.

192. *Id.* at 892.

193. *Id.* at 889 ("While *pari passu* clauses can be reworded, the concern remains that distressed debt funds will continue to come up with creative interpretations to clauses buried in debt documentation in order to disrupt sovereign debt restructurings.").

194. *Sovereign Debt Workouts*, *supra* note 10, at 3 (noting key problems with current sovereign debt workouts are the fragmentation and lack of coordination largely due to the absence of an international forum dealing with the resolution of sovereign debt problems).

the increased power given to holdout creditors as a result of the dispute between Argentina and NML Capital.

B. OPPOSITION AND NEED FOR A SOVEREIGN BANKRUPTCY REGIME

One of the main reasons for the lack of universal international adoption of a sovereign default restructuring process is the difference between sovereigns' interests and those of the creditors. Mainly the idea that some favor contractual solutions, and some favor the idea of a universal international treaty or statutory solution.[195] There have been numerous forms presented, but none have received the level of political support needed for widespread adoption.[196] The lack of political urgency for adoption of a sovereign default restructuring mechanism is puzzling given the obvious shortcomings of the current system and the rise in litigation to nearly 50 percent of all sovereign defaults.[197] One of the more glaring statistics proving the severity of the absence of a sovereign default workout mechanism is the high number of serial sovereign defaults. Between 1978 and 2010, there have been 41 serial sovereign defaulters, with an average of four defaults per sovereign and an average of about three years between restructurings.[198] In other words, since 1970, more than half of all sovereign default restructurings were followed by another default within five years.[199] This is clear evidence that the current sovereign default restructuring process is not meeting the goals of sovereign default and restructuring—"to restore the sustainability of public debt with high probability"—and a universal sovereign default workout mechanism is needed.[200]

As evidenced by the failed proposals that largely aim to eliminate holdout creditors while giving little regard to the other issues of sovereign default, it is time for the international financial market to broaden its focus in fixing the sovereign

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195. *See* Rossi, *supra* note 159, at 191.

196. *See id.*

197. Schumacher et al., *supra* note 27, at 5 ("In recent years, 50 percent of debt crises involved litigation, compared to less than 10 percent in the 1980s and early 1990s.").

198. Tamon Asonuma, *Serial Sovereign Defaults and Debt Restructurings*, (Int'l Monetary Fund WP/16/66 Mar. 2016).

199. Guzman & Stiglitz, *supra* note 17.

200. *Id.*

default restructuring process. Most notably, more focus should be given to preventing a repetitive cycle of default by the sovereign. The consequences of default, including international financial market freezeouts, an increase in the cost of borrowing, and large amounts of both time and money associated with coming to a restructuring agreement, all significantly contribute to the cyclical nature of defaults.[201] This cyclical result is, at least in part, due to the fact that both the financial and political consequences of default incentivize sovereigns to avoid defaulting for as long as possible, with sovereigns even going so far as to service their debt at the expense of basic social programs for its citizens.[202] This leads to the persistence of both the well documented "too little too late" phenomena as well as the over-borrowing problem.[203]

C. ONE INTERNATIONAL BANKRUPTCY COURT IS THE BEST SOLUTION

There is only one option that would enable consistency, eliminate holdout creditors on already outstanding debt (effectively apply retroactively), and most importantly, create a predictable, orderly, and transparent solution to sovereign default. This solution is the creation of one International Bankruptcy Court. An International Bankruptcy Court is the best solution because it provides uniformity and predictability.[204] These principles will allow for lower interest rates both before and after default as creditors will know what to expect if default occurs.[205] In addition, an orderly workout

201. Kedgley-Foot, *supra* note 56, at 890.

202. Emma Graham-Harrison, *Hunger Eats Away at Venezuela's Soul as its People Struggle to Survive*, GUARDIAN (Aug. 26, 2017, 7:05 PM), https://www.theguardian.com/world/2017/aug/26/nicolas-maduro-donald-trump-venezuela-hunger; Fred Imbert, *Venezuela is Staying on Top of Its Debts, Even With its People Going Hungry*, CNBC (May 26, 2017, 7:20 PM), https://www.cnbc.com/2017/05/26/why-the-venezuelan-government-is-throwing-its-people-under-the-bus.html ("A default could lead to Venezuela being closed out of international markets."); Mariana Zuniga, *Barely Surviving: Amid Soaring Inflation, Life is a Daily Struggle in Venezuela*, NBC NEWS (Mar. 12, 2018, 5:09 AM), https://www.nbcnews.com/news/latino/barely-surviving-amid-soaring-inflation-life-daily-struggle-venezuela-n854746.

203. Molly Ryan, *Sovereign Bankruptcy: Why Now and Why Not in the IMF*, 82 FORDHAM L. REV. 2473, 2516–17 (2014).

204. *Id.*; *see also* Walter, *supra* note 40, ¶ 50 (noting current national courts, international courts, and international tribunals lack the clarity to act).

205. Ryan, *supra* note 203, at 2483 (noting that under the current system

process will lessen credit freezeouts and likelihood of serial default.[206]

There are two options for how to implement this proposed Court. The first option is that it could be done through an international treaty agreement among the IMF member sovereigns. The idea of a treaty-based solution is one that has long been endorsed by the IMF and the U.N., but it has historically been dismissed for its complexity, political costs, and the length of time it would take to implement.[207] However, just because these roadblocks may be legitimate, it doesn't necessarily mean this solution should be avoided. Sovereign default has been around since at least the fourth century BCE, and all the other attempted solutions at improving the process have failed thus far.[208] Meanwhile, the current amount of outstanding international debt is well above its 2008 levels,[209] and the sovereign default system is at its most fractured, unpredictable, and vulnerable given the alarming increasing rise in creditor litigation and power. The consequences of the messy ad-hoc system were on full display during the international financial crisis that started in 2008–09, and many, including the IMF, think we may be on the brink of another one, even more so because of the COVID-19 pandemic.[210] There have been countless failed attempts at making the sovereign default restructuring process more orderly, all the while refusing to come up with a treaty-based solution simply because it is too expensive, challenging, time consuming, and politically costly to do so. Given the potentially impending financial crisis as well as the increasing instances of litigation, now may finally be the

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the average interest rate is variable).

206. *Id.* at 2517 (noting a new solution should reduce deadweight costs associated with debt workouts).

207. *See generally IMF Survey*, *supra* note 120.

208. Ryan, *supra* note 203, at 2475.

209. Inman, *supra* note 22 ("The world economy is at risk of another financial meltdown, following the failure of governments and regulators to push through all the reforms needed to protect the system from reckless behavior, the International Monetary Fund has warned. With global debt levels well above those at the time of the last crash in 2008, the risk remains that unregulated parts of the financial system could trigger a global panic, the Washington-based lender of last resort said.").

210. *Id.*, Dan Mangan et al., *Coronavirus Pandemic Economic Fallout 'Way Worse Than the Global Financial Crisis,' IMF Chief Says*, CNBC (Apr. 3, 2020, 12:51 PM), https://www.cnbc.com/2020/04/03/coronavirus-way-worse-than-the-global-financial-crisis-imf-says.html ("The coronavirus pandemic has created an economic crisis 'like no other' — one that is 'way worse' than the 2008 global financial crisis.").

time to consider a treaty-based solution.

The second option for implementation would be through a model law approach, where a model law is proposed and then each individual jurisdiction enacts enact legislation following the model law.[211] There are several benefits of a model law approach as compared to a treaty-based solution.[212] A model law approach would provide flexibility in the drafting of the law which would allow each jurisdiction to tailor its legislation to meets its concerns and adequately protect its interests, and still provide for a more orderly sovereign default workout solution.[213] Secondly, while drafting a model law and getting sovereigns to adopt it may be challenging, because of this flexibility, it likely would not take as much time to negotiate as a treaty-based solution.[214] In addition, the ability for countries to modify and enact their own versions of the model law should allow for a better balancing of the widely differing interests and concerns between developed nations and developing nations. This should lead to a better chance of widespread adoption as compared to an international treaty. Finally, the model law of the country where the debt is issued is what should be enforced in the proposed International Bankruptcy Court, giving transparency to creditors in what law will be applicable in the event of default. Some drawbacks of a model law include the risk that not enough countries adopt it in any form, making it virtually worthless, as well as the possibility that countries will adopt the model law, but change it so much that the model law's intentions are lost. However, these issues can all be addressed.

First, to address the issue that not enough countries will adopt the model law, the drafting of it could take place at the G7, G8, or G20 meetings where the countries who, based on their respective voting histories, are most likely to be opposed to the adoption of it can negotiate and draft the model law, helping to ensure that they will eventually adopt the model law.[215] Next,

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211. *See* Joycelin Chinwe Okubuiro, *Harmonization as an Effective Tool Facilitating Synchrony Laws Governing International Trade*, 3(1) PYREX J. L. & CONFLICT RESOL. 1, 4 (2019) (describing model laws).

212. *Id.*

213. *See id.*

214. Ryan, *supra* note 203, at 2518 ("Perhaps the chief criticism to a treaty proposal is that achieving it would be difficult, if not impossible.").

215. *See generally* G.A. Res. 68/319, *supra* note 154; Rossi, *supra* note 159, at 191; *U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, *supra* note 153 ("The United States, which voted 'no,' stated its objection to a 'right' to restructure sovereign debt and highlighted its concern

the IMF could propose an amendment to its Articles that states that countries have a certain amount of time, such as two to three years, to draft and adopt some version of the model law in their respective jurisdictions, or they will no longer be members of the IMF. At that time, or sometime sooner when a certain majority of the members have adopted the model law, the U.N. would establish the International Bankruptcy Court. In order to be binding upon all members of the IMF, this amendment would need the affirmative vote of three-fifths of the members, having 85 percent of the total voting power.[216] The United States has over 15 percent of the total voting power,[217] so its support will be crucial, providing further support that the model law should be negotiated at a G7, G8, or G20 meeting where the United States can substantially contribute to its contents to assure its approval. Further, the United States has been very vocal that it favors an alternative solution to the sovereign default restructuring process over a treaty-based solution as the United States feels an alternative solution will better protect creditors' rights, so a model law approach will likely be favored over a treaty.[218]

Second, to address concerns that the adopted laws establishing the sovereign default workout mechanism in each respective jurisdiction will be too different or not encompass the proposed ideals, the amendment adopted by the IMF should contain provisions or principles that each member state's model law must contain in order for that country to gain access to the International Bankruptcy Court's jurisdiction. Alternatively, the International Bankruptcy Court could embody the mandatory ideals by making them procedural requirements or conditions to the approval of any restructuring plan.

Overall, the model law approach may be a better solution than a treaty-based approach given its flexibility, shorter time frame to implementation, and greater likelihood of adoption.

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that the principles may undermine the enforcement of contractual terms. The EU common position expressed reservations that the resolution did not adequately support the preferred creditor status of international financial institutions or the decisions of competent courts. It also noted that the IMF is the "appropriate institution" to host such discussions.").

216. Krueger, *supra* note 121, at 33–35.

217. *IMF Members' Quotas and Voting Power, and IMF Board of Governors*, *supra* note 152.

218. *See U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, *supra* note 153 (noting the United States also voted against the U.N.'s proposal, favoring the idea of a contractual solution instead).

D. MAIN PRINCIPLES OF REFORM

As identified by the U.N.[219] and the IMF,[220] sovereign default restructuring reform should, first and foremost, preserve sovereign immunity and the ability for sovereign states to design its restructuring plan and its macroeconomic policy.[221] This can be done through a policy written similar to that of Sections 903 and 904 of the United States Bankruptcy Code. Absent the sovereign debtor's consent, such a mechanism would prevent the International Bankruptcy Court from interfering with: (1) any of the political or governmental powers of the sovereign debtor; (2) any of the property or revenues of the sovereign debtor; or (3) the sovereign debtor's use or enjoyment of any income-producing property.[222] Second, it should preserve creditors' rights and focus on promoting fair treatment and engagement of all creditors to foster good faith between the parties and not allow for holdout creditors.[223] This could be done by requiring the sovereign to prove it filed the petition in good faith in order to be eligible for jurisdiction in the International Bankruptcy Court, similar to Section 921(c) of the United States Bankruptcy Code.[224] Third, the mechanism should aim for sustainability by completing restructuring negotiations in a timely and efficient manner that results in a stable and manageable debt level and management program for the sovereign to both prevent an increase in interest rates and decrease the probability of serial default.[225] Fourth, the mechansim should ensure a transparent process governed by an expert, impartial third-party body to promote fairness and equitable treatment of all stakeholders.[226]

The purpose of the International Bankruptcy Court should be to provide a financially-distressed sovereign state "protection from its creditors while it develops and negotiates a plan for adjusting its debts" to emerge from default with a sustainable debt level and economic outlook.[227] In addition, the International

219. *U.N. Sovereign Debt Principles*, *supra* note 38.
220. *See* Krueger, *supra* note 121, at 4.
221. *U.N. Sovereign Debt Principles*, *supra* note 38.
222. *See* 11 U.S.C. §§ 903–04 (1978).
223. *U.N. Sovereign Debt Principles*, *supra* note 38.
224. 11 U.S.C. § 921(c) (2005).
225. *U.N. Sovereign Debt Principles*, *supra* note 38.
226. *U.N. Sovereign Debt Principles*, *supra* note 38.
227. *Chapter 9 - Bankruptcy Basics*, UNITED STATES COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics (last visited Feb. 16, 2020).

Bankruptcy Court should limit its role to that of the United States Bankruptcy Court in a Chapter 9 proceeding. This would limit its role to (1) approving the petition, (2) confirming a plan of debt adjustment, and (3) ensuring implementation of the plan.[228]

E. IMPLEMENTATION AND FACTORS TO CONSIDER IN THE PROPOSAL

The sovereign default workout mechanism should be modeled after the United States Chapter 9 Bankruptcy Code, and the International Bankruptcy Court should be modeled after the ICJ, as well as the United States Bankruptcy Court. The U.S. Bankruptcy Code is well-regarded as meeting the four main principles of reform, and it systematically works extremely well.[229] In addition, the U.N. should oversee the International Bankruptcy Court. The IMF, while it has the expertise to do so, should not oversee the International Bankruptcy Court. This is because the IMF is often a creditor of defaulting sovereigns, so it would be impossible for the IMF to be completely fair and impartial as the overseeing body of sovereign restructurings.[230] On the other hand, the U.N. has both the expertise and the impartiality needed to oversee sovereign restructurings, especially given its role in establishing and maintaining the ICJ.[231] The ICJ, as discussed above, presents an ideal model upon which to base this International Bankruptcy Court. The ICJ currently cannot oversee current restructuring workouts between sovereigns and creditors because the ICJ does not have jurisdiction over the creditors as the creditors are not themselves states.[232] However, the ICJ could expand its jurisdiction over these matters.[233] This would be an ideal option because the ICJ already has procedures and resources in place, is run by the U.N., is independent, and has substantial experience in overseeing international affairs. The International Bankruptcy Court that this Note proposes could follow the operations and

228. *Id.*

229. *See id.*

230. *See* Gulati & Triantis, *supra* note 48, at 994.

231. *The Court*, INT'L COURT OF JUSTICE, https://www.icj-cij.org/en/court (last visited Feb. 16, 2020).

232. *How the Court Works*, *supra* note 165.

233. *Id.* (describing how the ICJ can enter into special jurisdiction agreements).

independence of the ICJ. However, its role would be more like that of the United States Bankruptcy Court—one that facilitates a restructuring, rather than renders a binding decision restricting the rights of the parties. While this International Bankruptcy Court would serve to interpret and settle disputes between the sovereign and its creditors, as much effort as possible would be geared toward the negotiation of a restructuring agreement that binds all creditors. In this way, this International Bankruptcy Court would provide one forum for sovereign default disputes, resulting in significantly more predictability and consistency in the interpretation of the applicable sovereign debt instruments.

Only the sovereign should be allowed to file for relief under the International Bankruptcy Court, and such filings should be optional. This is because about half of all sovereign default restructurings do not move to litigation in the negotiation of a restructuring agreement with creditors, as they are negotiated by the parties without the assistance of any court.[234] Therefore, to have the assistance of the International Bankruptcy Court be automatically invoked by default or by the creditor when the sovereign deems it unnecessary may actually result in a more inefficient process by inserting unwanted procedural requirements into the negotiation process. The purpose of the proposed International Bankruptcy Court would be to provide the sovereign state relief in the form of a fresh-start and a sustainable debt level. Therefore, since the proposed Court would exist mainly for the sovereign's benefit, only the sovereign should be able to seek relief in the International Bankruptcy Court.

To seek relief under the International Bankruptcy Court, the sovereign should be required to meet the following four requirements: 1) the sovereign must be specifically authorized to be a debtor by its own law; 2) the sovereign must have defaulted on its debt; 3) the sovereign must desire to effect a plan to adjust its debts; and 4) the sovereign must meet one of the following: a) already obtained the agreement of creditors holding at least a majority of the outstanding debt, b) already negotiated in good faith with creditors and failed to obtain the agreement of creditors, c) is unable to negotiate with creditors because such negotiation is impracticable, or d) reasonably believe that a

234. Schumacher et. al, *supra* note 27, at 5.

creditor may attempt to obtain a preference.[235]

Once relief is sought under the proposed International Bankruptcy Court by the sovereign, the Court should be the sole jurisdiction for a workout negotiation and should preempt any litigation by creditors in any other court while proceedings are still ongoing in the International Bankruptcy Court. Creditors should only be allowed to litigate outside of the International Bankruptcy Court if the sovereign does not seek relief under the International Bankruptcy Court or if a plan has already been approved by the International Bankruptcy Court, but the sovereign refuses to abide by it. If a sovereign does not abide by the approved plan, then creditors should be allowed to bring suit in the International Bankruptcy Court to seek rescission of the plan. The creditors should then be allowed to litigate outside of the International Bankruptcy Court much like they would today, and the sovereign shall be precluded from using the International Bankruptcy Court for a certain amount of time thereafter. This should provide enough incentive for the sovereign debtor to comply with and implement the restructuring plan. Because the International Bankruptcy Court would be limited in its powers to interfere with the property or operations of the sovereign, there are few, if any, other options for implementation of the restructuring plan.

In addition, the International Bankruptcy Court, as a condition to its approval of the plan, should inquire into the likely economic status of the sovereign following implementation of the restructuring plan. The IMF, given its position in evaluating the economic policies and positions of its members, would likely be in the best position to assess this. While the IMF should not oversee the proceedings due to conflict of interest concerns, serious consideration should be given to the idea of bringing in the IMF as an independent expert to evaluate the likely effects of the restructuring plan prior to approval by the International Bankruptcy Court. This would assist the proposed Court in its goal of giving the sovereign a chance at a sustainable economic emergence from default.

Finally, the International Bankruptcy Court should follow the cram-down provisions of Chapter 11 of the United States Bankruptcy Code to solve the holdout creditor issue and make the restructuring agreement binding on all the creditors.[236] The

235. *See* 11 U.S.C. § 109(c) (2010) (these factors are based on the factors outlined for municipalities in Chapter 9 of the United States Bankruptcy Code).

236. 11 U.S.C. § 1129(b) (2010).

cram-down provisions of Chapter 11 of the United States Bankruptcy Code allow for the United States Bankruptcy Court to approve a plan if at least one impaired class of creditors has accepted the plan.[237] Once one impaired class of creditors accepts the plan, the plan may become binding on all other classes of creditors.[238] While typically each class of creditor whose rights are being impaired by the plan are required to approve it, the cram-down procedure would allow the proposed International Bankruptcy Court to accept a plan, even if not all classes of creditors affected by it have accepted the plan. It is likely that, by eliminating the potential for holdout creditors and incentivizing creditors to accept the plan, a cram-down provision would likely be the most impactful portion of any adopted sovereign default workout mechanism, and therefore, also the most controversial and heavily negotiated section of any adopted mechanism.

F. CONCERNS WITH THE PROPOSAL

The main issue with this proposal will be the political cost of approving and implementing it. Many of the IMF member countries' concerns with both the U.N. Basic Principles and the IMF's SDRM will apply to this proposal as well.[239] Most pressing is the fear of infringing on existing contracts and creditor rights, which are likely to be the biggest inhibitor to any solution.[240] However, given the positive correlation between the increased adoption of CACs and the increase in both the claims and the instances of sovereign default litigation, it may be time for the U.S. and other opponents of a solution to abandon the unwavering position that contractual solutions are superior to any other possible solution. At the very least, this correlation

237. *Id.*

238. *Id.*

239. *See* G.A. Res. 69/319, *supra* note 154; Rossi, *supra* note 159 at 192; *U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, *supra* note 153 ("The United States, which voted 'no,' stated its objection to a 'right' to restructure sovereign debt and highlighted its concern that the principles may undermine the enforcement of contractual terms. The EU common position expressed reservations that the resolution did not adequately support the preferred creditor status of international financial institutions or the decisions of competent courts. It also noted that the IMF is the 'appropriate institution' to host such discussions.").

240. *U.N. General Assembly Adopts "Basic Principles" on Sovereign Debt Restructuring*, *supra* note 153.

certainly serves to discredit the position that an international treaty-based solution or model law approach should be sacrificed in favor of ad-hoc contractual solutions for fear that creditors and contractual rights will be impaired. This Note is not arguing that the increased prevalence and array of contractual solutions in sovereign debt instruments has caused an increase in litigation. However, the correlation between these events cannot be ignored any longer.

Another significant issue is the implementation of any plan adopted by the International Bankruptcy Court, given the Court's inability to infringe on the rights or operations of the sovereign. However, two key powers the court should possess should serve well to greatly influence the sovereign's cooperation with the plan. First, the Court could give creditors the right to litigate. Second, the Court could restrict the sovereign's access to seek relief in the court if it violates a restructuring plan without good cause, a devastating punishment for a sovereign with few options for relief. In addition, the IMF can currently refuse to lend money to a member for virtually any reason, and could extend that right to circumstances when a sovereign violates a restructuring plan without good cause, leaving the sovereign with basically zero hope of financial relief.[241] Overall, even though the court cannot infringe on the rights and operations of a sovereign, there are many powerful factors which make the sovereign's implementation and cooperation likely.

CONCLUSION

Looking ahead to the next string of sovereign defaults, the international finance community should be greatly concerned about the lack of innovation and progress made in improving the sovereign default workout process since the last global financial crisis. Sovereigns still suffer from great political and economic costs of default. Citizens of defaulting sovereigns are increasingly facing terminated social programs, currency issues, and are suffering. The creditors are growing increasingly dissonant, facing something of a prisoners' dilemma when deciding whether to negotiate and accept a restructuring agreement or to go to court. Global financial markets continue

241. *See IMF Lending*, INT'L MONETARY FUND, https://www.imf.org/en/About/Factsheets/IMF-Lending (last visited Feb. 16, 2020).

to suffer from the costs of an imperfect and inefficient system that has ripple effects difficult to even quantify. Overall, *pari passu* clauses, CACs, engagement clauses, trust structures, and litigation have so far failed to provide any improvement to the sovereign debt restructuring process. This is likely due, at least in part, to the current solutions' sole focus of eliminating holdout creditors, without addressing the other consequences of sovereign default.

Overall, the best solution will be to establish one International Bankruptcy Court through either an international treaty or a model law approach among the IMF member sovereigns. This court should be overseen by the U.N., not the IMF. While it may be a political chess match to negotiate and implement either a treaty agreement or a model law among the IMF member sovereigns, it should certainly be a quicker, more reliable, and superior solution than waiting for all $900 billion of outstanding sovereign debt to expire or be renegotiated and then hope that (1) CACs are uniformly present in all the debt contracts, (2) the judges interpret the CACs in a consistent manner, and (3) CACs reduce the frequency of both holdout creditors and sovereign default litigation. While it would not easy to negotiate and implement a model law establishing an International Bankruptcy Court like the one proposed, with the united endorsement of the members of the G20, the IMF, the World Bank, and the U.N., it should certainly be possible, especially given their influence over international financial markets and member states.