

A PROPOSAL FOR UNCITRAL RESEARCH: A MODEL-LAW APPROACH TO SOVEREIGN DEBT RESTRUCTURING

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ABSTRACT

Unresolved sovereign debt problems and disruptive litigation are hurting debtor nations and their citizens, as well as their creditors. A default can also pose a serious systemic threat to the international financial system. Yet the existing “contractual” approach to sovereign debt restructuring, including the use of so-called collective action clauses, is insufficient to solve the holdout problem, and the political economy of treaty-making makes a multilateral “statutory” approach highly unlikely to succeed in the near future. We need a more effective and realistic approach.

This article shows why a model-law approach to sovereign debt restructuring should be legally, politically and economically feasible and could be pursued in parallel to other approaches. Even if a model-law approach accomplishes nothing else, it would build incremental steps toward developing norms for a sovereign debt restructuring legal framework that goes beyond mere contracting.

INTRODUCTION

Court decisions in the United Kingdom regarding the illegality of exit consents,² and in the United States regarding *pari passu* clauses in Argentine sovereign debt,³ as well as

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² The Chancery Division of the English High Court held, in the *Anglo Irish* case *Assénagon Asset Management S.A. v. Irish Bank Resolution Corporation Limited* (formerly *Anglo Irish Bank Corporation Limited*) [2012] EWHC 2090 (Ch), that exit consents are illegal, casting doubt on the effectiveness of exit consents to restructure debt under English law. *See, e.g.*, Patrick S. Kenadjian, *The Aggregation Clause in Euro Area Government Securities*, in *COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT* 143 (Patrick S. Kenadjian, Klaus-Albert Bauer & Andreas Cahn, ed. 2013) (observing that the judge in the *Anglo Irish* case “held that it was not lawful for the majority to aid in the coercion of a minority by voting for a resolution which expropriates the majority’s rights for nominal consideration[,] thus cast[ing] doubt on the legality

the ongoing Greek debt saga and newly arising questions about Ghana, the Ukraine, Venezuela, and other countries, have dramatically highlighted the risks of an inadequate legal resolution framework for restructuring unsustainable sovereign debt. Even those who are not adherents of sovereign “bankruptcy” believe that the status quo contractual approach is “deeply dysfunctional and produces bad law.”⁴ Unresolved sovereign debt problems are hurting individual debtor nations and their citizens, as well as their creditors,⁵ and (as the United Nations Conference on Trade and Development has observed) are endangering the economic stability of many developing countries.⁶ A sovereign debt default can also pose a serious systemic threat to the international financial system.⁷

under English law of any form of exit consent that imposes less favorable conditions on those who refuse to participate in the associated exchange offer.”).

³ *NML Capital, Ltd. v. Republic of Argentina*, No. 08–CV–6978 TPG, 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012) (holding that the pari passu clause in Argentina’s defaulted bonds contract “prohibits Argentina, as bond issuer, from formally subordinating the bonds by issuing superior debt” and “prohibits Argentina, as bond payor, from paying [restructured] bonds without paying on the [holdout] Bonds”). Thus Argentina must pay all outstanding sums on its defaulted bonds simultaneously if it makes any payment on its restructured bonds). That decision was affirmed in its entirety by *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2d Cir. 2013), cert. denied in *Republic of Argentina v. NML Capital, Ltd.*, 134 S. Ct. 2819 (2014).

⁴ Anna Gelpern, *A Skeptic’s Case for Sovereign Bankruptcy*, in *A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE?* 262 (Christoph Paulus, ed. 2014).

⁵ Cf. Joseph E. Stiglitz et al., *Frameworks for Sovereign Debt Restructuring*, IPD-CIGI-CGEG Policy Brief from a November 17, 2014 conference held at Columbia University, at 1 (stating that “[p]oorly designed arrangements for resolving sovereign debt problems can lead to inefficiencies and inequities . . . Delays in restructuring can be very costly. Insufficiently deep restructuring can force the economy through multiple crises and restructuring—at a high cost.”).

⁶ Statement of UNCTAD, Oct. 26, 2016 (also observing that unresolved sovereign debt problems “would thwart the 2030 Agenda for Sustainable Development before it had taken off”), available at

http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1364&Sitemap_x0020_Taxonomy=UNCTAD%20Home;#1705;#Debt and Development Finance;#1602;#Sovereign Debt Portal.

⁷ See, e.g., Jay L. Westbrook, *Sovereign Debt and Exclusions from Insolvency Proceedings*, in *A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE?*, at 251 (Christoph Paulus, ed. 2014). Cf. e-mail from Eva Hüpkes, Adviser on Regulatory Policy and Cooperation at the Financial Stability Board (FSB), to

THE CONTRACTUAL APPROACH IS INADEQUATE

One of the main impediments is that the existing “contractual” approach to sovereign debt restructuring — the use of so-called collective action clauses (CACs) — is insufficient to solve the holdout problem. CACs are clauses in debt contracts that enable a specified supermajority, such as two-thirds or three-quarters, of the contracting parties to amend the principal amount, interest rate, maturities and other critical repayment terms. The holdout problem is a type of collective action problem in which certain creditors, such as vulture funds that may have bought debt in the secondary market at a deep discount, hope to extract value from other creditors to obtain more than their fair share of payment. They do this by litigating for payment and refusing to agree to a debt restructuring plan that would change critical terms, even though the other creditors consider the plan reasonable. Empirical research indeed shows “a drastic rise of sovereign debt litigation” by holdout creditors.⁸

CACs are insufficient for several reasons. Many sovereign debt contracts lack them, requiring unanimity to change critical repayment terms — and thus enabling any party to the contract to act as a holdout. For example, after years of trying to include CACs, relatively few Greek debt agreements actually contained such clauses and those that did were generally restricted to bond issues. Even in contracts that include CACs, the supermajority requirement may be so high (for example, three-quarters) that vulture funds are able to purchase vote-blocking positions that enable them to act as holdouts.

Furthermore, a CAC ordinarily binds only the parties to the particular contract that includes it. The parties to any given sovereign debt contract therefore could act as

the author (July 14, 2015) (observing that “doubts about the ability of states to provide additional resources can make financial institutions more fragile, in particular where there are no regimes in place that provide authorities with powers and tools to resolve financial firms without use of public funds”).

⁸ Julian Schumacher, Christoph Trebesch, & Henrik Enderlein, “Sovereign Defaults in Court” i (May 6, 2014 draft, available at <https://ssrn.com/abstract=2189997>). That research also suggests “that creditor litigation is increasingly common and costly for defaulting sovereigns”). *Id.* at 1.

holdouts in a debt restructuring plan that requires all of a debtor-state's debt issues to agree to the plan. Although in 2014 the International Capital Market Association ("ICMA") proposed revised and updated forms of CACs that would aggregate voting across debt issues, the experience with standard CACs shows that many sovereign debt contracts will lack them. Moreover, even if all new sovereign debt contracts were to include aggregate-voting CACs, it will be many years before existing debt contracts, which do not include them, are paid off.⁹

CACs have been a step forward in some ways, but they are not a substitute for pursuing a more systematic legal resolution framework for helping debtor-states to restructure unsustainable debt. In the past, the International Monetary Fund (IMF) unsuccessfully proposed, and recently the General Assembly of the United Nations has voted to pursue, a treaty or convention that would govern sovereign debt restructuring.¹⁰ The political economy of treaty-making, however, makes that type of multilateral approach highly unlikely to succeed in the near future.

ADVANTAGES OF A MODEL-LAW APPROACH

A model-law approach to achieving a more systematic legal resolution framework should be legally, politically and economically feasible.¹¹ A model law is suggested legislation

⁹ See, e.g., International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring* 33 (2014), available at <http://www.imf.org/external/pp/longres.aspx?id=4911> (observing that approximately 29% of all sovereign bonds outstanding, and approximately 39% of all such bonds governed by New York law, "will mature after ten years").

¹⁰ In 2014, the United Nations General Assembly voted to begin work on a statutory approach, referred to as a "multilateral legal framework," for sovereign debt restructuring. The resolution was introduced by Bolivia on behalf of the Group of 77 developing nations (of which Bolivia was then the chair) and China. See <http://www.un.org/press/en/2014/gaef3417.doc.htm>. The United States and apparently the European Union opposes this approach. The United Nations Conference on Trade and Development (UNCTAD) has been tasked with moving this approach forward. There is skepticism, however, whether any formal framework, such as a convention, is feasible—at least in the near future—without U.S. and E.U. support.

¹¹ See also Steven L. Schwarcz, *Sovereign Debt Restructuring: A Model-Law Approach*, 6 JOURNAL OF GLOBALIZATION AND DEVELOPMENT 343 (2016).

for national (and sometimes subnational) governments to consider enacting as internal law in their jurisdictions. Each government enacting a model law should therefore take the steps necessary to make the law effective in its jurisdiction. To facilitate cross-border legal comparability, each government enacting a model law should, ideally, enact the same legislative text. For that reason, model laws are sometimes called uniform laws. The UNCITRAL Model Law on International Commercial Arbitration exemplifies a model law that has been uniformly enacted in an international context; the Uniform Commercial Code (UCC) in the United States exemplifies a model law that has been uniformly enacted in a subnational context.

The less formal process of developing and enacting a model law can be politically appealing. Indeed, adoption of the UNCITRAL Model Law on International Commercial Arbitration, in an area of law that had for many years struggled to realize reform, may have been successful, in part, due to its less formal structure as a model law. A model-law approach would not require general acceptance for its implementation. Nations and even subnational jurisdictions could individually enact a model law as their internal law.¹² Contracts governed by that law would thereby become governed by the model law. Choice of law thus gives a model-law approach a powerful multiplier effect.

A PROPOSED MODEL LAW

The Appendix to this article proposes a Sovereign Debt Restructuring Model Law.¹³ Among other things, the proposed Model Law addresses the holdout problem by legally mandating supermajority voting that, assuming the requisite percentages agree, can bind

¹² This is especially significant because, as explained below, most sovereign debt contracts are governed by either New York or English law. One or both of those jurisdictions — in the case of New York law, a subnational jurisdiction — could enact legislation based on a model law.

¹³ Earlier versions of this Model Law have been vetted in discussions with working groups of the International Insolvency Institute (“III”) and the Centre for International Governance Innovation (“CIGI”). *See infra* note 35.

holdout creditors.¹⁴ It also enables a debtor-state to aggregate creditor voting beyond individual contracts. Aggregate voting is critical for at least two reasons: it can prevent creditors of individual sovereign debt contracts from acting as holdouts vis-à-vis other sovereign debt contracts; and it allows a debtor-state to designate large enough classes of claims to prevent vulture funds (or similar holdouts), as a practical matter, from purchasing enough claims to block a restructuring plan or otherwise control the voting.

The Model Law solves the problem of pari passu clauses.¹⁵ Pari passu clauses currently in sovereign debt contracts (at least those governed by New York law, which are the majority) effectively require that payments to creditors under a given debt contract be made pari passu to all of that contract's creditors—even creditors who exchanged their original claims for debt claims under a new debt contract.¹⁶ Say, for example, that a particular debt contract with Country X has three creditors—Creditor A with a claim of \$1,000, Creditor B with a claim of 2,000, and Creditor C with a claim of \$3,000. If Country X makes a \$1,000 payment on this debt, that payment must be shared equally and ratably (i.e., on a pari passu basis) among the three creditors. Thus, Creditor A would have the right to receive its ratable share ($\$1,000/\$6,000$, or one-sixth), Creditor B would have the right to receive its ratable share ($\$2,000/\$6,000$, or one-third), and Creditor C would have the right to receive its ratable share ($\$3,000/\$6,000$, or one-half), of that \$1,000 payment. Once sovereign debt claims are modified in accordance with the Model Law's supermajority aggregate voting, however, their principal amounts would, as so modified, legally change.

The Model Law also addresses the critical need for a financially troubled debtor-state to obtain liquidity during its restructuring process. Although this funding has in the

¹⁴ This assumes, of course, that the claims of those holdout creditors are governed by the law of a jurisdiction that enacts the Model Law.

¹⁵ See *supra* note 3 and accompanying text.

¹⁶ Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, in 72 BIS PAPERS 121, 124–26 (discussing the meaning of the pari passu clause, in the sovereign debt context, in the *Bliott* case in Belgium and the *Argentina* case in New York).

past often been provided by the IMF, the IMF may be unable, or unwilling, to continue providing funding in the amounts needed.¹⁷ Absent the IMF, whose loans have de facto priority, no one would lend new money without obtaining a priority repayment claim. Unless (as in the case of Greece) virtually all of a debtor-state's indebtedness is held by a relatively small number of governmental organizations, it would be impractical to get the existing creditors to contractually subordinate their claims to the new money. The Model Law, however, gives such new-money lenders priority over existing creditors, provided existing creditors have notice and the opportunity to block the new lending if its amount is too high or its terms are inappropriate. (The Model Law does not, of course, prevent a debtor-state from also, or alternatively, obtaining such financing through a governmental or multi-governmental source, such as the IMF.)

The Model Law contemplates a “neutral international organization” as the law’s supervisory authority. It is currently unclear what organization might qualify as truly neutral; existing organizations such as the IMF, the World Bank, or a court of the debtor-state may be considered too political or conflicted. That temporary lack of clarity should not be confused, however, with an unrelated issue that is inapplicable to the Model Law. Formal sovereign debt restructuring solutions, such as a treaty, are often conflated with broadly empowered supervisory bodies that exercise debt-restructuring discretion which can impinge on national sovereignty. In contrast, the supervisory authority under the Model Law lacks authority to exercise discretion. All disputes are adjudicated through binding arbitration. The main role of the supervisory authority is administrative and non-discretionary: to fact-check information, to maintain a list of creditors, and to oversee the creditor voting process.

As an option, the Model Law also includes retroactivity. Because most outstanding sovereign debt contracts (if not governed by the debtor-state’s law) are

¹⁷ Cf. Brad Setser, IPD Task Force on Sovereign Debt brief, *The Political Economy of the SDRM* 5 (Jan. 3, 2008), http://www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf (observing that “it is unrealistic for the major emerging economies to think that the IMF will prevent all default”).

governed by New York or English law,¹⁸ enactment by those jurisdictions of the Model Law, with retroactivity, could greatly facilitate the restructuring of not only future but also existing sovereign debt contracts.

Although retroactive lawmaking is somewhat atypical, as a normative matter it would provide significant social benefit and little harm—and thus should be morally imperative. The significant social benefit would be the opportunity that a retroactive Model Law could provide to countries, whose outstanding debt is or becomes unsustainable, to try to renegotiate that debt to sustainable levels. Renegotiation could reduce economic hardship to innocent citizens and deprivation of essential government services,¹⁹ forestall the likelihood of riots and other popular protests,²⁰ and reduce the potential for financial chaos resulting from a country’s debt default.²¹ At the same time, retroactivity would impose little harm. The only parties whose expectations would be impaired would be holdout creditors. But any such impairment would be limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors based on the debtor-state’s deteriorating economic circumstances, and thus should reflect the

¹⁸ See e.g., Philip R. Wood, *Governing Law of Financial Contracts Generally*, in CONFLICT OF LAWS AND INTERNATIONAL FINANCE 12 (ed. 2007); Setser, *supra* note 17, at 16 (observing that “[a]lmost all international bonds are now governed by New York law, English law, and to a lesser extent Japanese law”).

¹⁹ See, e.g., Nick Robins-Early, *What’s Behind the Economic Chaos in Venezuela*, June, 2016, available at http://www.huffingtonpost.com/entry/venezuela-economic-crisis-explainer_us_57507abde4b0eb20fa0d2c54; Lucy Rodgers & Nassos Stylianou, *How Bad are Things for the People of Greece?*, July, 2015, available at <http://www.bbc.com/news/world-europe-33507802>.

²⁰ See, e.g., Niki Kitsantonis & Rachel Donadio, *Greek Parliament Passes Austerity Plan After Riots Rage*, Feb. 12, 2012, available at <http://www.nytimes.com/2012/02/13/world/europe/greeks-pessimistic-in-anti-austerity-protests.html>.

²¹ See, e.g., *Finding Solutions to the Debt Problems of Developing Countries*, Report of the Executive Committee on Economic and Social Affairs of the United Nations, May 1999, available at <http://www.cepal.org/publicaciones/xml/6/4306/lc11230i.pdf>. Cf. James S. Rogers, *The Impairment of Secured Creditors’ Rights in Reorganization: A Study on Relationship between The Fifth Amendment and The Bankruptcy Clause*, 96 HARV. L. REV. 973, 1016 (1983) (explaining the importance of retroactive bankruptcy legislation).

economic reality—and therefore the reasonable expectations—of what those creditors expect to receive as payment under those changed circumstances.²²

As a legal matter, retroactivity is permitted under international law so long as it is neither discriminatory nor arbitrary. The Model Law’s key operative provisions — supermajority aggregate voting, and the granting of priority to financiers of a debtor-state’s debt restructuring — should be neither. Retroactivity is also permitted under English law.²³ Retroactivity might raise a controversial legal issue, however, for sovereign debt contracts governed by New York law.

The “Contracts Clause” of the US Constitution, in Article I, Section 10, prohibits states, such as New York (as opposed to the federal government), from enacting any legislation that impairs existing contractual obligations. Nonetheless, I have separately concluded that New York State should be able to frame its enactment of the Model Law in such a way as to not violate the Contracts Clause.²⁴ In general, a state has leeway to retroactively impair contracts if the impairment is reasonably necessary to further an important public purpose and also reasonable and appropriate to effectuate that purpose. This leeway may be even greater if the contractual impairment is not substantial. New York State could therefore frame enactment of the Model Law, with retroactivity, as an exercise of its police powers to reduce sovereign debt defaults that could lead to a systemic economic collapse, thereby protecting economic activity within its borders. The Model Law’s supermajority aggregate voting and granting of priority to financiers of a debtor-state’s debt restructuring are appropriately tailored to reduce that threat. Furthermore, as discussed above, any contractual impairment should not be “substantial,”

²² Even if that impairs a holdout creditor’s ability to blackmail a country’s debt restructuring in order to extract value from the other creditors, that holdout behavior would be morally repugnant.

²³ Steven L. Schwarcz, *Sovereign Debt Restructuring and English Governing Law*, BROOKLYN JOURNAL OF CORPORATE, FINANCIAL AND COMMERCIAL LAW (forthcoming 2017 symposium issue on “Public Bankruptcy”), available at <http://ssrn.com/abstract=2952776>.

²⁴ See *supra* note 11.

being limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors based on the debtor-state's deteriorating economic circumstances.²⁵

POLITICAL ECONOMY OF THE MODEL LAW

A final question is whether the Model Law would be economically and politically feasible. Some nations may be concerned, for example, that enactment of the Model Law might increase their borrowing costs by making creditor claims more subject to bail-in. Economists have recently argued and provided empirical evidence to the contrary — that uncertainty due to the absence of an effective sovereign debt resolution framework actually increases the costs of borrowing.²⁶ However, even if the Model Law would increase borrowing costs, it should not exceed the cost increase resulting from aggregate-voting CACs being included in all debt contracts, which has been the ideal goal of the contractual approach to sovereign debt restructuring.²⁷

The Model Law should also be politically feasible. As mentioned, its less formal enactment process can be appealing to debtor-states. The Model Law would not require general acceptance by the world's nations for its implementation. Jurisdictions that are interested in becoming or continuing as global leaders in debt restructuring—especially those with a reputation in finance and the rule of law—should want to enact the Model Law, in order to persuade parties to choose their law to govern new debt issuances. Countries will want their debt to be governed by a law that solves the holdout problem.

²⁵ See *supra* notes 21-22 and accompanying text. Cf. *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006) (“To assess whether an impairment is substantial,” a court should “look at ‘the extent to which reasonable expectations under the contract have been disrupted’.”) (quoting *Sanitation & Recycling Indus., Inc. v. City of New York*, 107 F.3d 985, 993 (2d Cir 1997)); Steven L. Schwarcz, *A Minimalist Approach to State ‘Bankruptcy’*, 59 UCLA L. REV. 322, 336-37 (2011) (advocating for a consensual debt restructuring process that enables states to seek relief from their unsustainable debt burdens and also protects creditor expectations—other than those of holdout creditors who are trying to extract value from others).

²⁶ Stiglitz et al., *supra* note 5, at 1.

²⁷ See text accompanying note 9, *supra*. The inclusion of those types of CACs is also part of the ninth goal of the UN's Basic Principles on Sovereign Debt Restructuring Processes, discussed below.

Investors will want the governing law not only to be that of a neutral jurisdiction but also to reduce uncertainty and disruptive litigation.

It is also informative to assess the Model Law's political feasibility from the perspective of the politics of the IMF's failed treaty approach. That approach failed for several reasons. Certain emerging market countries feared it would raise their cost of borrowing. As mentioned, however, the Model Law arguably should reduce or not affect that cost.²⁸ At the time the IMF proposed its treaty approach, many believed that exchange offers could solve the sovereign debt problem. Experience, however, has long since undermined that belief. Some also opposed the IMF's treaty approach because of suspicions about the IMF's conflicting role as both treaty sponsor and supervisory authority thereunder. The Model Law, in contrast, is not designed by the IMF, nor is the IMF part of its supervisory process. Furthermore, as indicated, the Model Law limits the supervisory process to non-discretionary administrative actions. Debtor-states should therefore want — and creditors, other than rent-seeking holdouts, should want them — to enact the Model Law.

THE MODEL LAW EMBRACES THE UN'S BASIC PRINCIPLES ON SOVEREIGN DEBT RESTRUCTURING PROCESSES

The Model Law embraces these Basic Principles (“Principles”), adopted by the United Nations General Assembly in 2015.²⁹ The first Principle is that “A Sovereign State has the right . . . to design its macroeconomic policy, including restructuring its sovereign debt Restructuring should . . . preserv[e] at the outset creditors’ rights.” The Model Law may indeed be enacted, voluntarily, by any debtor-state. The very fact that it is a “model” law means that a debtor-state could modify its terms. The second Principle concerns good faith, holding that “Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring

²⁸ See *supra* note 26 and accompanying text.

²⁹ “*Basic Principles on Sovereign Debt Restructuring Processes*” (A/69/L.84), adopted by the General Assembly of the United Nations in New York at its Sixty-Ninth Session on 10 September 2015.

workout negotiations . . . with the aim of a prompt and durable reestablishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.” The Model Law’s Preamble states in relevant part that its purpose is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce the social costs of sovereign debt crises. Article 6 of the Model Law requires that the restructuring plan will enable the State’s debt to become sustainable. The Model Law’s supermajority voting requirement for restructuring also respects the need for a “critical mass of creditors” to support the restructuring terms.

Under the third Principle, “Transparency should be promoted in order to enhance the accountability of the actors concerned” The Model Law requires full transparency, including disclosure of any claims not included in the restructuring. The Model Law clearly embraces the fourth Principle (“Impartiality”), being completely impartial. The fifth Principle concerns equitable treatment: imposing on debtor-states “the duty to refrain from arbitrarily discriminating among creditors Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded ex ante from the sovereign debt restructuring process.” The Model Law embraces this Principle by including all of a debtor-state’s debt claims except for internal operational claims (such as pension and retiree obligations, tax refunds, unpaid salaries to public employees, and social program payments), and also by requiring pari passu claims to be treated alike or else giving their holders a supermajority-voting power to veto a restructuring. The Model Law at least de facto respects the sixth Principle, that “Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts” by recognizing the reality that a creditor obtaining a foreign judgment against a debtor-state cannot use that judgment to attach sovereign assets within that state.³⁰

³⁰ For that reason, the Model Law does not include a stay.

The seventh Principle, “Legitimacy,” “entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement.” The Model Law fully respects legitimacy in all of these forms. The eighth Principle, “Sustainability,” is one of the Model Law’s primary goals. This Principle “implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors’ rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.” The Model Law is designed to restructure unsustainable debt in order to achieve a stable debt situation. Its very Preamble explains that the Model Law will provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce the social costs of sovereign debt crises, systemic risk to the financial system, creditor uncertainty, and the need for sovereign debt bailouts, which are costly and create moral hazard.

The Model Law is explicitly designed to facilitate the ninth Principle, “Majority restructuring,” which “implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be . . . impeded by . . . a non-representative minority of creditors States should be encouraged to include collective action clauses in their sovereign debt to be issued.” The Model Law enables a specified majority of creditors, voting on an aggregate basis, to bind all *pari passu* creditors, thereby preventing vulture funds and other holdouts from impeding a debtor-State’s debt restructuring. The Model Law also works in parallel with, and embraces, collective action clauses. A debtor-state could, for example, decide to exclude claims that incorporate collective action clauses from the Model Law’s operation, so long as it discloses those excluded claims. Creditors on those claims also have the right, if they choose, to contractually opt into the Model Law’s terms, conditions, and provisions.

RECOMMENDATIONS

This article proposes a model-law approach to sovereign debt restructuring as a topic for UNCITRAL research. Such an approach would be modest, compared to a multilateral treaty; but the ability of debtor nations and their creditors to choose the model law to govern their debt contracts gives a model-law approach a powerful multiplier effect, and thus a significant potential impact. As a starting point, this article proposes the text of such a law (defined herein as the Model Law), which already has been vetted in discussions with leading experts worldwide.³¹ That vetting also indicates that a model-law approach should have widespread acceptance.³²

Even if it achieves nothing else, UNCITRAL's researching a model-law approach should provide incremental steps toward developing norms for a sovereign debt restructuring legal framework that goes beyond mere contracting. An incremental approach to developing norms has strong precedent in the legal ordering of international relationships,³³ especially "where law reformers possess limited authority and where the subject [like sovereign debt restructuring] is either controversial or technical."³⁴ A model

³¹ See *supra* note 13 and accompanying text.

³² Given that vetting, this article's Model Law should in principle be ready for enactment by interested jurisdictions, whether or not UNCITRAL selects this article's topic for further research.

³³ Cf. Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 UNIVERSITY OF CHICAGO LAW REVIEW 469, 531 (2005) (observing that "states can be gradually led toward stronger legal rules . . . by starting with relatively weak international rules backed by little or no sanctions that all states feel comfortable joining, but then gradually pushing states to accept successively stronger and more challenging requirements").

³⁴ Susan Block-Lieb & Terence Halliday, *Incrementalisms in Global Lawmaking*, 32 BROOKLYN JOURNAL OF INTERNATIONAL LAW 851, 852 (2007). Cf. John A.E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935, 939 (2005) (observing that UNCITRAL's Model Law on Cross-Border Insolvency "created an opportunity to bridge the theoretical gap between universalists and territorialists . . . by appearing to be a hybrid of universalism and territorialism[,] . . . thus allow[ing] hesitant states to 'acclimate' to a regime of universalism"). An incremental approach to developing norms has also been valuable for addressing international environmental problems, such as climate change. See, e.g., DANIEL J. FIORINO, *THE NEW ENVIRONMENTAL REGULATION* 221 (2006) (arguing that "an incremental . . . strategy for

law could also be pursued in parallel as part of a broader strategy for developing a legal resolution framework for sovereign debt restructuring.

change offers the best alternative for speeding up the transition to a new environmental regulation”).

APPENDIX

Sovereign Debt Restructuring Model Law³⁵

Preamble

The Purpose of this Law is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce (a) the social costs of sovereign debt crises, (b) systemic risk to the financial system, (c) creditor uncertainty, and (d) the need for sovereign debt bailouts, which are costly and create moral hazard.

Chapter I: Scope, and Use of Terms

ARTICLE 1: SCOPE

- (1) This Law applies where, by contract or otherwise, (a) the law of [this jurisdiction³⁶] governs the debtor-creditor relationship between a State and its creditors and (b) the application of this Law is invoked in accordance with Chapter II.
- (2) Where this Law applies, it [shall operate retroactively and, without limiting the foregoing,³⁷] shall override any contractual provisions that are inconsistent with the provisions of this Law.

³⁵ In writing this Model Law, the author benefited greatly from discussions with colleagues on the International Insolvency Institute (III) Working Group on Sovereign Insolvencies and the CIGI ILRP Working Group on Cross-Border and Sovereign Insolvencies. Besides the author, the members of these working groups are, respectively, Donald Bernstein, Zack Clement, Allan Gropper, Robin Itkin, Steven T. Kargman, Kenneth N. Klee, Christopher Klein, Bruce Leonard, Charles W. Mooney, Christoph Paulus and Ignacio Tirado; and Mona Davies, Oonagh Fitzgerald, Mark Jewett, Bruce Leonard, John Murray, Catherine Walsh and Miranda Xafa.

³⁶ This would refer to a jurisdiction enacting this Model Law, for example, New York, England, a nation, etc. Articles 3(3) and 12 further expand this Law's application.

³⁷ This provision is optional. Retroactivity would be especially powerful if New York State or England enacts the Model Law. *See supra* notes 18-24 and accompanying text.

ARTICLE 2: USE OF TERMS

For purposes of this Law:

- (1) “creditor” means a person or entity that has a claim against a State;
- (2) “claim” means a payment claim against a State for monies borrowed or for the State’s guarantee of, or other contingent obligation on, monies borrowed; and the term “monies borrowed” shall include the following, whether or not it represents the borrowing of money per se: monies owing under bonds, debentures, notes, or similar instruments; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers’ acceptances, or other extensions of credit; and monies owing on money-market instruments or instruments used to finance trade;
- (3) “Plan” means a debt restructuring plan contemplated by Chapter III;
- (4) “State” means a sovereign nation;
- (5) “Supervisory Authority” means [name of neutral international organization].

Chapter II: Invoking the Law’s Application

ARTICLE 3: PETITION FOR RELIEF, AND RECOGNITION

- (1) A State may invoke application of this Law by filing a voluntary petition for relief with the Supervisory Authority.
- (2) Such petition shall certify that the State (a) seeks relief under this Law, and has not previously sought relief under this Law (or under any other law that is substantially in the form of this Law) during the past [ten] years, (b) needs relief under this Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State, (c) agrees to restructure those claims in accordance with this Law, (d) agrees to all other terms, conditions, and provisions of this Law, and (e) has duly enacted any national law needed to effectuate these agreements. If requested by the Supervisory Authority, such petition shall also attach documents and legal opinions evidencing compliance with clause (e).

(3) Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority [or this jurisdiction] for lack of good faith, the terms, conditions, and provisions of this Law shall (a) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of [this jurisdiction]; (b) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this Law; and (c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this Law.

ARTICLE 4: NOTIFICATION OF CREDITORS

- (1) Within 30 days after filing its petition for relief, the State shall notify all of its known creditors of its intention to negotiate a Plan under this Law.
- (2) The Supervisory Authority shall prepare and maintain a current list of creditors of the State for purposes of supervising voting under this Law.

Chapter III: Voting on a Debt Restructuring Plan

ARTICLE 5: SUBMISSION OF PLAN

- (1) The State may submit a Plan to its creditors at any time, and may submit alternative Plans from time to time.
- (2) No other person or entity may submit a Plan.

ARTICLE 6: CONTENTS OF PLAN

A Plan shall

- (1) designate classes of claims in accordance with Article 7(3);
- (2) specify the proposed treatment of each class of claims;
- (3) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment;
- (4) disclose any claims not included in the Plan's classes of claims;

- (5) provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or cancelling or modifying any liens or encumbrances; and
- (6) certify that, if the Plan becomes effective and binding on the State and its creditors under Article 7(1), the State's debt will become sustainable.

ARTICLE 7: VOTING ON THE PLAN

- (1) A Plan shall become effective and binding on the State and its creditors when it has been submitted by the State and agreed to by each class of such creditors' claims designated in the Plan under Article 6(1). Thereupon, the State shall be discharged from all claims included in those classes of claims, except as provided in the Plan.
- (2) A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number of the claims of such class [voting on such Plan³⁸] [entitled to vote on such Plan] agree to the Plan.
- (3) Each class of claims shall consist of claims against the State that are *pari passu* in priority, provided that (a) *pari passu* claims need not all be included in the same class, (b) claims of governmental or multi-governmental entities each shall be classed separately, and (c) claims that are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law shall not be classed with other claims.

Chapter IV: Financing the Restructuring

ARTICLE 8: TERMS OF LENDING

- (1) Subject to the provisions of this Article 8, the State shall have the right to borrow money on such terms and conditions as it deems appropriate.
- (2) The State shall notify all of its known creditors of its intention to borrow under Article 8(1), the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the Supervisory Authority within 30 days, stating (a) whether they approve or disapprove of such loan, (b)

³⁸ The Plan can be more easily approved if this alternative is selected, but reliable notice to creditors then becomes more important.

the principal amount of their claims against the State, and (c) the principal amount of those claims that are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law.

(3) Any such loan must be approved by creditors holding at least two-thirds in principal amount of the claims of creditors responding to the Supervisory Authority within that 30-day period.

(4) In order for the priority of repayment (and corresponding subordination) under Article 9 to be effective, any such loan must additionally be approved by creditors holding at least two-thirds in principal amount of the “covered” claims of creditors responding to the Supervisory Authority within that 30-day period. Claims shall be deemed to be “covered” if they are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law.

ARTICLE 9: PRIORITY OF REPAYMENT

(1) The State shall repay loans approved under Article 8 prior to paying any other claims.

(2) The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9. Such claims are not subordinated for any other purpose.

(3) The priority of repayment (and corresponding subordination) under this Article 9 is expressly subject to the approval by creditors under Article 8(4).

Chapter V: Adjudication of Disputes

ARTICLE 10: ARBITRATION

(1) All disputes arising under this Law shall be resolved by binding arbitration before a panel of three arbitrators.

(2) The arbitration shall be governed by [generally accepted international arbitration rules of (name of neutral international arbitration body)] [the rules of the International Centre for Settlement of Investment Disputes/ International Centre for Dispute Resolution/ International Chamber of Commerce International Court of Arbitration].

- (3) Notwithstanding Article 10(2), if all the parties to an arbitration contractually agree that such arbitration shall be governed by other rules, it shall be so governed. Such agreement may be made before or after the dispute arises.
- (4) The State shall pay all costs, fees, and expenses of the arbitrations.

Chapter VI: Opt In

ARTICLE 11: OPTING IN TO THIS LAW

- (1) Any creditors of the State whose claims are not otherwise governed by this Law may contractually opt in to this Law's terms, conditions, and provisions.
- (2) The terms, conditions, and provisions of this Law shall apply to the debtor-creditor relationship between the State and creditors opting in under Article 11(1) as if such relationship were governed by the law of [this jurisdiction] under Article 3(3).