Fordham International Law Journal

Volume 37, *Issue* 6 2014 *Article* 1

Not Just the Luck of the Irish: a Contractual Solution to the Problems of Sovereign Debt Restructuring

Katherine Crispi*

*Fordham Law School

Copyright ©2014 by the authors. *Fordham International Law Journal* is produced by The Berkeley Electronic Press (bepress). http://ir.lawnet.fordham.edu/ilj

NOTE

NOT JUST THE LUCK OF THE IRISH: A CONTRACTUAL SOLUTION TO THE PROBLEMS OF SOVEREIGN DEBT RESTRUCTURING

Katherine Crispi[*]

INTRODUCTION 1860
I. THE CURRENT WORLD OF SOVEREIGN DEBT, DEFAULT, & RESTRUCTURING 1866
A. The Basics Of Sovereign Debt Default & Restructuring 1866
1. Sovereign Debt Agreements 1866
2. Sovereign Debt Default & Restructuring 1868
B. The Nature Of Sovereign Debt Default & Restructuring 1870
1. The Complexity of Debt Restructuring Negotiations 1871
2. The Systemic Costs to the Sovereign 1873
C. The IMF's Current Role in Restructurings 1875
1. The IMF's Mission and Political Pressure 1876
2. The IMF & Moral Hazard 1878
II. REFORMING SOVEREIGN DEBT RESTRUCTURING: WHY IT IS NEEDED AND HOW TO DO IT 1879
A. The Republic of Ireland: A Painful Illustration of the Current Landscape of Sovereign Debt 1879
1. The Irish Economic Slowdown 1879
2. Ireland's Austerity Program 1882
3. Ireland Today 1883

[*] J.D. Candidate, 2015, Fordham University School of Law; B.A., International Relations, 2012, Wellesley College. The Author would like to offer her most sincere gratitude to Professor Caroline Gentile for her invaluable guidance, expertise, and camaraderie throughout the formation of this Note and beyond. She would also like to thank her mother Dorothy for her support and Irish citizenship. ZD. Finally, the Author would like to thank the Volume XXXVII *Fordham International Law Journal* Board, especially Joanna Pagones.

B. Comparing Statutory and Contractual Reform Proposals 1885
1. An International Bankruptcy Regime 1885
2. Reforming Contractual Terms....................................1886
III. A PROCEDURAL SOLUTION: IMPROVING THE NEGOTIATION PROCESS USING CONTRACT TO MINIMIZE CRISIS TIME VARIABLES............................1888
A. The Plan: Adding a Trigger Term to Sovereign Debt Contracts..1889
1. The Benefits of Contractual Reform 1889
2. Contracting Around Uncertainty: The Trigger Term 1890
B. Why the Trigger Term is Better than Extant Proposals....1892
CONCLUSION...1893

INTRODUCTION

The European sovereign debt crisis began in October 2009 when Greece announced that the previous administration had severely misreported the country's 2009 fiscal statistics to the European Union.[1] Following this revelation, investors panicked as they became increasingly concerned about their investments in Greece, as well as other countries in the Eurozone with large amounts of debt: Portugal, Spain, and the Republic of Ireland.[2] Subsequently, the three major credit rating agencies ("CRAs")—Standard & Poor's, Moody's, and Fitch—started to downgrade Greece, Portugal, Spain, and Ireland's ratings, thus signaling the beginning of the European sovereign debt crisis.[3]

1. *See* Kevin Featherstone, *The Greek Sovereign Debt Crisis and EMU: The Failing State In a Skewed Regime*, 49 J. COMMON MIKT. STUD. 193, 199 (2011) (stating that George Papakonstantinou, the Greek finance minister, announced a tripling of the national debt from 3.7% of GDP to 12.5% of GDP); *see also* Christopher Alessi, *The Eurozone in Crisis*, Council on Foreign Relations, *available at* http://www.cfr.org/world/eurozone-crisis/p22055?cid=rss-fullfeed-the_eurozone_in_crisis-120211 (last visited Mar. 14, 2014) (explaining the origins of the crisis).

2. Alessi, *supra* note 1 (explaining that instabilities in those markets that existed at this time of heightened investor caution); Paul Taylor, *Anxiety Rises in Euro Zone Bond Market*, THE N.Y. TIMES (Nov. 30, 2009), http://www.nytimes.com/2009/12/01/business/global/01inside.html?ref=europeansovereigndebtcrisis (reporting on the panic spreading throughout bond markets).

3. *See generally* Martin Mayer, *Credit Rating Agencies in the Crosshairs*, Brookings Institute (2010), *available at* http://www.brookings.edu/research/articles/2010/08/31-ratings-

This crisis was pervasive enough to destroy the Irish economy, which had been booming for decades.[4] Although Ireland experienced tremendous economic growth during the period from 1995 to 2000 known as *The Celtic Tiger*, economic conditions had declined sharply when the Irish property bubble burst in 2009.[5] Banks began scrambling for enough cash to stay afloat.[6] Attempting to solve this problem domestically, the Irish government guaranteed the banks' loans, converting their private bank debt into government debt.[7]

This public sector debt became unsustainable for Ireland.[8] Ireland therefore had to ask the official sector, the International Monetary Fund ("IMF") and the European Union, for a bailout.[9] After

---

agencies-mayer (defining the "big three" rating agencies as Standard & Poor, Moody's and Fitch, which are considered "Nationally Recognized Statistical Rating Organizations" by the United States government); *Moody's cuts Irish debt down to junk*, RTE NEWS (July 12, 2011), http://www.rte.ie/news/business/2011/0712/303559-bailout/ (anouncing the drop in ratings). *See also Greece debt rating downgraded by third agency*, BBC NEWS (Dec. 22, 2009), http://news.bbc.co.uk/2/hi/8426085.stm (reporting that Moody's was the final agency to downgrade Greece due to concerns about its ability to reduce its high levels of debt).

4. Michael Busby, *Luck of the Irish: How Ireland Has Become the Technological Wonderland of the European Union*, 11 CURRENTS INT'L TRADE L.J. 55, 62-63 (2002) (explaining Ireland's market competitiveness); Michael Lewis, *When Irish Eyes Are Crying*, Vanity Fair, March 2011, *available at* http://www.vanityfair.com/business/features/2011/03/michael-lewis-ireland-201103.print (describing the post-collapse situation in Ireland attributing the bubble to a short-term demand for real estate).

5. Lewis, *supra* note 4 (describing the post-collapse situation in Ireland). *See generally* GEORGE MORDAUNT, SHEPHERD'S PIE, 191 (2011) (setting forth his experience as a middle class Irish citizen both during the Tiger and after the crisis).

6. *See* MORDAUNT, *supra* note 5 at 106 (chronicling his experience as a business owner in dealing with bank representatives); *see also* Lewis *supra* note 4 at 3 (contextualizing the exposure of Irish banks; for example, in 2007 they had lent 40% more to property developers in the failing construction industry than they had to the *entire Irish population* in 2000).

7. *See* Credit Institutions (Financial Support) Act 2008 (Act No. 18/2008) (Ir.), *available at* http://www.irishstatutebook.ie/2008/en/act/pub/0018/sec0006.html#sec6 (providing the Irish Government's legislative power to take action for financial recovery); Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 (S.I. No. 490/2009) (Ir.), *available at* http://www.ntma.ie/business-areas/funding-and-debt-management/eligible-liabilities-guarantee-scheme/ [hereinafter *ELG*] (providing the text of the Eligible Liabilities Guarantee, Ireland's legislative response).

8. John Murray-Brown & Neil Dennis, *Ireland Guarantees Six Banks' Deposits*, FIN. TIMES, Sept. 30, 2008, (describing the effect of the ELG on the Irish national debt); *Irish deficit balloons after new bank bail-out*, BBC NEWS (Sept. 30, 2010), http://www.bbc.com/news/business-11441473 (reporting the Irish debt level as 32% of GDP); Michael Breen, *The International Politics of Ireland's EU/IMF Bailout*, Irish Studies In International Affairs 75, 8 (2012), *available at* http://doras.dcu.ie/17600/1/Breen_Ireland_EU-IMF_doras.pdf behavior and deposits returned to Irish banks).

9. *Q&A: Irish Republic bail-out*, BBC NEWS (Nov. 29, 2010), http://www.bbc.co.uk/news/business-11766346 [hereinafter *Bail-out Q&A*] (announcing the general timeline and basic facts of the bail-out); *see, e.g.*, *Eurogroup ministers discuss Ireland*

months of global speculation, Ireland signed a Memorandum of Understanding ("MoU") with these official sector institutions on December 7, 2010; the MoU specified the monetary amount of the assistance package, as well as the economic policies Ireland was required to implement.[10] The final rescue package amounted to EU€85 billion, with EU€22.5 billion coming from the IMF.[11] In order to receive periodic installments from the sovereign debt restructuring agreement, Ireland needed to implement a strict austerity program, which included cuts in social programs. For example, the MoU required cutting Disability Allowance from EU€192 to EU€186 per week and reducing Supplementary Welfare Allowance by EU€10 per week.[12] Such costs came alongside the negative publicity Ireland had endured surrounding the bailout request and negotiations.[13]

---

money crisis, CNN (Nov. 16, 2010), http://edition.cnn.com/2010/BUSINESS/11/16/ireland.economy/ (reporting that Ireland has no immediate funding and speculating about the pressure it was under to request a bailout); Neil Hume, *Statement by the Eurogroup on Ireland*, FIN. TIMES (Nov. 16, 2010), http://ftalphaville.ft.com//2010/11/16/406886/statement-by-the-eurogroup-on-ireland/ (characterizing the lack of Ireland's bailout request as a "standoff").

10. *Ireland timeline*, BBC NEWS, http://news.bbc.co.uk/2/hi/europe/country_profiles/1038669.stm (last visited March 8, 2014) (outlining the chronology of the bailout); *see also Budget Ireland 2011: Highlights from Brian Lenihan's Budget Speech from 3:45pm*, FINFACTS IRELAND (Dec. 7, 2010), http://www.finfacts.ie/irishfinancenews/article_1021198.shtml [hereinafter *Budget Ireland 2011*] (reporting on the Minister's presentation of Budget 2011 as the first step to implement the fiscal consolidation disbursements of bailout funds were conditioned on).

11. *The Economic Adjustment Programme for Ireland* (Directorate-General for Economic and Financial Affairs, Eur. Comm'n, Occasional Paper No. 76, 2011), *available at* http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/op76_en.htm [hereinafter *Memorandum of Understanding*] (providing Ireland's responsibilities in order to receive the bailout); *Bail-out Q&A*, *supra* note 9 (announcing the general timeline and basic facts of the bail-out).

12. *Budget Ireland 2011*, *supra* note 10 (reporting on the Minister' presentation of Budget 2011); *Irish Finance Bill 2011*, FINFACTS IRELAND, (Jan. 21, 2011) http://www.finfacts.ie/irishfinancenews/article_1021463.shtml (reporting on the measures contained in the bill); *see also Ireland timeline*, BBC NEWS, http://news.bbc.co.uk/2/hi/europe/country_profiles/1038669.stm (last visited Mar. 8, 2014).

13. *See, e.g.*, *Ireland sets out record austerity budget*, EURACTIV.COM, (Dec. 12, 2010), http://www.euractiv.com/euro-finance/ireland-sets-record-austerity-bu-news-500390 (assessing the Irish newly announced budget as "the toughest budget on record" and referring to the Irish government as a "puppet government" in light of the IMF's control); Charles Forelle & David Enrich, *Ireland's Fate Tied to Doomed Banks*, Wall Street Journal (Nov. 10, 2010), http://online.wsj.com/news/articles/SB10001424052748704506404575592360334457040 (reporting on the expanse of the Irish financial crisis); Bruno Waterfield, *Ireland bail-out: 'gloves off' as Irish battered into submission over debt crisis*, THE TELEGRAPH, (Nov. 22, 2010), *available at* http://www.telegraph.co.uk/news/worldnews/europe/ireland/8150233/Ireland-bail-out-gloves-off-as-Irish-battered-into-submission-over-debt-crisis.html (painting a negative picture of Ireland); Ciarian Hancock, *Moody view of*

On November 14, 2013, Ireland announced that it would conclude the austerity program in December 2013 by fulfilling its commitments, and it would not extend the program by seeking precautionary credit.[14] After the IMF and European Union conducted its twelfth review of Ireland's progress, they approved the disbursement of their final payments, ending the program.[15] The final review found that Ireland had consistently met deficit targets, successfully consolidated its debt, and implemented expenditure-based fiscal adjustment, or austerity measures.[16]

The IMF, the European Union, and the CRAs consider Ireland's progress to be a "success."[17] In January 2014, Moody's became the last credit rating agency to upgrade Ireland's credit rating back to investment grade, as the country was preparing to satisfy its bailout requirements.[18] The European Union's review reported that, "Ireland

---

Ireland shared by Central Bank, THE IRISH TIMES (Dec. 11, 2013), http://www.irishtimes.com/business/sectors/financial-services/moody-view-of-ireland-shared-by-central-bank-1.1623507 (last visited Dec. 13, 2013) (explaining that at the time, credit rating agency's negative outlook on Ireland continued to deter potential investment).

14. European Commission, *Economic Adjustment Programme for Ireland Autumn 2013 Review*, Occasional Papers 167 (Dec. 2013), *available at* http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op167_en.htm [hereinafter *2013 Review*]; Suzanne Lynch & Harry McGee, *Decision to exit bailout without precautionary credit 'fully supported' by EU-IMF*, THE IRISH TIMES (Nov. 14, 2013) http://www.irishtimes.com/news/politics/decision-to-exit-bailout-without-precautionary-credit-fully-supported-by-eu-imf-1.1594695 (reporting Minster for Finance Michael Noonan's statement that it was in the best interest of Ireland and on the IMF and EU's support of Ireland's decision).

15. *See 2013 Review*, *supra* note 14 (reporting their findings); European Commission, *Commission publishes final review of programme for Ireland – gives green light for final disbursement*, EUROPA.COM (Dec. 13, 2013), http://europa.eu/rapid/press-release_MEX-13-1213_en.htm (reporting on the decisions of the EU and the IMF).

16. *See 2013 Review*, *supra* note 14 (reporting Ireland's fulfillment of its policy requirements and targets); European Commision, *supra* note 15 (reporting the resulting disbursement of funds).

17. European Commission, *European Economic Forecast: Winter 2014*, EUR. ECON. 2 (2014), *available at* http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee2_en.pdf [hereinafter *2014 Forecast*] ("Ireland has successfully completed its financial assistance programme in December 2013"); *see Ireland: Fourth Review Under the Extended Arrangement and Request for Rephasing of the Arrangement*, IMF Country Report No. 11/356, 49 (Dec. 2011), *available at* http://www.imf.org/external/pubs/ft/scr/2011/cr11356.pdf [hereinafter *IMF Fourth Review*] (characterizing the accompanying data as "concrete signs of recovery").

18. Arthur Beesley & John McManus, *Ireland regains investment grade rating from Moody's*, THE IRISH TIMES (Jan. 17, 2014), http://www.irishtimes.com/business/economy/ireland-regains-investment-grade-rating-from-moody-s-1.1659667 (describing the increase as a "notch" and noting that Moody's is the last of the three main credit rating agencies to give Ireland an investment level grade); *Rating Action: Moody's upgrades*

has performed very well under this EU/IMF programme, paving the way for successful completion of the arrangement."[19]

Many investors, economists, and citizens, however, question the appropriateness of any sort of praise due to the fact that the Irish economy continues to suffer.[20] The European Union forecasted that Irish GDP will only grow by 1.8% in 2014, while unemployment is expected to remain at 11.9% and youth unemployment is at 26%.[21] Germany, on the other hand, has an unemployment rate of 5%, and the European Union projected significant increases in German investment, pensions, and wages.[22] The severity of Ireland's economic conditions has forced over 397,500 people to leave Ireland since 2008, the highest number since the 1980s, in order to find jobs abroad.[23] Additionally, the Republic is dotted with half-completed

---

Ireland's sovereign ratings to Baa3/P-3: outlook changed to positive, MOODYS.COM (Jan. 17, 2014), https://www.moodys.com/research/Moodys-upgrades-Irelands-sovereign-ratings-to-Baa3P-3-outlook-changed--PR_290559 [hereinafter *Moody's Rating*] (announcing the ratings increase). "Investment grade" indicates that an asset has a relatively low risk of default, thus it refers to the level of ratings at which an investor would purchase an asset. *See Moody's Rating Symbols and Definitions* (June 2009), *available at* https://www.moodys.com/sites/products/AboutMoodysRatingsAttachments/MoodysRatingsSymbolsand%20Definitions.pdf (explaining that while Moody's does not officially rate sovereign debts "investment grade" or not, they do give them ratings parallel to other assets officially rated investment grade).

19. *2013 Review*, *supra* note 14, at 5; *see also* European Commission, *supra* note 15, (reporting on the decisions of the EU and the IMF).

20. *See, e.g.*, Stephen Castle, *Setting Pace, Ireland Predicts December Exit from Bailout*, THE N.Y. TIMES (Oct. 14, 2013), *available at* http://www.nytimes.com/2013/10/14/world/europe/setting-pace-ireland-predicts-december-exit-from-bailout.html (discussing Ireland's future obstacles); Fintan O'Toole, *Ireland's Rebound Is European Blarney*, THE N.Y. TIMES, Jan. 12, 2014, *available at* http://www.nytimes.com/2014/01/11/opinion/irelands-rebound-is-european-blarney.html?src=me&ref=general&_r=0 (pointing out that such improvement is found in Ireland's global economy while its domestic economy remains weak).

21. *2014 Forecast*, *supra* note 17, at 61 (reporting the European Union's forecasts for Irish GDP growth and unemployment); Joana Taborda, *Ireland Unemployment Rate*, TRADING ECONOMICS, http://www.tradingeconomics.com/ireland/unemployment-rate (last visited April 3, 2014) (providing youth unemployment statistics and projections); Suzanne Lynch, *Europe forecasts lower growth rate for Ireland in 2014*, THE IRISH TIMES (Feb. 24, 2014), http://www.irishtimes.com/business/economy/europe-forecasts-lower-growth-rate-for-ireland-in-2014-1.1704058 (contextualizing Ireland's high 122.3% debt to GDP ratio for 2013).

22. *2014 Forecast*, *supra* note 17, at 57 (reporting the European Union's projection for German GDP and expansionary fiscal stance); European Commission, *German government projects 2015 GDP growth of 2%: European Commission report*, THE ECON. TIMES (Apr. 8, 2014), http://articles.economictimes.indiatimes.com/2014-04-08/news/48971275_1_gdp-economic-growth-new-report (explaining the European Union's positive outlook on Germany for 2014).

23. Aiden Sheehan, *Emigration still hitting hard as 250 leave daily*, INDEPENDENT.IE (Dec. 27, 2013), http://www.independent.ie/irish-news/emigration-still-hitting-hard-as-250-

building projects that were in progress when the crisis began.[24] It is in the face of these dismal projections, that the IMF congratulates Ireland and the CRAs upgrade its credit ratings.[25]

The disconnect between Ireland's economic reality and the IMF's understanding of Ireland's economy is a product of the competing objectives of participating parties.[26] The IMF bails out countries to stabilize the global economy; the measures it requires sovereigns to implement are focused on facilitating *global* recovery.[27] Consequently, it can go against the best interest of a nation to implement an IMF-led program.[28] These measures are not designed to accomplish the domestic restoration that sovereigns with uncontrollable debt levels need.[29] Sovereign debt lending needs a restructuring process that aligns the economic health of the debtor country with investor repayment.[30]

This Note analyzes the cost of negotiating a sovereign debt restructuring when economic conditions have reached the point of near catastrophe. Using Ireland as a case study, this Note addresses the complexity of debt restructuring and proposes a contractual solution. Part I of this Note explains the general concepts of sovereign debt default and restructurings, as well as characteristics of the current restructuring process. Part II chronicles Ireland's recent financial crisis and bailout program to demonstrate the costs of the current process and then compares statutory and contractual approaches to reforming the program. Finally, Part III advocates for

---

leave-daily-29868486.html (calculating Irish emigration statistics as of 2013); *see also* Lewis, *supra* note 4 at 7 (explaining that Ireland had prided itself on the high levels of immigration into the country and was glad to be something other than "Europe's poor outpost").

24. James Croke, *Chuaigh 'ar l'a - Debt of A Gaelsman: Ireland's Sovereign Debt Crisis, National and International Responses*, 32 NW. J. INT'L L. & BUS. 365, 378 (2012) (describing these partially completed residences as "ghost estates"); Lewis, *supra* note 4 (remarking on the site of these projects).

25. Paul Krugman, *The IMF on Ireland, The Conscience of a Liberal*, THE N.Y. TIMES (Dec. 21, 2011), http://krugman.blogs.nytimes.com/2011/12/21/the-imf-on-ireland/?_php=true&_type=blogs&_r=0 (analyzing the IMF's review of Ireland and noting that most of the economic growth is in the pharmaceutical industry which does not help most Irish citizens); *IMF Fourth Review*, *supra* note 17 (reviewing Ireland's progress so far).

26. *See infra* notes 32-45 and accompanying text (categorizing different forms of sovereign debt arrangements and the party interests they reflect).

27. *See infra* notes 92-101 and accompanying text (explaining the IMF and its goals).

28. *Infra* notes 92-101 and accompanying text (outlining the IMF's interests which are separate from a sovereign's).

29. *Infra notes* 92-101 (showing that the two parties have different goals).

30. *See infra* notes 62-69 and accompanying text (showing the lack of aligned interests).

contractual reform by advocating for the adoption of a new term to "trigger" or designate the point at which a sovereign must begin to restructure.

I. *THE CURRENT WORLD OF SOVEREIGN DEBT, DEFAULT, & RESTRUCTURING*

This Part explains how sovereign debt defaults and restructurings are completed. Part A provides an overview of sovereign debt agreements, as well as default and restructuring mechanisms. Part I.B outlines characteristics of the current process and analyzes systemic costs. Part I.C contextualizes the official sector institutions' involvement in the restructuring process.

A. *The Basics Of Sovereign Debt Default & Restructuring*

Sovereign debt is a fundraising mechanism by which countries gain access to necessary capital for domestic needs and projects.[31] This Section provides background information on the process of restructuring sovereign debt arrangements. Section A.1 discusses the different forms of debt agreements. Section A.2 explains the different courses of action available to a creditor when a sovereign is unable to make payments pursuant to these legal contracts.

1. Sovereign Debt Agreements

The sovereign that sells its debt is commonly referred to as the *debtor country*, or the *borrower*, while the purchasers are termed the *lenders* or the *creditors*.[32] A country's debt arrangements largely occur in four common forms.[33] Bilateral loans are only between two parties; in sovereign debt, they are usually between two governments. These arrangements tend to be more akin to political accommodations

---

31. *See* Alinna Arora & Rodrigo Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 L. & BUS. REV. AM. 629, 629 (2003) (explaining that debt is the largest source of capital to developing countries in the past fifty years); Adam Brenneman, *Gone Broke: Sovereign Debt, Personal Bankruptcy, and A Comprehensive Contractual Solution*, 154 U. PA. L. REV. 649, 650 (2006) (providing background for the mechanism).

32. *See, e.g.*, Brenneman, *supra* note 31 (using the phrase "lender"); *see* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 Vand. L. Rev. 1, 12 (2004) (using the phrase "creditor").

33. *See* Caroline Gentile, *The Market for Odious Debt*, 73 LAW & CONTEMP. PROBS. 151, 163 (Fall 2010); JOHN D. FINNERTY & DOUGLAS R. EMERY, DEBT MANAGEMENT: A PRACTITIONER'S GUIDE, 31–32 (2001) (categorizing the forms debt agreements can take).

whereby the lender's goal is to affect the borrower's behavior.[34] Thus, these agreements between governmental lenders and sovereign debtors are a way for the lender to secure influence rather than maximize economic profit.[35]

Countries can also enter into private loans; which can be in the form of either commercial loans or sovereign bonds.[36] Commercial loans are arranged between a sovereign and multiple commercial banks.[37] They are subject to market forces, and the lending party is usually focused on operating at a profit.[38]

Sovereign bonds are sold in various capital markets, including the domestic market in the United States and the international Eurobond market.[39] Institutional lenders, such as commercial banks, investment banks, insurance companies, pension funds, or mutual funds, purchase these bonds for profit maximization.[40] Bondholders usually are the most diverse group of creditors.[41]

---

34. Gentile, *supra* note 33 (explaining bilateral loans); A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 1008-09 (2004) (explaining the importance of political considerations as compared to in other arrangements).

35. *See* Gentile, *supra* note 33, at 163; *see also* Albert H. Choi & Eric A. Posner, *A Critique of the Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 33-52 (Summer 2007), *available at* http://scholarship.law.duke.edu/lcp/vol70/iss3/4 (explaining that these types of loans are frequently made to dictators).

36. *See* Gentile, *supra* note 33, at 163 (explaining private loan agreements); James M. Hays II, *The Sovereign Debt Dilemma*, 75 Brook. L. Rev. 905, 906 (2010) (explaining the increase in sovereign bonds since the 1980s).

37. *See* Gentile, *supra* note 33, at 165 (explaining how multiple commercial banks coordinate to form a "lending syndicate" which is managed by a large international bank).

38. *Id.* at 167-68 (establishing the profit-seeking motives of these loans); Ronald J. Silverman & Mark W. Deveno, *Distressed Sovereign Debt: A Creditor's Perspective*, 11 AM. BANKR. INST. L. REV. 179 (2003) (arguing that previously the majority of private debt owed by sovereign governments came in this form and these creditors had similar concerns and interests).

39. Gentile, *supra* note 33, at 167; Michael G. Kollo, *Underwriter Competition and Gross Spreads in the Eurobond Market*, EUR. CENT. BANK, Working Paper Series No. 550, 9-12 (Nov. 2005), *available at* https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp550.pdf (providing an example by analyzing competition in the Eurobond market).

40. *See* Hays II, *supra* note 36, at 906 (2010) (explaining that the global debt crisis of the 1980s also spurred the emergence of a secondary market for bonds); Gentile, *supra* note 33, at 163 (providing further background information).

41. *See* Steven L. Schwarcz, *"Idiot's Guide" to Sovereign Debt Restructuring*, 53 EMORY L.J. 1189, 1190-91 (2004) (discussing issues of sovereign debt focusing on state-issued bonds); *see* Arora & Caminal, *supra* note 31, at 629 (pointing out sovereign bond restructuring has gained in importance due to the increase in bonds and restructuring complications they present).

Finally, a country may receive a multi-lateral loan, where certain multinational organizations lend to the country in order to attempt to minimize disruption to the global economy and prevent default *after* an economic crisis.[42] Such organizations make up the official sector, which includes global organizations such as the World Bank and the IMF, as well as regional ones, such as the European Union and the European Central Bank in the case of Ireland. As public, non-party institutions, they have inherently different interests that motivate their participation in the process.[43] These institutions do not make financial decisions; they generally are advocating global political economic policies.[44] For example, the IMF's overarching priority is to further economic global development and stability.[45]

2. Sovereign Debt Default & Restructuring

A sovereign debt crisis occurs when the debtor country cannot make payments to its lenders because its debt burden is unsustainable.[46] When a debtor is unable to meet its legal repayment obligation, it defaults.[47] When a default occurs or appears imminent, a sovereign will usually attempt to restructure its debt.[48] The options

---

42. *See* Gentile, *supra* note 33, at 165 (explaining how multiple commercial banks coordinate to form a "lending syndicate" which is managed by a large international bank); *see, e.g.*, *supra* note 10 and accompanying text (demonstrating when in the process the multi-lateral loans are typically given).

43. *See infra* notes 92-101 and accompanying text (explaining the IMF's priorities and motivations); *see also* Hays II, *supra* note 36, at 919 (2010) (highlighting the IMF's inability to properly solve financial crises as well).

44. *See supra* note 43 and accompanying text (establishing that due to the IMF's interest in the overall global economy and lack of individual financial interest, its decisions are not financial).

45. *Id.*; *see* Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. Pa. L. Rev. 1483, 1490-91 (2004) (the IMF intervenes so as to prevent contagion by bailing out the sovereigns).

46. Arora & Caminal, *supra* note 31, at 630 (explaining how amassing large amounts of debt can cause a country to default). Scholars often draw a parallel to domestic corporate bankruptcy which occurs when a private company fails to make payments on its commercial debt or when its liabilities exceed its assets. *See, e.g.*, Gentile, *supra* note 33 (drawing a parallel between sovereign debt and commercial bankruptcy.) However, unlike in commercial debt there are no warning signs such as the amount of overdrafts on account, financial statements showing deteriorating conditions, and changing in purchasing habits. *See* Pamela S. Gotcher, *Guide to Commercial Banking Law*, Sheshunoff Information Services Vol. I, 4/11 (1989) (suggesting potential indicators of an oncoming crisis).

47. *Supra* note 46 and accompanying text (outlining the causes of defaults).

48. Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts*, IMF Paper No. 12/203, 8 (Aug. 2012), *available at* http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf

for a restructuring generally include some combination of: (1) rescheduling payments to lenders; (2) receiving external relief or debt reduction; and/or (3) obtaining a fresh infusion of money into its economy, such as a bailout.[49] Both debt reschedulings and debt reductions involve a "haircut," which is a decrease in the amount of repayment owed to creditors as a result of restructuring.[50]

Debt rescheduling lengthens the maturities of the old debt.[51] This usually entails a decrease in interest rates, which lessens the overall value of repayment.[52] Reschedulings offer relief to the sovereign because they shift payments into the future.[53] Debt reduction, on the other hand, is a decrease in the actual face value of the agreements.[54] Any form of external relief requires both parties to agree to alter to the debt agreement.[55]

If a country is unable to re-negotiate its agreement in this way, it will either default or ask for a *bailout*. A bailout is money offered in loans, bonds, stocks, or cash to prevent serious economic consequences that accompany a default.[56] While they often contain

---

(discussing the basic timeline); Arora & Caminal, *supra* note 31, at 657 (providing a brief overview of restructuring techniques).

49. *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 Vand. L. Rev. 1, 12 (2004) (explaining that sovereigns generally to the reschedule of obligations or reduce them rather than repudiating their agreements completely); Das et al., *supra* note 48 (explaining different technical components of restructuring).

50. Bratton & Gulati, *supra* note 49, at 18 (defining "haircut" as a reduction in the interest rate or the principal amount); Patrick Bolton & David A. Skeel, Jr., *Redesigning the International Lender of Last Resort*, 6 CHI. J. INT'L L. 177, 185 (2005) (defining "haircut" as debt reduction).

51. *See* Arora & Caminal, *supra* note 31, at 657; Das et al., *supra* note 48, at 7 (explaining rescheduling).

52. *See supra* note 51 and accompanying text (providing explanation of the effects of rescheduling on overall repayment).

53. *See* Das et al., *supra* note 48 (providing an explanation of debt rescheduling).

54. *See id.* (providing an explanation of debt reduction).

55. *See id.* (explaining the process by which these techniques are implemented). *See generally* Lee C. Buchheit & G. Mitu Gulati, *The Gathering Storm: Contingent Liabilities in a Sovereign Debt Restructuring* (Aug. 21, 2013), *available at* http://dx.doi.org/10.2139/ssrn.2292669 (pointing out that there is no procedure in place which necessitates these discussions).

56. *Bailout*, INVESTOPEDIA.COM, *available at* http://www.investopedia.com/terms/b/bailout.asp (last visited Feb. 27, 2014) (defining "bailout" [a] situation in which a business, individual or government offers money to a failing business in order to prevent the consequences that arise from a business's downfall taking the form of loans, bonds, stocks or cash; they may or may not require reimbursement); *see also* Sedlak, *supra* note 45, at 1487 (contrasting sovereign default with domestic bankruptcy).

some debt reduction, bailouts differ from external relief measures because they provide the sovereign with additional funds to avoid default, while external relief reduces the amount the sovereign already owes.[57] Since debt agreements do not typically contain procedures for restructuring, any combination of rescheduling, external relief, or bailout requires negotiations.[58]

B. *The Nature Of Sovereign Debt Default & Restructuring*

Economic and political crises usually impede a sovereign's ability to make debt payments, forcing it to negotiate with its creditors.[59] Restructuring negotiations between the borrower and lender typically have the dual purpose of modifying the terms of the loan and the borrower's behavior.[60] The negotiating period is usually public, expensive, and as in the Irish case, can leave the country vulnerable to further economic harms by making it harder for a country to re-enter capital markets as a result of the damage to its economic reputation.[61] Section B.1 identifies the competing interests inherent to debt restructuring that can prolong and complicate the process. Section B.2 explains how the timing of a restructuring affects the severity of an economic crisis in both quantifiable expenses and the effect on a sovereign's reputation.

---

57. *See supra* note 56 and accompanying text (defining a "bailout"); *supra* notes 51-54 and accompanying text (explaining external relief measures).

58. Buchheit & Gulati, *supra* note 55 (providing an example of missing procedural details); *see also* Sebastian Dellepiane Avellaneda & Niamh Hardiman, *The European Context of Ireland's Economic Crisis*, UCD Dublin European Institute Working Paper 10-3, 17 (Aug. 2010) (attributing a lot of Ireland's poor policy choices to the fact that it did not have any planned policy of what to do in terms of crisis).

59. *Government statement on request for support*, RTE NEWS (Nov. 21, 2010), http://www.rte.ie/news/2010/1121/294654-economy3/ (reporting the beginning of negotiations in the Irish case in 2010). *See generally* Buchheit & Gulati, *supra* note 55 (explaining the need for negotiation).

60. Daniel K. Tarullo, *The Role of the IMF in Sovereign Debt Restructuring*, 6 CHI. J. INT'L L. 287, 298 (2005) (explaining that the IMF frequently require austerity measures on the part of the sovereign); *supra* notes 130-135and accompanying text (detailing Ireland's terms with the IMF).

61. Bratton & Gulati, *supra* note 49, at 13 (explaining that in spite of these stigmatizing effects, there is concern that a sovereign may strategically default and stop the accruing of interest when it is unnecessary but beneficial to default); Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1045 (2004) (arguing that that current check against strategic defaults is the prohibitively long and expensive process of negotiating a restructuring with the debt holders often caused by holdout creditors).

1. The Complexity of Debt Restructuring Negotiations

Debt restructuring negotiations are complicated, as creditors' interests are often not aligned with the sovereign's or each other's.[62] Many sovereign debt contracts currently contain *unanimous action clauses* ("UACs"), which require that every creditor, regardless of its holdings, be in complete agreement about any changes, such as debt reductions or reschedulings.[63] Since a debtor usually only has the value to satisfy *some* debts, this creates perverse interests among creditors who are competing for payment from the country's limited funds.[64]

Creditors' non-aligned interests further complicate restructurings. The makeup of lenders has become increasingly diverse usually including a combination of national governments, the IMF, and private financial institutions, such as banks and mutual funds; these parties have competing interests and priorities in sovereign lending.[65] National governments have a variety of interests depending on their relationship with the debtor. For example, the United Kingdom invested heavily in Irish assets and markets because Ireland is a major market for many British products.[66] Meanwhile, the IMF's priority is to quickly stabilize the global economy by ensuring a sovereign repays its lenders and a crisis does not become contagious.[67] Banks and mutual funds are motivated strictly by

---

62. Bratton & Gulati, *supra* note 49, at 4 (highlighting the difficulty for a sovereign to obtain unanimous intent in light of a dispersed creditor base); Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L. REV. 977, 981 (2007) (explaining how a borrower's insolvency intensifies the competing interests of creditors because the sovereign doesn't have enough funds to satisfy all debts).

63. Bratton & Gulati, *supra* note 49, at 3 (stating that use of this boilerplate term is a significant barrier to the success of negotiations); Bolton & Skeel, *supra* note 50, (stating that this was the case until Mexico's 2003 bond issuance).

64. *See* Gulati & Triantis, *supra* note 62, at 981 (explaining creditors' perverse interests in light of a sovereign's insolvency where it doesn't have enough funds to satisfy all debts); *id.* (citing examples of creditors protecting their individual interests).

65. *See supra* notes 73-78 and accompanying text (discussing the varying instruments).

66. MATT COOPER, HOW IRELAND REALLY WENT BUST 120-21 (2011) (providing context to the British exposure to Irish banks). *See generally* TIM PAT COOGAN, IRELAND IN THE TWENTIETH CENTURY (2003) (describing Ireland's history as an sopen economy heavily based on trade).

67. Gulati & Triantis, *supra* note 62, at 995 ("The IMF's not-for-profit status and its commitment to the economic development of its members also assure creditors that the Fund is likely to assume the lead role in restructurings"); *see also* Bolton & Skeel, *supra* note 50, at 195 (arguing that its current mission is not the one it was set up to pursue). *See generally*, *Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal*

profits; therefore, they are interested in ensuring that these debts not only are repaid but that they generate maximum interest.[68] Thus, these institutions are less likely to forgive debt for political or other non-financial reasons.[69]

While amending a contract with potentially thousands of creditors around the world can be an uphill battle, one of the biggest disruptions to debt restructurings is *holdout creditors*.[70] The UAC motivates these creditors to refuse to cooperate in restructuring plans put forth by the sovereign.[71] These holdouts are legally protected by the UAC, which effectively guarantees their repayment and ensures no restructuring can move forward without their agreement.[72] In addition to withholding support in hopes of receiving better payment, some holdouts take sovereigns to court demanding full repayment.[73] The UAC further complicates the restructuring process because creditors who refuse to make any concessions threaten the orderliness of, and often prolong negotiations.[74]

---

and Policy Framework, IMF (2013) [hereinafter *IMF Policy*] (outlining the IMF's procedure in sovereign debt restructurings).

68. Dickerson, *supra* note 34, at 1009 (explaining the financial priorities of these creditors; *see* Silverman & Deveno, *supra* note 38 (arguing that restructurings were less complicated when financial institutions were the majority of creditors due to their aligned financial interests).

69. *See supra* note 68 and accompanying text (profiling these institutional lenders).

70. *See* Samuel E. Goldman, *Mavericks in the Market: The Emerging Problem of Hold-Outs in Sovereign Debt Restructuring*, 5 UCLA J. Int'l L. & Foreign Aff. 159, 173-174 (2000) (discussing potential solutions to this problem); Fisch & Gentile, *supra* note 61, at 1045 (2004) (discussing those holdout creditors known as "vulture funds"; *see also*, Anna Gelpern, *Building A Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1115, 1116-117 (2004) (explaining how as a sovereign funds start to run out, lenders unsure of their place in line or their "priority" in getting paid relative to one another can also stall negotiations).

71. *See supra* note 70 and accompanying text (establishing the motivation of holdout creditors).

72. *See* Fisch & Gentile, *supra* note 61, at 1047 (arguing that by holdout creditors enforcing their legal rights, they serve as an important check on opportunistic defaults); Anne Krueger, *International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring*, Address at the National Economists' Club Annual Members' Dinner American Enterprise Institute (Nov. 26, 2001), *available at* http://www.imf.org/external/np/speeches/2001/112601.htm (last visited Jan. 24, 2013) (arguing that a major problem with holdout creditors is created by the fact that individual bondholders have more legal leverage in restructuring than banks, and are subject to less regulation).

73. *See, e.g.*, Elliott Associates, L.P. v. Republic of Peru, 12 F. Supp. 2d 328 (S.D.N.Y. 1998), *rev'd sub nom.* Elliott Associates, L.P. v. Banco de la Nacion, 194 F.3d 363 (2d Cir. 1999); Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 522 (2d Cir. 1985) [hereinafter *Allied II*].

74. *See* Anne Krueger, *International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring*, IMF (Nov. 26, 2001), *available at* http://www.imf.org/

2. The Systemic Costs to the Sovereign

The current restructuring process is convoluted. The associated economic and reputational costs often cause sovereigns to delay restructuring when it is in their interest to restructure early and increase their chances of avoiding a default.[75] Negotiations are costly because of their direct expenses and the further external harms to which they expose the sovereign. For example, Greece endured an extremely protracted negotiation process from December 2009 to May 2010 as Germany and other countries strongly opposed any financial assistance from the European Union.[76] Consequently, although it serves the debtor's interest to restructure early, the costs of the current system often cause sovereigns to try to avoid restructuring debts when they are facing liquidity problems.[77]

One of the biggest harms is the negative effect on a sovereign's economic reputation; this makes future fundraising difficult when the sovereign eventually returns to international markets.[78] The

---

external/np/speeches/2001/112601.htm [hereinafter *SDRM 2002*] (acknowledging that difficulty in securing collective action makes sovereigns extremely reluctant to restructure their debt); *see also* Arora & Caminal *supra* note 31, at 630 (stressing the need for a rethinking of the current procedures).

75. Dickerson, *supra* note 34, at 1007 (explaining that sovereigns also avoid debt restructurings because of their concern that default signals that the sovereign is not creditworthy and that such a signal diminishes a sovereign's reputation in, and access to, international capital markets, of uncertainty whether the restructuring will be successful); Adam Feibelman, *Contract, Priority, and Odious Debt*, 85 N.C. L. REV. 727, 732 (2007) (arguing that the lack of orderly workouts can cause creditors to reduce the amount of credit available in general); Kreuger, *supra* note 74 (explaining the problems of delayed sovereign debt restructurings).

76. *Greece Timeline*, BBC NEWS, http://news.bbc.co.uk/2/hi/europe/country_profiles/1014812.stm (last visited Apr. 7, 2014) (chronicling the Greek situation); *'Detrimental to the Euro': European Central Bank Blasts Merkel on Greece*, SPIEGAL ONLINE (Mar. 24 2010), http://www.spiegel.de/international/europe/detrimental-to-the-euro-european-central-bank-blasts-merkel-on-greece-a-685519.html (explaining German chancellor Angela Merkel's position that the IMF not the European Union should provide Greece with financial aid).

77. Bratton & Gulati, *supra* note 61, at 19 (advocating for early restructurings as they protects a sovereign's future access to capital); Dickerson, *supra* note 34, at 998 (2004) (arguing that sovereigns delay both defaulting debts and restructuring those debts with their creditors because of the political and economic ramifications associated with default); *see SDRM 2002*, *supra* note 74 (explaining the delay is mainly the result of government decisions and political factors); *see infra* notes 65-72 and accompanying text (detailing the structural complexities of negations).

78. Bratton & Gulati, *supra* note 61, at 13 ("Access to funding is critical for the economic rehabilitation: a financially troubled State will need fresh working capital during restructuring, so that critical governmental functions don't collapse."); *see* Arora & Caminal,

negotiations themselves, as well as the reactions of other parties, such as CRAs, garner dramatic public attention.[79] Severe drops in market confidence usually accompany such notice as investors frequently cash in their investments, further exacerbating the liquidity crisis.[80] In such a situation, a country's liquidity can plummet before it has a chance to restructure.[81] Scholars argue that despite the austerity measures that the IMF requires sovereigns to impose, the effect on future access to borrowing is the biggest cost of a default because investors are reluctant to invest in countries that have defaulted for fear it will happen again.[82]

Negotiations are also inherently expensive.[83] First, during a restructuring trade flows generally shrink, as does foreign investment.[84] Secondly, sovereigns have to pay their financial and

---

supra note 31, at 642 (explaining that this financing can be obtained from two main sources: (1) official financing (bailouts) or (2) private sector (bail-ins)).

79. *See, e.g.*, *Moody's cuts Irish debt down to junk*, RTE NEWS, July 12, 2011 (anouncing the drop Ireland's debt ratings); Hancock, *supra* note 13 (reporting the persuasive effects of the rating on Ireland's credit outlook). *See generally* Mayer, *supra* note 3 (arguing that the CRAs exacerbated the financial crisis in 2008 both in their ratings before and after the bubble bursts).

80. Bratton & Gulati, *supra* note 61, at 14 (explaining this concept as part of a reputation theory of sovereign debt); Joanna Pagones, Note, *The European Union's Response to the Sovereign Debt Crisis: Its Effect on Labor Relations in Greece*, 36 FORDHAM INT'L L.J. 1517, 1520-32 (2013) (describing the impact of falls in confidence in a sovereign).

81. *Infra* notes 123-139 and accompanying text (illustrating this result in the Irish case).

82. *See* Miguel Fuentes & Diego Saravia, *"Sovereign Defaulters: Do International Capital Markets Punish Them?"*, J. DEV. ECON. 336, 336–47 (2010), *available at* http://www.economia.puc.cl/docs/dt_314b.pdf (analyzing foreign investment data on default and concluding that non-investment does serve as form of punishment for defaulting countries); Bratton & Gulati, *supra* note 61, at 14 (explaining this concept as part of a reputation theory of sovereign debt). *See generally* Pagones, *supra* note 80, at 1520-32 (describing the impact of falls in confidence in a sovereign).

83. Das et al., *supra* note 48, at 65-66 (pointing out the administrative costs of a restructuring); *see also* Dickerson, *supra* note 34, at 998 (explaining that sovereign debt restructurings are costly and inefficient partly because sovereigns do not begin renegotiate debts earlier).

84. Das et al., *supra* note 48, at 61-65 (concluding that recent studies of empirical data agree that debt crisis years are associated with a drop in GDP of between 2 and 5% per year and that this relationships is causal, rather than correlative); STURZENEGGER ET AL., DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 51-52 (2006) (conducting a statistical analysis of a sample of defaults to find that a defaulting country that is also experiencing a banking crisis will suffer output losses of 1.6% leading to an output level of 4.5% below five years after the crisis). *See generally* Fuentes & Saravia, *supra* note 82, at 336–347 (2010), *available at* http://www.economia.puc.cl/docs/dt_314b.pdf (establishing this relationship between crisis and investment).

legal advisors for negotiating and communicating with bondholders.[85] In addition to these direct expenses, debtors are also usually required to pay a restructuring fee, which is a percentage of the total restructured amount.[86] These costs further reduce a debtor's liquidity.[87] Thus, the longer it takes for the parties to come to an agreement, the more disruptive and severe the recession becomes.[88]

Aside from the monetary costs, the public perception of a country in the midst of restructuring negotiations can exacerbate a crisis. CRAs begin to lower a country's credit ratings during negotiations, which decreases its current and future access to capital markets.[89] Consequently, the sovereign's debt value is lower, exposing the sovereign to predatory holdouts, known as vulture funds, who purchase debt at this lowered price and demand payment at face value.[90] These prohibitive costs of negotiation often cause a sovereign to delay restructuring.[91]

C. *The IMF's Current Role in Restructurings*

This Section examines the IMF's participation in sovereign debt restructurings, as well as frequent criticisms of the organization and its operation. Section C.1 explains the argument that IMF lending is

---

85. Das et al., *supra* note 48, at 66 (detailing a sovereign's substantial expenses from financial and legal advisors); LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY, 129 (2003) (surveying trends in restructuring fees).

86. *See* RIEFFEL, *supra* note 85 (reporting findings that this fee tends to be of between 0.25 % and 2.25 % of the amounts restructured).

87. Das et al., *supra* note 48, at 45-55 (concluding from various survey results that the decrease in a sovereign's output and trade flows depends on the duration of arrears and negotiations); Fisch & Gentile, *supra* note 70, at 1089 (explaining that disruptions lengthen time and thereby increase associated costs and continue to deplete the sovereign's funds); Goldman, *supra* note 70, at 164 (explaining that longer negotiations signal that the sovereign cannot pay and thus encourages increased holdout behavior).

88. *See infra* note 113 (detailing the positive relationship between negotiation cost and length).

89. Marilyn Blumberg Cane et. al., *Below Investment Grade and Above the Law: A Past, Present and Future Look at the Accountability of Credit Rating Agencies*, 17 Fordham J. Corp. & Fin. L. 1063, 1066 (2012) (stating that "millions of investors across the world rely on rating agencies to help assess the creditworthiness of particular financial instruments"); *see, e.g.*, Hancock, *supra* note 13 (reporting the persuasive effects of the rating on Ireland's credit outlook).

90. *See, e.g.*, Fisch & Gentile, *supra* note 61, at 1071 (explaining the strategy of vulture funds); Goldman, *supra* note 70 (describing the difficulties for sovereign debtors and other creditors created by holdout litigation).

91. *See supra* note 77 and accompanying text (identifying this tendency in sovereigns); *supra* notes 82-88 and accompanying text (detailing these costs).

politically motivated due to its internal system of voting and governance. Section C.2 summarizes arguments that the IMF's current level of involvement promotes *moral hazard*.

1. The IMF's Mission and Political Pressure

The IMF was founded in December 1945 when the first members, the forty-five parties at the Bretton Woods conference, signed the Articles of Agreement; it began operations on March 1, 1947.[92] Initially, the IMF was created to oversee the rules on international monetary relations agreed on at Bretton Woods.[93] It was also created as a credit union where members would contribute an amount of money for the power to draw on the fund if they needed financial assistance.[94]

The IMF states that its primary goal is to stabilize the international financial system.[95] Like most official sector organizations, the IMF has an unequal structure of governance.[96] Each member country is required to pay an assigned "quota," which reflects the size of its economy.[97] Members also vote on the IMF's

---

92. *Cooperation and reconstruction*, IMF 1944–71, https://www.imf.org/external/about/histcoop.htm (last visited Apr. 9, 2014) (chronicling the foundation of the IMF); Tarullo, *supra* note 60, at 289-92 (explaining the changes in the role IMF over time).

93. *Cooperation and reconstruction*, IMF 1944–71, https://www.imf.org/external/about/histcoop.htm (last visited Apr. 9, 2014) (explaining the formation of the IMF and its founding purposes); Lee C. Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 Chi. J. Int'l L. 333, 334 (2005).

(asserting that the creation of the IMF gave Creditor Governments new methods through which to influence the behavior of sovereign debtors).

94. Tarullo, *supra* note 60, at 289-92 (discussing how the IMF used primarily serve as an international credit union as opposed to the economic monitoring and policy roles it has seen taken on); *Cooperation and reconstruction*, IMF 1944–71, https://www.imf.org/external/about/histcoop.htm (last visited Apr. 9, 2014) (explaining early IMF operations and stating that France was the first member to borrower from the IMF).

95. Bratton & Gulati, *supra* note 49, at 3. (arguing that the IMF acts to satisfy political goals of stability, making it predictable for the creditors to anticipate and thus removing any incentive on their part to negotiate); Tarullo, *supra* note 60, at 309 (arguing that the impact of the political foundation of the Fund should not be overemphasized).

96. *See* Tarullo, *supra* note 60, at 292 (explaining that the discrepancy in voting power in the IMF); Bolton & Skeel, *supra* note 67, at 198 (pointing out the concern, that as politicized institution, the IMF could be too liberal in offering its assistance); *see also IMF Executive Directors and Voting Power*, IMF, http://www.imf.org/external/np/sec/memdir/eds.aspx (last visited Mar. 13, 2014) [hereinafter *IMF Voting*] (providing a breakdown of the amount of votes held per country).

97. *FactSheet: IMF Quotas*, IMF (Mar. 25, 2014), *available at* https://www.imf.org/external/np/exr/facts/quotas.htm [hereinafter *IMF Quotas*] (explaining generally how quotas are determined and how a member's quota determines that country's financial and

decisions and policies; a member's voting power reflects its financial contribution.[98] Thus, a small group of wealthy nations has a dominant voting position: twenty-two out of the 184 member countries hold sixty percent of the votes.[99]

As a public institutional actor, the IMF usually is not party to the initial sovereign debt contract and does not automatically have a legal claim when a sovereign defaults.[100] Consequently, it does not participate in restructurings to make strictly financial decisions. Instead, with powerful shareholders, it can serve as a catalyst for lenders to extend relief in the restructuring process and to stabilize markets.[101] Critics argue that the IMF's structure allows global politics to dictate restructurings by enabling powerful members to create IMF policies in light of their domestic interests.[102] The Irish negotiations with the IMF provide an apt example of this. Germany, France, and the United Kingdom are all in the group of five countries with the highest number of votes in the IMF. They also are major Irish creditors.[103] Thus, it is not surprising that the IMF's assistance

---

organizational relationship with the IMF); s*ee also* Tarullo, *supra* note 60, at 289-92 (discussing how the IMF formerly served as an international credit union as opposed to its additional economic monitoring and policy roles).

98. *See IMF Voting*, *supra* note 96 (explaining the voting power in the IMF); *IMF Quotas*, *supra* note 97 (explaining the economic basis for power within the IMF).

99. Tarullo, *supra* note 60, at 292 (contextualizing the votes by pointing out that the United States, with over seventeen percent of the total voting power has the single greatest number of votes). *But see* Paul R. Masson & Michael Mussa, *The Role of the IMF: Financing and Its Interactions with Adjustment and Surveillance*, IMF Pamphlet Series No 50 (1995) (arguing the Fund has concentrated its surveillance on countries that are likely to need its help).

100. *See* Gulati & Triantis, *supra* note 63, at 977-78 (positing that despite the security that official sector institutions enjoy, there is no legal basis for it). *See generally*, W. Mark C. Weidemaier, *Disputing Boilerplate*, 82 TEMP. L. REV. 1, 2 (2009) (explaining the legal mechanisms of sovereign debt contracts).

101. Gulati & Triantis, *supra* note 63, at 994 (explaining this power as a function of the IMF's "international status and political clout"); Bolton & Skeel, *supra* note 67, at 182-83 (arguing that the IMF is disproportionally sensitive to creditor disputes at the expense of other economic issues such as the sovereign's domestic recovery).

102. *See* Tarullo, *supra* note 60, at 288-89 (arguing that because everyone will try to avoid generalized financial distress, the IMF has a bias in favor of lending money to countries).

103. *IMF Voting*, *supra* note 96 (providing a breakdown of the amount of votes held per country); *see also* Tarullo, *supra* note 60, at 309 (arguing that such a structure gives the IMF a political foundation).

was conditional on Ireland implementing severe financial reforms to ensure creditor repayment.[104]

2. The IMF & Moral Hazard

Critics also argue that the IMF's consistent involvement in sovereign debt restructurings creates moral hazard.[105] Moral hazard refers to the tendency of actors who are protected from the consequences of risky behavior to use less caution in their financial decisions.[106] This inclination can be found on both the creditor and sovereign sides of debt lending; sovereigns who expect the official sector to bail them out have less incentive to adopt prudent, economic strategies.[107] Similarly, creditors who anticipate being protected from a default may not lend as carefully.[108]

Many scholars also argue that IMF bailouts and austerity programs further incentivize holdout creditors by making it rational for them to wait for a better deal.[109] Experts argue that the IMF's role as the lender of last resort increases the frequency of defaults because it reduces creditors' incentives to make concessions that would result in a haircut.[110] In other words, the reliability of an eventual IMF

---

104. *See infra* notes 126-128 and accompanying text (explaining how the influence of powerful IMF members, Germany, France and U.K. prevented the IMF from creating a bailout that left banks and other investors exposed).

105. Schwarcz, *supra* note 41, at 1194 (defining moral hazard); Dickerson, *supra* note 34, at 1010 (explaining the view that the prospect of an IMF support package arguably creates a moral hazard risk by encouraging countries both to maintain domestic economic policies that are not fiscally sound and to borrow recklessly from private capital markets).

106. Schwarcz, *supra* note 41, at 1194 (acknowledging the varying definitions of moral hazard across different disciplines); *see, e.g.*, Richard A. Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645, 653 (1985) (defining moral hazard as "the deliberate efforts by the insured to bring about the insured event, as when the owner of life insurance commits suicide).

107. Schwarcz, *supra* note 41, at 1194 (explaining that moral hazard on both lender and sovereign sides); Dickerson, *supra* note 34, at 1010 (providing an example of such behavior on the sovereign's side).

108. *See, e.g.*, Dickerson, *supra* note 34 (arguing that the prospect of a support package from the IMF arguably encourages creditors to take excessive risks and lend recklessly); Tarullo, *supra* note 60, at 288 (establishing the frequency of IMF bailouts).

109. *See supra* notes 71-77 and accompanying text (establishing the incentives for holdout creditors once they know repayment is legally inevitable); Bratton & Gulati, *supra* note 49 (explaining that at the bottom line, the sovereign must cater to the creditors, since it pays them only for the purpose of the potential for future arrangements).

110. *See, e.g.*, Arora & Caminal, *supra* note 31, at 651; Bratton & Gulati, *supra* note 49, at 3 (both arguing that in the anticipation of an official sector bail out, creditors see no benefit in accepting a restructuring contract).

bailout incentivizes creditors to force the debtor into default in order to secure full repayment through the bailout.[111]

II. *REFORMING SOVEREIGN DEBT RESTRUCTURING: WHY IT IS NEEDED AND HOW TO DO IT*

This Part examines the sovereign debt restructuring process and discusses proposed reforms. Part II.A uses Ireland as a case study of the current system of restructuring highlighting the immense costs Ireland has endured. Part II.B compares the two main types of sovereign debt reforms: statutory and contractual.

A. *The Republic of Ireland: A Painful Illustration of the Current Landscape of Sovereign Debt*

This Section examines Ireland's economic crisis and its restructuring process. Section A.1 discusses the causes of the crisis, Ireland's attempts to avoid restructuring through the Eligible Liabilities Guarantee ("ELG"), and the competing interests present in the negotiations with the European Union and the IMF. Section A.2 explains the austerity program through which the European Union and the IMF provided financial assistance. Section A.3 examines the current state of Ireland now that it has completed its restructuring through the austerity program.

1. The Irish Economic Slowdown

The Irish economy is inherently vulnerable to global economic disruptions because it is predominantly an export economy.[112] During the increased wealth and prosperity of the *Celtic Tiger*, new job opportunities in the growing information technology industry caused property values to rise exponentially.[113] This created an Irish property

---

112. *See generally* DIARMAID FERRITER, THE TRANSFORMATION OF IRELAND (2005); COOGAN, *supra* note 66 (accrediting this vulnerability to when Ireland wanted to join the European Economic Community ("EEC") in the 1960s and opened its economy to trade in order to improve its chances of admission; however as the economy became more open it was also became more vulnerable to global economic fluctuations).

113. Lewis, *supra* note 5 (attributing the bubble to the foreign residents who came to work in the growing technology industry and rented homes creating a short-term demand for real estate; thus when the economy slowed down and they left, property developers were left with many vacant and many partly completed residences); Busby, *supra* note 4, at 62-63

bubble similar to the one experienced in the United States in 2007; when the Irish housing bubble burst in 2008, it sent the entire economy reeling.[114] The banks began to see the value of their assets dwindle, and the six major Irish banks (Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life & Permanent, Irish Nationwide Building Society, and Educational Building Society) were on the brink of default.[115] If these banks defaulted, Ireland's entire economy was in jeopardy of a default.[116]

First, Ireland attempted to resolve its economic crisis through legislation instead of trying to restructure.[117] In December 2009, the Irish government guaranteed of all the banking sector's loans with the Eligible Liabilities Guarantee.[118] With the ELG, the government transformed private bank debt into sovereign debt to be borne by the Republic itself.[119] This, unfortunately, was the decision that sealed Ireland's fate.[120] Transforming private sector debt into public sector

---

(explaining Ireland's market competitiveness in attracting investment from the technological sector).

114. James Croke, *Chuaigh Ár Lá - Debt of A Gaelsman: Ireland's Sovereign Debt Crisis, National and International Responses*, 32 NW. J. INT'L L. & BUS. 365, 378 (2012) (stating that Ireland's GDP, which grew every year since 1993, declined by 3.5% in 2008 and is expected to contract by approximately 13.5% from 2008 through 2010); *see also*, Busby, *supra* note 4, at 63-64 (pointing out Ireland's economic vulnerability as early as 2002); Pagones, *supra* note 80, at 1531 (describing Ireland's budget deficit as part of the broader Eurozone crisis).

115. John Murray-Brown & Neil Dennis, *Ireland Guarantees Six Banks' Deposits*, FIN. TIMES, Sept. 30, 2008 (announcing the government's decision); COOPER, *supra* note 626, at 9 (explaining the economic outlook among Irish officials at the time).

116. *See supra* note 115 and accompanying text (providing context for the widespread economic panic).

117. Credit Institutions (Financial Support) Act 2008, *supra* note 7, § 6(4) (providing the Irish Government's legislative power to take action for financial recovery); *ELG*, *supra* note 7 (providing the text of the Eligible Liabilities Guarantee, Ireland's legislative response).

118. Murray-Brown & Dennis, *supra* note 115 (announcing the Irish government's decision); *see also* COOPER, *supra* note 66, at 91, 161 (explaining the economic outlook among Irish officials at the time).

119. Murray-Brown & Dennis, *supra* note 115 (reporting on this transformation of debt); COOPER, *supra* note 66, at 121 (explaining that the ELG came into effect on December 9, 2009 at midnight providing an unconditional and irrevocable state guarantee for "eligible liabilities," which are all deposits except retail deposits of up to EU€100,000, and it will expire at midnight on September 29, 2015).

120. *See* Anne Seith, *EU Too Slow to Provide Answers in Financial Crisis*, SPIEGEL ONLINE (Oct. 6, 2008), *available at* http://www.spiegel.de/international/europe/knee-jerk-reactions-eu-too-slow-to-provide-answers-in-financial-crisis-a-582526-druck.html (characterizing the ELG as a "knee-jerk response"); Avellaneda & Hardiman, *supra* note 58, at 18 (characterizing the decision as an imperfect one made under the pressure of a deepening crisis). *See generally* COOPER, *supra* note 66 (adopting the view that the Irish government's

debt required Ireland to cut its public spending significantly; many citizens lost their pensions.[121] Although the ELG worked for a while, the national debt continued to rise at an alarming rate to 32% of Ireland's GDP.[122] As the national debt hit unsustainable levels, global speculation increased and persisted for weeks about when Ireland would request a bailout from the IMF.[123] On November 21, 2010, the Irish government announced that it had requested financial assistance through a joint program between the European Union and the IMF.[124] This announcement did not immediately resolve Ireland's economic issues, and it triggered several weeks of contentious negotiations, as the other countries and institutions tried to limit their own exposure.[125] For example, the European Central Bank ("ECB") refused to offer Ireland a bank bailout because it did not want to set a

---

decision to bail out the banks using tax payer money was a mistake the plummeted Ireland's economy further into crisis).

121. *Bail-out Q&A*, *supra* note 9 (explaining that the Irish government contributed EU€17.5 billion drawing from its reserves and the National Pension Reserve Fund. The IMF provided EU€22.5 billion, the European Financial Stability Facility (EFSF) contributed EU€17.5 billion, and the UK, Sweden, and Denmark provided bilateral loans); COOPER, *supra* note 66, at 129 (explaining that the government reduced the cost of pension by implementing a pay freeze for state pensioners until 2015 and by determining pensions for new state employees based on career-average earnings instead of final salary and that age qualifications for pensions will continue to rise until 2028).

122. *Budget Ireland 2011*, *supra* note 10 (reporting recent findings from the Irish Department of Finance); Murray-Brown & Dennis, *supra* note 115 (describing the effect of the ELG on the Irish national debt); *Irish Deficit Balloons After new Bank Bail-out*, BBC NEWS (Sept. 30, 2010), http://www.bbc.com/news/business-11441473 (reporting the Irish debt level as 32% of GDP); *see also* COOPER, *supra* note 66, at 50-57 (describing the political pressures present in Ireland as the country tried to complete the ELG).

123. *See, e.g.*, *Eurogroup ministers discuss Ireland money crisis*, CNN (Nov. 16, 2010), http://edition.cnn.com/2010/BUSINESS/11/16/ireland.economy/ (reporting that Ireland has no immediate funding needs and speculating about the pressure it was under to request a bailout); Neil Hume, *Statement by the Eurogroup on Ireland*, FIN. TIMES (Nov. 16, 2010), http://ftalphaville.ft.com//2010/11/16/406886/statement-by-the-eurogroup-on-ireland/ (characterizing the fact that Ireland had not yet requested a bailout as a "standoff"); *see also* Forelle & Enrich, *supra* note 13 (giving an account of the Irish economic situation through early November 2010, before the EU announced a bailout of Irish banks).

124. *See Government statement on request for support*, RTE NEWS (Nov. 21, 2010), http://www.rte.ie/news/2010/1121/294654-economy3/ (reporting that European ministers began talks on how to resolve the financial troubles of Ireland, even as the Republic denied that it was facing default and had asked for help).

125. *See* Avelleneda & Hardiman, *supra* note 58 (contextualizing Ireland's capacity to devise a response to the crisis within the fragmentation of the larger European Union and its weak coordinating capacity); *see also* COOPER, *supra* note 66, at 9 (analyzing Ireland's experience trying to obtain relief); Breen, *supra* note 8, at 5 (categorizing the relative power of IMF member nations according to their status as shareholders).

precedent for other members and their banks.[126] France and Germany were also strongly opposed to an ECB bailout because it would cripple their bigger banks that were significantly exposed to multiple Eurozone economies through lending.[127] The United Kingdom was also not willing or able to offer any meaningful external relief as many of its assets were tied up with Irish ones.[128] Additionally, because Germany and France are the IMF's largest European shareholders, no features of the austerity program could run contrary to their national interests.[129]

2. Ireland's Austerity Program

Ireland signed the MoU with the IMF and the European Union on December 7, 2010.[130] Through the MoU, the European Union and the IMF agreed to provide Ireland with financial assistance that was conditional on fulfilling the requirements of the austerity program.[131] The MoU divided the rescue funds into quarterly installments and required Ireland to meet certain austerity goals in order to receive each installment of the loan.[132] In January 2011, four months after debt levels had skyrocketed, Ireland received its first loan payment

---

126. *See* COOPER, *supra* note 66, at 120-26 (explaining the effect of the European countries' exposure to Ireland in the negotiations); *see also* Breen, *supra* note 8, at 7-9 (explaining that ECB, the EU, France, and Germany were "united" in their desire to avoid creditor losses through haircuts.)

127. *See* COOPER, *supra* note 66, at 120-21 (explaining the effect of the European countries' exposure to Ireland in the negotiations); *see also* Breen, *supra* note 8, at 8 (attributing France and Germany's influence as "key shareholders" of the ECB to the institution's refusal to offer Ireland meaningful relief).

128. *See* COOPER, *supra* note 66, at 123 (discussing the large amount of British assets tied up in Ireland; *see also* Breen, *supra* note 8, at 10 (explaining the UK's attitude towards Ireland in the context of the economic and historical ties between the nations).

129. *See* Breen, *supra* note 8, at 5 (categorizing the relative power of IMF member nations according to their status as shareholders); *IMF Voting*, *supra* note 96 (explaining the relative power of member nations through the voting process).

130. *See Memorandum of Understanding*, *supra* note 11 (detailing Ireland's requirements to receive each payment); *see also Bail-out Q&A*, *supra* note 9 (outlining the program).

131. *See Memorandum of Understanding*, *supra* note 11, at 59 (stating that the European Union and the IMF will provide financial assistance to Ireland if it complies with specific policies); *see also Bail-out Q&A*, *supra* note 9 (reporting on the basic facts of the bail-out).

132. *See Memorandum of Understanding*, *supra* note 11, at 26 (characterizing such austerity measures as "ambitious but realistic fiscal consolidation" to restore financial stability); *see also Bail-out Q&A*, *supra* note 9 (providing the general timeline for the austerity program).

after Dáil Éireann, the Irish legislature, published the 2011 Finance Bill imposing the required austerity measures.[133]

The most significant requirement was the austerity measures Ireland was required to impose in the name of fiscal consolidation.[134] The program required Ireland to cut public spending by decreasing food subsidies, wages, minimum wage, unemployment benefits, and pension benefits, in addition to imposing an unprecedented property tax.[135] Due to the governing structure of the IMF, these policies were created with significant input from Ireland's creditors whose interests prevented them from offering Ireland any other relief.[136]

3. Ireland Today

The official sector, as well as the CRAs, supports the view that Ireland has recovered from its sovereign debt crisis.[137] It has not.[138] When the European Union and the IMF authorized the disbursement of their final payments to Ireland, European Union President José Manuel Barroso stated, "Ireland's success sends an important message—that with determination and support from partner countries we can and will emerge stronger from this deep crisis."[139] Laudatory statements aside, such a "milestone" is not reflective of the health of

133. *See Budget Ireland 2011*, *supra* note 10 (reporting on the Minister' presentation of Budget 2011); *Irish Finance Bill 2011*, *supra* note 12 (reporting on the measures contained in the bill); *Memorandum of Understanding*, *supra* note 11, at 59 (stating that the adoption of the budget will trigger release the first disbursement of payment).

134. *See Memorandum of Understanding*, *supra* note 11 (characterizing such austerity measures as "ambitious fiscal adjustment to restore fiscal sustainability"); *see also Ireland sets out record austerity budget*, *supra* note 13 (reporting on the budget the Irish government designed to comply with the austerity program and deeming it "the toughest budget on record").

135. *See Ireland sets out record austerity budget*, *supra* note 13 (detailing specific cuts in the budget); *see also* COOPER, *supra* note 66, at 129 (showing that these austerity measures were imposed in addition to previous government spending cuts necessitated by the ELG).

136. *See IMF voting*, *supra* note 96 (demonstrating specific countries' relative power through voting); COOPER, *supra* note 66, at 120-126 (explaining countries' behavior in negotiations as reflective of their financial exposure to Irish debt).

137. *See infra* notes 139-41 and accompanying text (discussing the praise Ireland received from the IMF and the increase in its credit ratings).

138. *See infra* notes 141-144 and accompanying text (highlighting Ireland's dismal economic conditions such as its unemployment and emigration rate).

139. *See* European Commission, *President Barroso welcomes Ireland's exit from its assistance programme*, Press Releases Database MEMO/13/1149 http://europa.eu/rapid/press-release_MEMO-13-1149_en.htm. (providing the transcript of the statement); *Barroso congratulates Ireland*, BBC NEWS (Oct. 3, 2009), http://news.bbc.co.uk/2/hi/europe/8288586.stm (providing a video of President Barroso's remarks).

the Republic; it merely indicates that Ireland has managed to meet the terms of the austerity program.[140] In fact, Moody's upgrade was based on: (1) the growth potential of the economy, which is expected to reduce government debt ratios with ongoing austerity; and (2) the government's exit from the austerity program on schedule, with restored market access.[141]

Ireland is still suffering despite completing its participation in the austerity program; property values, wages, and employment rates remain low.[142] The IMF's austerity measures continue to impact Irish citizens who are seriously affected by the elimination of unemployment assistance, minimum wage reduction, and pension cuts.[143] Moreover, Ireland is still experiencing low levels of market confidence in its bonds and is faced with the prospect of a long period of economic hardship.[144] Ireland continues to be plagued by the costs of the current system of sovereign debt restructuring: economic harm such as reputational damage and large deficits exacerbated by the costs of negotiations.[145] These losses, combined with the harsh

---

140. *See 2013 Review*, *supra* note 14 (referring to Ireland's progress as a milestone); *see also Ireland's tough economic policies to continue, says finance minister*, BBC NEWS (Dec. 10, 2013), http://www.bbc.co.uk/news/business-25362493 (both announcing Ireland's then imminent departure from the IMF bailout); *see* Castle, *supra* note 20 (analyzing future hardship Ireland will face).

141. *See Rating Action: Moody's upgrades Ireland's sovereign ratings to Baa3/P-3: outlook changed to positive*, Moody's Investor Services (Jan. 17, 2014), https://www.moodys.com/research/Moodys-upgrades-Irelands-sovereign-ratings-to-Baa3P-3-outlook-changed--PR_290559 (explaining the dual bases for the ratings increase); *supra* note 18 and accompanying text (contextualizing Ireland's new rating of *Baa3* on the rating scale that goes up to the highest possible AAA rating which Ireland held prior to the crisis).

142. *See* O'Toole, *supra* note 20 (differentiating between Ireland's global economy which has remained "robust" and its domestic economy which still remains weak); *Ireland's tough economic policies to continue, says finance minister*, *supra* note 140 (reporting that Ireland's economy is not strong enough for the government to relax austerity measures).

143. *See supra note* 12 and accompanying text (citing to a detailed list of cuts); *2013 Review*, *supra note* 14 (discusing the policies Ireland will continue despite the end of the bailout); *see supra* note 143 and accompanying text (explaining that tight budgetary constraints will persist).

144. *See* Castle, *supra* note 20, at 1-2 (reporting that the Irish economy is still very vulnerable as the euro remains fragile, and pointing out that Ireland is not due to pay off its international loans until the year 2042); O'Toole, *supra* note 20, at 3-4 (citing the fact that many young Irish professionals are leaving the country as evidence of poor economic prospects, and noting that the economy has only grown by half of the IMF's projected 5.25%). *See generally* Pagones, *supra* note 80 (arguing that IMF-imposed austerity measures in Greece similarly had harmful effects on the Greek domestic economy).

145. *See* Seith, *supra* note 12 (noting that stalled negotiations weaken confidence in markets, further frustrating economic conditions); *see also* Avellaneda & Hardiman, *supra* note 58, at 14 (noting that larger countries with more stable economies, i.e. Germany can

austerity measures that the European Union and the IMF required, will affect Irish citizens for decades.[146] Ireland's experience illustrates the current systemic issues in both the process of restructuring and its solution of IMF rescue programs.

B. *Comparing Statutory and Contractual Reform Proposals*

This Section examines the two main types of sovereign debt reforms. Section B.1 gives an overview of the breadth of proposals advocating for statutory reform by implementing an international bankruptcy regime. Section B.2 elucidates opportunities for reform within the language of sovereign debt contracts, referred to as contractual reform.

1. An International Bankruptcy Regime

The main statutory reform proposal in the sovereign debt context is to create an international bankruptcy regime.[147] Many scholars and practitioners favor the Sovereign Debt Restructuring Mechanism ("SDRM") approach, which would serve as a bankruptcy mechanism allowing the IMF to oversee sovereign debt transactions outside the context of a bailout or restructuring.[148] To oversee the SDRM, the IMF would create an international bankruptcy court where a disinterested party would adjudicate lenders' claims of repayment.[149] Such a court would be similar to the World Trade Organization arbitration process for trade disputes.[150]

---

better afford to engage in lengthy policy disputes); *see also* Breen, *supra* note 8, at 1 (highlighting the lack of credibility of the IMF's recovery program because even the IMF knew it would not put Ireland on a sustainable path to recovery).

146. *See supra* note 135 and accompanying text (explaining the IMF's requirements).

147. *See, e.g.*, *infra* note 150 and accompanying text (citing the wealth of bankruptcy regime proposals).

148. *See* Brenneman, *supra* note 31, at 692-93 (comparing different proposals); *see* Tarullo, *supra* note 60, at 303 (discussing different features in these proposals); *see SDRM 2002*, *supra* note 74, at 6-9 (articulating a recent SDRM proposal by IMF leadership).

149. Sedlak, *supra* note 45, at 1494 (discussing the IMF's goal of creating a more orderly process). *See generally SDRM 2002*, *supra* note 74 (discussing the limitation of enforcement of sovereign debt by existing courts).

150. *Understanding on Rules and Procedures Governing the Settlements of Disputes*, WTO, *available at* http://www.wto.org/english/docs_e/legal_e/28-dsu.pdfWTO (last visited Mar. 18, 2014) (setting forth the process for WTO dispute settlement); *see also* Tarullo, *supra* note 60, at 291 (explaining how the WTO administers its rules through an independent, quasi-judicial proceeding).

The IMF proposed creating an independent framework to handle future sovereign debt problems through an international version of a domestic bankruptcy code.[151] The IMF's proposals have been structured with an eye towards a defined set of issues: (1) preventing creditors from obtaining relief through national courts; (2) providing a guarantee that the debtor country would act responsibly during the course of a stall in the restructuring; (3) encouraging private lenders to provide fresh money; and (4) restructuring agreements should bind all of the parties not only the majority that has agreed.[152]

In addition to modeling the SDRM on domestic bankruptcy proceedings, drafters have proposed several other procedures. For example, some drafts have required that the IMF officially certify that a country's debts are unsustainable before allowing a restructuring to occur.[153] Other versions borrow from bankruptcy law and suggest giving the IMF access to tools such as standstills, adjudication, cram-down authority, and priority financing.[154] Thus, the SDRM approach and other statutory proposals enhance the IMF's involvement in sovereign debt lending and restructuring.[155]

2. Reforming Contractual Terms

Contract reform proposals focus on amending the restructuring process through the language in debt agreements. For example, an

---

151. Lee Buchheit, *Use of Creditor Committees in Sovereign Debt Workouts*, 10 Bus. L. Int'l 205, 342 (2009) (seeing this as modernizing change is needed since "gunboat captains" can no longer enforce sovereign debt arrangements); *see also* Bolton & Skeel, *supra* note 50, at 178-79 (pointing out that in addition to solving the problem of sovereign debt restructuring, such a reform could also result in an even larger role for the IMF in restructurings). *See generally SDRM 2002*, *supra* note 74 (laying out the IMF's proposal).

152. Arora & Caminal, *supra* note 31, at 633-34 (analyzing the four key issues to be addressed by the IMF's proposal); *id.* (confirming the IMF's prioritization of issue (1)).

153. Tarullo, *supra* note 60, at 301 (explaining that such a requirement is an effort to maintain the practice of good macro-economic policies on the part of the IMF); Brenneman, *supra* note 31, at 692-93 (describing proposals' efforts to prevent debtors from opportunistically invoking restructuring clauses).

154. Tarullo, *supra* note 60, at 303 (explaining how these mechanisms would be re-configured to the case of sovereign debt). Standstills would suspend the legal obligation to repay debts during some period of workout efforts. Adjudication includes decisions such as how to group creditors into classes for scheduling purposes. Cram-down authority would force creditors to accept a rescheduling or reduction of the debt they hold. With priority financing, lenders could make new funds available to the sovereign and be entitled to repayment of the entire amount before any debt assumed prior to the sovereign "bankruptcy" can be repaid. *See* 11 U.S.C.A. § 1101 (West 1978) (providing the text of Chapter 11).

155. *See supra* note 149 and accompanying text (explaining how these proposals would give the IMF power to oversee the court).

increasing number of debt contracts have started to use *collective action clauses* ("CACs").[156] Such clauses replace the UAC and permit creditors to amend debt agreements with super majority support, usually 75%, instead of the unanimous support required in UACs.[157] Designed to prevent holdouts by enabling a super majority to approve changes in payment, CACs can facilitate restructurings more easily than UACs.[158]

The US Treasury has offered its own variation of contract reform.[159] Its approach to CACs is that only the creditors could initiate a restructuring after a super-majority vote.[160] Other examples of contractual reforms include clauses that specify the jurisdiction where claims will be adjudicated or a clause that would give sovereigns the legal right to begin restructuring when certain conditions are met.[161]

---

156. Bolton & Skeel, *supra* note 50, at 181 (detailing the growing acceptance and use of these terms). *See generally* Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929 (2004) (finding that since the end of 2003, nearly every new issuance of sovereign bonds has featured a CAC).

157. Bolton & Skeel, *supra* note50, at 181 (detailing the growing acceptance and use of these terms); *see* Arora & Caminal, *supra* note 31, at 650 (comparing different proposals based on the CAC template); *see also* Choi & Gulati, *supra* note 156 (finding that since the end of 2003, nearly every new issuance of sovereign bonds has featured a CAC).

158. Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. 713, 714-15 (2004) (stating that the inclusion of CACs into bond contracts represents substantial progress in the effort to facilitate orderly restructurings); Bratton & Gulati, *supra* note 49, at 4 (analyzing the difference in the odds of a UAC and CAC in allowing a sovereign to obtain the necessary support in a growing, global financial market).

159. John B. Taylor, *Sovereign Debt Restructuring: A U.S. Perspective, Remarks at the Conference, Sovereign Debt Workouts: Hopes and Hazards?*, Institute for International Economics (Apr. 2, 2002), *available at* http://www.treas.gov/press/releases/po2056.htm (discussing further details to be decided on at the time of the agreement). *See generally* Sedlak, *supra* note 45 (analyzing various U.S. Treasury reform proposals both contractual and statutory).

160. Sedlak, *supra* note 45, at 1501 (discussing the specifics of one of the Treasury's variations); *see* Michelle J. White, *Sovereigns in Distress: Do They Need Bankruptcy?*, 2002 Brookings Papers on Econ. Activity 287, 308 (criticizing CAC proposals because they were extremely similar to already proposed and unworkable plans).

161. *Compare* Brenneman, *supra* note 31, at 688-92 (providing an example of another contractual reform targeting certainty in the restructuring process), *with* Arora & Caminal, *supra* note 31, at 644-45 (analyzing other proposals, such as variation of the market-based SDRM).

The language in sovereign debt contracts is a target for reform because these contractual provisions usually become boilerplate.[162] Further, the lack of detail in current agreements often necessitates further *ex post* coordination, such as determining whether a restructuring is necessary and when the debtor will repay the lenders.[163] Thus, contractual reforms seek to reduce such procedural gridlock by amending the language that parties negotiate and sign *ex ante*, before any sign or pressure of an economic crisis.[164] International legal precedent makes it likely that contracts will continue to be important tools in sovereign debt relations.[165]

III. *A PROCEDURAL SOLUTION: IMPROVING THE NEGOTIATION PROCESS USING CONTRACT TO MINIMIZE CRISIS TIME VARIABLES*

This Part argues that the best reform method involves contract reform. More specifically, a provision should be added to contracts that identifies an economic indicator to automatically trigger restructuring negotiations. This contractual mechanism would be inserted into bond contracts *ex ante* to create a well-organized process that aligns interests of both creditors and debtors.[166] Part III.A explains why contractual reform is a better option for reform and

---

162. Weidemaier, *supra* note 100 (explaining the prominence of boilerplate language in debt agreements); *see* Choi & Gulati, *supra* note 156 (finding that since the end of 2003, nearly every new issuance of sovereign bonds has featured a CAC).

163. *See* Bratton & Gulati, *supra* note 49, at 3 (stating that use of this boilerplate term is a significant barrier to the success of negotiations); Bolton & Skeel, *supra* note 50 (stating that this was the case until Mexico's 2003 bond issuance).

164. *See* Arora & Caminal, *supra* note 31, at 630 (stressing the need for a rethinking of the existing sovereign debt restructuring procedures and mechanisms, and analyzing others that are being considered); Brenneman, *supra* note 31, at 19 (stating the importance of *ex ante* action for its own insolvency and restructuring procedures).

165. *See, e.g.*, *Allied II*, *supra* note 73 (holding the Central Bank of Costa Rica's refusal to authorize payment of promissory notes to the United States would be inconsistent with orderly resolution of debt issues); James Thuo Gathii, *The Sanctity of Sovereign Loan Contracts and Its Origins in Enforcement Litigation*, 38 GEO. WASH. INT'L L. REV. 251, 252 (2006) ("Since *Allied II*, equitable, statutory, and affirmative defenses to sovereign default were virtually extinguished as every sovereign debt default became susceptible to being construed as a unilateral restructuring of sovereign debt contracts, a repudiation, or a taking that violated the sanctity of the underlying contractual obligation to repay under the loan contract.").

166. *See* Arora & Caminal, *supra* note 31, at 631 (advocating this as a priority in light of increasingly diverse creditors); *see also SDRM 2002*, *supra* note 74 (advocating a similar focus).

details the proposed term. Part III.B explains why this term is preferable and necessary in light of other reform proposals.

A. *The Plan: Adding a Trigger Term to Sovereign Debt Contracts*

Debt agreements should contain a contractual provision to dictate when a sovereign will begin restructuring.[167] Parties would negotiate *ex ante* and agree on an economic trigger that would make restructuring negotiations automatic.[168] The provisions would also include a time limit within which the restructuring would have to occur otherwise creditors lose their right to repayment.[169] For example, in the case of Ireland, when the property bubble sent shocks through the economy, Ireland could have been contractually obligated to restructure instead of trying to avoid it with the ELG.[170] Section A.1 argues that contractual reform is a better method of reform because it can have far-reaching effects on the entire process by aligning parties' interests. Section A.2 discusses how agreeing upon a time to restructure *ex ante* would result in more efficient negotiations and consequently will help sovereigns regain access to capital markets more easily.

1. The Benefits of Contractual Reform

Contractual reform provides the opportunity for parties to disclose and agree upon the *process* of default or restructuring, not just their ultimate demands.[171] A contractual solution would give creditors a key role in drafting the agreement with an economic trigger, thus reducing fears of moral hazard.[172] The provision would also specify a number of days after discussions open within which the

---

167. *See supra* notes 77-78 and accompanying text (establishing that early restructurings are in the sovereigns' best interests).

168. Brenneman, *supra* note 31, at 19 (stating the importance of *ex ante* action); Buchheit & Gulati, *supra* note 55 (highlighting details contracts currently lack).

169. *See supra* notes 70-71 and accompanying text (establishing the importance of timeliness in light of the disruption legally protected holdout creditors cause).

170. *See supra* notes 114-119 and accompanying text (explaining the economic factors that preceded the ELG).

171. *See* Brenneman, *supra* note 31, at 703 (advocating that such a solution would likely alleviate high interest rates currently caused by uncertainty); *supra* notes 75-91 and accompanying text (explaining and citing to identifying features of current process that result in unnecessary costs to the sovereign).

172. *See* Brenneman, *supra* note 31, at 687 (arguing that this change will reduce moral hazard as opposed to an SDRM proposal where the IMF is setting the term); Bratton & Gulati, *supra* note 49, at 30 (stating that IMF also supports a contractual mechanism for this reason).

parties must agree upon a restructuring plan, enabling orderly *ex post* cooperation by aligning their interests.[173] Any holdout behavior would forfeit a lender's legal right to repayment, thus incentivizing them to cooperate.[174]

Under this plan, a sovereign would clear its biggest obstacle before the crisis occurs: getting creditors to agree on restructuring terms.[175] An *ex ante* restructuring strategy is preferable because parties are more likely to make well-informed decisions before a crisis happens rather than afterwards.[176] This would give parties the opportunity to make informed policy and economic choices without the pressure of a continuing panic.[177] Further, contractual reform is easy to implement, as the language can simply be inserted into future contracts, keeping the cost of reform low and increasing the likelihood of use.[178]

2. Contracting Around Uncertainty: The Trigger Term

Economic indicators are attractive triggers because they are objective.[179] Parties could choose a specific indicator based on the relevant concerns and characteristics of that agreement.[180] They could use indicators such as GDP, debt-to-GDP ratio, export-to-import ratio, and debt-to-equity ratio for triggers.[181] There is already a

---

173. *See* Bratton & Gulati, *supra* note 49, at 30 (discussing the desirability of this transfer of the burden); *see* Brenneman, *supra* note 31, at 687 (explaining how this would align sovereign and creditor interests through drafting).

174. *SDRM 2002*, *supra* note 74, at 2 (specifying a lack incentives for countries to resolve unsustainable debt burdens "promptly and in an orderly way" as one of the main problems in the current system); *see supra* note 77 and accompanying text (identifying the common delays in restructurings as a major impediment to a sovereign's recovery).

175. *See supra* notes 159-161 and accompanying text (citing examples of other proposals with this focus).

176. Brenneman, *supra* note 31, at 685 (arguing that decisions made before a crisis can be more efficient as analogized to domestic bankruptcy); *see* Feibelman, *supra* note 75, at 732 (demonstrating the need for a contractual term to make *ex post* relief easier by eliminating disorderly workouts which drain a sovereign's funds).

177. *See supra* note 176 and accompanying text (citing proposals with similar priorities); *see also* Avellaneda & Hardiman, *supra* note 58, at 17 (discussing the pressure of crisis time decisions as seen in the European Union context).

178. *See supra* notes 156-158 and accompanying text (discussing the example of CACs).

179. *See supra* notes 100-104 and accompanying text (illustrating the need for this in light of the IMF's political character).

180. *See supra* notes 100-104 and accompanying text; Gulati & Triantis, *supra* note 62, at 985 (proposing the use of such indicators).

181. *See supra* note 180 and accompanying text (showing how much indicators will solve a current problem in the restructuring process).

significant amount of research and analysis on which economic factors can be used to determine the likelihood of a default.[182] Parties could choose to condition a restructuring on the occurrence of a single event, such as a certain debt-to-GDP level, or they could use an average over time, allowing more flexibility for unexpected factors while still keeping the process objective.[183]

By reducing the costs of negotiation, the trigger term preserves the sovereign's future access to capital.[184] Agreement on a pre-determined trigger would eliminate drawn out negotiations, minimizing direct expenses.[185] A more orderly restructuring process would also protect the sovereign from reputational damage caused by external actors such as CRAs.[186] By reducing the overall cost of the restructuring, the trigger term would alleviate sovereigns' hesitance to restructure.[187]

Trigger terms could also curb the damaging influences of CRAs.[188] If the likelihood of a default was clear and identifiable through a specified trigger, creditors would be better able to anticipate their risks without CRAs.[189] The market would likely give priority to bonds issued by sovereigns with more reliable economic reputations

---

182. *Compare* Brenneman, *supra* note 31, at 693, *and* Sedlak, *supra* note 45, at 1489 (both discussing suggested factors to clearly determine when a "credit event" or "unsustainable debt" is present), *with IMF Policy*, *supra* note 67 (evidencing that the IMF has actually suggested using triggers within the current system however, it would make use of rating triggers for credit ratings agencies, however, still reflecting a preference for economic triggers of a country's economic viability and for these triggers to be objective).

183. *See infra* notes 190-93 and accompanying text (illustrating the need for and research conducted on the use of indicators); Tarullo, *supra* note 60 (discussing the preference for flexibility in reforms).

184. *See supra* notes 86-100 and accompanying text (evidencing the effect of debt defaults on a sovereign's access to capital); *supra* notes 79-82 and accompanying text (describing how this happened in Ireland).

185. Dickerson, *supra* note 34, at 1011-12; *see also*, Brenneman, *supra* note 31, at 693 (discussing the values of quick, orderly workouts).

186. *See supra* notes 78-82 and accompanying text (explaining the usual peripheral involvement of CRAs and the major impact it can have); *see also supra* note 5 and accompanying text (illustrating the impact on Ireland).

187. *See supra* notes 77-78 and accompanying text (attributing delayed restructurings to current systemic costs that this term would be alleviating); *see also*, Sedlak, *supra* note 45, at 1497 (arguing within the context of the SDRM, quick and predictable workouts reduce overall restructuring costs).

188. *See supra* note 89 and accompanying text (explaining these damaging influences).

189. Feibelman, *supra* note 75, at 731 (explaining the desirability of an identifiable standard for sovereign debt with respect to odious debt); *see supra* note 183 and accompanying text (citing the advantages of economic indicators).

based on publicly available indicators, reducing the importance of ratings.[190]

The trigger also would allow sovereigns to construct restructuring solutions aside from IMF-led austerity programs. IMF programs and participation may still be necessary as sovereigns will still default, and the IMF remains a powerful institution financially capable of providing large funds.[191] The trigger term, however, would change the IMF's involvement by eliminating its current referee role by contractually obligating sovereigns and creditors to negotiate directly.[192]

B. *Why the Trigger Term is Better than Extant Proposals*

The trigger term is preferable to existing reform proposals, such as the SDRM. The SDRM *increases* the role of the IMF in sovereign debt restructurings.[193] By implementing a more rule-based system the SDRM could make the process *appear* more neutral and predictable; however, such a change could prove to be only cosmetic because the IMF would maintain its political structure.[194] Further, without decreasing IMF involvement in a restructuring it is not clear that there would be any effect on the timing of restructurings or the possibility of moral hazard.[195]

While contractual terms are effective in amending the restructuring process, CACs alone are insufficient because they do not

---

190. Feibelman, *supra* note 75, at 731 (explaining that in making an debt standard predictable, the market will segment itself between different calibers of investment); *see also* Bratton & Gulati, *supra* note 49, at 25 (explaining that despite the type of proposal, the best interest of creditors results from their assent, thus a goal should be to facilitate creditor choices).

191. *See, e.g.*, *supra* notes 1-4, 118-22 and accompanying text (providing an example of a far-reaching regional economic crisis); *see also* Sedlak, *supra* note 45, at 1485 (providing a brief history of sovereign debt and its incentives on both sides).

192. *See supra* notes 100-111 and accompanying text (explaining the IMF's role in the current system and the conflicts it creates).

193. *See supra* notes 152-156 (explaining the SDRM and the enhanced role it would give the IMF).

194. *See* Bolton & Skeel, *supra* note 50, at 201 (explaining that even those who favor the IMF's current role feel that the IMF's SDRM proposal is incomplete in that it does not address the following issues with such a plan, if desired: the absence of a coherent priority scheme; the need for an interim financing strategy that refines and alters the role of the IMF; and the need for an independent decision maker to oversee the sovereign bankruptcy framework); *see also* *id.* (elucidating the desirability of addressing these fundamental issues).

195. *See generally supra* notes 79-82 and accompanying text (explaining the occurrence of downgrades in the current system and their effects).

set out any parameters for restructuring *before* a default occurs.[196] CAC proposals generally only address how creditors will amend the payment terms *after* a default or crisis.[197] The trigger term on the other hand, has the potential to bring about system-wide reform.

CONCLUSION

The practice of sovereign debt fundraising is not going to diminish in the foreseeable future, as nations need access to capital. Currently, sovereign debt restructurings impose prohibitive costs on the sovereign, making it harder and harder for sovereigns to regain access to capital markets. Consistent IMF bailouts exacerbate the problem as they remove any incentive for the parties to negotiate, as happened in Ireland. The Irish case provides a tangible example of the current conflicts inherent to debt restructurings and their mammoth costs to the sovereign.

This Note proposed a contractual term to be inserted into bond contracts to determine when a sovereign should begin restructuring. The parties would negotiate *ex ante* and agree on an economic trigger at which restructuring would automatically begin. There would be a time limit within which the restructuring would have to occur, deterring holdout creditors. A more efficient agreement between parties would appropriately minimize the role of the IMF and other actors. This would alleviate current costs of restructuring by reducing uncertainty and prolonged negotiations, making it easier for countries to recover from economic crises. Go nÉirí an tÁdh Libh.[198]

---

196. Brenneman, *supra* note 31, at 689 (arguing that the CAC is too flexible to constitute reform on its own); *see also* Bolton & Skeel, *supra* note 50, at 182 (arguing that CACs still do not address the procedural issue of standstill during restructuring negotiations).

197. *See supra* note 196 and accompanying text (highlighting CACs' lack of reforms to the restructuring process).

198. *May your luck rise, Ireland.*