

Sovereign Debt Restructuring and English Governing Law¹

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Abstract: The problem of sovereign indebtedness is becoming a worldwide crisis because nations, unlike individuals and corporations, lack access to bankruptcy laws to restructure unsustainable debt. Decades of international efforts to solve this problem through contracting and attempted treaty-making have failed to provide an adequate debt-restructuring framework. A significant amount of outstanding sovereign debt is governed, however, by English law. This essay argues that the U.K. Parliament has the extraordinary power to help solve the problem of unsustainable country debt by changing English law to facilitate fair and consensual debt restructuring.

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GLOBALIZATION & DEVELOPMENT 343 (2016) (hereinafter “*A Model-Law Approach*”).

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INTRODUCTION

In recent years, many countries—including Greece, Argentina, Ukraine, and perhaps now Venezuela³—have found themselves indebted beyond their ability to pay. The threat of default can harm not only debtor nations and their citizens but also their creditors.⁴ An actual default can jeopardize the very stability of the financial system.⁵

The problem of unsustainable sovereign debt is especially serious because international law—unlike domestic bankruptcy law for companies and individuals—does not yet facilitate reasonable debt restructuring. Sovereign debt restructuring has therefore been limited to contractual negotiation, raising the holdout problem.⁶ This is a type of

³ Cf. Dimitra DeFotis, *Venezuela Debt Deadlines: Will Oil Cover February?*, BARRON'S EMERGING MARKETS DAILY, Feb. 3, 2017 (reporting that the government of Venezuela and state-controlled oil company Petroleos de Venezuela together face \$10 billion in debt payments in 2017, and that April deadlines “could prove especially onerous”), available at <http://blogs.barrons.com/emergingmarketsdaily/2017/02/03/venezuela-debt-deadlines-will-oil-cover-february/>.

⁴ 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.”).

⁵ 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 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”). Sometimes a pre-default scenario can be destabilizing if, for example, it threatens debt securities that are widely held by financial institutions, motivating panicked sales that drive down prices.

⁶ Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL LAW REVIEW 956, 960 (2000), also available at

collective action problem in which one or more creditors refuse to agree to a debt restructuring plan that proposes to change critical payment terms—such as principal amount, interest rate, and maturities, which may require unanimity to change—in order to extract more than their fair share of a debt-restructuring settlement.⁷

Some sovereign debt contracts—including bond contracts governed by English law⁸—include provisions, called collective action clauses (“CAC”s), that attempt to mitigate the holdout problem by enabling a specified supermajority, such as two-thirds or three-quarters, of the contracting parties to change critical repayment terms.⁹ Relying solely on such a contractual approach, however, has been insufficient.¹⁰ Even in sovereign debt contracts that include CACs,¹¹ holdouts may be able to purchase vote-blocking positions.¹² More critically, a CAC ordinarily binds only the parties to the

http://scholarship.law.duke.edu/faculty_scholarship/508/ (hereinafter “*Sovereign Debt Restructuring*”).

⁷ *Id.* Economists regard this as a form of “rent-seeking” behavior. Kenneth M. Kletzer, *Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention*, IMF Working Paper, at 4 (2003). Recent empirical research shows “a drastic rise of sovereign debt litigation” by holdout creditors. 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.

⁸ *See, e.g.*, International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring* 17 (Oct. 2014), available at <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> (stating that “CACs allowing for collectively-binding restructuring decisions have traditionally been included in sovereign bonds governed by English . . . Japanese law”).

⁹ Westbrook, *supra* note 5, at 255.

¹⁰ *Cf.* 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) (characterizing sole reliance on a contractual approach as “deeply dysfunctional and produce[ing] bad law”).

¹¹ Many sovereign debt contracts simply lack CACs. Steven L. Schwarcz, *Sovereign Debt: The Statutory Solution*, INTERNATIONAL FINANCIAL LAW REVIEW (Dec. 2014); also available at <http://www.iflr.com/Article/3405641/Sovereign-debts-statutory-solution.html>. *Cf.* text accompanying note 70, *infra* (observing that even after years of trying to include CACs, relatively few Greek debt agreements actually contained such clauses).

¹² *See, e.g.*, John A. E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings*, LAW & ECONOMICS WORKING

particular contract that includes it¹³; hence, the parties to any given sovereign debt contract can act as holdouts in a debt restructuring plan that requires parties to all such contracts to agree to the plan.¹⁴ This explains the recent inability to restructure English-law governed Greek bonds that contained CACs.¹⁵

To attempt to address this cross-contract holdout problem, the International Capital Market Association (“ICMA”) has proposed CACs that also aggregate voting across debt issues.¹⁶ But aggregate-voting CACs have some of the same limitations as other CACs, notably binding only creditors who are parties to agreements that include them.¹⁷ More importantly, even if all new sovereign debt contracts were to include

PAPERS 81 (2013), available at http://repository.law.umich.edu/law_econ_current/81 (vulture funds “may easily be able to marshal blocking positions, especially when a sovereign has issued multiple rounds of debt”). Cf. John Muse-Fisher, *Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds*, 102 CAL. L. REV. 1671, 1707 (2014) (illustrating how holdouts can “bid up the price of defaulted bonds in order to achieve a blocking position”); Molly Ryan, *Sovereign Bankruptcy: Why Now and Why Not in the IMF*, 82 FORDHAM L. REV. 2473, 2502 (2014) (stating that “Greek bonds governed by U.K. law restructured in 2012 contained a CAC, but holdout investors successfully purchased blocking minorities in individual bond series that could not be offset by pro-restructuring majorities”). The higher the voting requirement (e.g., three-quarters), the easier it is to block the requisite vote.

¹³ Cf. International Monetary Fund, *supra* note 8, ¶ 25 at 18 (observing that “most existing CACs operate on a series-by-series basis”).

¹⁴ *Sovereign Debt Restructuring*, *supra* note 6, at 960.

¹⁵ International Monetary Fund, *supra* note 8, ¶ 4 at 5 (stating that of “the 36 [Greek] bond issuances governed by English law that were eligible to participate in the debt exchange, and which contained CACs, only 17 were successfully restructured using the CACs. The operation of the CACs in the remaining bond issues was effectively neutralized by holdout creditors . . .”).

¹⁶ See *Standard Aggregated Collective Action Clauses (“CACs”) For The Terms and Conditions of Sovereign Notes*, International Capital Market Association, Aug. 2014, at 3. The IMF and the G20 have supported the effort to include these aggregate-voting CACs in sovereign debt contracts.

¹⁷ Cf. Stiglitz et al., *supra* note 4, at 2 (observing that ICMA’s CAC aggregate-voting clauses “are improvements over the old terms, but are not sufficient to solve a variety of problems faced in sovereign debt restructurings”).

aggregate-voting CACs, it will be many years before existing debt contracts, which do not include them, are paid off.¹⁸

CACs are therefore an inadequate substitute for pursuing a more systematic legal framework for sovereign debt restructuring.¹⁹ However, a multilateral framework, such as a convention or treaty, is not currently politically feasible. In 2014, for example, the United Nations General Assembly voted to begin work on a “multilateral legal framework” for sovereign debt restructuring. The resolution—originally promoted by Argentina, apparently in response to the U.S. Supreme Court’s decision to let stand a lower court ruling enforcing *pari passu* clauses in Argentine sovereign debt—was introduced by Bolivia on behalf of the Group of 77 developing nations (of which Bolivia was then the chair) and China.²⁰ But both the United States²¹ and the European Union²² opposed the resolution, to some extent paralleling opposition to an earlier International Monetary Fund (IMF) proposal for a Sovereign Debt Restructuring Mechanism

¹⁸ See, e.g., International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring* 33-34 (2014), available at <http://www.imf.org/external/pp/longres.aspx?id=4911> (observing that approximately 29% of all sovereign bonds outstanding, and 21.2% of all such bonds governed by English law, “will mature after ten years”).

¹⁹ For a systematic comparison of contractual and statutory legal resolution frameworks, see Steven L. Schwarcz, *Sovereign Debt Restructuring Options: An Analytical Comparison*, 2 HARVARD BUSINESS LAW REVIEW 95 (2012), also available at <http://ssrn.com/abstract=1872552>.

²⁰ See current status here: <http://www.un.org/press/en/2014/gaef3417.doc.htm>.

²¹ Press Release, General Assembly, Proposal for Sovereign Debt Restructuring Framework among 6 Draft Texts Approved by Second Committee, U.N. Press Release GA/EF/3417 (Dec. 5, 2014) (“Also speaking before the vote, the representative of the United States was obliged to vote ‘no’ on the draft resolution as there was ongoing work on the technically complex issue in such bodies as the International Monetary Fund (IMF), which were more appropriate venues”).

²² Italy, speaking on behalf of the EU, stated that the IMF is the “primary forum to discuss sovereign debt restructuring.” *Id.* Apparently few, if any, developed economy countries supported the resolution, although many abstained rather than vote no. See Recorded Vote at 37th meeting, Dec. 5, 2014, available at <http://www.un.org/en/ga/second/69/modalities.pdf>.

(“SDRM”) convention.²³ Although the United Nations Conference on Trade and Development (UNCTAD) has been tasked with moving the General Assembly’s approach forward, there is skepticism whether any such framework is feasible without U.S. and E.U. support.²⁴

This essay proposes an inventive, and arguably more effective, approach to achieving a sovereign-debt-restructuring framework by focusing on the governing law. Most sovereign debt contracts are governed either by the debtor-state’s law or by New York or English law.²⁵ For contracts governed by the debtor-state’s law, that nation itself could enact law to facilitate its debt restructuring.²⁶ For contracts governed by New York law, I have elsewhere examined in depth how that state could enact law to facilitate sovereign debt restructuring.²⁷ This essay examines how English law could be modified to facilitate the restructuring of sovereign debt contracts governed by that law.

To that end, Part I of the essay proposes modifications to English law based on a model law for sovereign debt restructuring (hereinafter, “Model Law”). Part I also

²³ Cf. *A Model-Law Approach*, *supra* note 1, at 9 (discussing U.S. opposition to the IMF’s proposed SDRM). It appears that at least part of that opposition was due to lobbying by major financial industry associations. Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT’L L. 299, 391–93 (2005). I later compare that opposition to potential opposition to this essay’s proposed model-law approach. See *infra* notes 132-142 and accompanying text. The opposition to the IMF’s proposed SDRM is especially ironic in light of Italy’s comment, *supra* note 22.

²⁴ *A Model-Law Approach*, *supra* note 1.

²⁵ See e.g., Philip R. Wood, *Governing Law of Financial Contracts Generally*, in CONFLICT OF LAWS AND INTERNATIONAL FINANCE 12 (ed. 2007); Brad Setser, IPD Task Force on Sovereign Debt brief, *The Political Economy of the SDRM* 16 (Jan. 3, 2008), http://www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf. (observing that “[a]lmost all international bonds are now governed by New York law, English law, and to a lesser extent Japanese law”).

²⁶ See *Sovereign Debt Restructuring*, *supra* note 6, at 1034. See also *Governing Law in Sovereign Debt—Lessons from the Greek Crisis and Argentina Dispute of 2012*, Feb. 2013, available at <http://www2.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf>.

²⁷ *A Model-Law Approach*, *supra* note 1.

distinguishes this approach from a legal treaty or convention,²⁸ explains how the Model Law provisions could be enacted into English law, and discusses certain of those provisions. For example, although the Model Law provides for prospective application, it includes an option to be enacted with both prospective and retroactive application.²⁹ Retroactivity would facilitate any needed restructuring of the immense stock—perhaps a quarter³⁰ to a third³¹ or more³² of all outstanding sovereign debt contracts—of such contracts governed by English law.³³ Part II of the essay analyzes the legal, economic, and political feasibility of a model-law approach. Finally, the essay’s Appendix suggests the Model Law’s text.

²⁸ For a detailed discussion of the history of attempted treaty approaches to sovereign debt restructuring, *see A Model-Law Approach*, *supra* note 1.

²⁹ *See* Model Law Article 1(2).

³⁰ *See, e.g.*, Michael Tomz, *Empirical Research on Sovereign Debt and Default* (Oct. 22, 2012), <http://web.stanford.edu/~tomz/working/TomzWright2012-w18598.pdf> (finding that around a quarter of sovereign debt contracts are governed by English law with 28% by value and 22% by number).

³¹ *See, e.g.*, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, Sept. 2014, available at <http://www.imf.org/external/np/pp/eng/2014/090214.pdf> (finding that about a third of sovereign bonds outstanding are issued under English law).

³² *See, e.g.*, International Monetary Fund, *supra* note 8, ¶ 6 at 6 (estimating that international sovereign bonds governed by the laws of [England] represent approximately . . . 40 percent of the notional amount of the outstanding stock of international sovereign bonds”). This percentage references “international” sovereign bonds, which appears to mean sovereign bonds governed by the law of a jurisdiction other than that of the debtor-state issuing the bonds. Because some percentage of a debtor-state’s bonds tend, in my experience, to be governed by local law (in which case, the debtor-state itself could change that law to facilitate its debt restructuring; *see supra* note 26 and accompanying text), the actual percentage of sovereign bonds governed by English law is certainly less than 40 percent of all sovereign bonds.

³³ *Cf. Governing Law in Sovereign Debt—Lessons from the Greek Crisis and Argentina Dispute of 2012*, Feb. 2013, available at <http://www2.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf> (surveying twenty-three “relatively recent short and medium term debt offerings by sovereigns” where ten of twenty-three were governed by English law and nine of twenty-three were governed by New York law); *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts*, Aug. 2012, available at <https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf> (finding that 140 out of 631 issuances were governed by English law valued at 117 billion dollars out of 411 billion dollars total, second only to New York law).

I. A MODEL LAW TO FACILITATE SOVEREIGN DEBT RESTRUCTURING

A model law is suggested legislation for governments individually to consider enacting as domestic law in their jurisdictions.³⁴ In contrast, a treaty or convention—the terms are synonymous—is a multilateral agreement or compact among nations.³⁵ The more relaxed nature of a model-law approach can be more appealing than a formal treaty.³⁶

In the case of sovereign debt restructuring, for example, a model-law approach would bypass the current political impasse to achieve a treaty.³⁷ A model-law approach could also be pursued in parallel as part of an overall strategy for developing a legal resolution framework for sovereign debt restructuring, thereby helping “to develop consensus around [debt restructuring] ideas that are commercially sound and legally effective.”³⁸

A. Enacting the Model Law into English Law

³⁴ *UNCITRAL*, *supra* note 35.

³⁵ See BLACK’S LAW DICTIONARY 164 (4th pocket ed. 2011) (defining convention as “[a]n agreement or compact, especially one among nations; a multilateral treaty”). See also *FAQ – UNCITRAL Texts*, UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, available at http://www.uncitral.org/uncitral/en/uncitral_texts_faq.html (last visited Mar. 12, 2015) (defining a convention as “an instrument that is binding under international law on States and other entities with treaty-making capacity that choose to become a party to that instrument”).

³⁶ See, e.g., John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT’L L. 936, 984-86 (2005) (hereinafter “*Procedural Incrementalism*”) (discussing possible explanations for the recent success of model laws); GEORGE A. BERMAN, *INTEGRATION THROUGH LAW: EUROPE AND THE AMERICAN FEDERAL EXPERIENCE* 154 (1985).

³⁷ See *supra* notes 20-24 and accompanying text.

³⁸ Oonagh Fitzgerald, CIGI GLOBAL RULE OF LAW BLOG: “Next steps towards a multilateral debt workout process,” June 4, 2015, at 3-4.

English law refers to the law governing England and Wales, which are semi-autonomous subnational regions within the United Kingdom.³⁹ Statutory changes to English law are made by the U.K. Parliament (“Parliament”).

Parliament would enact the Model Law in the same way it legislates any other bill, a process that normally involves four stages.⁴⁰ The first stage is for a draft bill incorporating the provisions of the Model Law to be proposed for consultation by a government department and issued to interested parties or to select committees in the House of Commons or House of Lords.⁴¹ After approval by the applicable select committee, the second stage involves the bill being presented for debate before Parliament, as a proposal for a new law.⁴² In the third stage, the bill must be approved by a majority of both the House of Commons and the House of Lords.⁴³ If the bill receives that approval, the fourth and final stage is to send the bill to the monarch for Royal Assent—which, unlike in the United States where the president holds an oft-used veto power, is regarded as more of a formality.⁴⁴ After Royal Assent, the bill becomes an Act of Parliament, creating binding law.⁴⁵

³⁹ See, e.g., Tom Bolam, Fladgate LLP, *Common Mistakes in Choice of Law and Jurisdiction Clauses*, Sept. 2015, available at <http://www.lexology.com/library/detail.aspx?g=8f9476e8-b712-4726-b675-21463a3355e9> (explaining that the United Kingdom of Great Britain and Northern Ireland has three separate and distinct legal systems—Scotland; England and Wales; and Northern Ireland—and that English Law refers to the legal system of England and Wales).

⁴⁰ See, e.g., <http://www.parliament.uk/about/how/laws/>; <https://www.gov.uk/guidance/legislative-process-taking-a-bill-through-parliament>.

⁴¹ See *id.*

⁴² *Id.*

⁴³ *Id.* In each house, the bill must pass through a first reading, second reading, committee stage, report stage, and third reading with votes and amendments at each stage. Under certain conditions, and rarely used, the Parliament Acts 1911 and 1949 allow the House of Commons to pass a bill without the consent of the House of Lords. *Id.*

⁴⁴ *Id.* Although the monarch ordinarily gives Assent to a bill that has been duly approved by both Houses, there appears to be no constitutional mechanism by which to require that Assent to be given. E-mail from Riz Mokal, barrister, South Square Chambers, & Honorary Professor, University College London Faculty of Laws, to the author (Apr. 3, 2017).

⁴⁵ See *supra* note 40.

B. Key Provisions of the Model Law

The Model Law is designed to facilitate the restructuring of unsustainable sovereign debt contracts that are governed by English law. This essay next explains certain of the Model Law's key provisions.

Rationale. The Preamble explains the reasons for the Model Law. The ultimate goals are to restore the debtor-state to debt sustainability, so as to relieve the undue economic burden on the debtor-state's citizens; to enable the debtor-state to pay its debts, thereby avoiding a default that might have systemic economic consequences; to reduce creditor uncertainty, thereby reducing lending costs; and to reduce the need for costly and morally hazardous debt bailouts.

Optional Retroactivity. If and when enacted into English law, the Model Law would apply to future sovereign debt contracts that are governed by English law. As an option, Article 1(2) allows the Model Law to also apply retroactively.⁴⁶ This provides a unique opportunity. As observed, numerous sovereign debt contracts are currently

⁴⁶ The term "retrospectively" is sometimes used as a synonym for retroactivity under English law. *See, e.g.*, "Taxing out of time: parliamentary supremacy and retroactive tax legislation" in *BRITISH TAX REVIEW* ("there has been some confusion in the jurisprudence regarding the use of the terms 'retroactive' and 'retrospective.' . . . [I]n the context of legislation, each term is defined as a synonym of the other: a law is considered retroactive/retrospective where it is made operative at a past time. Different jurisdictions have, historically, favoured one term over the other."). Even if the terms were synonymous, this essay uses the term retroactive because it has a clearer meaning internationally. Furthermore, there may well be a subtle difference in meaning between the terms. *Cf. Benner v. Canada (Secretary of State)*, 1997 CANLII 376 (S.C.C.), [1997], 1 S.C.R. 358 at para. 39 (adopting a distinction made in Elmer Driedger, *Statutes: Retroactive Retrospective Reflections*, 56 CAN. BAR REV. 264, 268-69 (1978)): "A retroactive statute is one that operates as of a time prior to its enactment. A retrospective statute is one that operates for the future only. It is prospective, but it imposes new results in respect of a past event. A retroactive statute operates backwards. A retrospective statute operates forwards, but it looks backwards in that it attaches new consequences for the future to an event that took place before the statute was enacted."

governed by English law.⁴⁷ Retroactive application would enable the Model Law to resolve problems of unsustainable sovereign debt that arise under those contracts.

Some might criticize retroactive application of the Model Law as impairing sanctity of contract. I later analyze the legal and normative consequences of choosing the optional retroactivity.⁴⁸

Claims Covered. Article 2(2) broadly defines the types of debt claims that the Model Law covers. Notably, its coverage is not limited to bond debt or other debt instruments traded as securities. The Model Law covers all payment claims against a debtor-state for monies borrowed or for the debtor-state's guarantee of (or other contingent obligation on) monies borrowed.

Unlike the IMF's proposed SDRM, which covered only long-term-maturity claims (of the types of claims it otherwise covered), the Model Law does not discriminate between, and thus covers both, long-term and short-term maturities. This recognizes that, increasingly, most sovereign debt "bailouts have come in response to the [rollover] of short-term claims."⁴⁹ Covering this important cause of a debtor-state's inability to pay will help to facilitate necessary debt relief while also reducing short-term-lender moral hazard; short-term lenders can no longer assume that their claims against a financially troubled debtor-state will be paid in full. That, in turn, will reduce short-term sovereign lending and thereby reduce rollover risk—in this context, the risk that a debtor-state will be unable to borrow sufficient new funds to repay maturing short-term debt.⁵⁰ The head

⁴⁷ See *supra* notes 30-33 and accompanying text.

⁴⁸ See *infra* notes 97-109 and accompanying text (analyzing the legal consequences under international and English law) and notes 109-121 and accompanying text (analyzing the normative consequences).

⁴⁹ Setser, *supra* note 25, at 4.

⁵⁰ Steven L. Schwarcz, *Rollover Risk: Ideating a U.S. Debt Default*, 55 BOSTON COLLEGE LAW REVIEW 1, 4 (2014).

of the sovereign debt restructuring practice at Cleary Gottlieb Steen & Hamilton LLP has called rollover risk one of today's most critical sovereign debt problems.⁵¹

Article 2(2) also broadly defines “monies borrowed” to include a wide range of financing, other than trade accounts payable arising in the ordinary course of business. The Model Law’s coverage does not discriminate based on the nationality of the holders of the (otherwise) covered claims or the currency in which such claims are payable.⁵² Consistent with the historical norms of most sovereign debt restructuring, however, the Model Law does not cover a debtor-state’s internal operational debt claims, such as pension and retiree obligations, tax refunds, unpaid salaries to public employees, or social program payments. Normally these types of debts are paid in full in a later time.⁵³

Supervisory Authority. The definition of “Supervisory Authority” in Article 2(5) of the Model Law references a “neutral international organization.” This is likely to be one of the Model Law’s most controversial provisions. It currently is unclear what organization might qualify as truly neutral. Imperfect options might include, among other

⁵¹ Luncheon speech of Lee C. Buchheit, March 27, 2015 Imperial College conference, *supra* note 2. *Cf. Rollover Risk*, *supra* note 50 (discussing rollover risk as the most likely cause of a possible debt default by the United States). CACs typically do not apply to short-term sovereign debt (maturity less than one year) because of perceived restructuring complexities giving the restrictive timing. Only experience will show whether that presents an insurmountable obstacle.

⁵² Such discrimination could be problematic, not only motivating foreign creditors “to impose sanctions (usually trade-related) to punish [the] defaulting government” but also being “interpreted as a signal used by the government to communicate information to domestic and foreign agents about the [poor] fundamentals of the economy.” Guido Sandleris, *Sovereign Defaults: Information, Investment and Credit*, 76 JOURNAL OF INTERNATIONAL ECONOMICS 267, 267 & 273 (2008). For example, in the Icesave dispute, Iceland’s failure to assure protection for foreign creditors led to international litigation and motivated the United Kingdom to apply anti-terrorist legislation to freeze accounts of Icelandic citizens in the U.K. as retaliation. Jon Danielsson, *The First Casualty of the Crisis: Iceland*, in THE FIRST GLOBAL FINANCIAL CRISIS OF THE 21ST CENTURY Part II 11–12 (Andrew Felton & Carman Reinhart eds., 2009); Dalvinder Singh, *U.K. Approach to Financial Crisis Management*, 19 TRANSNAT’L L. & CONTEMP. PROBS. 868, 879 (2011).

⁵³ E-mail from Ignacio Tirado, Professor, Universidad Autonoma de Madrid, and advisor to the World Bank, to the author (Mar. 23, 2014).

possibilities, a neutral committee of the IMF, the World Bank, or UNCITRAL, or even a court of the debtor-state.⁵⁴ There are concerns, however, that existing organizations are too political or conflicted.⁵⁵

More generally, the very issue of the need for a supervisory authority can raise confusion. Formal sovereign debt restructuring solutions, such as a convention, are often conflated with the need for formal supervisory bodies.⁵⁶ Under the Model Law, however, no formal supervisory authority is needed to exercise discretion because disputes are adjudicated through binding arbitration.⁵⁷ The main role of a Supervisory Authority under the Model Law is in fact ministerial: to fact-check information, to maintain a list of creditors and verify claims, and to oversee the creditor voting process.⁵⁸

Many commentators on sovereign debt restructuring have focused on supervision of the process and resolution of disputes. Professor Paulus contends, for example, that there should be a “neutral supervisor” that would follow procedural rules for restructuring

⁵⁴ Professor Mooney proposes, in a different context, that a court of the debtor-state could serve as a supervisory authority in a sovereign debt restructuring. Charles W. Mooney, Jr., *A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep it Simple, Stupid) and Other Guiding Principles*, 37 MICH. J. INT’L L. ___ (forthcoming 2015). The Supervisory Authority might also consist of a rotating panel of III or CIGI members whose fees and expenses would be paid for by the debtor-state invoking application of the Model Law.

⁵⁵ Prof. Westbrook argues, for example, that one of the SDRM’s flaws is that the IMF, the supervisor thereunder, would be conflicted, having responsibility for both funding and administering the proceeding as well as addressing rights and priorities. Westbrook, *supra* note 5, at 256. Cf. Joseph E. Stiglitz & Martin Guzman, *A Rule of Law for Sovereign Debt*, available at <http://www.project-syndicate.org/commentary/sovereign-debt-restructuring-by-joseph-e-stiglitz-and-martin-guzman-2015-06> (arguing that the IMF “is too closely affiliated with creditors” to be neutral).

⁵⁶ That might in part help to explain U.S. and E.U. opposition to U.N. efforts to reach a formal sovereign debt restructuring mechanism. See *supra* notes 21-23 and accompanying text.

⁵⁷ Model Law Article 10. See also *Sovereign Debt Restructuring*, *supra* note 6, at 1023-29.

⁵⁸ Cf. Barry Eichengreen, *Policy Proposals for Restructuring Unsustainable Sovereign Debt*, in *THE NEW PUBLIC FINANCE* 444 (2006) (arguing that a sovereign debt resolution forum need only engage in ministerial actions).

and resolution.⁵⁹ Others advocate the creation of a permanent institutional framework for supervision⁶⁰ or argue that existing institutions may serve that purpose.⁶¹ And yet others advocate a contractually binding arbitration process.⁶² The author believes, however, that

⁵⁹ Christoph G. Paulus, *A Statutory Procedure for Restructuring Debts of Sovereign States*, 6 RECHT DER INTERNATIONALEN WIRTSCHAFT 401, 403 (2003).

⁶⁰ Two senior fellows of CIGI have proposed, for example, the creation of a Sovereign Debt Forum (SDF), which would be an incorporated non-profit, membership-based organization that would provide an independent standing body to research and preserve institutional memory on best practices in sovereign debt restructuring. Richard Gitlin & Brett House, *A Blueprint for a Sovereign Debt Forum* (CIGI Paper No. 27, at 10) (Mar. 12, 2014), available at <http://www.cigionline.org/publications/blueprint-sovereign-debt-forum>. The concept of the SDF was borrowed and expanded from “The Sovereign Debt Forum,” a paper that Richard Gitlin presented in 2002 at the Council on Foreign Relations. The SDF, they argue, could also serve as a venue to facilitate early engagement among creditors, debtors, and other stakeholders when sovereign nations encounter financial trouble. Gitlin & House, *supra* at 18. Professor Howse, in contrast, proposes a debt workout mechanism (DWM) that ensures the participation of all relevant stakeholders. Robert Howse, “Towards a Framework for Sovereign Debt Restructuring: What Can Public International Law Contribute?” (forthcoming in *Too Little, Too Late: The Quest of Resolving Sovereign Debt Crises*, Columbia University Press, New York, 2016).

⁶¹ See, e.g., Brooks, Skylar and Domenico Lombardi. “Governing Sovereign Debt Restructuring Through Regulatory Standards”. Paper presented at IPD-CIGI Conference on *Sovereign Debt Restructuring* at Columbia University, September 22, 2015. Forthcoming, *Journal of Globalization and Development*. Brooks and Lombardi argue there is a governance gap for resolving debt crises that can be filled by the Financial Stability Board (FSB), which could serve as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring.

⁶² See generally Jubilee USA Network, *Towards a Lasting Solution to Sovereign Debt Problems* (2012), available at <http://eurodad.org/1543743/>; Christoph G. Paulus & Steven T. Kargman, “Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal,” *Workshop on Debt, Finance and Emerging Issues in Financing Integration* (2008), available at http://www.un.org/esa/ffd/wp-content/uploads/2008/04/20080408_Kargman-Paulus-Paper.pdf; Hugo Ruiz Diaz, “The Creation of an Arbitration Tribunal on Debt: An Alternative Solution? On The Position to Take on the CADTM” (2003). Paulus and Kargman have advocated a “fair and transparent sovereign debt arbitration process,” also known as sovereign debt tribunals (“SDT”). Paulus & Kargman, *supra* at 3. Under the SDT process, the decision to subject disputes to an arbitration panel would be based on contractual agreements between sovereign debtors and their creditors. *Id.* at 8. The SDT process also contemplates building trust, confidence, and legitimacy by selecting a “pool of expert arbitrators” who have knowledge and experience to handle sovereign debt disputes through a neutral

if and when an international consensus emerges on the operative legal solutions needed to solve the holdout and funding problems, the institutional bodies needed for supervision and resolution will naturally follow.

Debt Sustainability. Article 3(2)(b) of the Model Law requires a debtor-state’s petition for relief to certify that the debtor-state “needs relief under this [Model] Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State.” Although the debtor-state itself would make the determination of debt sustainability for purposes of Articles 3(2)(b) (and also for purposes of Article 6(6)), it should be guided by the best practices in making such a determination. There does not yet, however, appear to be a universally accepted view of what constitutes debt sustainability for nations. Even the IMF framework for conducting debt sustainability analyses has been criticized for creating intercreditor inequities⁶³ and for being ineffective in detecting sustainability problems.⁶⁴

The Holdout Problem. Article 7 of the Model Law addresses the most critical problem that a debt-restructuring mechanism can solve—the holdout problem.⁶⁵ A Model Law or other statutory approach to sovereign debt restructuring should be more effective

institution. *Id.* at 5, 8. *Cf.* Jose Antonio Ocampo, “A Brief History of Sovereign Debt Resolution, and a Proposal for a Multilateral Instrument” (forthcoming in *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises*, Columbia University Press, New York, 2016) (proposing an arbitration and mediation approach similar to the WTO dispute mechanisms, including independent bodies of arbitrators and mediators).

⁶³ Brooks, Skylar, Martin Guzman, Domenico Lombardi, and Joseph E. Stiglitz. “Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring.” CIGI Policy Brief No.53, January (2015). The implementation of the Model Law should reduce the need for IMF bailouts, thereby reducing these intercreditor inequities.

⁶⁴ *See, e.g.*, Guzman, Martin and Daniel Heymann (2015). “Debt Sustainability Analysis: The IMF gets it wrong”. Forthcoming, *Journal of Globalization and Development*.

⁶⁵ *Cf. supra* notes 6-7 and accompanying text (explaining the holdout problem as a type of collective action problem). It should be emphasized that the Model Law preserves the holdout threat to the extent needed to motivate debtor-states to bargain fairly, and only seeks to limit that threat for rent-seeking holdouts who try to unreasonably extract value. *See infra* notes 119-120 and accompanying text.

in solving the holdout problem than a contractual approach.⁶⁶ Article 7(2), for example, legally mandates supermajority voting that (assuming the requisite percentages agree) can bind dissenting classes of claims. This eliminates the need for the contracts themselves to include CACs.⁶⁷ Article 7(3) of the Model Law, coupled with Article 6(1), also enables a debtor-state to use the Model Law 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-a-vis other sovereign debt contracts⁶⁸; 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.⁶⁹

In contrast, the Greek sovereign debt crisis has demonstrated that the CAC approach is insufficient to solve the holdout problem. Even after years of trying to include them, relatively few Greek debt agreements actually contained CACs, and those CACs were generally restricted to bond issues.⁷⁰ Furthermore, most of the CACs that were included in those debt agreements did not contemplate aggregate-voting and thus did not purport to bind creditors to supermajority voting beyond the individual bond issue; that enabled any given bond issue to serve as a holdout vis-a-vis other Greek bond issues.⁷¹ In contrast, statutory supermajority aggregate voting is the tried-and-true method

⁶⁶ *Sovereign Debt Restructuring*, *supra* note 6, at 1003.

⁶⁷ Although Article 7(2) proposes supermajority percentages that have been used successfully in U.S. bankruptcy law (*see* 11 U.S.C. § 1126(c)), other supermajority percentages could be substituted. It should be cautioned, however, that the higher the percentages, the easier it would be (other things being equal) for a vulture fund to buy a blocking position. *See supra* note 12 and accompanying text. *Cf. infra* note 69 and accompanying text (discussing how the Model Law's aggregate-voting can also help to prevent that).

⁶⁸ *Sovereign Debt Restructuring Options*, *supra* note 19, at 109.

⁶⁹ *Cf. supra* notes 16-17 and accompanying text (indicating ICMA's efforts to introduce updated forms of CACs that attempt to aggregate voting across debt issues).

⁷⁰ Recall that the Model Law covers a much broader range of a debtor-state's debt. *See supra* note 52 and accompanying text.

⁷¹ *The Statutory Solution*, *supra* note 11. *See also supra* note 68 and accompanying text.

by which corporate insolvency law successfully, and equitably, addresses the holdout problem.⁷²

Interim Funding. Chapter IV of the Model Law addresses the critical need for a financially troubled debtor-state to obtain liquidity during its restructuring process. Although this funding has in the past often been provided by the IMF, the “IMF’s lending policy . . . is not enough to resolve the problems posed by debt burdens beyond the country’s ability to pay.”⁷³ Absent the IMF, whose loans have de facto priority, no one would lend new money without obtaining a priority repayment claim. A contractual solution would be insufficient; it would be totally impractical to get all existing creditors to contractually subordinate their claims to the new money.⁷⁴

A statutory mechanism can help, however, to give such new-money lenders priority over existing creditors.⁷⁵ To minimize the risk of “overinvestment,” existing creditors should have notice and the opportunity to block the new lending if its amount is too high or its terms are inappropriate.⁷⁶ Articles 8(2) and 8(3) of the Model Law,

⁷² Brett W. King, *The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection*, 21 DEL. J. CORP. L. 895, 941 (1996) (noting that supermajority voting “protects the minority” and that the “tremendous growth in the size of the corporation as well as the number of shareholders probably extinguished any thought of returning to the unanimity rules . . . given the obvious potential for holdout rent seeking”).

⁷³ Stiglitz et al., *supra* note 4, at 2.

⁷⁴ The Greek debt restructuring may be an exception to this because “[m]ore than 90 percent of Greece’s 310 billion euro debt is owed to public institutions: other European governments, the International Monetary Fund and the European Central Bank.” Landon Thomas, *A Bold Proposal to Offer Greece Some Financial Relief*, N.Y. TIMES, July 11, 2015, at B1. Those institutions might therefore be persuaded, politically, to contractually subordinate their claims to a new-money lender.

⁷⁵ *Sovereign Debt Restructuring*, *supra* note 6, at 988 (“granting priority should only minimally affect ex ante availability and cost of credit [] because granting priority will not lower the State’s debt rating, and also because an IMF loan already has de facto priority over other claims”). New-money lenders could thereby gain priority over existing creditors whose claims are governed by English law. *See* Model Law, Appendix—Chapter IV.

⁷⁶ *Sovereign Debt Restructuring*, *supra* note 6, at 989-90. Prof. Westbrook favors the transparent public mechanism in the SDRM that would tie budget restructuring to the

respectively, provide that notice and (through reverse supermajority voting⁷⁷) opportunity. Article 8(4) also protects creditors whose claims are governed by the Model Law (or a similar law) from being outvoted by other creditors of the debtor-state.⁷⁸

Recently, the IMF has been considering more flexible options in funding sovereign nations “in the context of sovereign debt vulnerabilities.”⁷⁹ When a troubled member nation seeks financing above its normal IMF-access limits, the IMF will have to decide whether that nation’s problems can be resolved with or without a debt restructuring. Under its current policy, “if the [IMF] determines that the member’s debt is sustainable with high probability, it may provide large scale financing without the need for a debt restructuring. However, if such a determination cannot be made, exceptional access may only be provided if a debt restructuring is pursued that is sufficiently deep to restore sustainability with high probability.”⁸⁰

The IMF is also exploring whether it should have a broader range of responses. For example, if a member nation is unable to obtain private-sector funding but its debt is considered (albeit not with high probability) sustainable without the need for a debt restructuring, the IMF is considering providing debt relief by extending the maturities of its own debt claims against that nation.⁸¹ In the author’s view, that would effectively

granting of new finance. Westbrook, *supra* note 5, at 255. That conditionality, however, would be politically volatile and might impose harsh conditions on the citizens of the debtor-state.

⁷⁷ Reverse supermajority voting under Article 8(3)—as well as under Article 8(4); *see infra* note 78 and accompanying text—of the Model Law requires supermajority voting to approve, not to prevent, the priority.

⁷⁸ That protection is needed because creditors whose claims are not governed by the Model Law would likely argue that their claims are not legally subordinated by supermajority voting under that Law.

⁷⁹ *See* IMF Staff, “The Fund’s Lending Framework and Sovereign Debt-Preliminary Considerations” (June 2014), available at <http://www.imf.org/external/np/pp/eng/2014/052214.pdf>.

⁸⁰ *Id.* at 1.

⁸¹ *Id.*

constitute a unilateral debt restructuring—the IMF itself providing a form of debt relief without seeking a quid pro quo from the member nation.

Chapter IV of the Model Law also contemplates the possibility of a debtor-state financing its debt restructuring through the capital markets. Consistent with best practices in corporate bankruptcy cases, a debtor-state contemplating invoking application of the Model Law could pre-negotiate that financing in advance. Nothing in the Model Law prevents a debtor-state from also, or alternatively, obtaining such financing through a governmental or multi-governmental source, such as the IMF.

Arbitration of Disputes. The neutral international arbitration body referenced in Article 10(2) of the Model Law might include a newly created entity designed to arbitrate sovereign debt-related disputes, such as the free-standing “Sovereign Debt Tribunal” proposed by Paulus and Kargman.⁸² Even absent a statutory framework, the resort by sovereign-debt-restructuring parties to such a tribunal could be contractual. For example, such parties could agree—ex ante (via contractual agreement in their underlying loan documents) or ex post (by mutual agreement after the dispute has arisen)—to arbitrate sovereign debt-related disputes before the tribunal.

Stay of Enforcement Actions. The Model Law omits certain provisions that one might otherwise associate with a legal framework for sovereign debt restructuring. For several reasons, it does not propose a stay of enforcement actions. First, a stay does not appear to be critical to resolving sovereign debt problems. A debtor-state could unilaterally decide to suspend payments. And the main purpose of a stay, to prevent a grab race, is less significant in a sovereign debt context because creditors could only attempt to grab the State’s relatively few assets located in other jurisdictions.⁸³ Second,

⁸² See Paulus & Kargman, *supra* note 62, at 3.

⁸³ See *Sovereign Debt Restructuring*, *supra* note 6, at 984–85. See also Setser, *supra* note 25, at 5 (observing that “[e]ffective legal action by creditors against a sovereign in default is extremely difficult”) and at 12 (observing that “neither debtor nor creditor lawyers thought the absence of a formal stay was much of a problem”) (emphasis in original). *But*

model laws are less likely than conventions to effectively impose enforcement stays. If a creditor's claim against a debtor-state is governed by the law of a jurisdiction that has enacted the Model Law, such creditor would theoretically be prejudiced in a grab race by other creditors of that state whose claims are governed by the law of a jurisdiction that has not enacted the Model Law. That creates perverse incentives for creditors to want to have their claims governed by the law of a jurisdiction that has not enacted the Model Law. Third, a stay could be costly, leading to litigation over its scope and duration and also possibly affecting non-bankruptcy incentives, thereby increasing sovereign financing costs.⁸⁴

Cram Down. The Model Law also omits a cram-down alternative in the event one or more classes of claims fails to agree. Although Article 7(1) makes a debt-restructuring plan effective and binding on the debtor-state and its creditors when it has been submitted by the debtor-state and agreed to by each class of such creditors' claims designated in the plan, any such class of claims could stymie the plan's effectiveness by failing to agree. To overcome the possibility of one or more classes of claims unreasonably withholding consent to a plan, corporate debt-restructuring laws often provide for a cram-down power—making a debt-restructuring plan effective and binding despite the objection of creditors, so long as a court finds the plan to be fair and equitable.⁸⁵

Cram down has been applied in at least one governmental debt restructuring context: the application of Chapter 9 of the U.S. Bankruptcy Code to municipal debt restructuring. In that context, a municipal debtor can cram down—or force acceptance of—a debt-restructuring plan over the objection of one or more dissenting classes of creditors if, under the plan, the creditors are “receiving all they can reasonably expect to

cf. Eichengreen, *supra* note 58, at 444 (arguing that a statutory approach to sovereign debt restructuring should include hard restraints on litigation).

⁸⁴ *Sovereign Debt Restructuring*, *supra* note 6, at 984-85.

⁸⁵ The cram-down concept of Chapter 11 of the U.S. Bankruptcy Code, for example, requires the bankruptcy court to confirm a proposed reorganization plan that is, *inter alia*, “fair and equitable, with respect to each class of claims,” despite the objection of creditors). 11 U.S.C. §1129(b)(1).

receive under the circumstances.”⁸⁶ The application of cram down under Chapter 9 has focused on whether the municipality has imposed reasonable austerity measures and has made reasonable use of taxation, so that the plan’s treatment of the dissenting classes is fair and equitable.⁸⁷

The difficulties with applying cram down in a governmental debt restructuring context are in determining what governmental austerity measures and levels of taxation are reasonable, in order to assess whether the creditors are receiving all they can reasonably expect under the circumstances.⁸⁸ At the very least, these determinations

⁸⁶ More specifically, Chapter 9 allows a court to confirm a proposed municipal bankruptcy plan, despite creditor objection, if the plan is “in the best interests of the creditors.” 11 U.S.C. § 943(b)(7) (“The court shall confirm the plan if . . . the plan is in the best interests of the creditors.”). In making this “best interests” determination, Chapter 9 incorporates the Chapter 11 “fair and equitable” cram-down test. 11 U.S.C. § 901(a). *See also* 6 COLLIER ON BANKRUPTCY §943.03 [1][f][i][B]; *In re City of Stockton*, 478 B.R. 8, 26 (Bankr. E.D. Cal. 2012) (holding that for a plan to be confirmed as to a dissenting class of creditors, it must be “fair and equitable” and “not discriminate unfairly”). For the purposes of Chapter 9, fair and equitable has been held to mean “all [the creditors] can reasonably expect to receive under the circumstances.” *See e.g.*, *Lorber v. Vista Irrigation Dist.*, 127 F.2d 628, 639 (9th Cir. 1942).

⁸⁷ Cram down’s application must be different, of course, for corporate debtors and governmental debtors. In *Newhouse v. Corcoran Irrigation Dist.*, 114 F.2d 690 (9th Cir. 1940), cert. denied, 311 U.S. 717, 61 S. Ct. 440, 85 L. Ed. 467 (1941), the court explained that the bankruptcy of a public entity is distinguishable from that of a private entity. In a public bankruptcy the entity may not be liquidated with the resulting value applied to its outstanding debts. *Id.* at 690-91. Therefore, the expectations of existing creditors must consider that a reorganization plan needs to account for the continued operation of the debtor. *See Id.* For further discussion of how the “fair and equitable” cram-down standard works under Chapter 9 of the U.S. Bankruptcy Code (regarding municipal debtors), and its potential usefulness in a sovereign restructure, *see, e.g.*, Zack Clement & R. Andrew Black, *How City Finances Can Be Restructured: Learning from Both Bankruptcy and Contract Impairment Cases*, 88 AM. BANKR. L. J., 41-55, 72-84 (2014), and Zack Clement, *Restructuring Government Finances – In Public and in Less Than a Year*, 26 WESTLAW INSOLVENCY INTELLIGENCE 91-93 (2013).

⁸⁸ A possible related concern is that by identifying governmental austerity as a goal, cram down can inadvertently aggravate a recession. Cf. Jayadev, Arjun, and Mike Konczal. “The Boom Not the Slump: The Right Time for Austerity.” (2010) (arguing that fiscal austerity in a period of recession generally aggravates the recession).

would be complex, fact-intensive, and highly politically sensitive.⁸⁹ In the Chapter 9 context, federal bankruptcy courts make these determinations, yet the decisions are far from consistent.⁹⁰ In the sovereign debtor-state context, however, there is as yet no suitable judicial venue for making such determinations.

Furthermore, the “are creditors receiving all they can reasonably expect under the circumstances” standard is much vaguer in a sovereign debtor-state context than for domestic U.S. municipalities. In the United States, there are generally accepted norms about the range of what constitutes reasonable taxation. Also, the potential flight of residents to other municipalities—which is much less feasible in a sovereign nation context—sets pragmatic limits on taxation.

⁸⁹ See, e.g., *Sovereign Debt Restructuring*, *supra* note 6, at 1008-09. Another concern with the use of cram down for sovereign debtor-states is that expectations regarding taxation and public operations among creditors may be much more varied than would be expectations in a Chapter 9 case. Compare, for example, the City of Detroit’s recent Chapter 9 case with Argentina’s debt crisis. Detroit’s creditors are principally U.S. organizations (e.g., pension funds and bond holders). See *Detroit’s 20 Largest Unsecured Creditors*, DETROIT FREE PRESS, July 19, 2013, <http://archive.freep.com/article/20130719/NEWS01/307190029/detroit-bankruptcy-list-creditors>. By contrast, Argentina’s largest creditors were public and private parties from all over the globe. Andrew F. Cooper & Bessma Momani, *Negotiating Out of Argentina’s Financial Crisis: Segmenting the International Creditors*, 10 NEW POL. ECON. 305, 306 (2005).

⁹⁰ At least one court has held that a municipality is not required to raise taxes for a plan to be fair and equitable. In *In re Corcoran Hosp. Dist.*, 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999), the court held that raising taxes is unnecessary if it would be futile, and a municipality cannot be required to do so. By contrast, a plan has been held to not be fair and equitable where a small increase in tax revenue is possible and sufficient to satisfy creditors. In *Fano v. Newport Heights Irr. Dist.*, 144 F.2d 563, 565-66 (9th Cir. 1990), the appellate court rejected the determination that the plan was fair and equitable and overturned the lower court’s confirmation because there was not a sufficient showing that the municipality’s taxing powers were inadequate to generate the revenue needed to pay the dissenting creditors. But, if an increase in tax revenues would make matters worse for the municipality than the plan the may be confirmed. In *Lorber v. Vista Irrigation Dist.*, 143 F.2d 282 (9th Cir); *cert denied*, 323 U.S. 784 (1944), the court held that because increasing taxes would cause further harm to the debtor, and the best remedy for creditors was fifty-five cents on the dollar, the plan was fair and equitable. *Id.* (finding that “55 [cents] on the dollar was the maximum that the District could reasonably pay on outstanding bonds”).

For these reasons, and also because including cram down at this nascent point in the model-law process could engender significant creditor opposition,⁹¹ the Model Law currently omits a cram-down power. Even without cram down, the Model Law would still be a major advance, from the standpoint of debtor-states, over the status quo. If, however, experience with the Model Law demonstrates that a cram-down power is needed, this essay is open to its later inclusion.⁹²

Creditors' Committee. Finally, the Model Law does not provide for the formal creation of a creditors' committee, to officially represent the debtor-state's creditors in the debt restructuring. An official creditors' committee does not appear to be necessary in a sovereign-debt-restructuring context because "the claims against a State are so large that many creditors, or at least a de facto committee of creditors chosen consensually, should find it economically feasible to participate in the restructuring process."⁹³ Some have even argued that an official creditors' committee might be harmful, promoting collusive behavior among creditors.⁹⁴ Even absent such a committee, however, the Model Law should help to create what Professor Paulus calls an "enforced community," by including all of a debtor-state's creditors in a resolution proceeding.⁹⁵ Creating such a community, he contends, should promote inter-creditor fairness because all of those creditors—whether domestic or foreign, private or governmental—are affected by the debtor-state's financial condition.⁹⁶

⁹¹ The Model Law should be much easier to 'sell' to creditors who (subject to being outvoted under supermajority aggregate voting) feel they have some control.

⁹² *Cf. Sovereign Debt Restructuring*, *supra* note 6, at 1009 (suggesting that cram down should be included in the Model Law if "experience later demonstrates that debtor-States and their creditors cannot reach consensual agreements without it").

⁹³ *Sovereign Debt Restructuring*, *supra* note 6, at 1002. *But cf.* Setser, *supra* note 25, at 7 (describing the refusal of debtor-states to agree to pay the expenses of bondholders creditors' committees as "a seemingly small demand that looms surprisingly larger in the list of 'rights' [that] creditors wanted" debtor-states to respect).

⁹⁴ Stiglitz et al., *supra* note 4, at 3.

⁹⁵ Paulus, *supra* note 59, at 402.

⁹⁶ *Id.* at 402-03.

Next consider the Model Law’s feasibility, focusing first on legal feasibility, then on economic feasibility, and finally on political feasibility.

II. FEASIBILITY

A. Legal Feasibility

This essay implicitly throughout has addressed the Model Law’s legal feasibility. Even given the optional retroactive effect,⁹⁷ the Model Law’s principal operative provisions—supermajority aggregate voting, and the granting of priority to financiers of a debtor-state’s debt restructuring—should not be discriminatory or arbitrary.⁹⁸ Those provisions should therefore be enforceable under international law.⁹⁹

The Model Law (including the optional retroactivity) would also be valid and enforceable under English law if and when enacted by Parliament. The Sovereignty of Parliament doctrine recognizes Parliament as the supreme legal authority of the United Kingdom, with authority to create or end any law.¹⁰⁰ Absent a written constitution,

⁹⁷ See Model Law Article 1(2).

⁹⁸ Steven L. Schwarcz, *Global Decentralization and the Subnational Debt Problem*, 51 DUKE L. J. 1179, 1227–28 (2002). Cf. *Sovereign Debt Restructuring*, *supra* note 6, at 1012-14 (analyzing those same types of retroactive provisions under international law and concluding that none of the provisions on “super-majority voting, discharge, and the granting of priority to financiers of the State’s debt restructuring ... discriminates based on the nationality of the bondholders ... [or] is arbitrary because all are essential to a debtor-State’s ability to restructure its debt”).

⁹⁹ Legal retroactivity is respected under international law so long as it is neither discriminatory nor arbitrary. *Sovereign Debt Restructuring*, *supra* note 6, at 1012-13 (citing sources including 1 OPPENHEIM’S INTERNATIONAL LAW 918-921 (Sir Robert Jennings & Sir Arthur Watts eds., 9th ed. 1992)). The issue of legal risk is related to retroactivity. Legal risk refers to the risk that substantive provisions of a jurisdiction’s law change after an agreement is signed incorporating that jurisdiction’s law as its governing law. Legal risk is an inevitable risk in international agreements. See, e.g., Wood, *supra* note 25, at 15 (observing that “[i]t is not possible by contract to stabilise the law, e.g., that the governing law is that at the time of the contract. The fluctuating governing law must still be ascertained and will apply to this term of the contract. A change in the governing law will override.”).

¹⁰⁰ See <https://www.parliament.uk/about/how/role/sovereignty/>.

Parliamentary sovereignty itself is considered “the most important part of the UK Constitution.”¹⁰¹ As a result—at least after Brexit, when any potentially conflicting E.U. law will no longer be relevant—even British courts cannot overrule Parliamentary legislation.¹⁰²

The only potential post-Brexit complication might be the First Protocol to the European Convention on Human Rights, which has been incorporated into English law.¹⁰³ Article 1 of that Protocol provides that every person is “entitled to the peaceful enjoyment of his possessions,” raising a question about the Model Law’s optional retroactivity. At least one decision interpreting the First Protocol confirms that a right to payment, such as a claim against a debtor-state, is a “possession” thereunder.¹⁰⁴ Nonetheless, the First Protocol, by its terms, can be trumped by laws that either deprive a person of possessions “in the public interest” or “control the use of property in accordance with the general interest.” Retroactivity under the Model Law should arguably satisfy both tests (although it would only need to satisfy either) because unsustainable sovereign debt can harm debtor nations, their citizens, and their creditors, and can also jeopardize the stability of the financial system.¹⁰⁵ Moreover, after Brexit, the First Protocol could be modified or ended by Parliament acting alone.¹⁰⁶

¹⁰¹ *See id.*

¹⁰² *See, e.g.*, IVOR JENNINGS, *THE LAW AND THE CONSTITUTION* 170 (5th ed. 1959) (“Parliament can enact legislation dealing with any subject and the legislation of the Parliament is superior to the jurisdiction of the courts”); ALBERT VENN DICEY, *AN INTRODUCTION TO THE STUDY OF THE LAW OF THE CONSTITUTION* 38 (10th ed. 1959) (stating that “no person or body is recognized by the law of England as having a right to override or set aside the legislation of Parliament”); MAREK GARLICKI, *THE DOCTRINE OF PARLIAMENTARY SOVEREIGNTY AFTER THE LISBON TREATY*, available at <http://www.globalpolitics.cz/zamereno-na-eu/the-doctrine-of-parliamentary-sovereignty-after-the-lisbon-treaty> (stating that “the first implication of Dicey’s definition is that the courts cannot overrule the legislation of Parliament”).

¹⁰³ *See* Human Rights Act 1998.

¹⁰⁴ *See Agneessens v. Belgium*, 58 D. & R. (DECISIONS & REPORTS, EUROPEAN COMM’N ON HUMAN RIGHTS) 63 (1998); 19 D. & R. 172 (1980).

¹⁰⁵ *See supra* notes 4-5 and accompanying text.

¹⁰⁶ *See supra* note 100 and accompanying text (observing that Parliament has authority to end any law).

Parliamentary sovereignty thus logically should allow the enactment of retroactive laws. Courts and commentators agree. Lord Rodger of Earlsferry, one of the most renowned justices of the Supreme Court of the United Kingdom, has observed that Parliament “can change the legal significance of past events,” including “provid[ing] that something which was lawful when it was done should be treated as having been unlawful, or conversely, that what was unlawful at the time should be treated as having been lawful.”¹⁰⁷ The old common law presumption against legal retroactivity has been interpreted as being “always subject to Parliament’s expressed contrary intention.”¹⁰⁸

If, therefore, Parliament enacts the Model Law—even including its option of retroactivity—such Law’s only vulnerability would be changes thereto or revocations thereof enacted by a future Parliament.¹⁰⁹ That begs the normative question, though, of why Parliament *should want to* enact the Model Law. The answer is that such enactment would provide significant social benefit and little harm, and thus should be morally imperative.¹¹⁰

The significant social benefit would be the debt relief that the Model Law could provide to countries whose debt contracts are governed by English law. Recall that a quarter to a third or more of all sovereign debt contracts appear to be governed by that

¹⁰⁷ *Foreword, in* RETROACTIVITY AND THE COMMON LAW 1 (Ben Juratowitch, ed. 2008).

¹⁰⁸ *Colonial Sugar Refining Co. Ltd. v. Irving*, AC 360 PC at 366 (1906) (also stating that “Judges and scholars have commented frequently that the power of Parliament to legislate retroactively where it wishes to do so is ‘undoubted’”). These views of English law retroactivity are consistent with the view of Michael Crystal, Q.C., expressed to the author on June 15, 2015, at an International Insolvency Institute meeting in Naples, Italy.

¹⁰⁹ DICEY, *supra* note 102, at 39 (stating that Parliamentary sovereignty means “Parliament thus defined has, under the English constitution, the right to make or unmake any law whatsoever”).

¹¹⁰ *Cf.* SIR LESLIE STEPHEN, *THE SCIENCE OF ETHICS* 145 (1882) (observing that if Parliament “decided that all blue-eyed babies should be murdered, the preservation of blue-eyed babies would be illegal”; but pointing out that “political constitutionalism as opposed to legal constitutionalism” explains why Parliament does not pass laws ordering the murder of blue-eyed babies: “it is political, not legal, factors—including, one hopes, legislators’ own sense of morality—that operate as the restraining force”).

law.¹¹¹ Enactment of the Model Law, especially if retroactive,¹¹² would give those countries the reasonable opportunity, if needed, to try to renegotiate that debt to sustainable levels. That, in turn, would reduce economic hardship to innocent citizens and deprivation of essential government services,¹¹³ forestall the likelihood of riots and other popular protests,¹¹⁴ and reduce the potential for financial chaos resulting from a country's debt default.¹¹⁵ There is recent precedent for Parliament enacting law to facilitate sovereign debt relief.¹¹⁶

Enactment of the Model Law would impose little harm. Even if that Law applies retroactively, the only parties whose expectations would be impaired would be holdout creditors, who oppose being bound by supermajority voting and demand payment according to their debt contract's original terms. Any such impairment, however, would be limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors¹¹⁷ based on the debtor-state's deteriorating economic circumstances, and thus

¹¹¹ See *supra* notes 30-32 and accompanying text.

¹¹² See *supra* notes 46-47 and accompanying text.

¹¹³ 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>.

¹¹⁴ 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>.

¹¹⁵ 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).

¹¹⁶ U.K. Debt Relief (Developing Countries) Act 2010.

¹¹⁷ See Model Law Article 7(3).

should reflect the economic reality—and therefore the reasonable expectations—of what those creditors expect to receive as payment under those changed circumstances.¹¹⁸

Admittedly, those changes might impair a holdout creditor’s expectation of blackmailing a country’s debt restructuring, in order to extract value from the other creditors.¹¹⁹ Such an expectation, however, would be morally repugnant—and thus impairing that expectation should not violate the moral sensibility that operates as the restraining force on members of Parliament.¹²⁰

In short, enacting the Model Law, even with its option of retroactivity, should be reasonably necessary and appropriate to further the important public purpose of enabling countries to restructure their debt to sustainable levels.¹²¹

B. Economic Feasibility

The economic feasibility of the Model Law will turn on its costs and benefits, both to debtor-states and to their creditors. Certainly a nation whose debt has been restructured should be able to borrow at attractive rates. In the non-sovereign context, by analogy, lending rates to restructured companies are much lower than rates charged before the restructuring.¹²² But would a model-law approach increase a nation’s ex ante borrowing costs by making creditor claims more subject to bail-in?

¹¹⁸ 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).

¹¹⁹ See *supra* notes 6-7 and accompanying text.

¹²⁰ See *supra* note 110.

¹²¹ Cf. *Healthnow N.Y. Inc. v New York State Ins. Dept.*, 110 A.D. 3d 1216, 1217 (N.Y. App. Div. 3d Dep’t 2013) (applying that standard under U.S. constitutional law to determine whether to allow a state law to retroactively impair contracts).

¹²² *Sovereign Debt Restructuring Options*, *supra* note 19, at 110–11. This is because creditor support through participation, combined with operational restructuring that often

Leading economists have recently argued to the contrary—that uncertainty due to the absence of an effective sovereign debt resolution framework “increases the costs of borrowing.”¹²³ However, even if such a framework would increase costs, overall sovereign borrowing rates should not be affected any more than if—as most agree would be desirable—workable collective action aggregate-voting clauses were in fact included in all sovereign debt contracts. Empirical analysis suggests that the inclusion of those clauses should not increase (and may even reduce) sovereign borrowing rates.¹²⁴ That analysis has been since reinforced by the actual market pricing of sovereign bonds that include those clauses.¹²⁵

Furthermore, the possibility that a model-law approach might increase a nation’s ex ante borrowing costs should be viewed in a larger context. Any such cost increase should be offset by the cost saving that would result from a model law. By loose analogy to corporate bankruptcy,¹²⁶ few economists would suggest that corporate bankruptcy

accompanies debt restructuring, is viewed favorably by the market. The lower rates also reflect firms’ lower debt-to-equity ratios. Similarly, a debtor-state should have a lower debt-to-GDP ratio and thus should be less likely to default in the future. *Id.*

¹²³ Stiglitz et al., *supra* note 4, at 1.

¹²⁴ See Michael Bradley & Mitu Gulati, *Collective Action Clauses for the Eurozone*, 18 REVIEW OF FINANCE 2045 (2013) (finding that the presence of CACs is associated with a lower cost of capital, possibly due to an expectation of faster debt restructuring).

¹²⁵ The first public offering of sovereign bonds that contained collective action aggregate-voting clauses, made by Mexico in November 2014, was priced at historically low interest rates. Mark Sobel, *Strengthening Collective Action Clauses: Catalyzing Change—the Back Story*, 11 CAPITAL MARKETS LAW JOURNAL 1, 10 (2016). The IMF reports that the subsequent inclusion of those clauses in sovereign debt issues appears to have had no observable impact on pricing. International Monetary Fund, “Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts” 6 (Dec. 27, 2016) (basing its report on “consultation with selected public debt managers and market participants (including through two surveys conducted by [IMF] staff in March and June 2015 of public debt managers)”).

¹²⁶ The analogy is at best loose because there are fundamental differences between restructuring a corporation’s debt and a sovereign nation’s debt, including that a corporation, unlike a sovereign, can be liquidated and its assets sold.

law—which imposes collection action aggregate-voting¹²⁷—should be repealed because it might increase the borrowing cost of solvent companies.

The economic feasibility of a model-law approach should also take into account its costs and benefits to creditors. Reduced uncertainty has already been mentioned as a potential benefit.¹²⁸ A potential cost, however, is that the Model Law would facilitate the transfer of value from creditors to a debtor-state if a class of claims agrees to a restructuring that reduces its principal amount or interest rate. That transfer of value nonetheless would be bargained for; each class of claims has the power to veto the debtor-state’s restructuring plan.¹²⁹ Furthermore, any transfer of value from creditors to their debtor-state would be less under the Model Law than under a typical corporate bankruptcy law, because the latter gives debtors cram-down powers.¹³⁰

C. Political Feasibility

This essay has already observed several reasons why a model-law approach to sovereign debt restructuring should be politically more feasible than a convention. Most significantly, a model-law approach would not require general acceptance by the world’s nations for its implementation.¹³¹ If English law incorporated the Model Law, a debtor-state whose debt contracts are governed by English law could realistically be able to restructure that debt. Experience shows that a model law’s more relaxed nature, being domestic law, and (for that reason) less formal enactment process and minimal

¹²⁷ See, e.g., 11 U.S.C. § 1126(c).

¹²⁸ See *supra* note 123 and accompanying text.

¹²⁹ See Model Law Article 7(1) (providing that a restructuring plan needs the agreement of each class of claims to become effective and binding).

¹³⁰ See *supra* notes 84-92 and accompanying text (discussing that, unlike typical corporate bankruptcy law, the Model Law does not permit a debtor-state to cram down a plan over dissenting creditor classes).

¹³¹ See *supra* notes 34-36 and accompanying text. A model-law approach, unlike a treaty, thus would not face the “profound difficulties [of] building international consensus behind any sweeping change in global financial regulation.” Setser, *supra* note 25, at 3.

interference with sovereignty can succeed where a formal treaty approach can languish.¹³²

It is also informative to assess the political feasibility of a model-law approach from the perspective of the politics of the IMF's failed SDRM. As mentioned, that approach failed because it was opposed by major financial industry associations and also by certain emerging market countries that feared it would raise their cost of borrowing.¹³³ Part II.B of this essay has argued, however, that a model-law approach should reduce those costs.

A model-law approach should also surmount most other reasons suggested to explain the SDRM's failure. At the time the SDRM was proposed, many believed that “[e]xchange offers, combined with the ability to amend a bond’s terms[,] provide a mechanism for [sovereign] debt restructuring even in the absence of a [statutory debt restructuring] regime.”¹³⁴ Experience, however, has undermined that belief.¹³⁵ Also at that time, “the major emerging economies—and particularly the Latin American economies—feared losing access to large scale emergency credit from the IMF in return for legal protection of only marginal value.”¹³⁶ The new reality is that debtor-states cannot always count on the IMF for that credit,¹³⁷ whereas the value of a model law’s protection should be significant.

¹³² Cf. Setser, *supra* note 25, at 6 (observing that debtor-states opposed the SDRM because they were “keen to protect their sovereignty, and to prevent an international organization from gaining jurisdiction over their domestic-law debt”).

¹³³ See *supra* note 23 and accompanying text.

¹³⁴ Setser, *supra* note 25, at 5.

¹³⁵ *A Model-Law Approach*, *supra* note 1, at 31.

¹³⁶ Setser, *supra* note 25, at 5.

¹³⁷ See *supra* note 73 and accompanying text. See also Setser, *supra* note 25, at 5 (observing that “it is unrealistic for the major emerging economies to think that the IMF will prevent all default”).

Finally, some may have opposed the SDRM because of “[s]uspicious about the role the IMF would play in a restructuring process designed by the IMF.”¹³⁸ This appears to explain, for example, the financial industries’ opposition.¹³⁹ The model-law approach is not designed by the IMF, nor is the IMF necessarily part of its supervisory process.¹⁴⁰ Others have observed that some nations may oppose any international tribunal (even one that is otherwise neutral) interfering with sovereign political discretion.¹⁴¹ Because this essay’s proposed Model Law limits the supervisory process to ministerial actions,¹⁴² the Supervisory Authority managing that process would lack authority to interfere with political discretion.

A model-law approach could also provide clear positive political benefits. By helping to privatize interim funding to a debtor-state,¹⁴³ it could reduce the burden on IMF creditor countries of funding IMF bailout loans.¹⁴⁴ Reducing the need for IMF funding would also reduce the conditionality that the IMF, politically, imposes on borrowing nations, which can sometimes exacerbate the nation’s economic woes.¹⁴⁵

¹³⁸ Setser, *supra* note 25, at 17.

¹³⁹ *See, e.g.*, Hagan, *supra* note 23, at 391–93 (observing that the opposition to the SDRM by major financial industry associations was attributable to their suspicions regarding IMF motivation). Certain emerging market countries, including Turkey, Mexico and Brazil, also opposed the SDRM, concerned that it would raise interest rates on their sovereign bonds. Setser, *supra* note 25, at 6, 16.

¹⁴⁰ *See supra* notes 53-54 and accompanying text. This essay’s proposed Model Law specifies that the Supervisory Authority must be a “neutral international organization.” Model Law Article 2(5).

¹⁴¹ *Cf.* Richard Conn, Principal and Managing Dir., Innovate Partners LLC, Keynote Address at the General Assembly of the United Nations, 6th Meeting, 2nd Working Session of the Ad Hoc Committee on Sovereign Debt Restructuring Processes (Apr. 28, 2015) (emphasizing that developed nations are concerned about international tribunals exercising what should be a nation’s political discretion in a sovereign debt restructuring).

¹⁴² *See supra* note 58 and accompanying text.

¹⁴³ *See supra* notes 73-82 and accompanying text; *see also* Model Law Articles 8 & 9.

¹⁴⁴ *Cf.* Setser, *supra* note 25, at 3 (discussing that many IMF creditor countries favored the SDRM for this same reason).

¹⁴⁵ Jayadev & Konczal, *supra* note 88. *Cf. supra* note 76 (arguing that the conditionality that would have been imposed under the IMF’s proposed SDRM would be politically volatile and might impose harsh conditions on the citizens of the debtor-state).

Furthermore, a model-law approach could provide a political cover for painful decisions that can be attributed by state to a supervising entity or to legal requirements.¹⁴⁶

None of this means that a model-law approach to sovereign debt restructuring, or at least this essay's proposed Model Law, will be politically feasible. For example, some debtor-states might oppose the Model Law's similar treatment¹⁴⁷ of domestic and foreign claims.¹⁴⁸ Some private creditors might also oppose the Model Law's supermajority aggregate voting, believing that the threat of holdouts is necessary to ensure that debtor-states will bargain fairly¹⁴⁹ (but failing to understand that the Model Law preserves that threat to the extent necessary to motivate fair bargaining¹⁵⁰).

At the very least, however, this essay should serve to increase a model-law approach's political feasibility by explaining the approach and its potential benefits and limitations, including its ability to equitably relieve debtor-states from unsustainable debt burdens. An incremental approach to developing norms has strong precedent in the legal ordering of international relationships,¹⁵¹ especially "where law reformers possess limited

¹⁴⁶ Westbrook, *supra* note 5, at 256.

¹⁴⁷ See *supra* note 52 and accompanying text.

¹⁴⁸ Cf. Setser, *supra* note 25, at 19 (observing that including "domestic debt" claims in the SDRM "was a bridge too far for almost everyone").

¹⁴⁹ *Id.* at 7–8 (and also observing that some creditors believe that the existing contractual restructuring process is already favorable to debtor-states).

¹⁵⁰ The Model Law preserves the holdout threat to the extent needed to motivate debtor-states to bargain fairly. See *supra* note 65. Absent a fair bargain, no creditor class would have an incentive to vote to approve a debt restructuring plan—and each class has the power to veto the debtor-state's restructuring plan. See *supra* note 129 and accompanying text. The Model Law seeks to eliminate the holdout threat only for rent-seeking holdouts, who use that threat to unreasonably extract value (at least in part) from other similarly situated creditors. See *supra* note 6 and accompanying text.

¹⁵¹ Cf. Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. CHI. L. REV. 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").

authority and where the subject is either controversial or technical,” such as “global insolvency law reform.”¹⁵²

CONCLUSIONS

Whether or not their fault, nations sometimes borrow at levels that become unsustainable. Until resolved, the resulting debt burden hurts not only those nations (such as Greece) but also their citizens, their creditors, and—by posing serious systemic risks to the international financial system—the wider economic community.

The existing contractual framework for restructuring sovereign debt is inadequate, often leaving little alternative between a bailout, which is costly and creates moral hazard, and a default, which raises the specter of financial contagion and chaos. Although global organizations, including the United Nations and the International Monetary Fund,

¹⁵² Susan Block-Lieb & Terence Halliday, *Incrementalisms in Global Lawmaking*, 32 BROOK. J. INT’L L. 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 change offers the best alternative for speeding up the transition to a new environmental regulation”); Richard B. Stewart, *A New Generation of Environmental Regulation?*, 29 CAP. U. L. REV. 21, 133–34 (2001) (observing that “any solution to current concerns with the U.S. environmental regulatory system is likely to be and is best served by an incremental approach”); Philippa England, *Book Reviews*, 54 INT’L & COMP. L.Q. 1037, 1038 (2005) (reviewing Francis Botchway, *International Encyclopaedia of Laws, Supplement 46, in INTERNATIONAL ENCYCLOPAEDIA OF LAWS: ENVIRONMENTAL LAW*) (“More sophisticated legal techniques are not necessarily the solution—realistic, feasible solutions driven by the political will of leaders, the general population and supported by the international community may offer a more incremental but ultimately more effective method of dealing with environmental issues”). And recently, an incremental approach to developing norms has succeeded in legalizing gay marriage. *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015).

have tried to strengthen the sovereign-debt-restructuring framework through treaties, such a multilateral legal approach is highly unlikely to succeed in the near future.

This essay argues, in contrast, that a model-law approach should facilitate sovereign debt restructuring much more feasibly than a multilateral approach. Model laws have long been used in cross-border lawmaking, when treaties fail. Unlike a treaty, a model law does not require widespread acceptance for its implementation. In particular, if this essay's model law were enacted into English law, that alone would enable the fair and consensual restructuring of the immense stock—perhaps a quarter to a third or more of all sovereign debt contracts¹⁵³—of such contracts governed by that law.¹⁵⁴ And because it would achieve, by operation of law, the equivalent of the ideal goal of including aggregate-voting collective action clauses in all sovereign debt contracts, such enactment should ensure the continuing legitimacy and attractiveness of English law as the governing law for future sovereign debt contracts.

¹⁵³ *See supra* notes 30-32 and accompanying text.

¹⁵⁴ The Model Law's application to existing sovereign debt contracts governed by English law assumes such Law's enactment includes the option of retroactivity. *See supra* note 46-47 and accompanying text.

APPENDIX**SOVEREIGN DEBT RESTRUCTURING MODEL LAW**

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 jurisdiction¹⁵⁵] 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 retroactively¹⁵⁶ and, without limiting the foregoing, shall] override any contractual provisions that are inconsistent with the provisions of this Law.

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

¹⁵⁵ This refers to a jurisdiction that enacts a law in the form of the Model Law—in this essay’s specific case, English law. Articles 3(3) and 11 further expand the Model Law’s application.

¹⁵⁶ This optional retroactive application would enable the Model Law to also resolve problems of unsustainable sovereign debt that arise under existing debt contracts. *See supra* notes 46-47 and accompanying text.

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 [ten¹⁵⁷] 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-

¹⁵⁷ The reason for inserting a time limit is to deter a debtor-state’s abuse of the Model Law’s provisions.

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 and verify claims 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 favourable treatment;
- (4) disclose any claims not included in the Plan's classes of claims¹⁵⁸;

¹⁵⁸ Depending on the contractual terms, a debtor-state could, for example, decide to exclude claims that incorporate collective action aggregate-voting clauses from the Plan's classes of claims and deal with those claims separately. The debtor-state then would be required to disclose those excluded 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.¹⁵⁹

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 principal amount and more than [one-half] in number of the claims of such class [voting on such Plan¹⁶⁰] [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,¹⁶¹ (b) claims of governmental or multi-governmental entities each shall be classed separately,¹⁶² and (c) claims that are governed by this Law or by the law of another jurisdiction that is substantially in the form of this Law shall not be classed with other claims.¹⁶³

¹⁵⁹ Because the debtor-state itself makes the determination of debt sustainability, such determination could take into account whatever criteria the debtor-state deems relevant, including economic policy measures adopted by the debtor-state to help ensure the future payment of its debt.

¹⁶⁰ The Plan can be more easily approved if this alternative is selected, but reliable notice to creditors then becomes more important.

¹⁶¹ The Plan can, for example, designate one or more classes of *pari passu* creditors from multiple debt issues.

¹⁶² This separate classification should apply only for entities that vote in good faith.

¹⁶³ Article 7(3)(c) prevents creditors whose claims are governed by the Model Law (or a similar law) from being outvoted by other creditors of the debtor-state. *Cf. infra* note 164 and accompanying text (showing how separate voting protects those creditors from becoming unfairly subordinated to new-money financing).

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) the principal amount of their claims against the State, and (c) the principal amount of those claims that are governed by this Law or by the law of another jurisdiction that is 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 by the law of another jurisdiction that is substantially in the form of this Law.¹⁶⁴

ARTICLE 9: PRIORITY OF REPAYMENT

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

¹⁶⁴ Article 8(4) protects creditors whose claims are governed by the Model Law (or a similar law) from being outvoted by other creditors of the debtor-state. *See supra* note 78 and accompanying text. *Cf. supra* note 163 and accompanying text (discussing how separate Plan classification protects those creditors from becoming unfairly outvoted).

(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 (ICSID)/ International Centre for Dispute Resolution/ ICC 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.¹⁶⁵

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).

¹⁶⁵ This is consistent with best practices in a corporate bankruptcy case, under which the estate normally pays all costs. Alternatively, the Model Law could provide that the parties to the dispute should pay their own expenses.