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In Bonds We Trustee: A New Contractual Mechanism To Improve Sovereign Bond Restructurings

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NOTES

IN BONDS WE TRUSTEE: A NEW CONTRACTUAL MECHANISM TO IMPROVE SOVEREIGN BOND RESTRUCTURINGS

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Governments around the world raise significant amounts of capital by issuing sovereign bonds in international financial markets. These bonds are typically purchased and traded by foreign investors who seek a profitable return on their investment. The issuing country incurs sovereign debt, which it must repay over a predetermined period of time. Occasionally, sovereigns—typically emerging market governments—become unable or unwilling to repay their sovereign debt.

A country's ability to repay its debt is difficult to assess given the multitude of nonfinancial factors that affect the assessment. As a result, investors are vulnerable to opportunistic defaults which can deprive them of their investment. Additionally, investors cannot collect on their investment through bankruptcy proceedings because a country cannot declare bankruptcy. The financial markets have responded to this challenge with a variety of contractual mechanisms aimed at facilitating a debt restructuring, which will simultaneously lower the sovereign's debt burden while ensuring that investors receive payment on their investment. Unfortunately, the contractual mechanisms currently utilized in sovereign bond contracts have proven to be inadequate.

This Note begins by explaining sovereign debt and the major problems with the current international sovereign bond market. Next, this Note explores the global community's various efforts to address these problems thus far and explains why these solutions have proven inadequate. Ultimately, this Note proposes a new contractual mechanism that provides for the creation and use of a new type of trustee to monitor, enforce, and renegotiate sovereign bonds.

TABLE OF CONTENTS

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INTRODUCTION

On October 2, 2012, NML Capital, a U.S. hedge fund, was granted an injunction from the Ghanaian Commercial Court to prevent a 103-meter-long Argentine naval vessel—the ARA Libertad—and its crew from leaving the Ghanaian port of Tema.[1] NML Capital is a subsidiary of Elliott

1. *See* Drew Benson, *Bond Vigilantes' Ghana Ambush Proves Default Hex Unbroken*, BLOOMBERG NEWS (Oct. 4, 2012, 5:07 PM), http://www.bloomberg.com/news/2012-10-04/bond-vigilantes-ghana-trap-shows-default-hex-argentina-credit.html; *see also Seized Ship Crew Back in Argentina from Ghana*, BBC NEWS (Oct. 25, 2012, 3:50 PM), http://www.bbc.co.uk/news/world-latin-america-20078320.

Associates—a U.S. hedge fund that owns Argentine debt worth 1.6 billion U.S. dollars (USD), dating back to Argentina's 2001 default.[2] Argentina's triple-mast frigate represents a mere fraction of the total amount Elliott seeks to collect from Argentina.[3]

Elliott has been aggressively pressing Argentina to pay the full value of the sovereign bonds that Elliott has held since Argentina defaulted on its bonds in 2001 and subsequently issued exchange offerings in 2005 and 2010.[4] At those times, roughly 94 percent of the bonds at issue were exchanged.[5] The restructurings offered bondholders an exchange at approximately thirty cents on the dollar, a 70 percent loss on their investment.[6]

Unfortunately for Elliott, a United Nations court—the International Tribunal for the Law of the Sea—ordered Ghana to release the Libertad on December 15, 2012.[7] While Argentina appears to be victorious on this front, it faces a more costly battle in the Second Circuit.[8] In October 2012, the Second Circuit ruled that should Argentina make payments to creditors who participated in the 2005 and 2010 bond exchanges, and it must pay NML Capital and other similarly situated holdout creditors as well, up to the full accelerated principle and interest on the defaulted bonds: USD 1 billion.[9]

The ongoing struggle between a hedge fund and a sovereign nation is illustrative of the chaotic process countries typically encounter when they restructure their sovereign bonds. This Note suggests a new contractual mechanism that should be included in sovereign bond contracts that will bring order to the tumultuous restructuring process. Part I of this Note provides background information about debt, sovereign bonds, and the major problems with the current restructurings system. Next, Part II explores the failures of the current contractual mechanisms. Finally, Part

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2. *See* Benson, *supra* note 1; *Argy-Bargy*, ECONOMIST, Dec. 1, 2012, at 80, *available at* http://www.economist.com/news/finance-and-economics/21567386-argy-bargy.

3. *See* Benson, *supra* note 1; *Seized Ship Crew Back in Argentina from Ghana*, *supra* note 1 ("The fund, NML Capital, argued it was owed [USD 370 million] as a result of Argentina's debt default a decade ago. It is seeking [USD 20 million] in return for the release of the ship, a three-masted training vessel.").

4. *See* Benson, *supra* note 1; *see also infra* notes 159–84, and accompanying text.

5. *See* Benson, *supra* note 1; *see also infra* notes 304–13, and accompanying text.

6. *See* Benson, *supra* note 1; *Seized Ship Crew Back in Argentina from Ghana*, *supra* note 1.

7. *See* Jude Webber & Xan Rice, *UN Tells Ghana To Release Argentine Ship*, FIN. TIMES (Dec. 15, 2012), http://www.ft.com/intl/cms/s/0/f9b1dd84-46db-11e2-8b2f-00144feab49a.html#axzz2GSgDetmR.

8. *See generally* NML Capital, Ltd. v. Republic of Arg., Nos. 12-4694, 12-4865, 2013 WL 4487563 (2d Cir. Aug. 23, 2013); *see also* Jude Webber & Robin Wigglesworth, *Bondholders Add Twist to Argentine Debt Spat*, FIN. TIMES (Dec. 28, 2012), http://www.ft.com/intl/cms/s/0/181ccd5c-50c2-11e2-9623-00144feab49a.html #axzz2HQpX9ZKy; Webber & Rice, *supra* note 7.

9. *See NML Capital*, 2013 WL 4487563, at *11; NML Capital, Ltd. v. Republic of Arg., 699 F.3d 246, 263 (2d Cir. 2012), *cert. denied*, No. 12-1494, 2013 WL 3211846 (U.S. Oct. 7, 2013); *see also* Anna Gelpern, *Pari Passu Wipeout in the Southern District*, CREDIT SLIPS (Nov. 25, 2012, 11:56 PM), http://www.creditslips.org/creditslips/2012/11/pari-passu-wipeout-in-the-southern-district.html.

III offers a new mechanism for addressing the systemic difficulties inherent in sovereign bond restructurings.

I. FROM MECHANISMS TO COLLECTIVES: THE CURRENT STATE OF SOVEREIGN BOND RESTRUCTURINGS

Before analyzing the challenges that arise during restructurings, this Note provides background information about sovereign bonds. Part I.A begins with a basic overview of sovereign bonds and defines the relevant terminology. Part I.B discusses the qualities that make sovereign bonds unique. Next, Part I.C examines the reasons countries may be reluctant to initiate a bond restructuring. Finally, Part I.D evaluates the problems with restructurings and explores the various efforts of the international community and the bond market to resolve them.

A. The Basics of Bonds and Sovereign Bonds

Any study of sovereign bond restructurings must begin with an understanding of the relevant subject matter. *Black's Law Dictionary* defines a bond as an obligation or a promise; more specifically, a written promise to pay money after a certain time elapses.[10] The date when the full payment is due is referred to as the date of maturity.[11] Bonds are a type of debt instrument, meaning they are a type of written legal document that defines rights, duties, entitlements, or liabilities.[12] The purchaser of a bond—the investor or creditor—is essentially loaning money to the issuer—the debtor—for a fixed period of time.[13]

In return for their purchase, investors receive a guarantee that they will have the principal[14] amount repaid by a certain future date, and that they will receive interest payments at certain intervals.[15] The amount of interest the bond is going to pay on the basis of predetermined intervals, stated in percentage terms, is known as the coupon rate.[16] The details pertaining to the expected repayment, including the interest rate, are laid out in the bond contract, also known as a bond indenture.[17]

10. *See* BLACK'S LAW DICTIONARY 200 (9th ed. 2009); *see also* MARK MOBIUS, BONDS: AN INTRODUCTION TO THE CORE CONCEPTS 2 (1st ed. 2012) ("Bonds are basically long-term IOUs between a borrower and a lender.").

11. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 452; *see also* MOBIUS, *supra* note 10, at 4.

12. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 869.

13. *See* MOBIUS, *supra* note 10, at 2.

14. Principal is "[t]he amount of a debt, investment, or other fund, not including interest, earnings, or profits." BLACK'S LAW DICTIONARY, *supra* note 10, at 1312.

15. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 869; *see also* MOBIUS, *supra* note 10, at 2–3.

16. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 888; *see also* MOBIUS, *supra* note 10, at 3.

17. *See* MOBIUS, *supra* note 10, at 3.

The face value of a bond reflects its dollar value at the time it is to be repaid—typically the principal plus the total interest.[18] However, the face value of a bond is not necessarily equal to its price.[19] Bonds are often traded on the secondary market before they reach maturity,[20] so the price may change in response to a number of factors, including the rise and fall of interest rates and the credit quality of the debtor.[21] The risk that a debtor will default[22] on its bonds can also lower the price of the bonds on the market.[23]

Sovereign debt is debt that governments incur (typically, the governments of developing countries) to foreign investors seeking a profitable return.[24] This definition of sovereign debt includes funds raised abroad through the issuance of bonds in foreign capital markets.[25] Sovereign debt allows governments to borrow substantial capital.[26] Governments typically repay much of what they borrow.[27] However, repayment can be complicated and often involves delays, renegotiations, public intervention, default, and restructuring.[28]

When sovereigns are unable to repay what they borrow, they may enter into what is known as a sovereign debt restructuring.[29] A sovereign debt restructuring is a legal process involving the exchange of outstanding sovereign debt, usually in the form of loans or bonds, for new debt instruments or cash.[30] Sovereigns typically restructure after they default on

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18. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 888; *see also* MOBIUS, *supra* note 10, at 3.

19. *See* BLACK'S LAW DICTIONARY, *supra* note 10, at 888; *see also* MOBIUS, *supra* note 10, at 3.

20. Maturity is the date on which the principal is paid back and the last interest payment is made. MOBIUS, *supra* note 10, at 4.

21. *See id.*

22. Default is "the failure to pay a debt when due." BLACK'S LAW DICTIONARY, *supra* note 10, at 480.

23. *See* MOBIUS, *supra* note 10, at 51.

24. *See* Jonathan Eaton & Raquel Fernandez, *Sovereign Debt* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 5131, 1995), *available at* http://www.nber.org/papers/w5131.pdf.

25. *See supra* notes 12–21 and accompanying text; *see also* MOBIUS, *supra* note 10, at 3; Eaton & Fernandez, *supra* note 24, at 1.

26. *See* Eaton & Fernandez, *supra* note 24, at 1; *see also* Alinna Arora & Rodrigo Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 L. & BUS. REV. AM. 629, 629 (2003) ("Debt has been the largest source of capital flow to developing countries in the past fifty years.").

27. *See* Eaton & Fernandez, *supra* note 24, at 1; *see also* Brian Perry, *Are Sovereign Bonds Worth the Risk?*, FORBES (June 21, 2011, 3:25 PM), http://www.forbes.com/sites/investor/2011/06/21/are-sovereign-bonds-worth-the-risk/.

28. *See* Eaton & Fernandez, *supra* note 24, at 1.

29. *See* Arora & Caminal, *supra* note 26, at 630.

30. *See* Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 7 (IMF Working Grp., Monetary & Capital Mkts. Dep't, Working Paper No. 12/203, 2012), *available at* http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf; *see also* Arora & Caminal, *supra* note 26, at 630.

their debt.[31] A restructuring that takes place after a sovereign has defaulted is known as a post-default restructuring.[32] When a sovereign defaults, its debt payments are usually accelerated[33]—meaning creditors are entitled to immediate and full repayment of the face value of the debt.[34]

There are generally two main elements in a debt restructuring: debt rescheduling and debt reduction.[35] A debt rescheduling lengthens the maturities of the old debt, which may also entail a decrease in interest rates.[36] Debt reschedulings are considered a type of debt relief because they shift payments into the future.[37] Debt reduction is a reduction in the face value of the old instruments.[38] Both debt reschedulings and debt reductions can involve a "haircut," which is a loss in the face value of the creditors' claims.[39] This Note focuses on distressed bond restructurings, which are restructurings at terms that are less favorable than the original bond terms.[40] Specifically, this Note is concerned with debt restructurings with foreign private bondholders.

Sovereign debt has vacillated between bank lending and bond lending over the last two centuries.[41] In the nineteenth and early twentieth centuries, sovereign debt was primarily in the form of bond lending.[42] Following that period, and up until the 1990s, medium- and long-term bank loan agreements made up the majority of sovereign debt.[43] Since the 1990s, the majority of sovereign debt is once again in the form of bond debt.[44] International bonds are typically issued in financial centers, under

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31. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 8; *see also* Arora & Caminal, *supra* note 26, at 630.

32. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 8; *see also* Arora & Caminal, *supra* note 26, at 630.

33. Acceleration clauses are standard in most sovereign debt contracts. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 47. In the event of any missed payments, all principal and accrued interest can become immediately due and payable. *See id.* Acceleration usually requires a minority vote of at least 25 percent of outstanding principal—meaning bondholders holding a collective amount of debt greater than or equal to 25 percent. *See id.*

34. *See id.* at 10.

35. *See id.* at 7.

36. *See id.*

37. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 630.

38. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 7; *see also* Arora & Caminal, *supra* note 26, at 630.

39. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 7; *see also* Arora & Caminal, *supra* note 26, at 630.

40. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 7; *see also* Arora & Caminal, *supra* note 26, at 630.

41. *See* A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 1012 (2004).

42. *See* Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 546–68 (1996).

43. *See* Lee C. Buchheit, *Cross-Border Lending: What's Different This Time?*, 16 NW. J. INT'L L. & BUS. 44, 46–51 (1995).

44. *See* Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1334–35 (2002).

the laws of the place where the financial center is located.[45] New York and English law bonds are the most common.[46]

In the United States, most sovereign bonds are issued under a fiscal agency agreement.[47] When bonds are issued under fiscal agency agreements, a fiscal agent is appointed as the agent of the bond issuer itself—for this Note's purposes, the sovereign debtor.[48] The fiscal agent is typically an investment bank serving as the underwriter for the bond offering.[49] Fiscal agency agreements do not give the fiscal agent exclusive enforcement rights.[50] Rather, each bondholder has the right to bring legal action against the sovereign in the event of default.[51] Each bondholder has the right to demand full payment of the principal amount of its bond, and to sue the sovereign debtor to collect the payment in the event of default.[52]

In contrast, bonds issued under a trust indenture limit the rights of individual bondholders.[53] Individual bondholders under a trust indenture only have the right to sue the debtor for payments of interest and principal that are not made on their due dates.[54] Only the trustee possesses the right to accelerate payment of the principal amount of all bonds and to sue the debtor for the total amount.[55]

B. Why Sovereign Debt Is Unique

Sovereign debt differs from private debt in three important ways. First, in an abstract sense, a country can always service—meaning, pay—its debt.[56] This can be accomplished by increasing taxes or by diverting funds from other projects.[57] As a result, it is difficult to determine if a country is insolvent.[58] In contrast, a corporation's ability to service its debt is

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45. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 41.

46. *See id.*

47. *See* Buchheit & Gulati, *supra* note 44, at 1332.

48. *See id.*

49. *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1102 (2004).

50. *See* Buchheit & Gulati, *supra* note 44, at 1332.

51. *See id.*

52. *See* Fisch & Gentile, *supra* note 49, at 1102–03.

53. *See id.* at 1103.

54. *See id.*

55. *See id.*

56. *See* Gunter Dufey, *Corporate Debt vs. Country Debt: Distinguishing Between Liquidity and Solvency Problems*, *in* PRIVATE SECTOR SOLUTIONS TO THE LATIN AMERICAN DEBT PROBLEM 35, 45 n.2 (Robert Grosse ed., 1992) ("Debt service is defined simply as the timely payment of interest."); *see also* Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 133 (2012) ("Even sovereigns in financial distress may arguably have some ability to liquidate assets to repay their debts subject to the constraints imposed by their populations. Greece, for example, could theoretically sell the Parthenon or some of its sovereign territory.").

57. *See* Jack Boorman, Special Advisor to the Managing Dir., Int'l Monetary Fund, Sovereign Debt Restructuring: Where Stands the Debate? (Oct. 17, 2002), *available at* http://www.imf.org/external/np/speeches/2002/101702.htm (describing the political, social, and moral threshold beyond which a country cannot justify further financial constraints).

58. *See* Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1487 (2004).

grounded in the value of the firm's assets and the burden of its obligations.[59]

A sovereign's ability to service its debt may include a similar initial analysis, but it also involves political, social, and moral questions.[60] These additional factors lead to the conclusion that there is a threshold limitation to a country's willingness to service its debt.[61] However, because of the imprecise nature of these additional factors, "it seems impossible to predict when this point will be reached."[62] Furthermore, changes in political leadership could potentially change the sovereign's calculus for determining the costs and benefits of defaulting on sovereign debt.[63]

The second difference between corporate and sovereign debt is that a country can use little as collateral to guarantee the value of its debt.[64] As a consequence, most sovereign debt is unsecured.[65] Secured debt plays a major role in corporate bankruptcies due to the belief that security increases the likelihood of payment in the event that the company goes bankrupt.[66] Because sovereign debt is typically unsecured, it does not lend itself to the use of domestic bankruptcy law as a model for sovereign debt restructuring.[67] Moreover, it is nearly impossible for creditors to rely on a sovereign's domestic assets in satisfaction of the debt, which is why Elliott Associates sought control of the Argentine naval ship while it was docked in Ghana.[68]

Thirdly, courts have extremely limited ability to force sovereign entities to comply with their rulings.[69] The traditional state law methods of debt collection are inapplicable to sovereign debt.[70] Furthermore, there is

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59. *See* CHARLES J. TABB & RALPH BRUBAKER, BANKRUPTCY LAW PRINCIPLES, POLICIES AND PRACTICE 663 (3d ed. 2010) (noting that a company's decision to enter bankruptcy depends on an evaluation of its assets and expenses).

60. *See* Boorman, *supra* note 57.

61. *See id.*

62. Sedlak, *supra* note 58, at 1488.

63. *See id.*

64. *See* Eaton & Fernandez, *supra* note 24, at 2.

65. "Unsecured debt" is defined as "[a] debt not supported by collateral or other security." BLACK'S LAW DICTIONARY, *supra* note 10, at 463.

66. *See* Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2067 (1994).

67. *See* Sedlak, *supra* note 58, at 1488–89.

68. *See supra* notes 1–9 and accompanying text.

69. *See* Eaton & Fernandez, *supra* note 24, at 2.

70. Traditionally, a creditor sues a debtor in civil court when the debtor has defaulted on its unsecured debt. *See* 2 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE § 20:1 (3d ed. 2008). A creditor must demonstrate the existence of a debt and the debtor's failure to pay the debt. *Id.* § 17:1; *see also* 11 U.S.C. § 109 (2006). The creditor can then obtain a writ of execution, which allows him to request the seizure and sale of the debtor's property. *See* TABB & BRUBAKER, *supra* note 59, at 15. However, the creditor does not need to sue a debtor when the debt is secured, as long as the property can be secured without a breach of the peace. *See id.* at 14. If the property cannot be secured peacefully, the procedure for recovery will be similar to that of unsecured debt. If these remedies are insufficient or unworkable, creditors can force the liquidation of a corporation through federal bankruptcy laws. *See* 11 U.S.C. §§ 701–784 (explaining the process of liquidation in bankruptcy proceedings).

presently no intergovernmental agency to adjudicate disputes between creditors and sovereign states.[71] Due to the absence of an international bankruptcy regime, sovereign debt restructurings are typically guided by the use of the contractual mechanisms contained in the sovereign bond contracts.[72]

International financial institutions (IFIs) often offer new loans to sovereigns while they are attempting to restructure their debts with creditors.[73] When the International Monetary Fund (IMF) acts as the IFI, it often conditions loans on certain economic policy reforms.[74] The IMF often lends to sovereigns that are unable to secure loans from private lenders, and on terms unavailable in capital markets.[75] The prospect of an IMF support package may create what is known as a "moral hazard risk."[76]

The moral hazard risk is the risk that IMF loans will encourage sovereigns to maintain domestic economic policies that are fiscally unsound and to borrow recklessly from private capital markets.[77] Sovereigns may be encouraged to make risky borrowing decisions based on the belief that the IMF will intervene with funds before a default or during a restructuring.[78] Moreover, IMF lending may insulate sovereigns from the damages of imprudent borrowing.[79]

IMF lending may create a moral hazard dilemma for lenders, as well.[80] When a realistic risk of default exists, creditors have a greater incentive to monitor their loans.[81] Conversely, if a lender of last resort reduces the chances of default, creditors have a lesser incentive to monitor their loans.[82] Creditors arguably are encouraged to lend recklessly and take excessive

71. *See infra* notes 185–96 and accompanying text.

72. *See* Arora & Caminal, *supra* note 26, at 632.

73. *See* Dickerson, *supra* note 41, at 1009.

74. *See id.*

75. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 642 ("[A] large scale private lending during a crisis has never taken place and it is primarily the IMF that has always provided the bail-outs to defaulting sovereign nations. This is why the IMF has become known as the International Lender of Last Resort (ILOLR) or the IMH (Institute for Moral Hazard)."). For a discussion of Moral Hazard, see *infra* notes 77–85 and accompanying text.

76. *See* Dickerson, *supra* note 41, at 1009; *see also* Arora & Caminal, *supra* note 26, at 642.

77. *See* Robert J. Barro, *The IMF Doesn't Put Out Fires, It Starts Them*, BUS. WK., Dec. 7, 1998, at 18, *available at* http://scholar.harvard.edu/barro/files/98_1207_imf_bw.pdf; *see also* Charles W. Calomiris, *The IMF's Imprudent Role As Lender of Last Resort*, 17 CATO J. 275, 277; Dickerson, *supra* note 41, at 1009.

78. *See* Dickerson, *supra* note 41, at 1010–11; *see also* Alon Seveg, *When Countries Go Bust: Proposals for Debtor and Creditor Resolution*, 3 ASPER REV. INT'L BUS. & TRADE L. 25, 44 (2003) ("For example, if a country's debt were written off automatically once it reached a certain level, governments would have an incentive to over-borrow because they would receive the benefit of the loan without incurring the cost of repaying it.").

79. *See* Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 961–62 (2000).

80. *See* Dickerson, *supra* note 41, at 1011; *see also* Seveg, *supra* note 78, at 44 ("Similarly, [creditors] would have an artificial incentive to make high-risk loans if they were automatically 'rescued' when their loans could not be repaid by debtors.").

81. *See* Barrow, *supra* note 77, at 18; Calomiris, *supra* note 77, at 277.

82. *See* Barrow, *supra* note 77, at 18; Calomiris, *supra* note 77, at 277.

risks.[83] An IMF financial package given to a distressed sovereign insulates the creditors from the costs of their inadequate risk assessment.[84] In addition, if the sovereign initiates debt restructuring negotiations or defaults on its debt, the potential for an IMF support package may alter creditors' incentives to renegotiate and could cause them to refuse to make concessions.[85]

C. Why Sovereigns May Be Reluctant To Restructure Their Sovereign Bonds

Sovereigns facing liquidity problems often go to great lengths to avoid restructuring their debts to foreign creditors.[86] Part I.C.1 to Part I.C.3 discusses the reasons why sovereigns may be reluctant to initiate a restructuring when faced with a financial crisis.

1. Economic Dislocation

Sovereigns facing liquidity problems often avoid restructuring their debts because a restructuring can impose severe economic costs on the sovereign.[87] Even an orderly restructuring can devastate a sovereign's domestic financial system.[88] For example, Argentina justified the terms of its 2005 bond exchange by claiming it could not continue to pay creditors without jeopardizing Argentine citizens' housing, jobs, education, and healthcare.[89] Loans from IFIs, like the IMF, allow sovereigns to postpone the initiation of a restructuring by providing needed capital in the form of loans or grants.[90] While orderly restructurings may be worrisome, a disorderly restructuring can make a bad situation worse by blocking a country's access to private capital for several years.[91]

2. Tarnishing the Sovereign's Reputation

Sovereigns may also seek to avoid debt restructuring out of a concern that it will signal that they are not creditworthy.[92] One of the primary costs

83. *See* Dickerson, *supra* note 41, at 1011.

84. *See* Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors?*, 37 INT'L LAW. 103, 113 (2003).

85. *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 17–18 (2004).

86. *See* Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring (Nov. 26, 2001), *available at* http://www.imf.org/external/np/speeches/2001/112601.htm.

87. *See id.*

88. *See id.*

89. *See* Nestor Kirchner, President of the Republic of Arg., Discurso del Señor Presidente de la Nación, Doctor Nestor Kirchner, Ante la Honorable Asamblea Legislativa [Inaugural Address Before the Legislative Assembly] (May 25, 2003), *available at* http://www.casarosada.gov.ar/index.php?option=com_content&view=article&id=24414&catid=28:discursos-ant; *see also infra* notes 281–305 and accompanying text.

90. *See supra* notes 73–85 and accompanying text.

91. *See* Krueger, *supra* note 86.

92. *See* Dickerson, *supra* note 41, at 1007.

of defaulting on debt is the sovereign's exclusion from future borrowing.[93] Regardless of whether a sovereign defaults strategically or out of financial distress, a default transfers a gain from creditors to the debtor sovereign.[94] This may trigger a phenomenon known as a "lender embargo."[95] A lender embargo occurs when creditors are unwilling to lend to a sovereign, effectively blocking the sovereign's access to credit markets.[96] Once a country defaults, it will not be able to access the international private capital markets until it has restructured its debt.[97]

Sovereigns may choose to initiate a restructuring when they are able but unwilling to pay their debt.[98] Policymakers may choose to save a country's resources for the needs of domestic constituents instead of repaying external creditors during times of financial distress.[99] Furthermore, a sovereign may be unwilling to enact reforms or pursue the fiscal adjustments necessary to achieve debt sustainability.[100] As a result, a government may default and restructure its debt even though it is capable of repaying the debts in full.[101]

Distinguishing between necessary and opportunistic defaults by sovereigns can be challenging for creditors.[102] A sovereign interested in avoiding payment can attempt to manufacture a crisis—for example, by overspending—to make it seem as though it is financially distressed and at risk of defaulting on its debts.[103] Opportunistic defaults enable sovereigns to drastically reduce their debt burdens, thereby externalizing the cost of default on creditors who face reductions in the value of their investments.[104]

Ecuador's 2008 default is an example of a sovereign opportunistically defaulting.[105] In November 2008, Ecuador suspended payment on two bonds after an audit commission declared the debts "immoral," "illegal," and "illegitimate."[106] Ecuador defaulted on its debt obligations, and subsequently initiated a debt exchange which repurchased the two bonds at a discount of 65 to 70 percent on their face value.[107] Creditors attempted to block the offer, but ultimately 95 percent of outstanding bonds were

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93. *See* Bratton & Gulati, *supra* note 85, at 14.
94. *See id.*
95. *See id.*
96. *See id.*
97. *See* Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, The Difference Is in the Debt: Crisis Resolution in Latin America (Nov. 14, 2003), *available at* http://www.imf.org/external/np/speeches/2003/111403a.htm.
98. *See* Michael Tomz & Mark L.J. Wright, *Do Countries Default in "Bad Times"?* 1, 6 (Fed. Reserve Bank of S.F., Working Paper No. 2007-17, 2007), *available at* http://www.frbsf.org/publications/economics/papers/2007/wp07-17bk.pdf; *see also* Das, Papaioannou & Trebesch, *supra* note 30, at 67.
99. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 67.
100. *See id.*
101. *See* Tomz & Wright, *supra* note 98, at 7; Das, Papaioannou & Trebesch, *supra* note 30, at 67.
102. *See* Choi, Gulati & Posner, *supra* note 56, at 132–33.
103. *See id.*
104. *See id.* at 133.
105. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 78.
106. *See id.*
107. *See id.*

exchanged in the restructuring.[108] Ecuador's default was not triggered by a severe economic crisis, and the ratio of public debt to gross domestic product (GDP) at the time of default was only 23 percent.[109] In contrast, Argentina's public debt to GDP ratio a year after its 2001 default was 130 percent.[110]

3. Uncertainty About What Awaits

Sovereigns cannot reasonably predict the likelihood of successfully restructuring.[111] Despite the enormous sums of money being lent to sovereigns, there is no international framework to coordinate sovereign defaults.[112] This is not the case in the corporate context. The United States has a detailed legal framework for corporate bankruptcy wherein debtor companies may undergo reorganization or liquidation.[113] The debtor company, its creditors, and courts devote significant resources towards determining whether the company should be reorganized or liquidated.[114] Sovereigns cannot be liquidated, so reorganization is the goal of any sovereign debt restructuring.[115]

Yet, sovereigns often avoid restructurings because of the inherent uncertainty regarding the results of the reorganization process.[116] Negotiating a debt restructuring can be a long and unpredictable process.[117] Without an orderly international framework, restructuring sovereign debt

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108. *See id.*

109. *See id.*

110. *See* Abaclat v. The Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 63 (Aug. 4, 2011), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC3130_En&caseId=C95 [hereinafter *Abaclat*].

111. *See* Dickerson, *supra* note 41, at 1007.

112. *See* Seveg, *supra* note 78, at 25.

113. U.S. bankruptcy law is governed by Title 11 of the U.S. Code. 11 U.S.C. §§ 101–1330 (2006).

114. The parties and the court both scrutinize whether the debtor company's value following a reorganization will be greater than the value of its assets sold piecemeal. Although a corporate debtor can choose either option at the beginning of a bankruptcy case, most initially opt for reorganization which is governed by Chapter 11. *See* 11 U.S.C. § 706(a) (permitting the debtor-company to convert a liquidation into a reorganization). However, the judge may convert the reorganization into a liquidation for a variety of reasons, including instances when no "reasonable likelihood of rehabilitation" exists or when the debtor is unable to "effectuate a plan" of reorganization. 11 U.S.C. § 1112(b)(1)–(2).

115. *See, e.g.*, Rory Macmillian, *Towards a Sovereign Debt Work-Out System*, 16 NW. J. INT'L. L. & BUS. 57, 75 (1995) ("Debates over whether reorganization or liquidation is more efficient for failing corporate debtors are inappropriate in the context of government debtors: there can be no talk of an economically efficient liquidation and distribution of a people's government." (citation omitted)).

116. *See* Dickerson, *supra* note 41, at 1007.

117. *See* Seveg, *supra* note 78, at 46–47; *see also* John B. Taylor, Under Sec'y of Treasury for Int'l Affairs, Sovereign Debt Restructuring: A US Perspective (Apr. 2, 2002), *available at* http://www.iie.com/publications/papers/paper.cfm?ResearchID=455 ("This uncertainty complicates decision-making for everyone—the private sector, the official sector, and the sovereign government itself. A more predictable sovereign debt restructuring process for countries that reach unsustainable debt positions would help reduce this uncertainty.").

has proven to be costly for both creditors and debtor nations.[118] The longer negotiations drag on, the more likely it is that the sovereign will drain its resources and will be unable to pay its debt obligations.[119] The process itself entails certain added costs, as restructurings typically require debtor governments to retain legal and financial advisors for the duration of the restructuring.[120]

Legal advisors help sovereigns predict possible legal hurdles inherent in a restructuring and can provide an overview of the legal characteristics of the bonds.[121] They may also assist in drafting the bond exchange documentation and the terms of the new bonds.[122] Financial advisors often help to identify and reach out to bondholders and can play a key role in designing the financial terms of the exchange.[123] These advisors add to the cost of the restructuring because the sovereign must pay legal and financial fees, as well as travel expenses, while the restructuring is conducted.[124] Restructurings may also create administrative costs because government staff and officials may need to invest months of work while preparing and implementing a debt exchange.[125] A sovereign's ability to incur the costs associated with a restructuring may lend support to the creditors' belief that the sovereign is engaging in an opportunistic restructuring.[126]

D. Systemic Complications with Restructuring: Catalyst for a Change

Part I.D explores the fundamental problems with sovereign bond contracts that spurred the international community into action. Part I.D.1 explores the unanimous action clauses of sovereign bond contracts. Part I.D.2 discusses the way investors were able to take advantage of these clauses and develop a holdout investment strategy at sovereign debtors' expense.

1. Unanimous Action Clauses

The majority of sovereign bonds are issued under New York law.[127] Until recently, sovereign bonds issued under New York law contained Unanimous Action Clauses (UAC).[128] The payment terms of a bond with a UAC can only be modified with the unanimous approval of the bondholders

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118. *See* Seveg, *supra* note 78, at 25.

119. *See id.*; *see also* Barry Eichengreen, *Restructuring Sovereign Debt*, J. ECON. PERSP. 1, 4 (2003), *available at* http://emlab.berkeley.edu/~eichengr/research/journaleconomicperspectivesaprileditsep22-03.pdf (detailing how countries expend cash reserves and increase interest rates to avoid suspending debt payments).

120. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 21.

121. *See id.*

122. *See id.*

123. *See id.*

124. *See id.* at 65.

125. *See id.*

126. *See supra* notes 98–110 and accompanying text.

127. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 41.

128. *See* Dickerson, *supra* note 41, at 1014; *see also* Arora & Caminal, *supra* note 26, at 637.

of that issue.[129] Consequently, each bondholder has the potential to veto any restructuring attempt.[130] As a result, the sovereign debtor must conclude a debt restructuring agreement with every individual bondholder in order to secure debt relief.[131]

2. The Holdout Problem

Because the payment terms of a bond issued with UACs cannot be amended or restructured unless all outstanding bondholders agree to the alteration, they are inherently difficult to restructure.[132] Some creditors may reject the new amendment[133] and decide to hold on to their old debt instead.[134] In an effort to have an amendment accepted, a sovereign debtor has incentives to make side payments to obstinate creditors.[135] The sovereign debtor thereby inadvertently encourages future holdouts.[136]

A holdout creditor receives the benefit of a side payment and may also pursue legal remedies to recover the full value of its debt.[137] If the holdout creditor succeeds in litigating its claim, it may deplete the funds available to satisfy the claims of other similarly situated creditors.[138] Even if the holdout does not succeed in litigation, the unanimity requirement of a UAC provision enables a single holdout to halt the entire restructuring process while the claim is litigated, thereby delaying the process for long periods of time.[139]

Holdouts are capable of preventing a potentially successful restructuring[140] and are burdensome on the citizens of the debtor nation.[141]

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129. *See* Michael Bradley, James D. Cox & Mitu Gulati, *The Market Reaction to Legal Shocks and Their Antidotes: Lessons from the Sovereign Debt Market*, 39 J. LEGAL STUD. 289, 295 (2010).

130. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 637.

131. *See* Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Dynamics of Contract Evolution* 9 (Univ. Chi. Law Sch., Chi. Inst. for Law & Econ., Working Paper No. 605, 2012), *available at* http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5298&context=faculty_scholarship.

132. *See* Dickerson, *supra* note 41, at 1013.

133. The amendment is accomplished by an exchange of the old bond for new bonds governed by a new bond contract with amended terms. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 21–23. A high participation rate by bondholders is key to an exchange offer. *See id.* at 22. Therefore, most exchange offers include terms that generate incentives for participation, such as upfront cash repayments or advantageous legal features of the new bonds. *See id.* Another strategy is to allow bondholders to choose among different new debt instruments, thereby accounting for differing preferences among creditors. *See id.* at 23. For example, retail investors often prefer new bonds with no cut in principal and are willing to accept long maturity and low coupons. *See id.* In contrast, institutional investors tend to prefer bonds with a principal haircut but shorter maturities and higher coupons. *See id.*

134. *See* Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 259 (2003).

135. *See id.* at 259–60.

136. *See id.*

137. *See id.* at 260.

138. *See id*.

139. *See* Dickerson, *supra* note 41, at 1014.

140. *See* Wheeler & Attaran, *supra* note 134, at 253.

Over USD 2 billion in claims have been filed by holdout creditors against heavily indebted, poor countries.[142] These claims often account for a considerable percentage of the country's GDP.[143] For example, the Republic of Congo faced sovereign debt litigation claims equal to roughly 15 percent of its GDP.[144]

i. The Vulture Funds Are Circling

Vulture funds—as they are pejoratively called—are funds that specialize in distressed assets.[145] A vulture fund is a new type of holdout creditor that has emerged since the shift to bond-based sovereign debt.[146] A vulture fund becomes a creditor by purchasing sovereign debt at a discount on the secondary market.[147] The discount typically occurs after a sovereign has defaulted and stems from concerns that the sovereign will need to restructure its debt, or that the sovereign is already mired in a long debt restructuring process.[148] In the event of a restructuring, vulture funds typically refuse to participate and attempt to collect the full face value of the claim from the sovereign debtor by litigating their claim.[149]

The vulture fund investment strategy is typically to purchase discounted bonds after a sovereign has defaulted, and then wait to see whether the market rises or falls with respect to the value of the debt.[150] If the market improves, the vulture fund benefits in two ways.[151] First, the vulture fund now holds a profitable investment compared to its initial purchase.[152] Second, the vulture fund has a stronger position going into restructuring negotiations and will be more effective in holding out against the restructuring.[153] Vulture funds may also profit by suing sovereigns for the full value of the defaulted debt.[154]

The United States has heard eleven cases brought by commercial investors against the governments of Cameroon, the Republic of Congo, and Nicaragua alone.[155] The investors have claimed approximately USD 695 million on debts which had an original face value of USD 195.9

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141. *See* LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY 111–12 (2003).

142. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 50.

143. *See id.*

144. *See id.* at 50–51.

145. *See* Wheeler & Attaran, *supra* note 134, at 254.

146. *See id.*

147. *See id.*; *see also* Seveg, *supra* note 78, at 47.

148. *See* Ryan E. Avery, *Out of the Desert and to the Oasis: Legislation on Predatory Debt Investing*, 18 U. MIAMI INT'L & COMP. L. REV. 267, 276 (2011); *see also* Seveg, *supra* note 78, at 47.

149. *See* Wheeler & Attaran, *supra* note 134, at 254.

150. *See* Avery, *supra* note 148, at 276.

151. *See id.*

152. *See id.*

153. *See id.* at 276–77.

154. *See, e.g.*, *infra* notes 160–75, 315–33 and accompanying text.

155. *See* Elizabeth Broomfield, *Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation*, 2010 COLUM. BUS. L. REV. 473, 507.

million.[156] The vulture funds have secured judgments of USD 659.4 million.[157] Argentina now faces similar litigation at the hands of one of the most well-known vulture funds: Elliott Associates.[158]

ii. King of the Vultures: Elliott Associates

Elliott Associates is a New York–based hedge fund credited with pioneering the vulture fund model in the 1990s.[159] Elliott is perhaps best known for its successful holdout litigation against Peru, in which the fund recovered 400 percent of what it paid for Peru's debt.[160] More recently, Elliott Associates has been attempting to collect on defaulted Argentine bonds through one of its subsidiaries, NML Capital.[161] NML Capital is the vulture fund responsible for seizing the Argentine ship in Ghana and is the plaintiff in the Second Circuit litigation over Argentine bonds.[162]

Elliott's litigation against Peru[163] began in federal court in New York.[164] Elliott had purchased Peruvian debt on the secondary market and had refused to enter into the Brady[165] restructuring.[166] The case went up to the Second Circuit, where the court ruled in Elliott's favor.[167]

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156. *See id.*

157. *See id.*

158. *See* Michael Cooper & Leslie Wayne, Publicity-Shy Giuliani Backer Is Thrust into Spotlight, N.Y. TIMES (Nov. 22, 2007), http://www.nytimes.com/2007/11/22/us/politics/22singer.html?pagewanted=all&_r=0.

159. *See* Nick Dearden, *Greece: Here Come the Vulture Funds*, GUARDIAN (May 17, 2012, 11:35 AM), http://www.guardian.co.uk/commentisfree/2012/may/17/greece-vulture-funds; *see also* Seveg, *supra* note 78, at 39.

160. *See* Nick Dearden, *Vulture Funds—Coming to a Country Near You?*, HUFFINGTON POST (Feb. 8, 2011, 1:00 AM), http://www.huffingtonpost.co.uk/nick-dearden/vulture-funds-coming-to-a_b_914691.html; *see also* Seveg, *supra* note 78, at 39.

161. Seveg, *supra* note 78, at 39.

162. *See id.*; *see also supra* notes 1–9, 159–84 and accompanying text.

163. Peru faced prior litigation in the 1990s in the case *Pravin Banker Associates v. Banco Popular del Peru*, 895 F. Supp. 660 (S.D.N.Y. 1995), and the subsequent appeal *Pravin Banker Associates v. Banco Popular del Peru*, 109 F.3d 850 (2d Cir. 1997). Pravin Banker had purchased small amounts of Peruvian debt in the secondary market and refused to participate in the liquidation process that followed. *See* Bradley, Cox & Gulati, *supra* note 129, at 291; *see also* Seveg, *supra* note 78, at 50. Peru's central bank was unable to pay its creditors. *See Pravin*, 109 F.3d at 853; *see also* Seveg, *supra* note 78, at 50. Instead of restructuring its debt, the bank appointed a committee of liquidators tasked with dissolving the bank and distributing its liquidated assets. *See Pravin*, 109 F.3d at 853. Rather than join the liquidation proceedings, Pravin brought suit against Peru's national bank. *See id.* The case was tried in New York because the bonds were issued under New York law. *See* Bradley, Cox & Gulati, *supra* note 129, at 291. The lower court granted Peru multiple stays but ultimately ruled against Peru. *See id.* On appeal, the Second Circuit rejected Peru's defense and ruled in favor of Pravin Banker out of an interest in enforcing contractual provisions. *See id.* Ultimately, Pravin Banker was unable to enforce its victory because it lacked a mechanism by which it could seize Peruvian assets. *See id.* This is the same reason Elliott sought seizure of the Argentine vessel in Ghana. *See supra* notes 1–9 and accompanying text.

164. *See* Bradley, Cox & Gulati, *supra* note 129, at 292.

165. During the 1980s, many of the world's least developed countries were unable to service their debt due to high debt levels, a decline in commodity prices, the appreciation of the U.S. dollar, and a sharp increase in interest rates. *See* Brian Lucey & Svitlana Voronkova, *Securitising International Sovereign Debt*, *in* PERSPECTIVES ON INTERNATIONAL

In the wake of its victory, Elliott sought attachment orders in multiple jurisdictions—including the United States, Canada, Belgium, the Netherlands, Luxemburg, England, and Germany—against the payments Peru sought to make on its restructured Brady bonds.[168] The district court in New York, hearing the case on remand from the Second Circuit, issued an attachment order in excess of USD 55 million against Peru.[169] The attachment order effectively prevented J.P. Morgan Chase Bank—the fiscal agent responsible for making payments to Peru's bondholders—from transferring payments to the bondholders who participated in the restructuring.[170]

Peru then sought to use the Euroclear Bank in Brussels to make the payments.[171] However, Elliott had already filed an attachment order in Brussels and the Court of Appeals in Brussels granted the injunction.[172] Peru now faced the risk of defaulting on its Brady bonds.[173] To avoid default and the consequences that came along with it, Peru settled with Elliott for USD 56.3 million.[174] Elliott had purchased the bonds—worth USD 20 million of Peruvian debt—on the secondary market for a discounted price of USD 11.4 million.[175]

The Elliott litigation was the first time a holdout creditor effectively used a litigation strategy to gain a disproportionate payment from a sovereign as compared to other similarly situated bondholders.[176] Prior to *Elliott Associates, L.P. v. De la Nacion*, holdouts had used litigation against sovereigns largely as an annoyance strategy.[177] Elliott's success potentially altered the risks for all outstanding sovereign bonds because the pari passu clause[178] at the heart of Elliott's claim against Peru is included in all

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DEBT 135, 135–36 (Constantin Gurdgiev et al. eds., 2007). In 1989, in response to the debt crisis, Brady bonds were introduced as a form of debt reduction. *See id.* at 136. The Secretary of the U.S. Treasury, Nicholas Brady, suggested the bonds as a way to relieve the debt burden of the least developed countries. *See id.* The United States and international agencies like the IMF and World Bank would restructure and reduce the debt owed to commercial banks by least developed countries that had pursued structural adjustments and economic reforms. *See id.* The developing countries issued Brady bonds in order to restructure their defaulted commercial bank debt. *See id.* The banks would exchange the nonperforming loans with U.S. dollar-denominated bonds. *See id.* The debtor country would have to undergo a number of economic reforms before the restructuring would be approved. *See id.* Once Brady bonds were issued, they could be traded in secondary markets. *See id.* at 141.

166. *See* Wheeler & Attaran, *supra* note 134, at 256–57.

167. Elliott Assocs., L.P. v. Banco de la Nacion, 194 F.3d 363, 378 (2d Cir. 1999).

168. *See* Bradley, Cox & Gulati, *supra* note 129, at 292.

169. *See* Elliott Assocs. v. De la Nacion, 194 F.R.D. 116, 117 (S.D.N.Y. 2000).

170. *See* Wheeler & Attaran, *supra* note 134, at 257.

171. *See id.*

172. *See* Bradley, Cox & Gulati, *supra* note 129, at 290.

173. *See id.* at 293.

174. *See id.*

175. *See* Cooper & Wayne, *supra* note 158; *see also* Bradley, Cox & Gulati, *supra* note 129, at 290.

176. *See* Bradley, Cox & Gulati, *supra* note 129, at 293.

177. *See id.*

178. Pari Passu means "[p]roportionally; at an equal pace; without preference." BLACK'S LAW DICTIONARY, *supra* note 10, at 1225. In the context of sovereign debt instruments, the

sovereign bond issues.[179] Creditors could now invoke the pari passu clause as a way to hold up sovereign debt restructurings.[180]

The *Elliott* ruling solidified creditors' holdout power, thereby injecting new risk into these securities.[181] *Elliott* increased the risk of holdout litigation due to the ubiquity of the pari passu clause.[182] There was also a risk that hedge funds would begin searching for additional techniques for successfully litigating holdout suits.[183] Elliott is now utilizing similar tactics in its efforts to collect on defaulted Argentine bonds.[184]

E. The Global Community Responds

Part I.E.1 details the IMF's failed proposal to create a mechanism for controlling sovereign bond restructurings. Next, Part I.E.2 looks at the international community's preferred solution: collective action clauses. Lastly, Part I.E.3 details some of the collective action clauses' shortcomings.

1. A Rejected Proposal: The Sovereign Debt Restructuring Mechanism

In 2001, the deputy director of the IMF, Anne Krueger, cited vulture funds as a major cause of the disorderly state of sovereign bond restructurings.[185] Krueger explicitly referenced Elliott Associates five times in her speech.[186] She sought a way to encourage debtors and creditors to collaborate and restructure unsustainable debts efficiently.[187] This led Krueger to lobby the IMF to create a formal mechanism—which became known as the Sovereign Debt Restructuring Mechanism (SDRM)—to control debt restructurings.[188]

The SDRM envisioned what would have been a formal mechanism with four key features.[189] First, the mechanism would prevent creditors from

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pari passu clause is typically understood as a contract provision that prevents the borrower from incurring debt obligations to other creditors and ranking them legally senior to the debt instrument containing the clause. *See* Lee C. Buchheit & Jeremiah S. Pam, *The* Pari Passu *Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 872 (2004); *see also* Joseph J. Norton, *International Syndicated Lending: The Legal Context for Economic Development in Latin America*, NAFTA L. & BUS. REV. AM., Summer 1996, at 21, 54 ("The *pari passu* clause prevents the borrower from assuming new debts which subordinate the interests of the syndicate members.").

179. *See* Bradley, Cox & Gulati, *supra* note 129, at 293.

180. *See id.* at 294.

181. *See id.*; *see also* Seveg, *supra* note 78, at 52–53 ("Most importantly, Elliott's success shows that it is possible for a vulture fund to successfully seize the assets of a sovereign debtor thereby undermining a sovereign's debt restructuring efforts.").

182. *See* Bradley, Cox & Gulati, *supra* note 129, at 293.

183. *See id.* at 294.

184. *See supra* notes 1–9 and accompanying text; *see also infra notes* 280–333, and accompanying text.

185. *See* Krueger, *supra* note 86.

186. *See id.*

187. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 633.

188. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 633.

189. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 633–34.

disrupting restructuring negotiations by pursuing holdout litigation.[190] Second, it would give creditors some guarantee that the sovereign debtor would adopt appropriate economic policies, negotiate in good faith with creditors, and refrain from giving preferential treatment to some creditors.[191] Third, in an effort to encourage private lenders to provide new funds to help the sovereign meet its financial needs, the mechanism would provide new creditors with some type of preferred creditor status, guaranteeing their repayment before existing private creditors.[192] Lastly, the mechanism would make a restructuring binding on minority creditors once a large enough majority of creditors accepted the restructuring agreement.[193]

Krueger believed the mere presence of the SDRM would encourage debtors and creditors to negotiate on their own and reach restructuring agreements without actually utilizing the mechanism.[194] If holdout creditors frustrated a restructuring agreement, the formal mechanism could be used to bind the potential holdout creditors to the majority's decision.[195] However, the SDRM was never created due, in large part, to the United States's disapproval.[196]

In April 2003, U.S. Treasury Secretary John W. Snow proclaimed that it was "neither necessary nor feasible to continue working on the SDRM."[197] The SDRM proposal received further criticism from creditors worried about tilting the balance of power in the borrowers' direction.[198] The United States favored a more market-driven solution and urged contractual reform as an alternative to the SDRM.[199] Eventually, the United States,[200] the IMF,[201] and the Group of 10 (G-10)[202] supported a complete transition from

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190. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 633–34.

191. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 634.

192. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 634.

193. *See* Krueger, *supra* note 86; *see also* Arora & Caminal, *supra* note 26, at 634.

194. *See* Krueger, *supra* note 86.

195. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 634.

196. *See* John W. Snow, U.S. Sec'y of the Treasury, Statement at the Meeting of the International Monetary and Financial Committee (Apr. 12, 2003), *available at* http://www.imf.org/external/spring/2003/imfc/state/eng/usa.htm.

197. *Id.*

198. *See* Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391, 398 (2005).

199. *See* Bradley, Cox & Gulati, *supra* note 129, at 296–97 n.9.

200. *See* Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L. J. 691, 707–08 (2004).

201. *See Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, INT'L MONETARY FUND (Sept. 21, 2003), http://www.imf.org/external/np/cm/2003/092103a.htm.

202. *See* GRP. OF TEN, WORKING GRP. ON CONTRACTUAL CLAUSES, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES 3–6 (2003), *available at* http://www.bis.org/publ/gten08.pdf. The "Group of Ten" is "the group of countries that have agreed to participate in the [IMF's] General Arrangements to Borrow (GAB), a supplementary borrowing arrangement that can be invoked if the IMF's resources are estimated to be below member's needs." INT'L MONETARY FUND, A GUIDE TO COMMITTEES, GROUPS, AND CLUBS 4 (2013), *available at* http://www.imf.org/external/np/exr/facts/pdf/groups.pdf. The G-10 members are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. *Id.*

unanimous action clauses to collective action clauses (CACs) in sovereign financing contracts.[203]

2. Heralding a Savior: Collective Action Clauses

English law bonds have utilized some form of CACs for more than a century.[204] However, CACs were not used under New York law until 2003.[205] In February 2003, Mexico issued the first sovereign bonds in the New York market that included CACs.[206] Since then, the use of CACs in New York bonds has become standard practice.[207]

Shocks to the sovereign debt market—including Mexico's financial crisis in 1995, the Asian crisis in 1997–98, and Argentina's 2001 default—are believed to have triggered the use of CACs in sovereign bonds issued on the New York market.[208] The jump from UACs to CACs was not instantaneous.[209] Rather, there was a shift in the boilerplate sovereign bond contract resulting from competition among market participants.[210]

Contracts, including sovereign bond contracts, are documents produced by law firms that serve large numbers of clients with a variety of interests and needs.[211] As a result, many contracts are modifications of existing templates.[212] Industry-wide change in contracts generally occurs in response to major events, like the financial crises in the late 1990s.[213] Immediately after Mexico's crisis in 1995, CACs were used infrequently and only by more marginal market participants.[214] Eventually, the cumulative effect of the crises led top-market participants to adopt CACs and to compete over CAC-related terms in an effort to control the eventual CAC standard.[215]

There are two broad categories of CACs.[216] The first type of CAC is a majority restructuring provision.[217] Majority restructuring provisions allow a specific majority of bondholders of a particular issuance to alter the bonds' financial terms—principal, interest, and maturity—and bind all other holders of that issuance by the alteration.[218] The second type of CAC is a majority enforcement provision.[219] A majority enforcement provision

203. *See* Arora & Caminal, *supra* note 26, at 632.
204. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 44.
205. *See id.*
206. *See id.*; *see also* Choi, Gulati & Posner, *supra* note 131, at 4.
207. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 44; *see also* Choi, Gulati & Posner, *supra* note 131, at 4.
208. *See* Choi, Gulati & Posner, *supra* note 131, at 4.
209. *See id.*
210. *See id.*
211. *See id.* at 6.
212. *See id.* at 4.
213. *See id.*
214. *See id.*
215. *See id.*; *see also* Arora & Caminal, *supra* note 26, at 651.
216. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 43.
217. *See id.*
218. *See id.*
219. *See id.*

enables a qualified majority of bondholders to prevent individual bondholders from accelerating payment and from commencing litigation against the sovereign.[220]

CACs make restructuring easier for the sovereign to execute, while simultaneously giving bondholders substantial control over the process.[221] This helps to ensure that countries cannot use the restructuring clauses to escape their debt obligations when they are capable of repaying.[222] Still, the presence of CACs does not necessarily guarantee an efficient restructuring.[223]

3. Underwhelming Success: A Few of the Lingering Problems

Part I.E.3.i to Part I.E.3.ii discusses two broad restructuring problems that remain, despite the market shift towards the ubiquitous inclusion of CACs in sovereign bond contracts.

i. Coordination Issues

The dominance of bond lending in sovereign debt has created coordination problems for sovereigns due to the increase in the number of creditors with whom the sovereign must negotiate in the event of a restructuring.[224] There are significantly more bondholders involved with bond issues than there were bank participants when bank lending was the dominant form of sovereign debt.[225] There are also more bondholders now than in the past eras in which bonds were the dominant form of sovereign debt.[226] Moreover, large banks maintained ongoing relationships with sovereigns, which created an expectation of future lending arrangements.[227] This expectation gave lenders an incentive to compromise during debt restructurings.[228] In contrast, bondholders do not have the same incentive to compromise, because they typically do not have an expectation of an ongoing relationship with the sovereign.[229]

In terms of logistics, restructuring bond debt is challenging because of the number of agreements—stemming from both the multiple issues of bonds as well as individual agreements with bondholders subject to UACs—a sovereign must reach.[230] Coordination problems have become increasingly difficult due to the bondholders' dispersion and the expansion

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220. *See id.*
221. *See* Choi, Gulati & Posner, *supra* note 56, at 159–60.
222. *See id.*; *see also supra* notes 102–10 and accompanying text.
223. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 45.
224. *See* Dickerson, *supra* note 41, at 1012; *see also* Seveg, *supra* note 78, at 46.
225. *See* Dickerson, *supra* note 41, at 1012.
226. *See supra* notes 41–45 and accompanying text.
227. *See* Anna Gelpern, *How Collective Action Is Changing Sovereign Debt*, 22 INT'L FIN. L. REV. 19, 19 (2003).
228. *See* RIEFFEL, *supra* note 141, at 111 ("The driving motivation for most banks . . . was the desire to continue doing business with the debtor country.").
229. *See* Schwarcz, *supra* note 79, at 1005 n.285.
230. *See id.* at 1004–05.

of the bond market.[231] There is also a high turnover of bondholders due to purchase and sale of bonds on the secondary market, which results in the added cost of having to locate and contact the new owners before negotiation can begin.[232] A small country may only have one or two bond issues, so the coordination problem is relatively manageable.[233] However, the coordination problem is far more complex for a larger country with upwards of one hundred bond issues and various forms of debt.[234]

CACs have been unable to remedy the coordination problem.[235] Some experts believe another method—which is yet undiscovered—must be combined with CACs to encourage coordination among creditors.[236] Publicly issued corporate bonds face collective action and coordination problems similar to those of sovereign bonds.[237] Scholars have recommended a new governance structure in the publicly issued corporate bond context that includes the creation of a "supertrustee" charged with monitoring, renegotiating, and enforcing bond covenants.[238] By vesting exclusive authority to renegotiate and enforce bond covenants in the supertrustee, this alternative governance structure weakens the procedural rights of bondholders.[239] The rationale behind such a structure may be equally applicable in the sovereign bond context.

Like sovereign bonds, public corporate bonds are typically dispersed among a large number of bondholders.[240] Each bondholder owns a small fraction of the company's bonds, so they may not have an incentive to obtain the relevant information about the company necessary to monitor its compliance with bond covenants, or to assess the types of enforcement action that should be taken in the event a covenant is breached.[241] Correspondingly, companies face increased costs while obtaining consent from the dispersed bondholders.[242]

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231. *See* John B. Taylor, Under Sec'y of Treasury for Int'l Affairs, Using Clauses To Reform the Process for Sovereign Debt Workouts: Progress and Next Steps (Dec. 5, 2002), *available at* http://www.stanford.edu/~johntayl/taylorspeeches/Using%20Clauses%20to%20Reform%20the%20Process%20for%20Sovereign%20Debt%20Workouts%20(5%20Dec%20%2002).doc.

232. *See* Schwarcz, *supra* note 79, at 1004–05.

233. *See* Adam Brenneman, *Gone Broke: Sovereign Debt, Personal Bankruptcy, and a Comprehensive Contractual Solution*, 154 U. PA. L. REV. 649, 682 (2006).

234. *See* Fisch & Gentile, *supra* note 49, at 1094 (noting Argentina had 152 different bond issues).

235. *See* Arora & Caminal, *supra* note 26, at 647.

236. *See id.*; *see also* Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will* 22 (Georgetown Univ. Law Ctr., Georgetown-Sloan Project on Bus. Insts., Working Paper No. 34, 2002), *available at* http://www.bankofengland.co.uk/publications/Documents/events/conf0207/buchheit_gulati.pdf.

237. *See* Yakov Amihud, Kenneth Garbade & Marcel Kahan, *A New Governance Structure for Corporate Bonds*, 51 STAN. L. REV. 447, 450–51 (1999).

238. *See id.* at 451. The proposed supertrustees would be compensated through an annual fee from the bond issue. *See* Amihud, Garbade & Kahan, *supra* note 237, at 473.

239. *See id.*

240. *See id.* at 459.

241. *See id.*

242. *See id.* at 459–60.

The supertrustee governance structure was proposed to lower agency costs while retaining liquidity in the public bond market.[243] The supertrustee would act as an agent of bondholders, but would differ from a traditional indenture trustee[244] in that the supertrustee would have the authority and incentives to execute the functions of active monitoring, enforcement, and renegotiation.[245] Companies would select the supertrustee before issuing the bonds and would have no right to replace the supertrustee once the bonds were issued.[246] Bondholders would only have a limited right to replace the supertrustee.[247] This structure was grounded in the belief that the supertrustee's reputation and potential to represent bondholders effectively would impact the price of the bonds.[248] Bondholders would pay less for bonds with an unreliable supertrustee, the same way that they pay less for bonds with contract terms that provide unsatisfactory protection.[249]

The supertrustee would be given access to, and would utilize, the same information about the company that lenders in the private market have: reports submitted by accountants, nonpublic financial data, inspection rights, and compliance certificates detailing whether bond covenants have been breached.[250] The supertrustee would be required to monitor the company with the same intensity as a reasonable lender in the private market under similar circumstances.[251] This standard would serve as a commercially practicable benchmark for evaluating whether a supertrustee has met its obligations.[252]

Supertrustees may be given the authority to renegotiate core financial terms—such as interest rate reductions and principal forgiveness. Even without such authority, however, a supertrustee can play an invaluable role in the restructuring process.[253] The supertrustee's past monitoring will impart substantial knowledge about the company and will position the supertrustee to evaluate the merits of a proposed restructuring.[254] As such, the supertrustee can act as an adviser to and representative for bondholders, even if the bondholders must ultimately consent to any changes to core financial terms that result from a restructuring.[255]

Some sovereign bonds have included trustee structures within the bond contracts; however, these sovereign bond trustees were given far less power

243. *See id.* at 469.
244. *See supra* notes 53–55 and accompanying text.
245. *See* Amihud, Garbade & Kahan, *supra* note 237, at 470.
246. *See id.* at 471.
247. *See id.*
248. *See id.*
249. *See id.*
250. *See id.* at 472.
251. *See id.* at 473.
252. *See id.*
253. *See id.* at 475–76.
254. *Id.* at 476.
255. *See id.*

than the supertrustee proposed in the corporate bond context.[256] For example, Uruguay included a weak trustee structure to provide bondholders with a centralized figure that could initiate collective legal actions, as well as distribute any resulting legal award.[257] Some experts believe that holdout litigation may be curbed by combining CACs with some type of trust structure.[258] The sovereign bond trustees that have been contemplated by debtor nations thus far have typically been geared towards directly controlling litigation arising from restructurings, rather than preventing litigation from arising in the first place.[259]

ii. A Lack of Aggregation

The coordination problems that arise from a high number of bondholders, combined with multiple series of bonds, may be curbed through the use of aggregation clauses.[260] Aggregation enables a supermajority of bondholders during a debt restructuring to force the agreed upon modification of certain matters across multiple series of bonds.[261] Without aggregation, an issuer must receive approval of a restructuring plan from a threshold percentage of bondholders in each individual bond series.[262] This can lead to restructuring problems both among bondholders within the same class, as well as among bondholders across the various bond series.[263]

As the number of bond series increases, the restructuring process becomes more complex.[264] Further complications arise when there are different modification provisions governing the various series of bonds.[265] These circumstances force a sovereign to renegotiate identical terms across multiple bond series, which can make the restructuring process exceedingly inefficient.[266] Without aggregation, a group of holdout bondholders within a single bond series can delay or even halt an otherwise successful restructuring that spans multiple bond issues.[267]

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256. *See, e.g.*, República Oriental del Uruguay, Prospectus Supplement to Prospectus Dated June 20, 2008 (Form 424B3), at S-20 to S-21 (Dec. 5, 2011), *available at* http://www.sec.gov/Archives/edgar/data/102385/000119312511329610/d265523d424b3.htm; *see also* Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. 713, 722 (2004).

257. República Oriental del Uruguay, *supra* note 256.

258. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 43–44.

259. *See id.*

260. *See* Galvis & Saad, *supra* note 256, at 722.

261. *See id.* at 715.

262. *See id.*

263. *See id.* at 722.

264. *See* David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 422–23 (2003).

265. For example, this might occur if one series of bonds is governed by CACs and another series has incorporated UACs. *See id.*

266. *See* Barry Eichengreen & Ashoka Mody, Is Aggregation a Problem for Sovereign Debt Restructuring? 1 (Jan. 2003) (unpublished manuscript), *available at* http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=801485.

267. *See* Fisch & Gentile, *supra* note 49, at 1098.

Aggregation clauses allow a sovereign issuer to focus the restructuring on areas of collective agreement across multiple bond series.[268] Similarly, the threat of "cramdown"[269] aggregation may encourage bondholders from different series to collaborate and arrive at a settlement that is mutually advantageous.[270] The highly liquid secondary market offers bondholders the freedom to avoid what they may view as inequitable concessions through the sale of their bonds in the open market.[271]

Uruguay was the first sovereign to incorporate aggregation mechanisms in its bonds contracts.[272] The bonds included clauses that permitted the modification of certain matters across multiple series of bonds.[273] Under these clauses, Uruguay would be required to obtain the support of holders of "at least 85% in the outstanding-principle amount of all affected series in the aggregate and at least two-thirds of each affected series individually."[274] Uruguay alleviated investor concerns about the potential issuance of "sham" bonds in order to attain the requisite 85 percent aggregate threshold.[275] It did so by including a provision in its bonds prohibiting the issuance of additional bonds "with the intention of placing such debt securities with holders expected to support any modification proposed by Uruguay (or that Uruguay plans to propose)."[276]

F. How It All Plays Out, or, Don't Cry for Me: Argentina

Since the resurgence of the sovereign bond market in the early 1990s,[277] there have been more than fourteen defaults followed by restructurings.[278] The first instance was Pakistan in 1999, and the most recent was Greece in 2011, whose restructuring continues to date.[279] Part I.F details Argentina's 2001 default to highlight some of the main obstacles a sovereign may face when attempting to restructure its debt following a default.

In 2001, Argentina defaulted on its international bonds—the largest sovereign debt default in history.[280] In the ten years leading up to its default, Argentina had issued 179 bonds in international capital markets,

268. *See id.* at 1044.

269. "Cramdown" is defined as "[c]ourt confirmation of a Chapter 11 Bankruptcy plan despite the opposition of certain creditors." BLACK'S LAW DICTIONARY, *supra* note 10, at 423. In the sovereign bond context, cramdown refers to forced adhesion to negotiated terms. *See* Galvis & Saad, *supra* note 256, at 722.

270. *See* Fisch & Gentile, *supra* note 49, at 1090–95.

271. *See id.*

272. *See* Arora & Caminal, *supra* note 26, at 663–64.

273. *See* Galvis & Saad, *supra* note 256, at 722.

274. *Id.*

275. *See id.*

276. República Oriental del Uruguay, *supra* note 256, at S-9.

277. *See supra* notes 41–44 and accompanying text.

278. *See* Choi, Gulati & Posner, *supra* note 56, at 173.

279. *See id.*

280. *See* Gelpern, *supra* note 198, at 407; *see also* Ross P. Buckley, *Why Are Developing Nations So Slow To Play the Default Card in Renegotiating Their Sovereign Indebtedness?*, 6 CHI. J. INT'L L. 345, 350 (2005).

raising a total of USD 139.4 billion.[281] These bonds were being held by roughly 500,000 separate bondholders.[282] By the late 1990s, it became clear that Argentina was facing a severe economic recession.[283]

Between 2000 and 2001, Argentina had three different presidents and had depegged its currency—the peso—from the dollar.[284] Over the next six months, the peso lost roughly three-quarters of its value, the Central Bank reserves were halved, and the Argentine people took to the streets in protest.[285] On December 23, 2001, Argentina defaulted on its debt when it publicly announced the deferral of over USD 100 billion owed to domestic and foreign creditors.[286] By the end of 2002, Argentina's public debt burden of approximately USD 137 billion represented 130 percent of its GDP.[287]

In September 2003, the IMF agreed to a USD 12.5 billon, three-year credit package.[288] Shortly thereafter, on September 22, 2003, Argentina presented its initial debt restructuring strategy called the Dubai Proposal.[289] Argentina's proposal was essentially a unilateral exchange offer.[290] Unilateral exchange offers occur when sovereigns bypass negotiations with their creditors and design new bonds aimed towards appealing to the market while simultaneously awarding themselves a degree of debt relief.[291] The amount of debt relief that should be awarded through the terms of the exchange-offer bonds is typically determined by the sovereign and the official sector—the IMF and World Bank.[292]

On January 12, 2004, the Global Committee of Argentina Bondholders (GCAB) was founded in Rome.[293] It was comprised of major bondholder groups representing more than half a million retail investors and numerous financial institutions, holding a total of approximately USD 37 billion in nominal value Argentine bonds.[294] The GCAB's aim was to improve coordination of the members' efforts to negotiate with Argentina, while attempting to reach a fair and efficient restructuring of the Argentine debt.[295] Argentina held discussions with creditor groups, like the GCAB, to negotiate the restructuring.[296] However, Argentina largely rejected the negotiations and proceeded towards the unilateral exchange.[297]

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281. *See Abaclat*, *supra* note 110, ¶ 50.
282. *See* Buckley, *supra* note 280, at 351.
283. *Id.*
284. *See* Gelpern, *supra* note 198, at 407; *see also* Buckley, *supra* note 280, at 351.
285. *See* Gelpern, *supra* note 198, at 407; *see also* Buckley, *supra* note 280, at 351.
286. *See Abaclat*, *supra* note 110, ¶ 58.
287. *See id.* ¶ 63.
288. *See id.* ¶ 70.
289. *See id.* ¶ 71.
290. *See* Mark B. Richards, *The Republic of Congo's Debt Restructuring: Are Sovereign Creditors Getting Their Voice Back?*, 73 LAW & CONTEMP. PROBS. 273, 281 (2010).
291. *See id.* at 274.
292. *See id.*
293. *See Abaclat*, *supra* note 110, ¶ 72; *see also* Richards, *supra* note 290, at 282.
294. *See Abaclat*, *supra* note 110, ¶ 72; *see also* Richards, *supra* note 290, at 282.
295. *See* Richards, *supra* note 290, at 282.
296. *See Abaclat*, *supra* note 110, ¶ 74.
297. *See* Richards, *supra* note 290, at 282.

On January 14, 2005, Argentina launched Exchange Offer 2005.[298] Under the exchange offer, bondholders could exchange 152 different bond series—which Argentina had suspended payment on in 2001—for newly issued Argentine debt instruments.[299] The exchange offer provided bondholders with three options from which to choose for the structure of their new bonds: (1) par bonds with the same principal but a lower interest rate, (2) discount bonds with reduced principal but a higher interest rate, or (3) quasi-par bonds with a principal and interest rate falling between the two other options.[300] This offer was a one-time bond-exchange option on a take-it-or-leave-it basis.[301] Participating bondholders received a 67 percent haircut[302] in the exchange.[303] Approximately 76 percent of all debt holdings participated in Exchange Offer 2005.[304] Argentina had managed to restructure approximately USD 62 billion.[305]

A number of creditors were unsatisfied with the terms and conditions of the exchange and initiated litigation proceedings.[306] This included several vulture funds.[307] A total of 158 suits have been filed in the United States alone as a result of Exchange Offer 2005.[308] In addition, a number of holdout creditors filed claims with the International Center for the Settlement of Investment Disputes (ICSID), claiming the Argentine restructuring equated to expropriation.[309]

Argentina still faced a significant debt load, despite the relatively high participation rate in the 2005 exchange.[310] On May 3, 2010, Argentina launched Exchange Offer 2010, aimed at restructuring and canceling defaulted debt obligations dating back to its 2001 default.[311] The exchange was for USD 18 billion of Argentine debt and offered creditors a 75 percent haircut.[312] Sixty-six percent of the targeted bondholders participated, accounting for USD 12.1 billion of the outstanding debt.[313] To date, USD

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298. *See Abaclat*, *supra* note 110, ¶ 77.
299. *See id.*
300. *See id.*
301. *See* U.N. Conference on Trade & Dev., Sovereign Debt Restructuring and International Investment Agreements, at 3 (July 2011), http://www.unctad.org/en/docs/webdiaepcb2011d3_en.pdf.
302. *See supra* note 39 and accompanying text.
303. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3.
304. *See* NML Capital, Ltd. v. Republic of Arg., 699 F.3d 246, 252 (2d Cir. 2012), *cert. denied*, No. 12-1494, 2013 WL 3211846 (U.S. Oct. 7, 2013); *Abaclat*, *supra* note 110, ¶ 80.
305. *See NML Capital*, 699 F.3d at 252; U.N. Conference on Trade & Dev., *supra* note 301, at 3.
306. *See Abaclat*, *supra* note 110, ¶ 82.
307. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3.
308. *Id.*; *see, e.g.*, H.W. Urban GmbH v. Republic of Arg., No. 02 Civ. 5699 (TPG), 2006 WL 587333, at *2 (S.D.N.Y. Mar. 9, 2006) (granting summary judgment as to Argentina's liability to a class of bondholders, but denying a motion for full payment of principal and interest due on Argentine bonds); *see also NML Capital*, 699 F.3d 246.
309. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3; *see also, e.g.*, *Abaclat*, *supra* note 110.
310. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3.
311. *See NML Capital*, 699 F.3d at 252–53; *Abaclat*, *supra* note 110, ¶ 93.
312. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3.
313. *See id.*

6.2 billion worth of bondholders continue to litigate in domestic courts as well as through ICSID.[314]

On October 26, 2012, Elliott Associates' subsidiary, NML Capital, received a favorable ruling in its case against Argentina in the Second Circuit.[315] The court held that Argentina was barred from discriminating against the bonds of groups like NML Capital in favor of bonds issued in Argentina's 2005 and 2010 exchanges.[316] The Second Circuit affirmed the judgment of the Southern District of New York, granting permanent injunctions designed to prevent Argentina from making payments on the 2005 and 2010 debt instruments without making comparable payments on the defaulted debt.[317] This was a sizable victory for the plaintiffs, as their collective unpaid principal and interest amounted to approximately USD 1.33 billion.[318] Argentina has since petitioned the U.S. Supreme Court for a writ of certiorari.[319]

NML Capital based its claim against Argentina on the pari passu clause,[320] the same tactic Elliott used in its litigation against Peru in the 1990s.[321] The court held that Argentina breached the pari passu clause of the bond contract because it ranked payment obligations to the 2005 and 2010 exchange bondholders above payments to the plaintiffs when it refused to pay on the defaulted bonds.[322] Moreover, the Second Circuit affirmed the district court's finding that, despite the financial crisis in the early 2000s, Argentina could now make payments to both the holdout creditors and the exchange bondholders.[323] Ultimately, the Second Circuit remanded to the district court to clarify how the injunction against Argentina would operate.[324]

In response to the Second Circuit's October 26, 2012 ruling, Argentina's President, Cristina Fernández de Kirchner, declared, "We will not surrender money at the cost of hunger and exclusion for millions of Argentines."[325]

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314. *See id.*

315. *See NML Capital*, 699 F.3d at 250; *see also* NML Capital, Ltd. v. Republic of Arg., Nos. 12-4694, 12-4865, 2013 WL 4487563, at *11 (2d Cir. Aug. 23, 2013) (affirming the district court's orders but holding "[e]nforcement of the amended injunctions shall be stayed pending the resolution by the Supreme Court of a timely petition for a writ of *certiorari*"); *see also* Gelpern, *supra* note 9.

316. *See NML Capital*, 699 F.3d at 250; *see also* Gelpern, *supra* note 9.

317. *See NML Capital*, 699 F.3d at 250; *see also NML Capital*, 2013 WL 4487563, at *11.

318. *See NML Capital*, 699 F.3d at 251.

319. *See NML Capital*, 2013 WL 4487563, at *1.

320. *See NML Capital*, 699 F.3d at 251.

321. *See supra* notes 163–71 and accompanying text.

322. *See NML Capital*, 699 F.3d at 259–60 ("The record amply supports a finding that Argentina effectively has ranked its payment obligations to the plaintiffs below those of the exchange bondholders.").

323. *Id.* at 263 ("The district court found that the Republic had sufficient funds, including over $40 billion in foreign currency reserves, to pay plaintiffs the judgments they are due.").

324. *See id.* at 255.

325. *See* Heather Stewart & Uki Goñi, *Argentina Fears Default After American Court Ruling*, GUARDIAN (Nov. 22, 2012, 2:43 PM), http://www.guardian.co.uk/world/2012/nov/22/american-ruling-fears-default-argentina; *see also* NML Capital, Ltd. v. Republic of Arg., No. 08 Civ. 6978 (TPG), 2012 WL 5895650, at *1 (S.D.N.Y. Nov. 21, 2012) (noting

This prompted the district court, on remand, to vacate a prior stay of enforcement,[326] thereby making the Second Circuit's injunction applicable to interest payments made to exchange bondholders in December 2012.[327] The district court also clarified the specific terms of the injunction, in accordance with the Second Circuit's instructions.[328]

According to the injunction, if and when Argentina makes an interest payment on the exchange bonds, it will be required to make a payment to the holdout creditors.[329] Specifically, if Argentina pays exchange bondholders 100 percent of what they are owed, it will be required to pay 100 percent of the total amount currently due to the holdout creditors.[330] The court found the amount currently due to holdout creditors to be the amount of unpaid principal plus accrued interest: approximately USD 1.33 billion.[331] The court ordered Argentina to put the USD 1.33 billion into escrow, and prohibited banks and other third parties from intervening on Argentina's behalf.[332]

Argentina subsequently appealed to the Second Circuit with the hope that the court would reverse the order for payment.[333] On August 23, 2013, the Second Circuit affirmed the district court's orders but stayed enforcement of the amended injunctions pending the Supreme Court's resolution of Argentina's petition for a writ of certiorari.[334]

II. AN INSUFFICIENT SOLUTION: COLLECTIVE ACTION CLAUSES ARE NOT ALL THEY'RE CRACKED UP TO BE

Part II of this Note discusses the problems with restructurings that CACs have been unable to address. Sovereign bond contracts must strike a

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President Cristina Kirchner made statements regarding Argentina's refusal to pay holders of the original bonds).

326. *See NML Capital*, 2012 WL 5895650, at *1–2 ("From the moment of the October 26, 2012 Court of Appeals' decision, the highest officials in Argentina have declared that Argentina would pay the exchange bondholders but would not pay one dollar to holders of the original . . . [b]onds. . . . It is the view of the District Court that these threats of defiance cannot go by unheeded, and that action is called for. . . . Therefore, the provision in the March 5, 2012 Order staying the carrying out of the February 23, 2012 Order is vacated and it is directed that the February 23, 2012 Order, as now somewhat modified, is to be carried out forthwith.").

327. *See id.* at *1–2.

328. *See id.*; *see also Judge Orders Argentina To Pay Holdout Investors*, N.Y. TIMES, Nov. 23, 2012, at B6.

329. *See* NML Capital, Ltd. v. Republic of Arg., Nos. 08 Civ. 6978(TPG), 09 Civ. 1707 (TPG), 09 Civ. 1708(TPG), 2012 WL 5895786, at *2 (S.D.N.Y. Nov. 21, 2012).

330. *See id.*

331. *See id.*

332. *See NML Capital*, 2012 WL 5895650, at *2 ("Since the Court of Appeals has not finally spoken on the subject of the calculation of the payment to plaintiffs, such payment is to be made into an escrow account, so that any adjustments required by the final Court of Appeals' ruling can be made."); *see also Judge Orders Argentina To Pay Holdout Investors*, *supra* note 328; *Argy-Bargy*, *supra* note 2, at 80.

333. *See Argentina Asks US Court To Revert Order To Pay Debt Holdout Creditors*, FOXNEWS.COM (Dec. 29, 2012), http://www.foxnews.com/world/2012/12/29/argentina-asks-us-court-to-revert-order-to-pay-debt-holdout-creditors/.

334. NML Capital, Ltd. v. Republic of Arg., 727 F.3d 230 (2d Cir. 2013).

balance that protects the interests of both creditors and debtors.[335] While it is true that creditors can rarely seize a sovereign's assets to repay defaulted debts,[336] creditors have had some success litigating contract claims in courts.[337] If investors are using bond contracts as a way of reducing the risk of investing in sovereigns, then bond contract terms may be directly related to the ability of investors to collect from sovereigns in the event of a default.[338]

Some studies have found a correlation between a sovereign's perceived riskiness and the contractual terms investors are willing to consent to.[339] When investors regard a country as virtually riskless, they are willing to consent to contracts that specify the interest rate and maturity, but do not incorporate other terms that limit the country's ability to manage its debt.[340] In contrast, when investors believe a country is risky, they typically require additional contractual terms aimed at increasing the probability of payment, managing restructuring, and preventing opportunistic behavior on the part of the sovereign.[341]

CACs were embedded in some of the bonds involved in Argentina's 2005 exchange, but the clause was unable to prevent the holdout problem Argentina continues to face years after its 2005 and 2010 restructurings.[342] Experts have begun to doubt the usefulness of CACs.[343] The CAC was supposed to provide a mechanism that would enable markets to deal with the holdout problem.[344] However, the market does not appear to attach much positive value to the use of CACs.[345]

There is little indication that including CACs in sovereign bond contracts has a significant effect on borrowing costs.[346] The impact that CACs have on borrowings costs should be dependent on the details and the design of the particular clause.[347] A CAC that reduces creditor rights is more likely to have an effect on the bond's price.[348] That CACs have not had an effect

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335. *See* Choi, Gulati & Posner, *supra* note 56, at 133 ("Sovereign debt contracts must balance several goals: encouraging sovereigns to repay in the good state; enabling value-increasing restructurings in bad states; preventing debtors from seeking to exploit divisions among creditors in order to opportunistically reduce their debt burden; and preventing debtors from taking risks in order to externalize the cost of default on creditors.").

336. *See supra* notes 64–68 and accompanying text.

337. *See supra* notes 159–84 and accompanying text; *see also* Choi, Gulati & Posner, *supra* note 56, at 133.

338. *See* Choi, Gulati & Posner, *supra* note 56, at 175.

339. *See id.*

340. *See id.*

341. *See id.*

342. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 45.

343. *See, e.g.*, Anna Gelpern & Mitu Gulati, *Sovereign Snake Oil* (Am. Univ. Wash. Coll. of Law, Research Paper No. 2011-05, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1732650; *see also supra* notes 235–36, and accompanying text.

344. *See* Bradley, Cox & Gulati, *supra* note 129, at 320.

345. *See id.*

346. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 45.

347. *See id.*

348. *See id.*

on prices may suggest that market participants do not find CACs to be an effective restructuring tool.[349]

Many experts view the current market-based restructuring regime—CACs—as "disorderly, inefficient, and overly costly."[350] Part II.A looks at the empirical evidence which suggests countries often delay in calling restructurings. Part II.B then turns to the fact that, once called, restructurings are often a lengthy process. Next, Part II.C examines the tendency for restructurings to be followed by extensive disputes. Finally, Part II.D lays out the additional challenges that a new contractual mechanism must address in order to improve sovereign bond restructurings.

A. Countries Stall When Prompt Action Is Necessary

Studies suggest countries often delay in initiating a restructuring. On average, sovereigns wait nine and a half months after their initial debt distress before they initiate restructuring negotiations.[351] This delay is mainly the result of government decisions and political factors.[352] These political factors include leadership changes, cabinet reshuffles, and a government's refusal to repay debt incurred by earlier governments.[353] However, the most common reasons for delays in initiating a restructuring seem to be aggressive debt policies, like a unilateral moratorium on repaying debt, as well as failed negotiations with the IMF.[354] CACs only come into effect after a restructuring has commenced, and therefore are ineffective in combating the delays in initiating necessary restructurings.[355]

B. The Restructuring Process Can Still Take Too Long

The restructuring process can be lengthy, sometimes lasting over ten years.[356] The duration of a restructuring is defined as the period of time beginning with either the month that the sovereign defaults or announces a restructuring and ending with the final implementation of the deal.[357] When a restructuring cannot be resolved within the first few years of financial distress, it becomes increasingly less likely that the sovereign will be able to exit its debt crisis.[358] Sovereigns and creditors alike share a common interest in preventing and resolving debt crises in an effort to promote greater financial stability.[359] It follows that they should be

349. *See id.*
350. *See id.* at 88.
351. *See* Christoph Trebesch, Delays in Sovereign Debt Restructurings 8 (July 2008) (unpublished manuscript), http://www.cid.harvard.edu/Economia/papers/Rio%202008/Trebesch%202.pdf.
352. *See id.*
353. *See id.* at 10.
354. *See id.* at 10–11.
355. *See supra* notes 165–70 and accompanying text.
356. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 26.
357. *See* Trebesch, *supra* note 351, at 6.
358. *See id.*
359. *See* Arora & Caminal, *supra* note 26, at 647–48.

interested in expediting the restructuring process.[360] On average, bond restructurings in the post-Brady[361] era have been completed in approximately thirteen months.[362] This average does not reflect the significant disparity in restructuring duration.[363]

In 2004, Uruguay was able to restructure its sovereign bonds in less than one month.[364] CACs were partly included in the original bonds exchanged and were utilized in Uruguay's exchange.[365] Yet, when Dominica restructured its bonds in 2004, the restructuring lasted fifteen months, despite the presence and use of CACs in the exchange.[366] Argentina's 2005 exchange partially included CACs in the original bonds, yet they were not utilized in the exchange, and the restructuring dragged on for years.[367]

C. The Possibility of Holdouts and Litigation Remains

Even after a successful restructuring, there are often a number of holdouts and lawsuits filed. Between 1980 and 2010, a total of 109 cases were filed against debtor governments in connection to a default on sovereign bonds or loans.[368] CACs have not been entirely effective in combating the holdout problem and preventing post-restructuring litigation.[369] In fact, the opposite appears to be true. Post-restructuring creditor litigation has become increasingly common and is "now widely regarded as a main obstacle to sovereign debt restructurings."[370] Furthermore, the outcome of Argentina's ongoing litigation with NML Capital could have a drastic impact on the effectiveness and frequency of creditor litigation.[371]

D. What the Sovereign Debt Market Needs from the Bond Contracts

The primary challenge for the sovereign debt market is reducing the debt level for sovereigns only when it is politically impossible for the country to repay the debt in full.[372] However, this determination depends on a number of intangible factors—for example, the state of the economy and the level of trust enjoyed by the government—and as a result cannot be written into the bond contracts.[373] Therefore, there is no objective metric that can be written into a contract to determine when a sovereign is truly unable to pay

360. *See id.* at 648.
361. *See supra* note 115 and accompanying text.
362. *See* Trebesch, *supra* note 351, at 7.
363. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 27.
364. *See* U.N. Conference on Trade & Dev., *supra* note 301, at 3.
365. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 46.
366. *See id.* at 37, 47.
367. *See id.* at 27; *supra* notes 280–333 and accompanying text
368. *See* Das, Papaioannou & Trebesch, *supra* note 30, at 51.
369. *See id.* at 49.
370. *Id.* at 50.
371. *See supra* notes 314–33 and accompanying text.
372. *See* Choi, Gulati & Posner, *supra* note 56, at 134, 137.
373. *See id.* at 137.

its debt.[374] This means creditors have no objective means of telling whether the government is threatening to default for opportunistic reasons.[375]

Currently, CACs require bondholders to vote on whether to accept a sovereign's proposed modifications of bond contract terms.[376] Yet, they must do so without a genuine understanding of the motive underlying the sovereign's default.[377] Because bondholders are dispersed and typically only hold a fraction of the total debt at stake, they do not have the incentive to monitor the sovereign debtor to the degree that would be necessary to inform their votes.[378] In addition, bondholders may have an incentive to agree to a potentially opportunistic restructuring due to the risk of being completely excluded from repayment.[379]

III. HAVE NO FEAR, SUPERTRUSTEE IS HERE: A NEW CLAUSE FOR SOVEREIGN BOND CONTRACTS

Part III attempts to resolve the remaining issues that plague sovereign bond restructurings by proposing the use of a new type of sovereign bond contract clause. This clause will create a bond trustee with expansive powers. A number of these powers are modeled after the proposed powers for the supertrustee envisioned in the corporate bond context.[380] Yakov Amihud, Kenneth Garbade, and Marcel Kahan proposed the supertrustee as a new type of governance structure for publicly issued corporate bonds.[381] This Note proposes the application of a similar supertrustee structure in the sovereign bond context.

Like its corporate bond counterpart, the sovereign bond supertrustee would be charged with actively monitoring the debtor country as well as renegotiating and enforcing its bond covenants.[382] The supertrustee would be selected by the sovereign before it issues its bonds.[383] Once the bonds are issued, the sovereign would have no right to replace the supertrustee.[384] Rather, bondholders would have a limited right to replace the supertrustee should the need arise.[385] This is because the supertrustee would act as an agent of bondholders and must have the authority and incentives to actively monitor the sovereign in an objective manner.[386] The supertrustee's reputation and effectiveness in representing the bondholders would most likely impact the price of bonds, as bondholders would assign less value to

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374. *See id.*
375. *See id.*
376. *See id.* at 142; *see also supra* notes 204–23 and accompanying text.
377. *See* Choi, Gulati & Posner, *supra* note 56, at 142.
378. *See id.* at 144; *see also supra* notes 224–29 and accompanying text.
379. *See* Choi, Gulati & Posner, *supra* note 56, at 142.
380. *See supra* notes 238–59 and accompanying text.
381. *See supra* note 238 and accompanying text.
382. *See supra* note 238 and accompanying text.
383. *See supra* note 246 and accompanying text.
384. *See supra* note 246 and accompanying text.
385. *See supra* note 247 and accompanying text.
386. *See supra* note 245 and accompanying text.

a bond with an unreliable supertrustee.[387] The inclusion of a supertrustee clause in sovereign bonds, and the use of a supertrustee once bonds are issued, would help to address the monitoring, coordinating, and negotiating issues that impede the sovereign debt restructuring process.[388]

In carrying out its monitoring duties, the supertrustee would utilize accounting reports, nonpublic financial data, and other information about the sovereign that market lenders typically access when investigating a sovereign's financial well-being.[389] The supertrustee would be required to monitor the sovereign with the same intensity as a reasonable lender.[390] This would serve as the standard in assessing whether the supertrustee has met its monitoring obligations.[391] Simply having a supertrustee to monitor the sovereign's financial affairs would address a number of the current challenges to restructuring.

First, having a supertrustee to monitor the sovereign would address the current widespread lack of creditor monitoring.[392] Rather than attempt to force creditors to monitor the sovereign when they lack the incentive to do so,[393] the supertrustee clause assigns the task to the person or institution acting as the bond's supertrustee. This ensures that someone is monitoring the sovereign and supervising the bondholder's investment. Second, the supertrustee's attentive monitoring would make it more difficult, if not impossible, for a sovereign to engage in an opportunistic restructuring.[394] While it is true that a sovereign's ability to service its debt includes more than simply financial considerations,[395] the supertrustee would be familiar with the general state of the sovereign and would be able to warn bondholders if a proposed restructuring was unwarranted.

Finally, the supertrustee's monitoring function would address the issue of a sovereign's delay in calling a restructuring when it is necessary.[396] The supertrustee could use the information at its disposal to pressure a sovereign to restructure its debt in a timely manner. This would help make restructurings more efficient. It would also curb the moral hazard concerns that arise from the IFI lending that often accompanies a restructuring. If sovereigns restructured their debt in a timely manner, they could potentially avoid IFI lending entirely.[397] Moreover, lender moral hazard would be decreased because there would be a supertrustee monitoring the bonds, thereby eliminating some of the risk inherent in the investments.[398]

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387. *See supra* notes 248–49 and accompanying text.
388. *See supra* notes 120–24, 224–29, 378 and accompanying text.
389. *See supra* note 250 and accompanying text.
390. *See supra* note 251 and accompanying text.
391. *See supra* note 252 and accompanying text.
392. *See supra* notes 224–29, 378 and accompanying text.
393. *See supra* note 360 and accompanying text.
394. *See supra* notes 60–63, 101–10 and accompanying text.
395. *See supra* notes 60–63 and accompanying text.
396. *See supra* Part II.A.
397. *See supra* notes 73–85 and accompanying text.
398. *See supra* notes 76–85 and accompanying text.

In addition, the supertrustee could be given the authority to call for a restructuring, provided a predetermined majority of bondholders vote in favor of initiating the process. This would be in both the sovereign's and the bondholders' interest because the faster a restructuring is concluded, the less it will cost all parties involved. The supertrustee's other proposed powers will further assist in making restructurings efficient.

The supertrustee would also have the powers necessary to serve a coordination function, due to its position as an agent of the bondholders.[399] The supertrustee would be aware of and in contact with all the bondholders at any given time, thereby eliminating much of the coordination confusion inherent in the initial phases of restructurings.[400] This would help cut sovereigns' agency costs and reduce the need for financial advisors to assist in a restructuring.[401] Improved coordination could help shorten the total duration of restructurings by decreasing the time typically devoted to the initial preparation.[402]

Once a restructuring is initiated, the supertrustee would be able to serve a negotiating function.[403] The supertrustee will be in a unique position to evaluate the merits of a proposed restructuring, due to its past monitoring and substantial knowledge about the sovereign.[404] The supertrustee's approval of a proposed restructuring should ease bondholder concerns that the sovereign is restructuring opportunistically.[405] Moreover, having the supertrustee negotiate on their behalf will eliminate the need for bondholders to form creditor groups to strengthen their negotiating power.[406] The presence of a well-informed negotiator, acting on behalf of all bondholders, should make restructurings significantly more efficient and faster to conduct.[407]

The sovereign bond supertrustee that this Note proposes differs from Amihud, Garbade, and Kahan's corporate bond supertrustee in that the sovereign bond supertrustee would apply its monitoring, coordinating, and negotiating powers across multiple bond issues.[408] This would result in a form of aggregation, as the supertrustee's actions would be binding on all prior bond issues.[409] The use of the supertrustee, paired with CACs and a degree of aggregation across all bond issues, would protect sovereigns from the threat of vulture funds.[410] To the extent that sovereigns have bonds with UACs in the market, the supertrustee clause would give the sovereign

399. *See supra* notes 243–45 and accompanying text.
400. *See supra* notes 123, 223–25 and accompanying text.
401. *See supra* notes 121–23 and accompanying text.
402. *See supra* Part II.B.
403. *See supra* notes 253–55 and accompanying text.
404. *See supra* notes 254–55 and accompanying text.
405. *See supra* notes 100–10 and accompanying text.
406. *See, e.g.*, *supra* note 294 and accompanying text.
407. *See supra* Part II.B.
408. *See* Amihud, Garbade & Kahan, *supra* note 237, at 470 (stating the supertrustee would monitor compliance with the bond indenture, not all of the company's issued bonds' indentures).
409. *See supra* notes 260–76 and accompanying text.
410. *See supra* notes 145–58 and accompanying text; *see also supra* Part II.C.

a means of restructuring the bond free from the subsequent holdout battles.[411]

The supertrustee would negotiate the restructurings on behalf of all bondholders, who would then vote on whether to accept the terms. Bondholders would be unable to holdout from the restructuring because it would be binding on everyone once the predetermined majority of bondholders voted in favor of the restructuring. This proposed structure would essentially combine the use of a supertrustee with the current function of CACs. The supertrustee would be unable to bind bondholders to the negotiated bonds unless a sufficient majority of bondholders approved the terms.[412] The proposed aggregation effect that the supertrustee would have on sovereign bonds embodies one of the purported benefits of the envisioned SDRM.[413]

The proposed supertrustee contractual mechanism follows the trend of contractual evolution in the sovereign bond market.[414] CACs were promoted as a contractual, market-based solution to restructuring problems.[415] Similarly, the proposed supertrustee clause would result in a contractual, market-based response to the remaining problems with sovereign restructurings. The supertrustee clause could be adopted organically—the way CACs were adopted—and gradually become a standard component of bond contracts.[416]

It is reasonable to expect the supertrustee clause will have an effect on bond prices.[417] However, creditors would probably attach positive value to the clause because the presence of a supertrustee would decrease the likelihood of default, as well as the negative consequences of a restructuring. In addition, the supertrustee clause may only be needed for bonds issued by sovereigns perceived to be at a high risk of default.[418] These risky bonds are typically sold at a reduced price on the secondary market due to the uncertainty of recovering on the investment.[419] If a supertrustee alleviates that concern, the prices should increase to reflect a value closer to the face value[420] of the bond.[421]

One weakness of the proposed supertrustee clause is that it has not been adopted in the corporate context. However, this is not dispositive in the sovereign bond context because there have been a series of reform efforts in the international community, evidencing an interest in contractual adaptation.[422] Moreover, corporate bonds are subject to state bankruptcy

411. *See supra* Part II.C.
412. *See supra* notes 216–23 and accompanying text.
413. *See supra* notes 190–92 and accompanying text.
414. *See supra* notes 199–215 and accompanying text.
415. *See supra* notes 199–202 and accompanying text.
416. *See supra* notes 204–15 and accompanying text.
417. *See supra* notes 21–23, 248–49, 338–41 and accompanying text.
418. *See supra* notes 21–25, 338–41 and accompanying text.
419. *See supra* notes 21–25 and accompanying text.
420. *See supra* notes 18–23 and accompanying text.
421. *See supra* notes 338–41 and accompanying text.
422. *See supra* notes 185–220 and accompanying text.

laws, so there is less of a need for contractual reform to stabilize corporate bankruptcies.[423] The supertrustee clause could effect meaningful change to the restructuring process, thereby providing the sovereign bond markets with greater stability and predictability.

If Argentina had utilized the supertrustee clause proposed in this Note, it could have avoided much of the trouble it finds itself in today.[424] A supertrustee would have been monitoring Argentina throughout its financial problems in the late 1990s and leading up to its 2001 default.[425] The supertrustee would have been able to warn bondholders that a restructuring was imminent, and it would have been able to advise them on the merits of Argentina's proposed exchange. In addition, bondholders would not have needed the GCAB because the coordination efforts would have already been improved by the supertrustee.[426] This probably would have resulted in a restructuring more closely resembling the 2001 default and had a greater bondholder participation rate.[427] Moreover, Argentina might not have needed the IMF's USD 12.5 billion credit package if it had conducted its restructuring prior to or immediately after the 2001 default.[428]

In addition, bondholders who attempted to hold out from the supertrustee-led restructuring would have been bound to the agreement, due to the aggregation power inherent in the supertrustee structure.[429] This would have eliminated the need for a second exchange.[430] It also would have negated Elliott Associates' and other vulture funds' ability to sue Argentina for the full value of the defaulted bonds.[431] Argentina would not have defaulted entirely and would not be paying other bondholders in violation of the pari passu clause.[432] Rather, all bondholders would receive the same haircut[433] and be paid equally, according to the restructuring negotiated by the supertrustee and voted on by a majority of bondholders.[434]

CONCLUSION

Sovereign bonds play a vital role in the international community. They provide sovereigns with much needed capital and have proved to be a profitable investment for creditors.[435] Unfortunately, not all sovereigns are able to meet all of their debt obligations.[436] Without an international

423. *See supra* note 113 and accompanying text.
424. *See supra* notes 1–9, 185–220 and accompanying text.
425. *See supra* notes 280–88 and accompanying text.
426. *See supra* note 294 and accompanying text.
427. *See supra* notes 304–05 and accompanying text.
428. *See supra* note 288 and accompanying text.
429. *See supra* notes 408–12 and accompanying text.
430. *See supra* notes 310–13 and accompanying text.
431. *See supra* notes 1–9, 280–333 and accompanying text.
432. *See supra* notes 177–82, 320–22 and accompanying text.
433. *See supra* note 39 and accompanying text.
434. *See supra* notes 399–407, 412 and accompanying text.
435. *See supra* note 26 and accompanying text.
436. *See supra* note 278 and accompanying text.

bankruptcy court, sovereign debtors and their creditors must rely on the terms of the bond contracts to guide the bond restructuring process.[437] The current contractual mechanism utilized, the CAC, has proved insufficient.[438]

This Note proposed the implementation of a contractual clause that would create a supertrustee role in the sovereign bond context.[439] This supertrustee would monitor the issuing sovereign's finances,[440] coordinate bondholders in the event of default,[441] and negotiate the terms of the restructuring on behalf of the bondholders.[442] The use of a supertrustee would help make restructurings more efficient,[443] eliminate the risk of opportunistic default,[444] and curb the holdout problem that has enabled vulture funds to profit off sovereign financial crises.[445] An improved restructuring process is in the interest of bondholders and creditors alike, as it would help maximize the flow of capital in both directions.

437. *See supra* note 70 and accompanying text.
438. *See supra* Part II.
439. *See supra* Part III.
440. *See supra* notes 396–98 and accompanying text.
441. *See supra* notes 399–402 and accompanying text.
442. *See supra* notes 403–07 and accompanying text.
443. *See supra* notes 401–07 and accompanying text.
444. *See supra* notes 394–96 and accompanying text.
445. *See supra* notes 410–12 and accompanying text.