UvA-DARE (Digital Academic Repository)

Sovereign Debt Restructuring: A Contract Theory Perspective

Chukwu, F.

DOI

[10.2139/ssrn.2800924](https://doi.org/10.2139/ssrn.2800924)

Publication date

2016

Document Version

Final published version

[Link to publication](#)

Citation for published version (APA):

Chukwu, F. (2016). *Sovereign Debt Restructuring: A Contract Theory Perspective*. Paper presented at Fifth Biennial Conference, Johannesburg, South Africa.
<https://doi.org/10.2139/ssrn.2800924>

General rights

It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations

If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: <https://uba.uva.nl/en/contact>, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

Society of
International
Economic
Law

Online Proceedings
Working Paper No. 2016/12

**FIFTH BIENNIAL GLOBAL CONFERENCE
JULY 7-9, 2016
SCHOOL OF LAW AND MANDELA INSTITUTE
UNIVERSITY OF THE WITWATERSRAND**

**Sovereign Debt Restructuring: a Contract Theory
Perspective**

**FRANCIS CHUKWU
UNIVERSITEIT VAN AMSTERDAM/CLIFFORD CHANCE EUROPE**

June 27, 2016

Published by the Society of International Economic Law

This paper can be downloaded free of charge from:

<https://ssrn.com/link/SIEL-2016-Johannesburg-Conference.html>

Sovereign Debt Restructuring: a Contract Theory Perspective

Francis Chukwu*

June 2016

Table of Contents

(A)	Introduction.....	3
(B)	The Contractual Approach: A Checkered History of Success?	4
(C)	Challenges of the Contractual Approach	4
	(i) Holdout litigation	4
	(ii) Vulture Culture.....	6
	(iii) Incomplete Restructuring	8
(D)	Collective Action Clauses as the Contractual Approach Response	10
	(i) A Brief Introduction to Pari Passu and Collective Action Clauses.....	11
	(ii) The Limitations of Collective Action Clauses	12
(E)	The ICMA and European Union Innovations.....	13
	(i) The ICMA Model Collective Action and Pari Passu Clauses.....	13
	(ii) The EA Model Collective Action Clause	16
	(iii) Expected Positive Impacts	19
	(iv) The Limitations of the ICMA and European Union Innovations	21
(F)	The Contract Theory Paradigm	24
	(i) A View from the Lens of Contract Theory.....	24
	(ii) The Footprint of Classical Contract Theory.....	24
	(iii) Should there be a Shift in Theoretical Approach?	26
	(iv) What Course for an Alternative Contract Theory?	26
	(v) Questions for an Alternative Contract Theory.....	28
(G)	Conclusion	30

* LLB (Nigeria); LLM (NYU); Finance and Capital Markets Lawyer, Clifford Chance Europe LLP; PhD Candidate, Universiteit van Amsterdam.

Abstract

The story of sovereign debt restructuring has been one mixed fortunes. While sovereign debt restructuring based on contractual approach has shown remarkable success, certain challenges (particularly holdout disruption) continue to beset it. Market players and other stakeholders in international finance have made some efforts to contain these challenges. However, they do not appear to have been laid to rest.

Recent history of sovereign debt restructuring appears to show that these challenges are rooted in a classical theoretical approach to sovereign debt restructuring. But, remedies and proposals to contain them have been sought almost exclusively from positive law (by positive law I refer to the bare body of man-made laws consisting of codes, regulations, and statutes enacted or imposed within a political entity such as a state or nation and stripped of underlying theoretical legal norms). The pith of this paper is to present an alternative way of looking at contractual sovereign debt restructuring – legal (contract) theory.

This perspective from contract theory presents an alternative approach to sovereign debt restructuring based on a theoretical enquiry into the contractual relationships that underlie sovereign debt transactions. This enquiry should lead to a formulation of normative principles of sovereign debt in context; and from these principles positive rules of law may be extrapolated to address issues arising from sovereign debt restructuring, based on the product of the enquiry. This is in contrast with the current approach to contractual sovereign debt restructuring where barefaced ex ante positive law of contract (mostly domestic) is applied to sovereign debt restructuring with little or no regard as to whether the legal norms that inform the positive law also underpin the sovereign debt relationship.

Key words

Sovereign debt; sovereign debt restructuring; contract theory; collective action clause; contractual approach; ICMA.

(A) Introduction

There are two generally acclaimed approaches to sovereign debt¹ restructuring. The first is the so-called "public law" or "statutory" approach. The public law approach sees, in the practice of sovereign lending and borrowing concepts, ideals, and practices that appear to have crystallized into norms and then seeks to create a body of positive laws for sovereign debt restructuring using these norms. Examples of the public law approach include the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the International Monetary Fund (IMF)² and the United Nations (UN) General Assembly (UNGA) Resolution 68/303 (towards the establishment of a multilateral legal framework for sovereign debt restructuring processes).³ The second is the so-called "contractual approach". The contractual approach applies the law of contract to the bargain struck by the sovereign debtor and the creditor and allows the debtor and creditor to agree the terms of the debt restructuring contractually and outside any formal statutory structure.

A point of departure for this paper is that sovereign debt restructuring (at least looking back from recently recorded history⁴) has always been contractual.⁵ The public approach therefore exists only to the extent that public law-centered proposals have been advanced as alternatives to the contractual approach because of seemingly intractable challenges encountered in contractual sovereign debt restructuring.

This purpose of this paper is not to address the merits or demerits of the public law approach; rather, this paper aims to examine the challenges of the contractual approach, evaluate the responses of stakeholders in international finance to these

¹ The term "sovereign debt" as used in this paper refers to external sovereign debt, for the apparent reason that it is the restructuring of external debt that presents the critical challenges to contractual sovereign debt restructuring, particularly as discussed in this paper. Further, the restructuring discussed in this paper is the restructuring of private (rather than official debt) for the reason that bilateral debt are typically dealt with under the Paris Club arrangements, while multilateral debt obligations are typically not subject restructuring because of acclaimed preferred creditor status of the multilaterals.

² See ANNE O. KRUEGER, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING (International Monetary Fund, 2002).

³ GENERAL ASSEMBLY OF THE UNITED NATIONS, RESOLUTION NO. A/RES/68/304, available at <http://www.un.org/en/ga/68/resolutions.shtml> (accessed on June 16, 2016).

⁴ See, for instance, Udaibir S. Das, Michael G. Papaioannou, and Christoph Trebesch, *Sovereign Debt Restructurings 1950 – 2010: Literature Survey, Data and Stylized Facts*, IMF WORKING PAPER WP/12/203 (2012); Tamon Asonuma, *Serial Sovereign Defaults and Debt Restructurings*, IMF WORKING PAPER, WP/16/66 (2016); Juan J. Cruces and Christoph Trebesch, *Sovereign Defaults: The Price of Haircuts*, 5(3) AMERICAN ECONOMIC JOURNAL: MACROECONOMICS 85, 93 -94 (2013); Federico Sturzenegger and Jeromin Zettelmeyer, *Haircuts: Estimating Investor Losses in Sovereign Debt Restructurings, 1998 – 2005*, IMF WORKING PAPER WP/05/137 (2005); Michael Tomz & Mark L.J. Wright, *Empirical Research on Sovereign Debt and Default*, 5(1) ANNUAL REVIEW OF ECONOMICS, ANNUAL REVIEWS (2013); and Bank of Canada, *Database of Sovereign Defaults, 2015*, <http://www.bankofcanada.ca/wp-content/uploads/2015/05/crag-database-update-04-05-15.xlsx> (accessed on June 16, 2016).

⁵ Although contractual terms, particularly CACs, have been widely used synonymously with and as representing the "contractual approach", and although the analysis for purposes of this paper largely follows that pattern, contractual sovereign debt restructuring includes any approach to sovereign debt restructuring using express or implied terms of the debt contract, based on the law of contract or other applicable law, and the negotiation of which is left to the parties to agree rather than imposed by some statutory or other public law rules.

challenges, and proffer a paradigm shift in the contractual approach based on contract theory.

(B) The Contractual Approach: A Checkered History of Success?

Certain indicators measure the success of a contractual debt restructuring, particularly the rate of creditor participation, the amount of haircut or creditor recovery rate, the implementation rate (i.e. whether the restructuring terms were successfully implemented or the country had to undergo yet another or other rounds of restructuring(s) on the same restructured debt), and time and cost of market re-access (i.e. how soon after the restructuring and at what cost was the country able to re-access the international capital markets for credit).

After analyzing the available studies and data on restructuring of sovereign debt, Udaibir S. Das, Michael G. Papaioannou, and Christoph Trebesch report that the Bank Advisory Committee/Creditor Committee restructurings can be regarded as a successful debt restructuring vehicle, as the 1980s and 1990s saw more than 100 debt restructurings under the London Club umbrella implemented without major hurdles or conflict. The authors also found that most recent bond exchanges (the history of bond exchanges has, in fact, been recent) were implemented quickly and without severe creditor coordination problems. Since 1998, only 2 out of 17 bond exchanges had a share of hold-outs exceeding 10 percent of the debt. Similarly, protracted creditor litigation in the context of bond restructurings has been rare, with the exception of Argentina's default after 2001. Overall, the system of ad-hoc debt exchanges seems to have worked reasonably well for emerging market countries, and the authors recommend that these experiences may prove useful to any distressed sovereign, including advanced economies.⁶ Private debt restructurings, despite not having the benefit of an institutionalized mechanism (like the Paris Club official debt treatment), has had a remarkable degree of success.

(C) Challenges of the Contractual Approach

The contractual approach, in spite of the considerable success it has recorded over the years, has also been beset by certain challenges. Notable among these challenges are: (i) holdout litigation; (ii) the 'vulture culture'; and (iii) 'incomplete restructuring'. I will briefly discuss these challenges in this section and reactions to them in the next section.

(i) Holdout litigation

The problem of holdout litigation and its disruptive impact on sovereign debt restructuring is well documented in the literature of international finance.⁷ For

⁶ See Das, Papaioannou, and Trebesch, *Sovereign Debt Restructurings 1950 – 2010: Literature Survey, Data and Stylized Facts*, *supra* note 4, at 19, 96.

⁷ I am also aware of some literature that extol certain perceived usefulness of holdout creditors and holdout litigation, but, on the balance of available evidence, I am of the view that holdout creditors and holdout litigation do more harm than good, and constitute a (in fact "the") major contemporary challenge to successful contractual restructuring of sovereign debt.

brevity, I will use the most notorious case for a brief illustration of the problem – the Argentine default and restructuring.

On December 19, 2001, following protracted economic crises dating back from the late 1990s, failed IMF interventions, drastic capital controls and a spate of riots and looting throughout the country, Argentine President de la Rúa declared a state of siege in the country. The following day, he resigned and the President of the Senate became provisional president. On December 23, 2001, Aldo Rodríguez, a provincial governor, was elected interim president, and he immediately declared a default on Argentina's public debt. He resigned one week later, paving way for Eduardo Duhalde (who had lost to Rúa in the 1999 election) to assume the office of the president on January 1, 2002.⁸

Following the declaration of default, Argentina stopped making payments on bonds worth USD 80 billion (which, at that time, was the biggest default in history), and subsequently held two rounds of restructurings in 2005 and 2010, making a take-it-or-leave-it offer of about 35 cents on the dollar to the bondholders.⁹ The owners of about 94 percent of the bonds accepted the exchanges, and Argentina vowed never to pay the holdouts.¹⁰

The holdout litigation that ensued was intense, protracted and far-reaching. In several court actions before the courts in the United States, United Kingdom and Germany, as well as ad hoc and International Center for the Settlement of Investment Disputes (ICSID) arbitrations, holdout litigators for the most part successfully pursued Argentina and its instrumentalities in judgment and enforcement proceedings, frustrated the implementation of the terms of its restructured debt, and ultimately forced it into a negotiated settlement in February 2016.¹¹

⁸ See generally the historical account of the Argentine debt crisis and ultimate default by Professor Andreas Lowenfeld. ANDREAS LOWENFELD, *INTERNATIONAL ECONOMIC LAW* (2nd ed. 2008) at 720 – 725.

⁹ FREE EXCHANGE ECONOMICS, *THE ECONOMIST*, SOVEREIGN DEBT: A LOSE-LOSE PROPOSITION, available at <http://www.economist.com/node/21604739/print> (accessed on December 6, 2015).

¹⁰ *Id.*

¹¹ For United States court decisions on the first round of restructuring, see *Lightwater Corporation Ltd. v. Republic of Argentina* 2003 WL 1878420 (SDNY, 2003) (District Court) (the first of the series of cases against Argentina in the New York District Court and wherein the court found in favor of the holdouts on all grounds including an interpretation of the pari passu clause that forbids Argentina from paying holders of its restructured bonds unless it pays the holdouts ratably and simultaneously); *NML Capital Limited & Another v. The Republic of Argentina* 2005 WL 743086 (SDNY, 2005) (District Court) (granting an order of attachment of the bonds that were to be exchanged by Argentina's participating creditors as they were being tendered to the Bank of New York as exchange agent and a day before the scheduled exchange); *EM Ltd v. Republic of Argentina*, 131 Fed. Appx. 745 (2d Cir. May 13, 2005) (affirming the order of attachment of the District Court in *NML Capital Limited & Another v. The Republic of Argentina* on the ground that it would not disturb an exercise of jurisdiction by the District Court where, as it saw it, the discretion was properly exercised and without resolving the issue whether the tendered bonds were to be regarded as assets or debts of Argentina). For United States court decisions on the second round of restructuring, see *NML Capital v Argentina* 08 Civ 6978 (TPG) (SDNY, 2012) (District Court) (holding that Argentina violated the pari passu clause in its unstructured bonds and enjoining Argentina from making payments to creditors on its 2005 and 2010 restructurings without making appropriate payments to the holdouts concurrent with or in advance of any payments to holders of the 2005 and 2010 restructured bonds); *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246 (2d Cir. 2012)

Although studies have shown that the holdout problem has not been as pervasive as many fear,¹² it poses real and persistent danger to sovereign debt restructuring in particular and the international financial architecture in general. Although the Argentine case may be seen as an outlier at the moment,¹³ there is a real danger that it has set a model for holdout litigators, and the relative success of the holdouts – across jurisdictions and including at ICSID – is a clear signal that even more determined holdouts are to come.¹⁴

(ii) Vulture Culture

This paper uses the term “vulture culture” to refer to the business practice of secondary market sovereign debt traders who buy distressed debts (mostly of poor countries) at steep discounts and seek to recover the entire principal and

(Circuit Court) (affirming the decision of the District Court but granting a stay of enforcement of the District Court’s injunctions pending the outcome of Argentina’s petition, on ground of sovereign immunity, to the US Supreme Court); and *Republic of Argentina v. NML Capital Limited*, 573 U.S. (2014) (United States Supreme Court) (refusing to hear Argentina’s appeal – without comment on the substantive issues – against the orders of the New York District and Circuit Courts and further holding that while the United States Federal Sovereign Immunities Act indeed grants sovereign states’ assets in the United States immunity from attachment and execution, that immunity does not extend to discovery suits on those same assets). For judgments of the German courts, see Judgment of 21st Civil Chamber, Landgericht, Frankfurt, of 14 March 2003; 2-21-O 294/02 (affirming Argentina’s liability on the restructured bonds); Decision 8U 52/03 of the German Court of Appeal, Frankfurt, on July 7, 2003 (affirming the decision of the lower court but granting a stay pending appeal to the German Constitutional Court on the ground that the effect of a declaration of emergency by a foreign sovereign on private actions raised a question of international law, and therefore might be subject to the exclusive jurisdiction of the Constitutional Court); and Decision 8U 107/03 of February 16, 2006 of the Court of Appeal of Frankfurt (before the German

Constitutional Court could rule on the matter, dismissing Argentina’s appeal in its entirety on the ground that Argentina could no longer invoke the state of emergency necessity, since President Kirchner had declared, in March 2005, that the restructuring of its debt had overcome Argentina’s international insolvency). For judgments of the courts of the United Kingdom, see *NML Capital Limited v Republic of Argentina* [2009] EWHC 110 (Comm); [2009] QB 579 (High Court) (finding in favor of the holdouts on all grounds in proceedings aimed at enforcing New York court judgments); [2010] ECWA Civ. 41; [2011] 1 QB 8 (Court of Appeal) (reversing the High Court on the ground that Argentina was protected by sovereign immunity; and [2011] UKSC 31 (Supreme Court) (reversing the Court of Appeal and finding for the holdouts on all grounds). For ICSID arbitrations, see *Ablacat and Others (case formerly known as Giovanna A Beccara and Others) and The Argentine Republic* (ICSID Case No. ARB/07/5) (2011) and *Ambiente Ufficio S.P.A. and Others (case formerly known as Giordano Alpi and Others) and the Argentine Republic* (ICSID Case No. ARB/08/9) (2013) (both decisions, on jurisdiction and admissibility, finding that that Argentina’s sovereign debt restructuring fell within the scope of the bilateral investment treaty between the United States and Argentina and that the ICSID tribunal had jurisdiction to determine the cases).

¹² Udaibir S. Das, Michael G. Papaioannou and Christoph Trebesch, *Restructuring Sovereign Debt, Lessons from Recent History*, at 21, available at

<https://www.imf.org/external/np/seminars/eng/2012/fincrisis/pdf/ch19.pdf> (accessed on June 16, 2016) (presenting data from studies that show that there has been only 108 individual holdout litigation occurrences since 1980 with a relatively small record of successes – settlements or successful attachment of sovereign assets – and concluding that taken together the facts indicate that creditor coordination and holdouts may be less of a problem than commonly believed).

¹³ *Id* (concluding that Argentina and Grenada experiences are outliers that had large scale holdouts and difficulties re-accessing international capital markets after their debt exchanges).

¹⁴ See Professor Stephen Choi’s declaratory affidavit opinion to the New York District Court in the case of *NML Capital v. Argentina*, 08-Civ-06978-TPG (2012).

accumulated interest from the debtor countries usually through litigation in creditor-friendly countries.¹⁵

If holdout creditors pose a problem to sovereign debt restructuring and the smooth operation of international finance, vulture funds are an even greater threat for a number of reasons.¹⁶ First, the apparent lack of morals in their business model make them practically impervious to any sense of moderation, fair play or comity, thus they are ‘a thousand times’ less likely to heed any call for haircut or similar sacrifices normally called for to help a debtor country restructure its debt and get back to sound economic footing. Secondly, the fact that they purchase the debt at steep discounts at the secondary market and seek full face value payment plus costs, makes litigation particularly appealing to them, since they stand to lose very little but gain so much.¹⁷ They are therefore much more likely to hold out from restructurings and enjoy a disruptive free ride on the rest of the creditors.

Given the pivotal role that sovereign financing plays in the international financial system, there is little doubt that the activities of vulture creditors pose a substantial risk to the stability of the system. Thus, in spite of possible arguments espousing potential salutary effect of vulture activities, the vulture culture does significant damage to the stability of the system without generating any positive net value for anyone but themselves.¹⁸

¹⁵ The United Nations Human Rights Council defines Vulture Funds as “private commercial entities that acquire, either by purchase, assignment or some other form of transaction, defaulted or distressed debts, and sometimes actual court judgments, with the aim of achieving a high return”. See Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, A/HRC/14/21, April 29, 2010, at 4. See also Christopher Wheeler and Amir Attaran, *Declawing the Vultures: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT’L. L. 253, at 262 – 263; and Jubilee USA Network, *Vulture Funds and Poor Country Debt: Recent Developments and Policy Responses*, available at http://www.jubileeusa.org/fileadmin/user_upload/Resources/Policy_Archive/408briefnotevulturefunds.pdf (accessed on December 27, 2015).

¹⁶ For some examples of the vulture culture see *Donegal International v. Zambia* [2007] EWHC 197 (Comm); [2007] 1 Lloyd’s Rep. 397 (pursuing Zambian distressed debt in the United Kingdom); *Lordvale Finance v. Bank of Zambia* [1996] QB 752 (also pursuing Zambian distressed debt in the United Kingdom); *Camdex International Ltd. v. Bank of Zambia* [1996] 3 All ER 431 (CA); [1997] CLC 714 (CA) (also pursuing Zambian distressed debt in the United Kingdom); *Hamsah Investments Ltd. & Anor v. The Republic of Liberia*, Case No. 2008/587 (High Court of Justice, London), judgment of November 26, 2009 (unreported) (pursuing Liberia’s distressed debt in the United States and United Kingdom); *Democratic Republic of the Congo v. FG Hemisphere Associates LLC (No. 1)* (pursuing Congolese distressed debt in the United States and Hong Kong) [2011] HKEC 747; [2011] 14 HKCFAR 95; and *Elliot Associates v. Banco de la Nacion*, No 96 Civ. 7916, 2000 U. S. Dist. LEXIS 14169, at p. 1 (SNDY Sept. 29, 2000) (pursuing Peruvian distressed debt in the United States and Belgium). The Belgian government effectively overruled the *Elliot* decision in November 2004 by enacting a law (Law 4765 [C-2004/03482]) precluding holdout creditors from obtaining orders blocking payments through Euroclear in future cases.

¹⁷ *Elliot*, for instance, reportedly earned a return on investment of 494 percent on the Peru debt. See Wheeler and Attaran, *supra* note 4, at 262.

¹⁸ In response to the vulture culture some countries have either passed or introduced legislation to curtail the vulture culture. These include the UK Debt Relief (Developing Countries) Act, 2010, the US “Stop Vulture Funds” bill (introduced in 2008 but appears to have died in Congress), the Belgian anti-holdout Law No. 4765 [C-2004/03482] and anti-vulture “Proposition de Loi Relative à la Lutte Contre les Activités des Fonds Vautours” (passed on July 1, 2015), and an unsuccessful attempt by the French in 2006 to enact similar legislation.

(iii) Incomplete Restructuring

Not infrequently, it happens that a country that just restructured its debt either defaults on the restructured debt or further restructures it to avoid a default. This phenomenon happens for a number of reasons, including disruptive holdout litigation. But oftentimes too, it happens because the terms of the initial restructuring did not go far enough to address the issues they ought to address, particularly the debt burden and or funding problems of the sovereign. I use the term ‘incomplete restructuring’ to indicate these instances when debt restructuring fails because the terms did not get it right. The case of Greece (2012) illustrates this problem.

In March/April 2012, Greece implemented a EUR 200 billion debt exchange resulting in the biggest sovereign debt restructuring in recorded history and a near elimination of Greece’s sovereign bonds held by private creditors.¹⁹ The Greek restructuring, apart from being the largest of all time, also achieved a significant 96.9 percent participation rate (for a EUR 199.2 billion of debt) (by end of the first exchange in April 2012), resulted in a vast transfer (about EUR 100 billion in present value terms, representing about 20 percent of the country’s 2012 GDP) from private creditors to Greece, and obtained for Greece a composite debt relief of about EUR 98 billion to 106 billion (or 51 to 55 percent of GDP) in present value terms.²⁰

However, not only did Greece had to carry out yet another debt buyback of its newly exchanged sovereign bonds in December 2012 (less than ten months after the initial restructuring) which resulted in the amount of Greek bonds in the hands of private creditors reducing to just EUR 35 billion (just 13 percent of where it stood when Greece lost access to capital markets in April 2010)²¹ the country also negotiated a bailout in 2015 with mostly its official/multilateral creditors after a debt crisis and political turmoil that nearly sent it packing from the Eurozone.²² And, after all said and done, yields on Greek bonds (8.32 percent, as at December 19, 2015)²³ continued to be by far the highest in the Eurozone²⁴ and higher than the emerging market average yield to maturity (5.21 percent, as at December 19, 2015),²⁵ thus signaling that markets remained unconvinced about the Greek debt situation. Furthermore, Greek debt to GDP ratio had risen to 178.6 percent by end 2014, higher

¹⁹ Zettlemeyer, Trebesch and Gulati, Jeromin Zettlemeyer, Christoph Trebesch and Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS: WORKING PAPER WP 13-8, at 2.

²⁰ *Id.*, at 2, 13, 24.

²¹ *Id.*, at 2. See also Miranda Xafa, *Sovereign Debt Crisis Management: Lessons from the 2012 Greek Debt Restructuring*, CIGI PAPERS, No. 33 June 2014, at 11.

²² See Nikos Chrysoloras, *Greece Seeks Third Debt Restructuring: Who’s on the Hook*, BLOOMBERGBUSINESS (February 3, 2015), available at <http://www.bloomberg.com/news/articles/2015-02-02/greece-seeks-third-debt-restructuring-who-s-on-the-hook> (accessed on December 19, 2015). Institute of International Finance, *Debt Restructuring: Drawing the Right Lessons*, CAPITAL MARKETS MONITOR (July/August 2015) at 2.

²³ FINANCIAL TIMES, BONDS AND RATES, available at <http://markets.ft.com/Research/Markets/Government-Bond-Spreads> (accessed on December 19, 2015).

²⁴ BloombergBusiness, Market: Rates and Bonds, available at <http://www.bloomberg.com/markets/rates-bonds> (accessed on December 19, 2015).

²⁵ BloombergBusiness, Bloomberg USD Emerging Market Sovereign Bond Index, available at <http://www.bloomberg.com/quote/BEMS:IND> (accessed on December 19, 2015).

than 172 percent by end 2011 and before the 2012 restructuring, and again remained the highest among Eurozone countries.²⁶ The IMF maintained, after the bail-out negotiation in 2015, that Greece needed more debt relief, and that it would not participate in any further restructuring of Greek debt unless there was an “explicit and concrete agreement” on debt relief.²⁷

The failure of the Greek debt restructuring has been blamed on a number of reasons but certain reasons stand out.

First European Central Bank and euro area national central banks resisted any write-downs on their debt and did not participate in the restructuring.²⁸ This immediately took the debt owed to Greece’s single largest bondholder by far (EUR 42.7 million worth and 16.3 percent of outstanding bonds) off the table, and so were the EUR 13.5 billion (and 5 percent of outstanding bond) debt owed to Eurozone national central banks and the EUR 315 million debt owed to the European Investment Bank.²⁹

Second, Greece implemented a one-size-fits-all mode of bond exchange. Every investor was offered exactly the same (and only one) package of securities, without discrimination as to governing law or maturity, which included a 15 percent of face value in the form of European Financial Stability Facility (EFSF) short term notes in two separate series payable one half each in March 2013 and March 2014.³⁰ This structure meant that there were lots of cash to be paid out in the very short term on the EFSF notes across all restructured privately held bonds (even in respect of bonds which – by the terms of the old instrument – much less would have been due for payment), thus immediately (and needlessly) draining more cash out of the Greek economy. According to Zettlemeyer, Trebesch and Gulati, “the costliest mistake ... was the ‘one-size-fits-all’ approach of offering the same bundle of new bonds and cash to all investors, irrespective of the maturity of their old bonds, and with no distinction between foreign law and Greek law bonds”.³¹

Third, Greece adopted a rather soft approach on holdouts (apparently in a bid to test negative to the Argentine syndrome). It elected to pay holdouts, against better judgment.³²

Finally, the size of haircut should have been higher. According to Zettlemeyer, Trebesch and Gulati, imposing an across board 70 percent haircut on all investors

²⁶ Eurostat, General Government Gross Debt – Annual Data, available at <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1> (accessed on December 19, 2015).

²⁷ See Heather Stewart, *IMF will refuse to join Greek bailout until debt relief demands are met*, THE GUARDIAN (Thursday, July 30, 2015); and Mohamed A. El-Erian, *IMF Gets Smart about Greece*, BLOOMBERGVIEW (July 31, 2015).

²⁸ Miranda Xafa, *Sovereign Debt Crisis Management: Lessons from the 2012 Greek Debt Restructuring*, CIGI Papers, No. 33 June 2014, at 10.

²⁹ Zettlemeyer, Trebesch and Gulati, *supra* note 19, at 10.

³⁰ *Id.*, at 21, 47.

³¹ *Id.*, at 38.

³² *Id.*, at 39.

would have resulted in additional debt relief of almost EUR 30 billion in face value terms and EUR 23 billion in present value terms.³³ Further, a differentiation by governing law, by imposing an additional 5 percent haircut on Greek law bondholders, could have achieved a further EUR 24 billion in face value debt relief, or it could have been used to reduce the official cash incentives by up to EUR 15 billion.³⁴

This sub-section has used the Greece restructuring as an example to illustrate the challenge of failed restructurings. It is noteworthy, however, that there have been several other debt restructurings in the past that failed because the terms thereof were simply wrong. The Baker and Brady Plans of the earlier 90s variously failed in some respects – the Baker Plan for misjudging the real problem behind the so-called 'petro-dollar' debt crisis – debt unsustainability; and the Brady Plan for misjudging the extent of it.

In sum, therefore the lessons from Greece and previous incomplete restructurings tell us that sovereign debt restructuring has to start as early as necessary and go as far as required to enable the country return to a debt level that allows for sustainable economic growth.

(D) Collective Action Clauses as the Contractual Approach Response

In response to the challenges besetting sovereign debt restructuring, key stakeholders in international finance have reacted with proposals, market instruments and legislations aimed at containing the problems of holdout disruption and enhancing creditor coordination. These proposals have bordered both on the public law spectrum and on the contractual spectrum. The public law approach-oriented responses include the SDRM, proposed by the IMF,³⁵ the UNGA Resolution 68/303 (towards the establishment of a multilateral legal framework for sovereign debt restructuring processes),³⁶ the European Crisis Resolution Mechanism (proposed by Gianviti, et. al.),³⁷ and the Sovereign Debt Tribunal (proposed by Christoph Paulus).³⁸ The contractual approach responses have come primarily in the form of innovations to collective action and *pari passu* clauses in sovereign bond

³³ *Id.*, at 38. This 70 percent haircut, the authors argued, would have been lower than the haircut that was deemed to be acceptable for short term creditors, hence surely feasible.

³⁴ *Id.*, at 38 – 39. For further reading on the Greek 2012 debt restructuring and why it failed see LEE C. BUCHHEIT AND ELENA L. DALY, *Minimizing Holdout Creditors: Carrots*, in SOVEREIGN DEBT MANAGEMENT (Rosa M. Lastra and Lee Buchheit eds. 2014), at 7; Yves Quintin, *Alis...da in Wonderland or Greek Tragedy? The Dynamics of Credit Default Swaps and the "Voluntary" Greek Debt Restructuring of 2011/2012*, INTERNATIONAL BUSINESS LAW JOURNAL (2012) at 277-288; Ioannis Glinavos, *Haircut Undone? The Greek drama and prospects for investment arbitration*, 5 JOURNAL OF INTERNATIONAL DISPUTE SETTLEMENT (3), (2014); and IMF, *Greece: Preliminary Debt Sustainability Analysis – Updated Estimates and Further Considerations*, IMF COUNTRY REPORT No. 16/130, (May, 2016).

³⁵ KRUEGER, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING, *supra* note 2.

³⁶ UNITED NATIONS GENERAL ASSEMBLY, RESOLUTION NO. A/RES/68/304, *supra* note 3.

³⁷ See François Gianviti, Anne O. Krueger, Jean Pisani-Ferry, André Sapir And Jürgen Von Hagen, *A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal*, Vol. 10 BRUEGEL BLUEPRINT SERIES (2010).

³⁸ See Christoph G. Paulus, *A Standing Arbitral Tribunal as a Procedural Solution for Sovereign Debt Restructurings*, available at http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1238442914363/5969985-1295539401520/9780821384831_ch13.pdf (accessed on June 17, 2016).

instruments. These responses include the International Capital Markets Association (ICMA) Model Collective Action Clauses (ICMA Model CACs) and Model Pari Passu Clauses (the ICMA Model Pari Passu Clauses) (together with the ICMA Model CACs, the ICMA Model Clauses), the Euro Area Model Collective Action Clause (EA Model CAC) and the gradual shift from Unanimous Action Clauses (UACs) to Collective Action Clauses (CACs) in New York law governed sovereign bonds.

Since this paper is focused on the contractual approach, I do not discuss the public law oriented proposals. Turning to the contractual approach responses, it is my view that while the innovations in collective action and pari passu clauses will go a long way to mitigate the challenges of creditor coordination and holdout disruption in sovereign debt restructurings, they will fall short of containing them. I will now discuss and appraise the innovations introduced by the ICMA Model Clauses and the EA Model CAC as responses to creditor coordination and holdout disruption in sovereign debt restructuring.

(i) A Brief Introduction to Pari Passu and Collective Action Clauses

A pari passu clause in a debt instrument typically provides that the obligations of the debt issuer under the debt instrument rank and will rank pari passu, without preference among themselves, with all other unsecured (and unsubordinated) debt of the debt issuer from time to time outstanding. In the sovereign debt context, this provision would specifically refer to pari passu ranking among themselves and other external unsecured (and unsubordinated) debt of the issuer. The pari passu clause, construed literally, would prevent the debt issuer from making payments on other debt (including restructured debt) ranking pari passu with a certain debt (such as the debt of a holdout creditor) save where payments are made on all concerned debt at or about the same time. This literal interpretation was about the most potent weapon wielded successfully by holdout creditors against Argentina over the past decade. Other than contractual changes or outright elimination of the pari passu clause, there appears to be little or nothing anyone can do about the effects of it, particularly where adjudicators give it a literal interpretation as was the case in the Argentina debt litigation.³⁹

CACs are contractual terms in debt instruments (presently seen in bond instruments, for the most part) that enable a given proportion of the creditors to agree to certain actions that modify the original terms of the debt instrument, including the pari passu clause and ranking of the debt, voting thresholds, reduction of face value, elongation of maturity or interest payment periods, reduction in interest and/or principal, etc. A CAC, thus, allows holders (typically of a class) of bond containing the CAC to take a majority action under a proposed debt restructuring in their collective interest, and presumably also in the interest of the debtor. Such a clause would enable a majority of the bondholders to make a decision that would bind any dissenting minority who own part of the concerned bonds.

³⁹ For an analysis of the impact of the pari passu clause in the Argentina debt restructuring and implications for the international financial system, see Anna Gelpern, *Sovereign Damage Control*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS: POLICY BRIEF, PB13-12 (May 2013).

CACs have, since the debt crisis of the 1980s, replaced the hitherto traditional UACs that were the hallmark of bonds issued in or governed by New York or other United States law. Evidence from the market as well governments and financial institutions indicate that creditors as well as debtors across the broad spectrum of international finance view the use of CACs in sovereign debt contracts positively (at least as far as the contractual approach is concerned). The market particularly prefers it to the public law approach because it avoids the shortcomings of a more intrusive regulatory solution.⁴⁰

(ii) The Limitations of Collective Action Clauses

Traditionally, CACs, in spite of their intended design to act as panacea to disruptive holdout litigation, have been known to be insufficient in containing the problem for a number of reasons.

First, CACs do not eliminate the strategic use of litigation by creditors to frustrate the restructuring process. Litigious creditors could sue for just about anything in the bond instrument that remotely confers a cognizable right to sue, in spite of the CAC. The use of strategic litigation to force settlement or gain some other advantage is particularly high in New York courts where a predilection to protect creditor (particularly minority creditor) rights using a menu of injunctions is pronounced.

Second, there is the risk that in the course of trying to reach a majority decision on the debt workout, intercreditor lawsuits may even derail the restructuring process, thus making the clause the devil rather than the savior.⁴¹ Again, the risk that litigious creditors could hold up a restructuring on procedural grounds (tyranny of the majority) in the voting process is not insignificant.

Third, CACs could only be used in new bond instruments or in existing instruments where they are contained. In existing bond instruments without CACs they are of largely of little or no significance (save as modified by the EA Model CAC). The IMF estimates that of the approximately USD 1.2 trillion foreign-law governed sovereign bonds outstanding as at 2014, about 25 percent do not include CACs; and, more specifically, about 20 percent of the outstanding stock of New York law bonds worth about USD 500 billion (representing about 40 percent of all foreign law issuances) do not contain CACs.⁴² A data set of sovereign bond issuances developed by Stephen Choi, Mitu Gulati and Eric Posner indicates that of 257 New York law bonds having a maturity date of 2013 or later (excluding Argentine bonds) 192 or 74.7 percent had a

⁴⁰See Jill Fish and Caroline Gentile, *Vultures or Vanguard: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L. J. 1043, 1085. See also Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract*, 84 WASH. U. L. REV. 1627, 1652; International Monetary Fund, *The Fund's Lending Framework and Sovereign Debt – Preliminary Considerations*, IMF POLICY PAPER (June 2014); Gelpern, *Sovereign Damage Control*, *id.*

⁴¹Fish and Gentile, *Vultures or Vanguard: The Role of Litigation in Sovereign Debt Restructuring*, *Id.*

⁴²International Monetary Fund, *The Fund's Lending Framework and Sovereign Debt – Preliminary Considerations*, *supra* note 40, at 30.

CAC. Thus 65 or 25.3 percent of New York law governed bonds maturing 2013 or later employ a UAC for changes to its terms.⁴³

Fourth, (at least until the implementation of the new EA and ICMA Model Clauses) CACs only enable majority creditors to restructure a particular issue of bonds. They do not permit holders of one issue of bonds to force holders of another to accept the terms of the restructuring; they neither require that all issues of bonds be restructured nor deal with the potential problem of unfairness among holders of different bond issues.⁴⁴ Thus, if a country has multiple bond issuances, a vote under a CAC to restructure one bond issuance will bind only the bondholders of that particular issuance. Holdouts may stop the restructuring by obtaining blocking positions under one or more series of bonds simply by purchasing the bonds of the relevant series up to the required threshold (after 25 percent or more under most CACs, including for Reserved Matters under the ICMA and EA Model Clauses). CACs may therefore work effectively to change the terms of a single issue of bonds, or perhaps a limited number of issues, but they offer very little help in dealing with coordination and collective action problems in complex cases (such as Argentina) where restructuring was sought for 152 different bond issues involving seven different currencies and the governing laws of eight different jurisdictions.⁴⁵

Finally, CACs, at least as currently designed, are meant to apply only to sovereign bonds and not other classes of sovereign debt, say commercial bank/official loans or sovereign guarantees of commercial bank/official loans. In cases, such as Greece 2012, where commercial bank and/or official loans constitute a significant proportion of the debt stock, CACs may not offer much help – little wonder that even the legislative retrofitting of Greek law bonds with CACs did little to help the restructuring once official debts were taken off the table.

(E) The ICMA and European Union Innovations

The foregoing shortcomings of CACs have led to certain market-based innovations in the provisions and applications of CACs in sovereign debt instruments by ICMA and the European Union, with broad-based backing across the broad spectrum of international finance. This section will discuss these innovations and the next section will critique them.

(i) The ICMA Model Collective Action and Pari Passu Clauses

Following worries over the disruption of sovereign debt restructurings by holdout creditors, and particularly given the protracted and disruptive fight between

⁴³ See Professor Stephen Choi's declaratory affidavit opinion to the New York District Court in the case of *NML Capital v. Argentina*, *supra* note 14 at 8.

⁴⁴ See David Skeel, *Can Majority Voting Provisions do it All?*, 52 EMORY L. J. 417, 422 – 23 (2003); Gelpern, *Sovereign Damage Control*, *supra* note 40, at 12; Gregory Makoff and Robert Kahn, *Sovereign Bond and Contract Reform: Implementing the New ICMA Pari Passu and Collective Action Clauses*, CIGI PAPERS, No. 56 (February, 2015); and Professor Stephen Choi's declaratory affidavit opinion to the New York District Court in the case of *NML Capital v. Argentina*, *id.*

⁴⁵ Fish and Gentile, *supra* note, 40, 1094.

Argentina and its holdouts, the ICMA, after consultations with its members and other public sector and private sector representatives, published a new set of model CACs and pari passu clauses for inclusion in the terms and conditions of both English and New York law governed sovereign debt securities in August 2014 (slightly revised in May 2015). The initiative was a product of an informal working group convened by the United States Treasury, comprising market participants, officials from wealthy and emerging market countries, multilateral institutions, and academics. The ICMA's Model Clauses went through multiple rounds of consultation across major stakeholders, including members of the ICMA and other market players and key international financial institutions (including the IMF).⁴⁶

The ICMA Model CACs introduced a number of innovations in the restructuring of sovereign debt, by providing three menu options for the distressed sovereign debtor to choose from, depending on its circumstances and the negotiating stance of the creditors.⁴⁷

First, it could poll the holders of each bond series. If at least 75 percent (in the case of Reserved Matters⁴⁸) or more than 50 percent (in other cases) of a series agree to the new terms, the remaining creditors would be bound. This is the "Single Series Resolution".

Second, (but only in respect of proposals including a Reserved Matter) it could poll holders of two or more series. If at least 66 2/3 percent of the aggregate principal amount of the outstanding debt securities of affected series of Debt Securities Capable of Aggregation⁴⁹ (taken in aggregate) and more than 50 percent of the aggregate principal amount of the outstanding debt securities in each affected series

⁴⁶ For details of the consultation and adoption process of the ICMA clauses visit ICMA's website at <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/> (accessed on June 20, 2016). See also Anna Gelpern, *A Sensible Step to Mitigate Sovereign Debt Dysfunction*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS: REALTIME ECONOMIC ISSUES WATCH (August 29, 2014); and Makoff and Kahn, *Sovereign Bond and Contract Reform: Implementing the New ICMA Pari Passu and Collective Action Clauses*, *supra* note 44; ANNA GELPERN, BEN HELLER AND BRAD SETSER, *Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Bonds*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, Jose Antonio Ocampo and Joseph E. Stiglitz eds, 2016) at 109-110; CHRISTIAN HOFFMAN, *Enfranchisement and Disenfranchisement in Collective Action Clauses*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT (Klauss-Albert Bauer, Andreas Cahn and Patrick S. Kenadjian, eds 2013) at 49-50; CHRIS O' MALLEY, *BONDS WITHOUT BORDERS: A HISTORY OF THE EUROBOND MARKET* (2015) at 224-225; and International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, IMF POLICY PAPER (October, 2014).

⁴⁷ Detailed provisions of the ICMA Model CACs is available at ICMA's website at <http://www.icmagroup.org/resources/Sovereign-Debt-Information/> (accessed on June 20, 2016); see also Anna Gelpern's analysis of the provisions in Gelpern, *A Sensible Step to Mitigate Sovereign Debt Dysfunction*, *id.*

⁴⁸ Reserved Matters, as defined under the ICMA Model CAC, roughly equates to the key terms of the bond instrument, including payment dates, governing law, currency of payment, legal ranking of the debts, acceleration and sovereign immunity clauses.

⁴⁹ A key feature (and limitation) of the ICMA Model CAC is the concept of "Debt Securities Capable of Aggregation" which requires, by definition, that only those debt securities whose instruments include (or incorporate by reference) the standard aggregation and relevant meeting/resolution provisions or similar terms which include provisions capable of being aggregated for voting purposes with other series of debt securities may be included for cross-series aggregation purposes.

of Debt Securities Capable of Aggregation (taken individually) agree to the new terms, the remaining creditors would be bound [emphasis supplied]. This is the "Multiple Series Two-Limb Resolution" and the one of two aggregation options.

Third, (again, only in respect of proposals including a Reserved Matter) it could poll holders of two or more series at once but take only a single vote across all affected series. If at least 75% of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate) agree to the new terms, the remaining creditors would be bound. No creditor, and no series, can drop out. The restructuring either goes ahead for everyone polled or fails for everyone polled. This is the "Multiple Series Single-Limb Resolution" and the second of two aggregation options. To ensure that minority holders are sufficiently protected, the Multiple Series Single-Limb Resolution provides for a "Uniformly Applicable" condition which any vote taken under the Multiple Series Single-Limb Resolution must satisfy and which broadly requires that all affected creditors are offered the same restructuring terms.

The ICMA Model CACs also contain events of default and acceleration clauses that fix a threshold of 25 percent of affected creditors to accelerate the notes following an event of default and aim to enable the sovereign debtor to cure an event of default and have the acceleration withdrawn (subject to prior accrued rights and without prejudice to creditors rights in respect of any separate events of default). The clauses also provide for certain information, voting, calculation, claims valuation and resolution mechanics that aim to ensure the smooth operation of the clauses in practice.

The ICMA Model CACs, in line with the G-10 recommended approach, excludes all bonds held by the issuer or any of its public sector instrumentalities or by any entity owned or controlled directly or indirectly by the issuer or any of its public sector instrumentalities, thus disenfranchising the relevant entities from voting for purposes of the restructuring under the clauses. It also includes a specific definition of "control" (in like manner as the EA Model CAC) and "public sector instrumentality" as the central bank and any other department, ministry or agency of the government or any other entity owned or controlled by the government or any of the foregoing.

The ICMA Model Pari Passu Clauses simply aim to reverse the course of interpretation of the pari passu clause (as popularly deployed against Peru, Dominica and Argentina by holdouts) to mean that the sovereign debtor is required to make payments under holdout debt ratably with payments under restructured debt, even as it still requires equal ranking of all the sovereign's external unsubordinated debt.

Thus, while the Argentine pari passu clause provided that that the Republic's payment obligations under the bonds shall at all times rank "at least equally with all the Republic's other present and future unsecured and unsubordinated External Indebtedness", the ICMA Model Pari Passu Clause for New York law governed bonds (substantially identical to its English law governed Model Pari Passu Clause) provides that "The Bonds constitute and will constitute direct, general, unconditional and

unsubordinated External Indebtedness of the Issuer for which the full faith and credit of the Issuer is pledged. The Bonds rank and will rank without any preference among themselves and equally with all other unsubordinated External Indebtedness of the Issuer. *It is understood that this provision shall not be construed so as to require the Issuer to make payments under the Bonds ratably with payments being made under any other External Indebtedness*" [emphasis supplied].

(ii) The EA Model Collective Action Clause

On February 2, 2012, all 17 governments of the euro area signed a modified version of the Treaty Establishing the European Stability Mechanism. Article 12, paragraph 3 of the treaty provides that:

"collective action clauses shall be included, as of 1 January 2013, in all new euro area government securities with maturity above one year, in a way which ensures that their legal impact is identical".⁵⁰

This treaty heralded the adoption of a model collective action clause to be included in all euro area government debt securities with a maturity exceeding one year and irrespective of their governing law. Subject to a "tapping" allowance thereunder, the EA Model CAC will not affect any euro area government securities issued prior to that date unless those securities include a collective action clause that allows for their modification on a cross-series basis as contemplated in the model CAC. Thus, euro area government securities issued prior to 1 January 2013 will not be subject to modification as part of a cross-series modification pursuant to the model CAC.⁵¹

The EA Model CAC makes a distinction between Reserved Matters and Non-Reserved Matters. Reserved Matters are defined in like manner as the ICMA Reserved Matter to encompass key provisions of the debt instrument. To modify Reserved Matters in a bond, the EA Model CAC requires an affirmative vote of 75 percent of the aggregate principal amount of the outstanding bonds represented at a duly called meeting of the bondholders. For a written resolution, the required threshold is 66 2/3 percent of the holders of the aggregate principal amount of the outstanding bonds. To modify Non-Reserved Matters in a bond, the EA Model CAC requires a voting threshold of 50 percent of the aggregate principal amount of the outstanding bonds for both a meeting of the bondholders and a written resolution of the bondholders. The requisite thresholds for Reserved and Non-Reserved Matters would apply for the modification of the terms of each applicable bond in cases of single or cross-series modification alike.

For cross-series modification, the EA Model CAC provides a menu of three options.

⁵⁰ For details of the modified Treaty Establishing the European Stability Mechanism, visit http://europa.eu/rapid/press-release_DOC-12-3_en.htm (accessed on June 20, 2016). EA Model Collective Action Clauses

⁵¹ See http://europa.eu/efc/sub_committee/cac/index_en.htm (accessed on June 20, 2016).

First, a written resolution signed by or on behalf of the holders of not less than 66 2/3 percent of the aggregate principal amount of the outstanding debt securities of all the series (taken in the aggregate) that would be affected by the proposed modification, and the affirmative vote of more than 66 2/3 percent of the aggregate principal amount of the outstanding debt securities represented at separate duly called meetings of the holders of each series of debt securities (taken individually) that would be affected by the proposed modification [emphasis supplied]. This is the "Multiple Series Two Limb" modification.

Second, the affirmative vote of not less than 75 percent of the aggregate principal amount of the outstanding debt securities represented at separate duly called meetings of the holders of the debt securities of all the series (taken in the aggregate) that would be affected by the proposed modification. This is the "Multiple Series Single Limb Live Meetings" modification.

Third, a written resolution signed by or on behalf of the holders of more than 50% of the aggregate principal amount of the then outstanding debt securities of each series (taken individually) that would be affected by the proposed modification. This is the "Multiple Series Single Limb Written Resolution" modification.⁵²

The foregoing menu of options for a cross-series modification was introduced in the revised EA Model CAC. The menu allows an issuer to elect to pursue a cross-series modification which may include some (but not all) of its outstanding bonds in a single cross-modification, and may also treat its remaining bonds (a) in one or more additional cross-modifications, (b) in several separate single-series modifications, or (c) in a combination of (a) and (b). The flexibility allowed the Issuer under the menu of options is meant to minimize the likelihood of a hold-out. A cross-series modification may include one or more proposed alternate modifications but only if all of the proposed alternatives are addressed to and may be accepted by any holder of any bond that would be affected if the cross-series modification were to be approved. The issuer is thus given the right to propose a menu of options and investors the right to pick the option they prefer, thus ensuring that all investors have the right to accept, from a common menu of options, the option that best suits their interests.⁵³

The EA Model CAC equally makes provisions for calculation and treatment of zero coupon bonds (bonds originally issued without express provisions for accrual of interest), stripped bonds (bonds consisting of the component parts of a bond that originally expressly provided for accrual of interest) and index-linked obligations. The face amount of each stripped component is adjusted so that the stripped

⁵² See generally the EA Model CAC Common Terms of Reference, supplemental provisions and explanatory notes at http://europa.eu/efc/sub_committee/cac/cac_2012/index_en.htm (accessed on June 20, 2016); ANNAMARIA VITERBO, *The Impact of Sovereign Debt on EU Monetary Affairs*, in *THE RULE OF LAW IN MONETARY AFFAIRS* (Thomas Cottier, Rosa M. Lastra, Christian Tietje and Lucia Satragno eds. 2014) at 232-255; and Christian Hofmann, *Sovereign Debt Restructuring in Europe under the New Model Collective Action Clauses*, 49 TEXAS INTERNATIONAL LAW JOURNAL 383 (2014).

⁵³ EA Model CAC Supplemental Explanatory Note.

components have, in the aggregate, the same voting rights as the original investor would have had in relation to the underlying interest-bearing bond. Similar mechanism is also adopted for obligations issued without express provision for the accrual of interest.⁵⁴ For index-linked obligations, crystallized values are to be used, principally because the adjustable portion of an index-linked obligation is keyed to changes in a published price index, and in the euro area these changes have over many years been almost entirely a one-way street of increasing prices.

For purposes of determining eligible holders of bonds who are entitled to vote for purposes of the restructuring, the EA Model CAC defines "Outstanding Bonds" in a manner that disenfranchises certain holders of bonds who are deemed, under that definition, to be a department, ministry or agency of the issuer, or a corporation, trust or other legal entity that is controlled by the issuer or a department, ministry or agency of the issuer and, in the case of a bond held by any such above-mentioned corporation, trust or other legal entity, the holder of the bond does not have autonomy of decision.⁵⁵

The EA Model CAC equally contains provisions on events of default and acceleration. Like under the ICMA Model CACs, the EA Model CAC provides a minimum threshold of the holder of the aggregate outstanding bonds to accelerate the bonds upon an event of default and allows 50 percent or more to rescind or annul the acceleration. If the bonds provide for a fiscal agent or trustee, the EU Model CAC also forbids any bondholder from instituting proceedings against the issuer or take steps to enforce the rights of the bondholders under the terms of the bonds unless the fiscal agent or trustee (as applicable), having become bound to proceed in accordance with the terms and conditions of the bonds, has failed to do so within a reasonable time and such failure is continuing.⁵⁶

⁵⁴ In the absence of this special treatment, the holder of a zero coupon obligation would enjoy preferential voting rights compared to the holder of an interest bearing bond (e.g. if the holders of stripped components were afforded voting rights based on the face amount of their holdings, the total voting rights enjoyed by the holders of all the stripped components would exceed the total votes that would otherwise have been cast by the holder of the original interest-bearing bond). See the explanatory note and supplementary explanatory note of the EFC Sub-Committee on EU Sovereign Debt Markets on the EA Model CAC at http://europa.eu/efc/sub_committee/cac/cac_2012/index_en.htm (accessed on June 20, 2016).

⁵⁵ See Article 2.7 of the Common Terms of Reference of the EA Model CAC. Apparently the qualification of "autonomy of decision" only applies if the entity in question is not the issuer's "department, ministry or agency". The disenfranchising provisions limit the scope of disenfranchised bondholders to instrumentalities of the sovereign debtor and legal entities controlled by the sovereign debtor. This was short of suggestions that the disenfranchisement encompasses all investors who have the same interests as the sovereign debtor and who are predictably likely to vote in favor of a proposed modification or who are likely to be motivated by circumstances other than the direct effect of a proposed modification on the value of their holdings (e.g. the European Central Bank and euro area sister central banks other than the central bank of the sovereign debtor). The Economic and Financial Committee Sub-Committee on European Union Sovereign Debt Markets disagreed with the wider suggestion on grounds that neither the investor's motives nor predilection to favor the debtor should be a sufficient ground for disenfranchising that investor of its legal rights (but apparently not answering the question of the ECB's massive interventions in the secondary market in the interest of safeguarding the financial stability of the euro zone, even where investor's interests may be generally hurt in a restructuring). *Id.* See also Christian Hofmann, *Sovereign Debt Restructuring in Europe under the New Model Collective Action Clauses*, *supra* note 52, at 411-424.

⁵⁶ EA Model CAC Supplemental Provisions of February 17, 2012.

While the EA Model CAC applies only to bond issuances from January 1, 2013, it also allows countries to "tap" debt issuances outstanding on the date of the CAC's mandatory introduction, in order to preserve market liquidity; and provided that the tapping does not push the total face amount of euro area central government debt securities that may be issued by any such country in a year, as part of the reopening of an issuance outstanding as at December 31, 2012, above the stated percentage.⁵⁷

The EA Model CAC also makes ancillary procedural provisions regarding bondholder meetings, quorum, calculation of eligible claims and votes, notices and other engagements with the bondholders to ensure transparency in the process.

(iii) Expected Positive Impacts

The ICMA Model Pari Passu Clauses make important strides in the quest to limit the free-ride syndrome and enhance the contractual approach to sovereign debt restructuring. The provisions on pari passu ranking and enforcement, while protecting the rights of creditors in the ranking of the debt, now limit the ability of holdout creditors to frustrate the terms of restructured debt through litigation or arbitration.

The ICMA Model CACs and the EA Model CAC also introduced a number of innovative changes.

First, the menu of restructuring options provides the sovereign debtor with considerable flexibility in designing a restructuring that best suits its circumstances and the negotiating pulse of its creditors.

Second, the thresholds now required under each restructuring option materially shifts incentives against holdouts. Potential holdouts would now need to amass significantly larger positions to be able to block the restructuring. This would substantially increase the potential economic costs of holding out.

Third, the aggregation and limbic grouping mechanism allows the sovereign debtor to choose which voting mechanism would apply to a series of bonds, with an additional option to apply aggregated voting to a subset of bonds of their choice. The sovereign debtor may, for instance, offer holders of short term bonds different terms than those offered to holders of longer term bonds; the issuer may then form two voting groups (one for the short term bonds and one for the longer term bonds) before the public launch of the restructuring, a potential holdout is unlikely to predict which voting mechanism or grouping will apply to the bonds it holds, thus making it harder to block the restructuring.

Fourth, the ICMA Multiple Series Single-Limb Resolution and the EA Multiple Series Single Limb, while ensuring that creditors across the series of bonds to be

⁵⁷ EA Model CAC Supplemental Explanatory Note. The stated percentage gradates from 45 percent in 2013 to 5 percent from 2023 onwards.

restructured are offered the same restructuring terms (using, in the case of ICMA Model CACs, the Uniformly Applicable condition; and in the case of the EA Model CAC, by mandating that all of the proposed alternatives are addressed to and may be accepted by any holder of any bond that would be affected if the cross-series modification were to be approved), gives the sovereign debtor about the best weapon against potential holdout disruption – the option to restructure multiple series of bonds using a single aggregated voting system.

Fifth, the ICMA Model CACs and EA Model CAC provisions on event of default and acceleration now permit a sovereign debtor to remedy the event of default and have the acceleration of the bonds reversed with a reasonable threshold of bondholder vote.

Finally, the ICMA Model CACs provide for considerable flexibility with respect to the design of the contractual basis for aggregation. The CAC provisions could, for instance, be contained in a master agreement (such as a trust indenture for New York law bonds or a trust deed for English law bonds) pursuant to which all the individual bonds that are subject to aggregation may be issued. The EA Model CAC also allows countries the flexibility to implement the CAC either by contractual incorporation in the bonds or by statute.⁵⁸

The EA Model CAC took certain steps further than the ICMA Model CACs, particularly in terms of:

- lower voting thresholds on certain modifications;
- greater flexibility and a wider aggregation scope in the sense that the issuer may elect to include some (but not all) of its outstanding bonds in a single cross-modification and treat its remaining bonds in one or more additional cross-modifications, in several separate single-series modifications, or in a combination of both;
- limitation (in the case of bonds providing for a fiscal agent or a trustee) of ability of holdouts to sue the sovereign debtor or to enforce the rights of bondholders under the terms of the bond instrument unless the fiscal agent/trustee's rights to take enforcement action has fully crystallized and the

⁵⁸ For discussions of the impacts of the ICMA Model CACs, see also Gelpern, *A Sensible Step to Mitigate Sovereign Debt Dysfunction*, *supra* note 46; Makoff and Kahn, *Sovereign Bond and Contract Reform: Implementing the New ICMA Pari Passu and Collective Action Clauses*, *supra* note 44; ANNA GELPERN, BEN HELLER AND BRAD SETSER, *Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Bonds*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, Jose Antonio Ocampo and Joseph E. Stiglitz eds, 2016) at 109-110; CHRISTIAN HOFFMAN, *Enfranchisement and Disenfranchisement in Collective Action Clauses*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT (Klauss-Albert Bauer, Andreas Cahn and Patrick S. Kenadjian, eds 2013) at 49-50; and INTERNATIONAL MONETARY FUND, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, *supra* note 46. For discussions of the impacts of the EA Model CAC see ANNAMARIA VITERBO, *The Impact of Sovereign Debt on EU Monetary Affairs*, *supra* note 52, at 232-255; and Christian Hofmann, *Sovereign Debt Restructuring in Europe under the New Model Collective Action Clauses*, *supra* note 52.

fiscal agent/trustee has failed to take such action and that failure is continuing – this provision perhaps makes up for the lack of a model pari passu clause for euro area bonds and arguably goes farther than the ICMA Model Pari Passu Clauses;

- the ability of countries to "tap" the EU Model CAC as part of the reopening of an issuance outstanding as at December 31, 2012, provided that the total face value of bonds issued by the sovereign for that year which benefit from the EA Model CAC does not exceed the prescribed percentage; and
- the EA Model CAC provides a lee-way for a restructuring to proceed if some series miss the required majority threshold for a cross-series modification. This is called the "Partial Cross-Series Modification" under the EA Model CAC Common Terms of Reference. The Partial Cross-Series Modification allows modifications to take place in a series that would have met the majority requirements if they had voted individually. This allowance is intended to reinforce the sovereign's arsenal against potential holdouts by making it unlikely that one or a group of investors could impede the cross-series modification by obtaining blocking positions in one or a few of the series.

Evidently, the ICMA and EA Model CACs have made significant and important steps in mitigating the free rider problem in sovereign debt restructuring. It also important to note that the ICMA Model CACs and Pari Passu Clauses, in particular, have enjoyed wide and broad-based support from key stakeholders in international finance (including the IMF, the Institute of International Finance and members of the academia) as a welcome improvement in contractual sovereign debt restructuring, particularly in the absence of some sort of statutory sovereign bankruptcy.⁵⁹

(iv) The Limitations of the ICMA and European Union Innovations

While the innovations introduced by the EA Model CAC and the ICMA Model CACs and Pari Passu Clauses indeed go a long way to mitigate holdout disruption in sovereign debt restructuring, certain inherent weaknesses and extraneous factors are likely to result in their minimal impact.

First the ICMA Model CAC and Pari Passu Clauses are only guides, although of considerable persuasion. Sovereign debtors and creditors are not obliged to use them, and when they do, they are not obliged to follow them word for word.

⁵⁹ For support from the Executive Board of the International Monetary Fund, see IMF Press Release no. 14/459 (October 6, 2014) available at <https://www.imf.org/external/np/sec/pr/2014/pr14459.htm> (accessed on June 21, 2016); for the support of the Institute of International Finance, see the IIF's Press Release of November 30, 2015, available at <https://www.iif.com/publication/regulatory-comment-letter/statement-support-full-adoption-icma-recommendations-enhanced> (accessed on June 21, 2016); for academic support, see Gelpern, Gelpern, *A Sensible Step to Mitigate Sovereign Debt Dysfunction*, *supra* note 46; Makoff and Kahn, *Sovereign Bond and Contract Reform: Implementing the New ICMA Pari Passu and Collective Action Clauses*, *supra* note 44; O' MALLEY, *BONDS WITHOUT BORDERS: A HISTORY OF THE EUROBOND MARKET*, *supra* note 46; and GELPERN, HELLER AND SETSER, *Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Bonds*, in *TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES*, *supra* note 46.

Sovereign debtors and creditors alike may pick and chose from the provisions of the clauses or adapt them to suit the bargain they want. Thus, a sovereign borrower may not be able to get the full benefit of the clauses, particularly when bargaining from a weak position. Similarly, creditors negotiating terms with a strong borrower may have to contend with adaptations strengthening the position of the sovereign borrower. The end result may therefore be that the ICMA Model Clauses are significantly twisted to an extent where their value, even as guide posts could become significantly low.⁶⁰ The EA Model CAC, although required to be implemented as a matter of law, again leaves the flexibility as to whether the implementation should be by way of a contractual incorporation or by statute to the implementing country. The latest report on the status of implementation of the EA Model CAC indicates that 15 euro area countries implement it by way of contractual incorporation and others by way of legislation, and that there are some differences in the way the clauses are implemented in euro denominated issuances and issuances in other currencies.⁶¹

Secondly, while the ICMA Model Clauses are gradually becoming market standard in new bond issues, especially non-euro area emerging market English law bonds, they are yet untested, especially in a restructuring or dispute resolution scenario. It is possible that when subject to a live scenario, the ICMA Model Clauses may undergo yet further changes and may be significantly watered down depending on the prevailing mood of judges and arbitrators who would be called upon to decide disputes involving their operation and application.

Third, both the ICMA Model Clauses and the EA Model CAC do not have retroactive effect. Thus, they may only be included in bonds issued subsequent to their respective adoptions, although the EA Model CAC allows countries to "tap" the model clauses up to a certain percentage. The amount of global outstanding bonds without either the euro area CAC or the ICMA Model Clauses is vast. The IMF estimates that there are about USD 900 billion of outstanding international sovereign bonds of which about 71 percent will mature within 10 years and 29 percent after 10 years, with 39 percent of the stock maturing after 10 years being New York law bonds (and thus with enhanced risk of court decisions modelled after the Argentina precedents).⁶² Given that most of these outstanding bonds either do not contain CACs or do not contain CACs modelled after either the ICMA or euro area models, the danger of holdout disruption will remain for the foreseeable future. This is further aggravated by the fact that countries have also continued to issue bonds not modelled after any of the euro area or ICMA Model Clauses after the adoption of these clauses.

⁶⁰ A parallel example may be shown with the Loan Markets Association's templates for loan agreements, which are being consistently updated and modified by the Loan Market Association to address particular problems arising from different markets or simply ignored by practitioners on issues where the lenders or borrower (where strong enough) want a different or modified bargain.

⁶¹ See the report on implementation of the EA Model CAC published at http://europa.eu/efc/sub_committee/cac/cac_2012/final_-_cac_public_report.pdf (accessed on June 21, 2016).

⁶² INTERNATIONAL MONETARY FUND, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, *supra* note 46, at 33.

Fourth, reaching required majorities would still be a challenge, particularly for cross-series modifications and especially under the ICMA models. Modification using the ICMA Single Series Resolution would, for instance, not be available if any creditor having up to a quarter of that series objects. Thus a creditor could obtain a blocking position by buying-up up to a quarter of that series and demanding full payment on its holding. The same limitation would apply to the euro area's single series modification, especially for Reserved Matters where a 75% threshold is required.

The ICMA Multiple Series Two-Limb Resolution is limited by the possibility that any series that falls short of the 50 percent individual series voting threshold can drop out of the restructuring and demand full payment. The same applies for the EA Multiple Series Two Limb modification, save where Partial Cross-Series Modification is applicable.

Fifth, minority protection issues would continue to linger, and may in fact be exacerbated by the ICMA and EA Model Clauses. There are legitimate issues to be addressed regarding minority protection in the notice, quorum, voting and threshold provisions of these clauses (particularly the disenfranchisement, meeting and voting provisions) as well as the issue of good faith duties on the majority bondholders as well as the fiscal agent or trustee. Thus, it is possible that besides actions against the sovereign debtor, intercreditor disputes could disrupt sovereign debt restructurings under the model clauses.

Sixth, it is hard to even hazard a guess as to what a court or an arbitrator may decide on disputes relating to any of the model clauses or other procedural or substantive actions on sovereign debt. Given the arguably inevitable serious intercreditor issues that the model clauses will throw up, it is not clear how much use the model clauses may be in a litigation scenario and particularly in creditor-friendly forums such as New York courts.

Finally, holdout disruption is just one, albeit the most critical, of the challenges facing contractual sovereign debt restructuring. Issues such as vulture culture and incomplete restructurings of sovereign debt are not addressed by the model clauses, even as evidence show that they also pose significant challenges to the successful restructuring of sovereign debt. For instance, a vulture fund that manages to amass the required percentage of a poor country debt may hold out from the restructuring of that debt and sue for the full debt and fees – *a la* the vulture culture – and their much criticized business practice of preying on poor countries' debt would not matter. Further, debt restructurings that fail because the terms did not go far enough would continue to pose a problem to the restructuring of sovereign debt, even where collective action clauses have been deployed. The case of Greece readily comes to mind, as not even the retrofitting of its domestic law debt with CACs was enough to save the restructuring once a substantial part of the process was flawed.

In sum, therefore, the innovations in the contractual approach to sovereign debt restructuring have made giant strides towards mitigating holdout disruption.

However, the innovations suffer from both inherent and extraneous limitations that could seriously impede their usefulness in addressing the problem of holdouts in contractual sovereign debt restructuring. Further, the innovations only speak to the problem of holdout disruption and do not address other challenges confronting the contractual approach to sovereign debt restructuring. In the next section, I explore an alternative approach to the challenges of contractual sovereign debt restructuring from contract theory.

(F) The Contract Theory Paradigm

(i) A View from the Lens of Contract Theory

The contract theory paradigm seeks answers to the challenges of sovereign debt restructuring from legal theory, and in particular contract theory. This is in recognition of the critical, but oft unacknowledged, role that legal theory plays in our understanding of the law.

Contract theory helps us explain certain puzzling concepts or phenomena in contract law and practice, in same way as constitutional or other legal theories help explain difficult concepts or phenomena in constitutional law or general legal jurisprudence. Behind every rule of positive law is an idea, an assumption, an understanding often taken as a given in society. According to Robert Hillman, “theory is important. [It] helps us understand our world, stimulates additional hypothesis and offers a framework for less theoretical thinking”.⁶³ In the words of Jay M. Feinman, “theory is important. Theory, including legal theory, frames the way we look at problems, the facts and values we think relevant to their solution, and even what we consider to be problems at all. More is at stake in this debate than getting straight the views of some academic scholars; the meaning and content of contract law are at stake as well”.⁶⁴

(ii) The Footprint of Classical Contract Theory

A look through the history of sovereign debt restructuring from a theoretical point of view will show that an overwhelming predilection towards classical theoretical perception of sovereign debt contract is implicated in the challenges encountered in contractual sovereign debt restructuring.

The classical theory of contract posits that parties enter into contracts on their own free volition and as rational individuals each acting in their respective best economic interests, hence the contract should be enforced as expressed or implied by the parties in the contract.⁶⁵ A classic expression of the classical school is found in the earlier writings of M. Pothier in the nineteenth century, thus:

⁶³ Robert A. Hilman, *The Crisis in Modern Contract Theory*, 67 TEX. L. REV. 103 (1988-1989) at 122.

⁶⁴ See Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283 (1989-1990).

⁶⁵ See Alice Belcher, *A Feminist Perspective on Contract Theories from Law and Economics*, FEMINIST LEGAL STUDIES 8, 29 (2000), at 30. See also Michel Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769 (1984-1985) at 824 – 827 (expounding the individualistic fulcrum of the classical contract theory).

"As every contract derives its effect from the intention of the parties, that intention, as expressed or inferred, must be the ground and principle of every decision respecting its operation and extent, and the grand object of consideration in every question with regard to its construction".⁶⁶

The basic paradigm of the classical contract theory is that contract is essentially a tool for dealing at arm's length: that the terms expressed by the parties in the contract are isolated from any past or future interactions between them, and the adjudicating apparatus of the state enlisted as a guarantee of their rights in the case of a breakdown of the particular contractual relationship expressed in the four walls of the contract.⁶⁷ This basic paradigm finds expression in various forms, including immutability or near immutability of the promise expressed in a contract⁶⁸, individualism as the core of contracting,⁶⁹ and the "private market" as a neutral, impersonal mediator of social relations.⁷⁰

The reliance on the classical contract theory, perhaps unintended, could be seen in the decision of courts and arbitrators,⁷¹ the transactional posture of market participants,⁷² and the decisions of policy makers.⁷³ The apparent footprint of

⁶⁶ See Anat Rosenberg, *Contract's Meaning and the History of Classical Contract Law*, 59 McGill L. J. 165 (2013 – 2014) at 165.

⁶⁷ See Dori Kimel, *The Choice of Paradigm for Theory of Contract: Reflections on the Relational Model*, 27 (No. 2) OXFORD JOURNAL OF LEGAL STUDIES, 233, 237 (2007).

⁶⁸ Such as is canvassed by Charles Fried. See CHARLES FRIED, *CONTRACT AS PROMISE* (2nd ed. 2015), at 7 – 26.

⁶⁹ Discussed by Anat Rosenberg as a core philosophical underpinning of the development of the classical contract theory. See Rosenberg, *supra* note 66, at 176 – 184.

⁷⁰ See Gary Peller, *The Classical Theory of Law*, 73 CORNELL L. REV 300 (1987-1988) at 300 – 301 (criticizing the perceived notion that the common law rules of law (including contract law) were supposed to provide the neutral, objective framework within which individuals could pursue their own self-defined ends free from social coercion).

⁷¹ See particularly New York and English court decisions such as *Allied Bank International v. Banco Credito Agricola de Cartago*, 566 F. Supp. 1440 (S.D.N.Y. 1983), 733 F. 2d. 23 (2d Cir. 1984), and 757 F. 2d. 516 (2d Cir. 1985) (on two rounds of appeal to the Circuit Court); *Pravin Banker Associates Ltd. v. Banco Popular de Peru*, 165 Bankr 379 (S.D.N.Y. 1994); 107 F. 3d. 850 (2d Cir. 1997); *Elliot Associates v. Banco de la Nacion*, 194 F. 3d. 363 (2d Cir. 1999); *National Union Fire Insurance Co. of Pittsburgh v. People's Republic of Congo*, 279 F. Supp. 936; *Commercial Bank of Kuwait v. Rifidan & Central Bank of Iraq*, 15 F. 3d. 238, 242 – 43 (2d Cir. 1994); *Turkmani v. Republic of Bolivia*, 193 F. Supp. 2d. 165 (D.D.C. 2002); *Hamsah Investment & Anor. v. The Republic of Liberia*, Case No. 2008/587 (High Court of Justice, London), judgment of November 26, 2009; *Donegal International Limited v. Zambia*, [2007] EWHC 197 (Comm.); [2007] 1 Lloyd's Rep. 397. See also the myriad of holdout litigation and arbitration proceedings against Argentina discussed in section B (i) above. See further James Ghati, *The Sanctity of Sovereign Loan Contracts and its Origins in Enforcement*, 38 GEO. WASH. INT'L. L. REV. 251, 258 – 289.

⁷² This is seen particularly in the repeated refusal of creditor-side market participants to countenance any other possible means of addressing sovereign debt dysfunction (including the public law approach) and their reluctance to embrace far-reaching contractual reforms that could sufficiently address the challenges of the contractual approach once the proposed reform is unfavorable to them. See for instance the ICMA's response to proposed EA Model CAC, available at <http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Sovereign-Debt-Information/ICMA%20CAC%20response%20%20September%202011.pdf> (accessed on June 23, 2016). See further Gelper & Gulati, *Public Symbol in Private Contract*, *supra* note 40, at 1652.

⁷³ Consider, for instance, the US government's *volte face* on the SDRM after an initial burst of support for the proposal due to protests from the buy-side of the sovereign bond market. See Gelper & Gulati, *Public Symbol*

classical contract theory in sovereign debt restructuring makes an enquiry from a contract theory perspective even more compelling.

(iii) Should there be a Shift in Theoretical Approach?

A theoretical shift should normally be justifiable if the approach to rights and obligations and the distillation of legal principles from a certain theoretical paradigm has stymied or worsened rather than improved the underlying legal relationship, hindered the realization of the goals of the contracting parties, or worked against the public good.⁷⁴

Dissatisfaction with the contractual approach to sovereign debt restructuring leading to calls for and suggestions on a public law approach to sovereign debt restructuring on the one hand, and frantic efforts to reform the contractual approach on the other hand, as discussed in this paper, is a strong indication that the classical theoretical approach has been a cog in the wheels of the contractual approach; hence a theoretical shift is called for.

I advocate a theoretical shift in the contractual approach: one that seeks answers to issues involved in contractual sovereign debt restructuring from a theoretical paradigm other than the classical. This theoretical shift should present a different way of looking at sovereign debt instruments and the rights and obligations that they create, particularly in a restructuring scenario. It should change the questions we pose and impact our interpretation and application of the legal principles implicated in sovereign debt restructuring. It should impact the manner in which courts and arbitrators interpret sovereign debt instruments and the rights and obligations they create, policy makers' approach to sovereign debt management, and market makers' transactional posture on sovereign debt restructuring.

(iv) What Course for an Alternative Contract Theory?

What course should the theoretical paradigm shift on the contractual approach take? Other than the classical theory of contract, there are several other theoretical approaches to contract law.⁷⁵

in Private Contract, Id. Consider also the IMF's apparent resignation to the use of CACs as the endorsed means of sovereign debt restructuring, in the absence of its members' support for alternate (and in particular public law) approach. See INTERNATIONAL MONETARY FUND, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, IMF POLICY PAPER, *supra* note 46. See also the report of the G10 decision endorsing the use of market-based CACs (permitting amendments to sovereign bonds "with the approval of a super majority of bondholders") as "perhaps the most critical of proposals" for sovereign debt restructuring, available at <http://www.bis.org/publ/gten08.pdf> (accessed on June 23, 2016). This report was published before the subsequent failed restructurings, including Greece (2012) and Argentina's second round in 2010, where full or partial use of CACs were of little or no use.

⁷⁴ See, for instance discussions on the evolution of neo-classical school from the shortcomings of the classical school at section G(iv) below.

⁷⁵ On a contract theory basis one may address a perceived 'masculinity' in contract law using a 'feminist theory' (see Alice Belcher, *A Feminist Perspective on Contract Theories from Law and Economics*, *supra* note 66, at 30); a need to bind the promisor to the commitment engendered by his promise, using a 'will theory' (see CHARLES FRIED, *CONTRACT AS PROMISE*, *supra* note 68) and Morris L. Cohen, *The Basis of Contract*, 46 HARVARD LAW REVIEW,

There are, however, two schools of contract theory that stand in perhaps better contrast to the classical school – the neo-classical and relational schools.

Neo-classical contract law is what many today also call “modern contract law” – to an extent both terms are interchangeable in academic literature. Simply put, the problems and challenges of contracting on the basis of the classical theory has led not only to gradual but sure inroads into the classical by courts (mainly English courts of equity) but also by law makers in the form of legislations that are geared towards redressing perceived injustices and or other shortcomings of classical contract law⁷⁶ thus leading to the concept of a neo-classical law of contract.⁷⁷

Relational contract theory is largely understood to have been developed and popularized by Ian MacNeil.⁷⁸ The fundamental foundation of the relational contract theory is that most private exchanges⁷⁹ occur within ongoing relationships between

553 (1933)); an abandonment of the common law requirement of “intention to create legal relations” because of perceived proof of “consideration” as evidence of that intent in a ‘consideration theory’ (see Bhawna Gulati, *‘Intention to Create Legal Relations’: A Contractual Necessity or an Illusory Concept*, 2 BEIJING LAW REVIEW, 127 – 133 (2011)); a normative guide to decision makers in the regulation of business contracts, supposed to be ideal for firms as sophisticated economic actors using an ‘efficiency theory’ (see ROBERT E. SCOTT & PAUL B. STEPHEN, *THE LIMITS OF LEVIATHAN: CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW* (2006) and MICHAEL J. TREBILOCK, *THE LIMITS OF FREEDOM OF CONTRACT* (1997)); a protection of a promisee’s reliance on the promise of the promisor using a ‘reliance theory’ (see P. S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1985); Stanley D. Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, THE YALE LAW JOURNAL 78.1 (1968); and William Lucy, *Philosophy and Contract Law*, UNIVERSITY OF TORONTO LAW JOURNAL, Volume 54, Number 1, Winter 2004, pp. 75-108 (Review) at 101); or a set of principles that describe how the rights that individuals in a society are initially acquired, how they are transferred from person to person, what the substance and limits of properly obtained rights are, and how interferences with these entitlements are to be rectified using a ‘consent theory’ (see Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUMBIA LAW REVIEW (1986)).

⁷⁶ See for instance Edwin Peel’s discussion of the critical inroads made into classical contracting by the (i) ‘objective principle’, (ii) ‘standards of behavior’ relative to the type of contract, (iii) ‘standard of good faith’, (iv) qualified ‘freedom of contract’, for example in relation to standard form contracts, (v) ‘legislative interventions’ – domestic, regional and international, and (vi) restriction on the ‘freedom not to contract’, for instance legislation forbidding discrimination on grounds of age, disability, race, religion, etc). See EDWIN PEEL, *TREITEL: THE LAW OF CONTRACT* (14th ed., 2015), at 1 – 4. See also certain domestic legislations on contract such as the Uniform Commercial Code (United States) first published in 1952, the Unfair Contract Terms Act, 1977 (United Kingdom), and the French Civil Code on contracts, 2015. See also regional and international hard and soft laws on modern contracts such as the United Nations Convention on Contracts for the International Sale of Goods, 1980, the *Organisation pour l’Harmonisation en Afrique du Droit des Affaires* (OHADA) Uniform Law on Contract (proposed), the several European Union Directives on diverse forms of contracts (Consumer Rights ((2011/83/EC, 2014), Unfair Contract Terms in Consumer Contracts (93/13/EEC, 1993) and Digital Contract Rules (proposed)), and the UNIDROIT Principles, to mention but a few.

⁷⁷ See Jay M. Feinman, *Relational Contract Theory in Context*, 94 NW. U. L. REV. 737 (1999-2000) at 1287.

⁷⁸ See DAVID CAMPBELL, ET. AL., *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* (David Campbell, ed. 2010) for detailed discussions of aspects of the relational contract theory as formulated and advocated by Ian MacNeil.

⁷⁹ Contracts are seen more as exchange relationships – the giving up of something in return for receiving something else – for purposes of the contract theory. See *id.*, at 89. It does not appear that this concept of contracts as exchange relationships is significantly different from what a classical or neo-classical theorist understands as a contract but its significance lies in a subtle tendency to deemphasize the individualistic bent of the classical and neo-classical theorists, and a focus more on reciprocity, cooperation and interdependence in human relationships, including economic relationships.

parties, rather than the discrete transactional environment assumed in classical or neoclassical contract theory.⁸⁰ The substantive core of the relational contract theory proceeds from two propositions: (a) that contract is basically about cooperative social behavior; and (b) that contracts containing significant relational elements are the predominant form of contracting.⁸¹ Thus relational contract theory suggests that there is a baseline of obligation in contracting (one of cooperative social behavior) as opposed to the classical position that there is a baseline of no obligation, or the neo-classical position that there is a core of self-interest affected at the periphery by custom and regulation.⁸²

In my view, the neo-classical and relational theories seem best suited to a theoretical enquiry on sovereign debt restructuring, as other theories either appear to dovetail with one or more of the classical, neo-classical or relational schools or are primarily hinged on domestic contract law and so ill-suited to (external) sovereign debt restructuring. It is probably the case that solutions based on neo-classical theory could be best suited to certain issues in sovereign debt restructuring while certain other solutions to some other problems would be best distilled from a relational theoretical enquiry. As a theoretical enquiry should not seek to lay down any hard rules, it should be left for the adjudicator, policy maker, market participant or other player in the sovereign debt context to make use of any theory (including the classical theory where it does not result in decisions that hamper the successful restructuring of sovereign debt) to arrive at an informed decision on the issue in question.

(v) Questions for an Alternative Contract Theory

An alternative contract theory of sovereign debt restructuring should probe certain critical questions raised by the classical theoretical approach, with a view to providing guidance on approaches and answers to the issues. A fuller enquiry into this function of an alternative contract theory is for a further and deeper discourse. However, some of these issues include:

- should judicial decisions on sovereign debt restructuring disputes be based on the strict terms of the debt instrument or also allow a resort to extraneous matters, such as the underlying relationship and assumptions of the contractual bargain, a need for equity and fairness, protection of minority rights, safeguarding the stability of global financial system, etc?
- when judicial officers apply the terms of the sovereign debt instrument, should they adopt a literal interpretation or is a departure from the express wording of the terms justified on any grounds, say, to realize the true intention or goals of the contracting parties based on the implied terms? For

⁸⁰ See Keith Palzer, *Relational Contract Theory and Sovereign Debt*, 8 NW. J. INT'L L. & BUS. 727 (1987-1988) at 727-730.

⁸¹ Feinman, *Relational Contract Theory in Context*, *supra* note 77 at 743.

⁸² *Id.* See also Ian R. MacNeil, *Relational Contract: What we do and do not know*, 1985 WIS. L. REV. 483 (1985) at 523-524.

instance, does the transfer and/or assignment clause in the sovereign debt instrument contemplate a sale of the debt to a vulture fund; should a sovereign be able to impose unilateral modification terms on creditors, does a waiver of sovereign immunity apply to all assets of the sovereign or are some exempt and what criteria or rule of law should define the exempt properties?

- should creditors who are 'forced' to participate in a restructuring by their host governments be able to rescind the bargain on grounds of duress or undue influence?
- should creditors who are 'forced' into a restructuring by the debtor using a threat of default be able to rescind the bargain on ground of duress or undue influence?
- do disenfranchisement provisions in CACs sufficiently protect contractual and legal rights of all, particularly minority creditors? If not, should adjudicators set aside restructuring terms obtained by means of that disenfranchisement?
- what are the reasons for excluding multilateral debt from restructuring (the so-called preferred creditor status)? Do the reasons remain justifiable given the strategic importance of sovereign debt management in the global financial system?
- does the odiousness of sovereign debt justify a repudiation or compel a restructuring of that debt?
- do the meeting, quorum and voting threshold provisions in sovereign bond collective action clauses sufficiently provide protection for minority interests, including the interest of unsophisticated investors?
- what law should govern the interpretation of rights and obligations under sovereign debt instruments or arising out of the restructuring of that debt? The governing law of the debt instrument only or an admixture of that law and international law? Should the domestic law of a country play a role in settling of disputes arising from a restructuring of that country's external debt?
- should international public policy play or be countenanced by adjudicators deciding disputes arising out of restructuring of sovereign debt?
- should human rights, including socio-economic rights, be countenanced in sovereign debt restructuring or play a role in the adjudication of disputes on sovereign debt restructuring?

An enquiry in contract theory requires that everyone (market players, adjudicators and policy makers alike) involved in contractual sovereign debt restructuring should consider the theoretical issues that help shed light on the contract terms (express or

implied) and the laws applicable to them, beyond the bare terms of the sovereign debt instrument and/or positive law applicable to them.

This consideration should not seek to replace the terms of the contract but should function as a means of understanding and applying the meaning and effect of the terms under the laws implicated by those terms.

(G) Conclusion

The contractual approach to sovereign debt restructuring has shown remarkable success over the course of recent history. As evidenced by repeated and persistent calls for the public law approach as well as frantic efforts to strengthen the contractual approach using innovations in CACs, the contractual approach unfortunately is beset by certain serious and seemingly intractable challenges.

This paper has not discussed the merits or otherwise of the arguments for a public law approach. While I agree that the innovations in CACs are a step in the right direction, I am also of the view that these innovations are unlikely to make as far reaching an impact as they are primed by design and popular acclaim, for the reasons I have discussed in this paper.

I present an alternative approach to the challenges of the contractual approach based on legal theory rather than the barefaced and often exclusive application of ex ante positive law of contract that characterize contemporary approach to issues involved in sovereign debt restructuring.

An alternative theory of contract should not attempt to lay down any positive rules of law as answers to the questions raised by a theoretical enquiry. Its function should be to open up a channel of enquiry beyond the bare legal terms of sovereign debt contracts and beyond the bare provisions of positive law, especially where reliance on the classical school has disappointed. A theoretical enquiry should not position itself as opposed to positive law or express terms of sovereign debt contracts but rather serve as a means of exploring the meaning and proper application of the terms and laws of the contract in the context of the legal relationship. It is probably impossible that any formal positive rules of law could be formed by a theoretical approach to sovereign debt restructuring, but such an approach would be useful in construing sovereign debt contractual terms and the laws applicable to them in full context either generally or on a case by case basis, depending on the nature of the issue, therefore affording a veritable insight into managing the challenges that confront contractual sovereign debt restructuring.